

## Forest Products

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Industry Comment

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## Building Materials

## Forest Products: Stabilizing Lumber Prices and Inexpensive Valuations Backstop Seasonal Lumber Trade

**Event** – We see evidence of lumber prices bottoming with Random Lengths lumber futures (as reported by CME) up ~8% from US\$225/mfbm to US\$243/mfbm. This is also reflected in higher reported cash prices with the Random Lengths benchmark pricing coming in at US\$234/mfbm as of Friday, up 5% from the previous week's price of US\$222/mfbm. While absolute levels remain uninspiring, we take the rapid upward moves as positive signs potentially indicating buyers are acting to secure volumes in response to low inventory levels.

**Seasonal lumber trade historically profitable, trough valuations provide downside protection** – The past two years have seen profitable seasonal lumber trades with benchmark WPSF prices appreciating 80% and 71% respectively while an index of lumber producer equities rose 84% and 55% (see Exhibit 1) - despite no sustained recovery in US housing markets. In fact, looking at historic monthly averages we identify Fall to Spring seasonal lumber price strength in 10 of the past 11 years with prices increasing an average of 25%. Given our expectation for a reduced 2011/12 winter logging program and a generally tight North American supply chain we continue to believe the opportunity for a lucrative seasonal trade exists and highlight Canfor (trading at 3.5x mid-cycle EV/EBITDA) West Fraser (3.4x), Interfor, (2.3x) and Conifex (2.5x) are each trading at or near trough multiples.

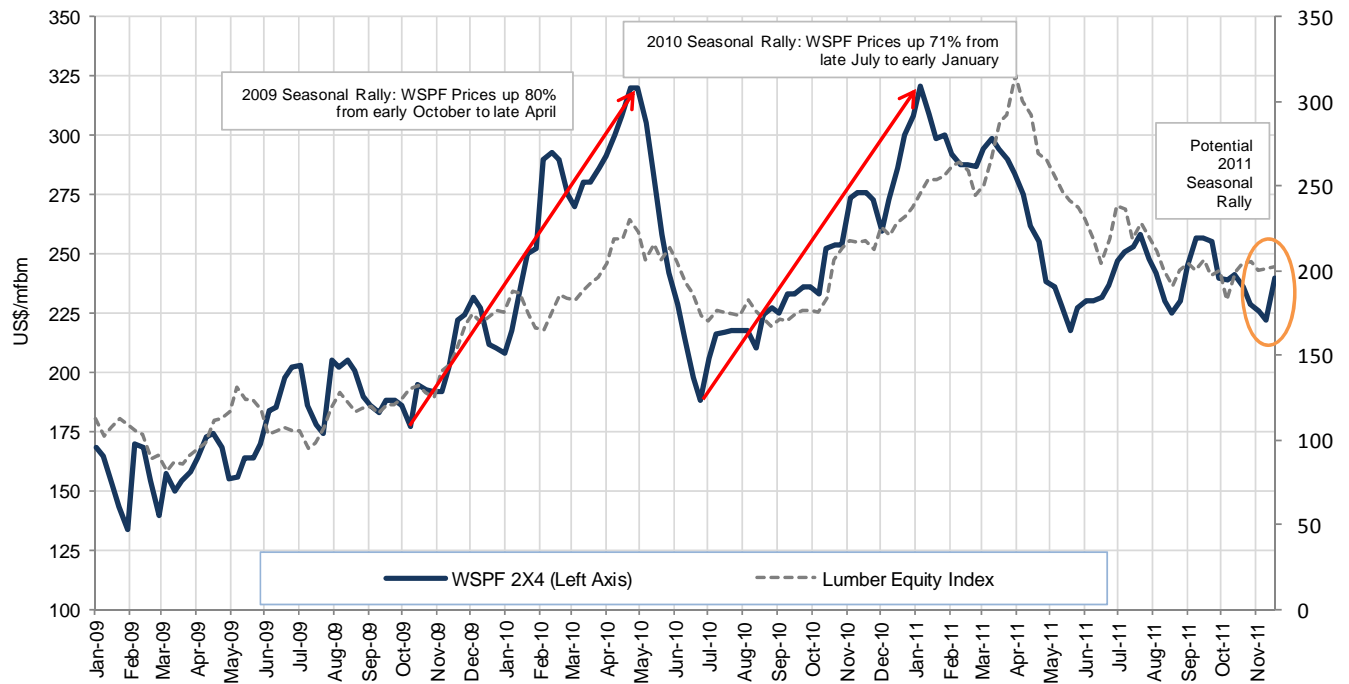
**Depleted supply chain, modest uptick in US demand, continued orders from China coming to bear on prices as well** – Industry sources indicate falling lumber prices caused some mills in Eastern Canada to take market related downtime for up to 3 weeks, while mills in BC also shuttered, generally for 1 week. We believe this contributed to a tightening North American supply chain assisted by mild US demand improvements. US housing starts have come in above consensus expectations for 2 consecutive months at 628K and 630K starts in September 2011 and October 2011 (respectively) while October 2011 housing permits were also a positive surprise at 653K, vs. consensus of 605K. We acknowledge these modestly positive US housing numbers are primarily due to the multi-family housing segment which typically consumes less lumber than single family housing starts. Nevertheless, with lumber demand very inelastic in the short run, even modest demand can exert a material impact on pricing, in our view. China is reportedly still ordering lumber, albeit not in the large volumes typically seen in November. We continue to expect Chinese demand to improve as temporarily oversupplied markets come back into balance.

**Sources indicate improved lumber order files; and reduced investment in logs** – Anecdotally we understand lumber producers are experiencing a flurry of orders with files now extending into mid-December. Meanwhile producers are behind in building winter log inventories with smaller lumber producers experiencing difficulty retaining woodlands staff, particularly in light of attractive competing employment opportunities in the oil patch. We expect this dynamic along with a relatively pessimistic outlook on the part of most producers to result in reduced log deck builds – something we continue to believe will put further upward pressure on lumber prices in coming months.

Company	Ticker Primary	Ticker Secondary	Current Price (6-12 months)	Target Price	Dividend Yield	Total Return To Target	Rating
<b>Building Materials</b>							
Canfor Corp.	CFP-TSX		C\$9.94	C\$16.00		61%	Outperform 2
Conifex Timber Inc.	CFF-TSXV		C\$8.00	C\$14.50		81%	Outperform 2
Interfor	IFP-A-TSX		C\$3.99	C\$7.00		75%	Outperform 2
Norbord Inc.	NBD-TSX		C\$7.46	C\$11.00		47%	Market Perform 3
West Fraser Timber	WFT-TSX		C\$43.00	C\$65.00	1%	52%	Outperform 2

Raymond James Ltd.

**Exhibit 1: Seasonal Lumber Trade**



Source: Random Lengths, Bloomberg, Raymond James Ltd.

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	RJL	RJA	RJ LatAm	RJL	RJA	RJ LatAm
<b>Strong Buy and Outperform (Buy)</b>	74%	58%	41%	51%	14%	26%
<b>Market Perform (Hold)</b>	25%	36%	52%	23%	5%	3%
<b>Underperform (Sell)</b>	1%	6%	8%	0%	6%	0%

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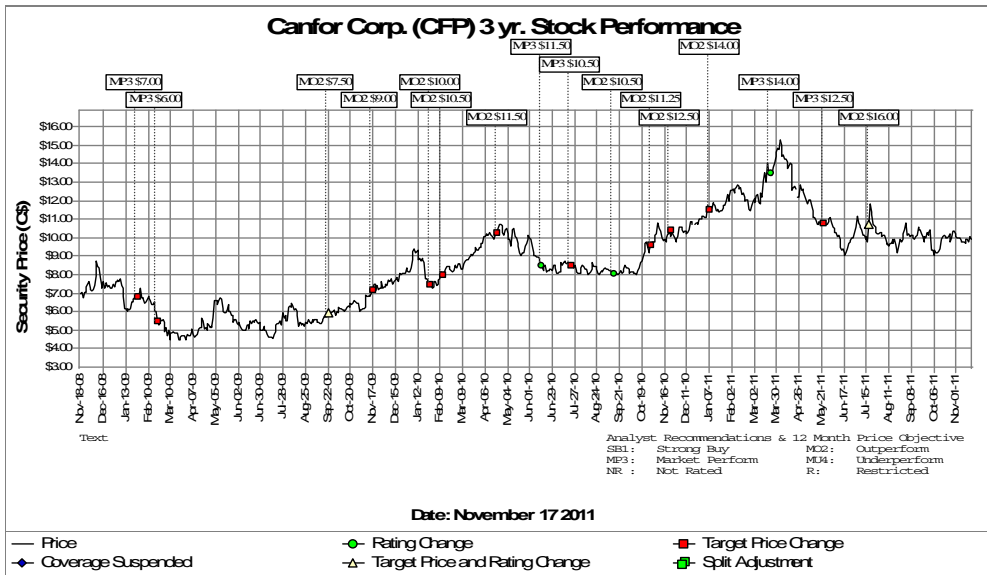
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**Target Prices:** The information below indicates target price and rating changes for the subject companies included in this research.



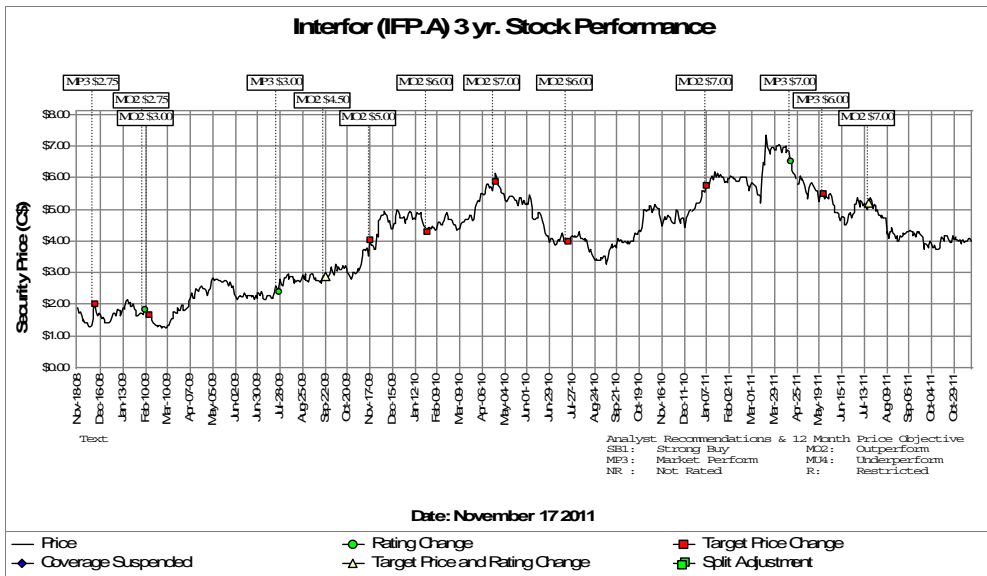
Update Date	Closing Price	Target Price	Rating
Sep-14-11	8.70	14.50	2

**Valuation Methodology:** We value Conifex on a comparative basis to peer group average multiples.



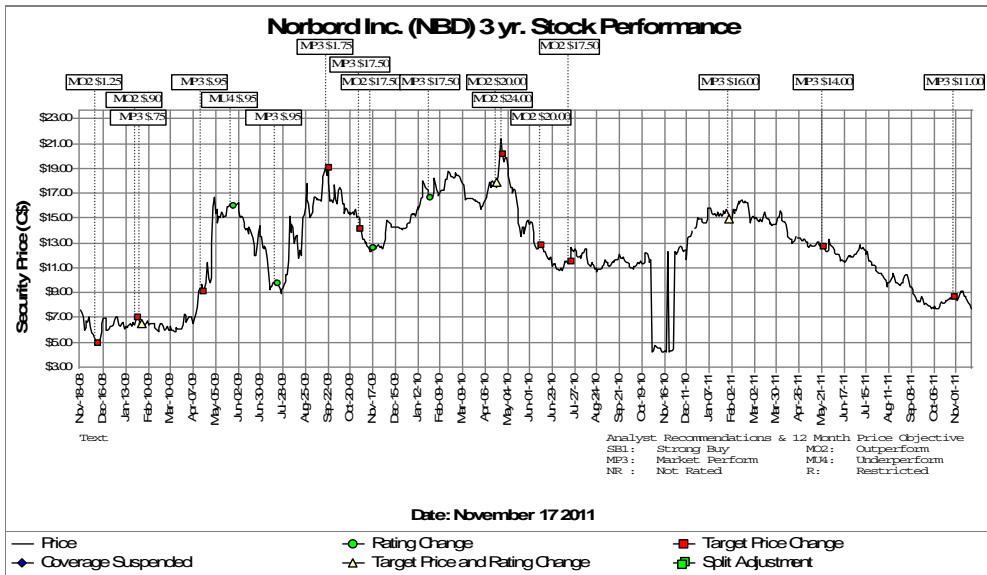
Update Date	Closing Price	Target Price	Rating
Jul-19-11	10.74	16.00	2
May-24-11	10.78	12.50	3
Mar-22-11	13.52	14.00	3
Jan-07-11	11.52	14.00	2
Nov-22-10	10.45	12.50	2
Oct-29-10	9.63	11.25	2
Sep-13-10	8.07	10.50	2
Jul-21-10	8.54	10.50	3
Jun-15-10	8.53	11.50	3
Apr-21-10	10.31	11.50	2
Feb-11-10	7.98	10.50	2
Jan-27-10	7.50	10.00	2
Nov-17-09	7.18	9.00	2
Sep-22-09	5.96	7.50	2
Feb-20-09	5.51	6.00	3
Jan-27-09	6.85	7.00	3

**Valuation Methodology:** We value Canfor on a comparative basis to historical multiples.



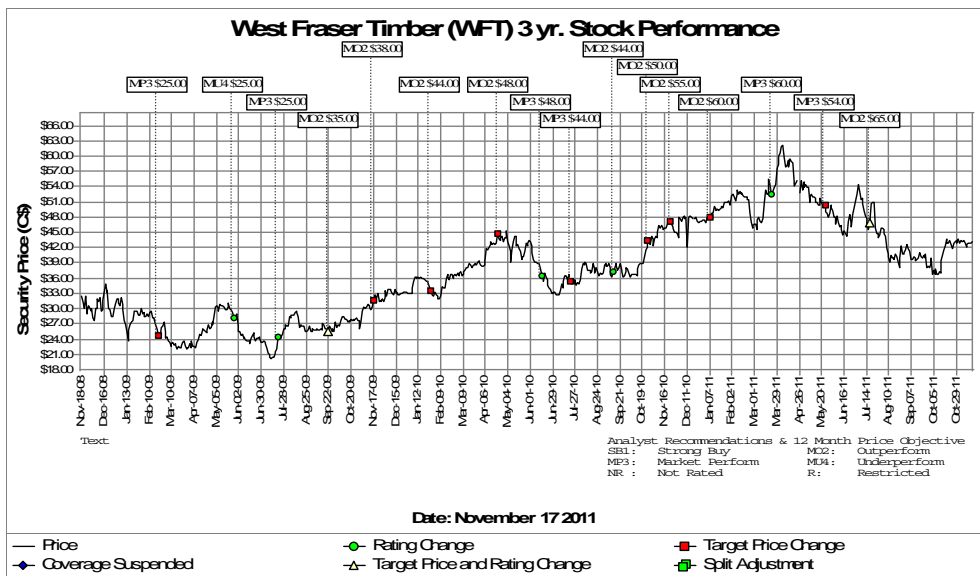
Update Date	Closing Price	Target Price	Rating
Jul-19-11	5.19	7.00	2
May-24-11	5.49	6.00	3
Apr-15-11	6.55	7.00	3
Jan-07-11	5.75	7.00	2
Jul-21-10	4.00	6.00	2
Apr-21-10	5.88	7.00	2
Jan-27-10	4.31	6.00	2
Nov-17-09	4.05	5.00	2
Sep-22-09	2.90	4.50	2
Jul-24-09	2.40	3.00	3
Feb-13-09	1.66	3.00	2
Feb-09-09	1.84	2.75	2
Dec-09-08	2.00	2.75	3

**Valuation Methodology:** We value Interfor on a comparative basis to historical multiples.



Update Date	Closing Price	Target Price	Rating
Oct-28-11	8.68	11.00	3
May-24-11	12.74	14.00	3
Feb-01-11	14.93	16.00	3
Jul-21-10	11.50	17.50	2
Jun-15-10	12.85	20.00	2
Apr-28-10	20.15	24.00	2
Apr-21-10	17.93	20.00	2
Jan-27-10	16.66	17.50	3
Nov-17-09	12.60	17.50	2
Nov-02-09	14.15	17.50	3
Sep-22-09	19.10	1.75	3
Jul-21-09	9.80	0.95	3
May-26-09	16.00	0.95	4
Apr-20-09	9.10	0.95	3
Feb-02-09	6.50	0.75	3
Jan-27-09	7.00	0.90	2
Dec-09-08	5.00	1.25	2

**Valuation Methodology:** We value Norbord on a comparative basis to historical multiples.



Update Date	Closing Price	Target Price	Rating
Jul-19-11	47.00	65.00	2
May-24-11	50.38	54.00	3
Mar-22-11	52.41	60.00	3
Jan-07-11	48.00	60.00	2
Nov-22-10	47.13	55.00	2
Oct-26-10	43.35	50.00	2
Sep-13-10	37.21	44.00	2
Jul-21-10	35.33	44.00	3
Jun-15-10	36.45	48.00	3
Apr-21-10	44.66	48.00	2
Jan-27-10	33.57	44.00	2
Nov-17-09	31.57	38.00	2
Sep-22-09	25.60	35.00	2
Jul-21-09	24.39	25.00	3
May-26-09	28.10	25.00	4
Feb-20-09	24.71	25.00	3

**Valuation Methodology:** We value West Fraser Timber on a comparative basis to historical multiples.

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**Risks - Conifex Timber Inc.**

i) Lumber prices are cyclical, slower than expected economic growth or higher mortgage rates could reduce our price forecasts. ii) As sales are denominated in U.S. dollars, a depreciation of the U.S. dollar could negatively affect earnings. iii) Conifex’s logging operations are primarily on Crown land. Government policy changes could negatively affect operating margins, iv) Forest product markets are global in nature issues affecting transportation or market access could impact earnings v) Conifex’s bio-energy project is yet to be completed and unforeseen delays in the implementation of the project could also negatively impact our earnings estimates.

**Risks - Canfor Corp.**

Forest product prices are cyclical, worse than expected economic conditions could reduce our price forecasts. ii) As sales are typically denominated in U.S. dollars, a depreciation of the U.S. dollar could negatively affect earnings. iii) Canfor operates on Crown land. Government policy changes could negatively affect operating margins. v) Forest product markets are global in nature issues affecting transportation or market access could impact earnings. vi) Extreme weather conditions or fires could impact harvesting plans and hence earnings.

**Risks - Interfor**

i) Lumber prices are cyclical, slower than expected economic growth or higher mortgage rates could reduce our price forecasts. ii) As sales are denominated in U.S. dollars, a depreciation of the U.S. dollar could negatively affect earnings. iii) Interfor’s logging operations are primarily on Crown land. Government policy changes could negatively affect operating margins, iv) Forest product markets are global in nature issues affecting transportation or market access could impact earnings.

**Risks - Norbord**

i) Wood based panel products are highly cyclical, slower than expected residential construction rates, economic growth or plywood substitution rates could reduce OSB demand, pricing and earnings. ii) Additional announced capacity increases or a faster ramp up of existing projects could reduce our commodity price forecasts and earnings. iii) A reduction in the availability or an increase in price of raw materials such as fibre (e.g., related to market conditions or weather) and resin (e.g., related to oil prices) could negatively affect operating margins iv) Forest product markets are global in nature, trade issues affecting market access could impact earnings.

**Risks - West Fraser Timber**

Forest product prices are cyclical, worse than expected economic conditions could reduce our price forecasts. ii) As sales are typically denominated in U.S. dollars, a depreciation of the U.S. dollar could negatively affect earnings. iii) West Fraser operates on Crown land. Government policy changes could negatively affect operating margins. v) Forest product markets are global in nature issues affecting transportation or market access could impact earnings. vi) Extreme weather conditions or fires could impact harvesting plans and hence earnings.

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