

The Deloitte logo is positioned in the top left corner of the slide. It consists of the word "Deloitte" in a white, bold, sans-serif font, followed by a small yellow dot. The background of the slide is a low-angle photograph of a forest with tall trees and a clear blue sky, with the sun visible through the branches in the lower left.

Deloitte.

Canada's Forest Industry

Challenges and Opportunities

Doug Wilkes
Maritime Lumber Bureau Annual Meeting
June 4, 2008

Audit • Tax • Consulting • Financial Advisory

Agenda

Part 1: State of the Industry

- i. Economic Conditions
- ii. Pulp and Paper
- iii. Solid Wood

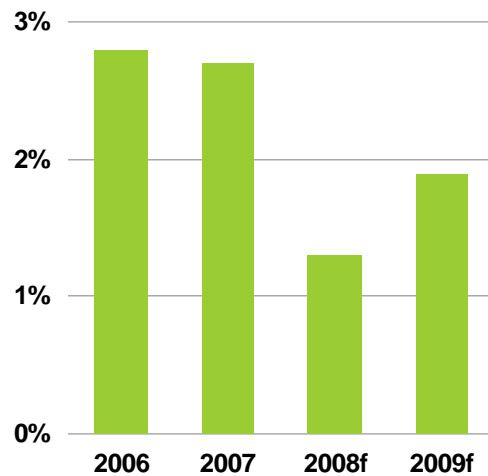
Part 2: What does the Future Hold?

- iv. Key Issues
- v. Opportunities for Eastern Canada
- vi. Product and Market Development
- vii. Conclusions

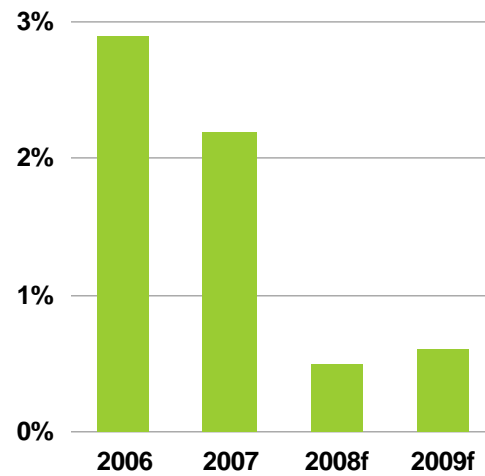
A Challenging Economic Environment

Real GDP forecasts indicate a significant slowing

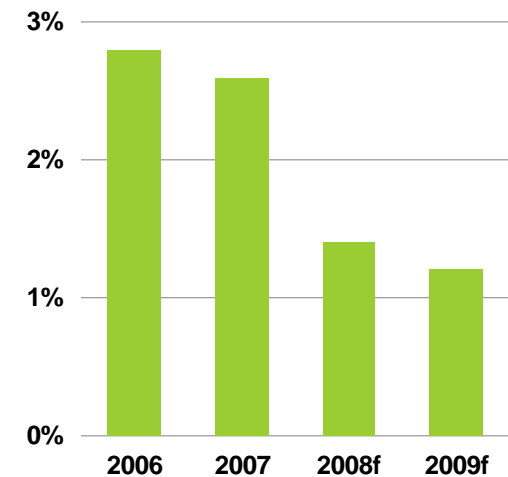
Canada



United States



Europe

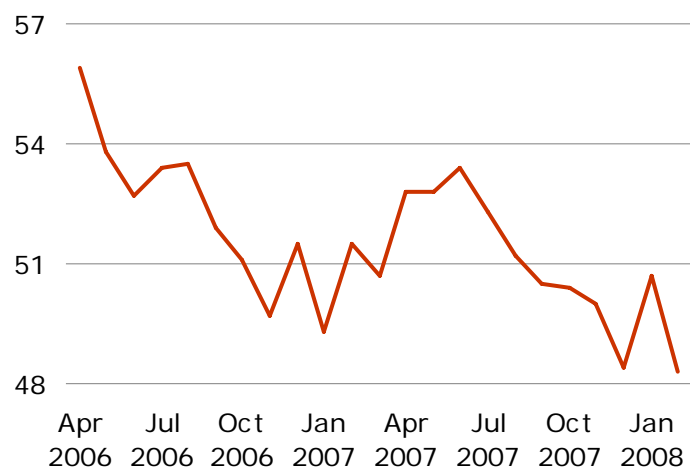


Source: International Monetary Fund

A Challenging Economic Environment

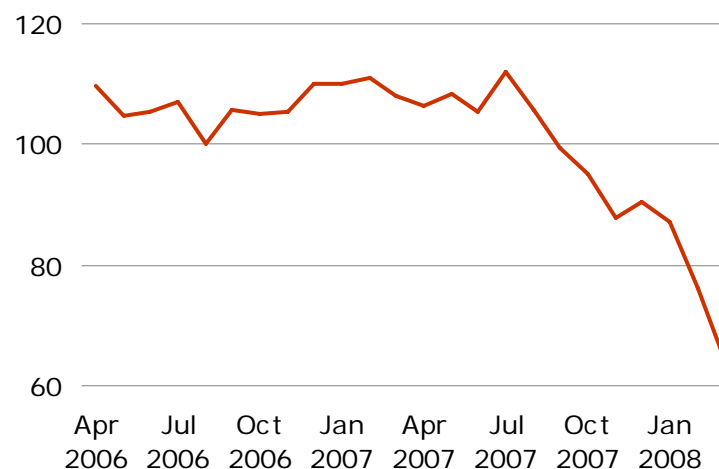
Confidence in the U.S. economy has declined rapidly

U.S. Business Confidence



Source: Institute of Supply Management

U.S. Consumer Confidence

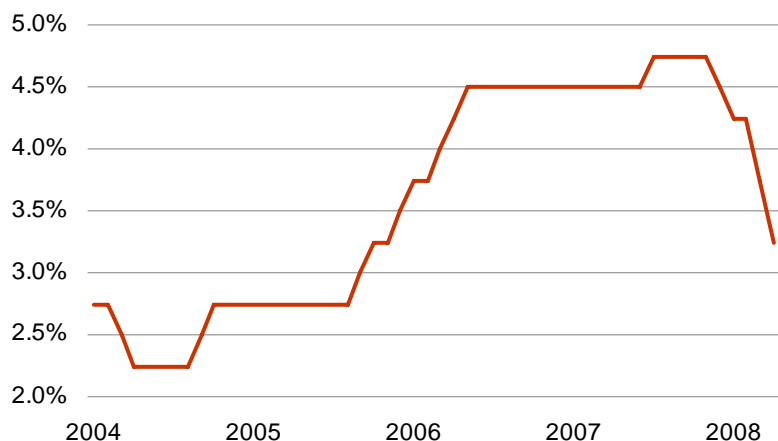


Source: Conference Board

A Challenging Economic Environment

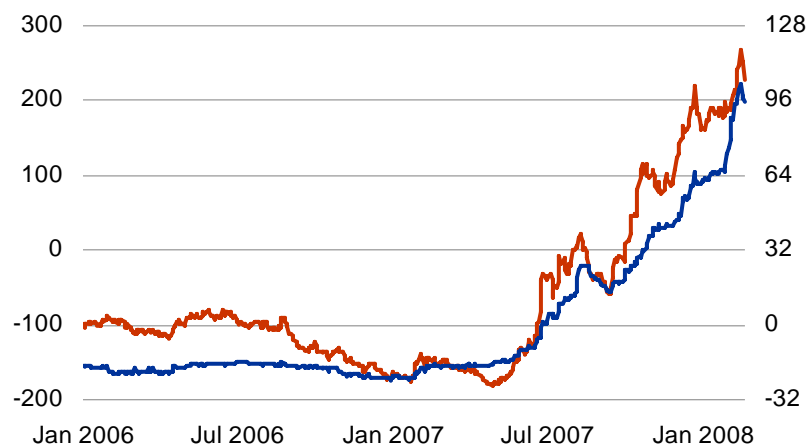
Credit Markets Remain Turbulent

Canadian Bank Rate



Source: Bank of Canada

Credit Spreads



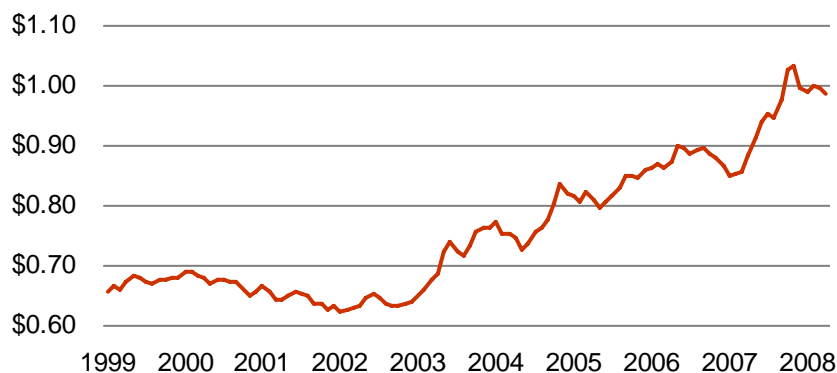
Source: IMF

A recent IMF report estimates bank losses from U.S. sub-prime mortgages, consumer loans, and corporate loans will be in the range of \$440 to \$510 billion

A Challenging Economic Environment

The strong Canadian dollar will be a continuing reality

USD/CAD Exchange Rate



Source: Pacific Exchange Rate Services

Factors Driving the Strong Dollar

- **Energy demand**
 - Oil at \$125 per barrel (and climbing)
 - Demand for natural gas increasing
- **Mineral and metals demand**
 - Prices remain at historical highs, with sustained emerging economy demand
- **Monetary policy**
 - U.S. Canada interest rate differential

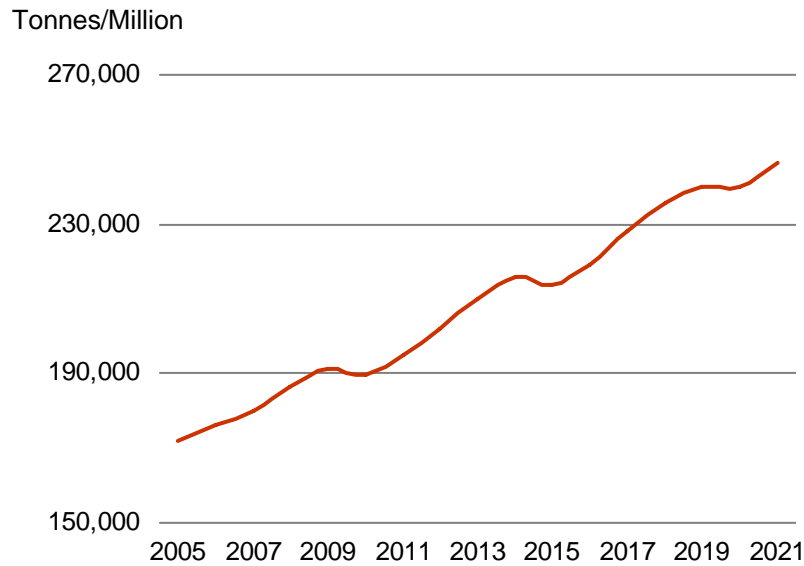
Pulp and Paper



Pulp and Paper Markets

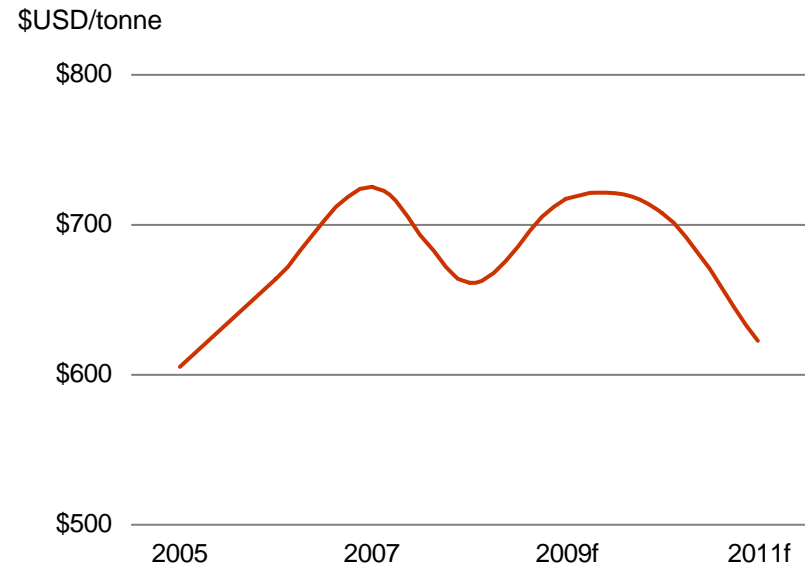
Demand is being driven by emerging markets

Total Paper Demand Forecast



Source: RISI

Average Pulp Price Forecast

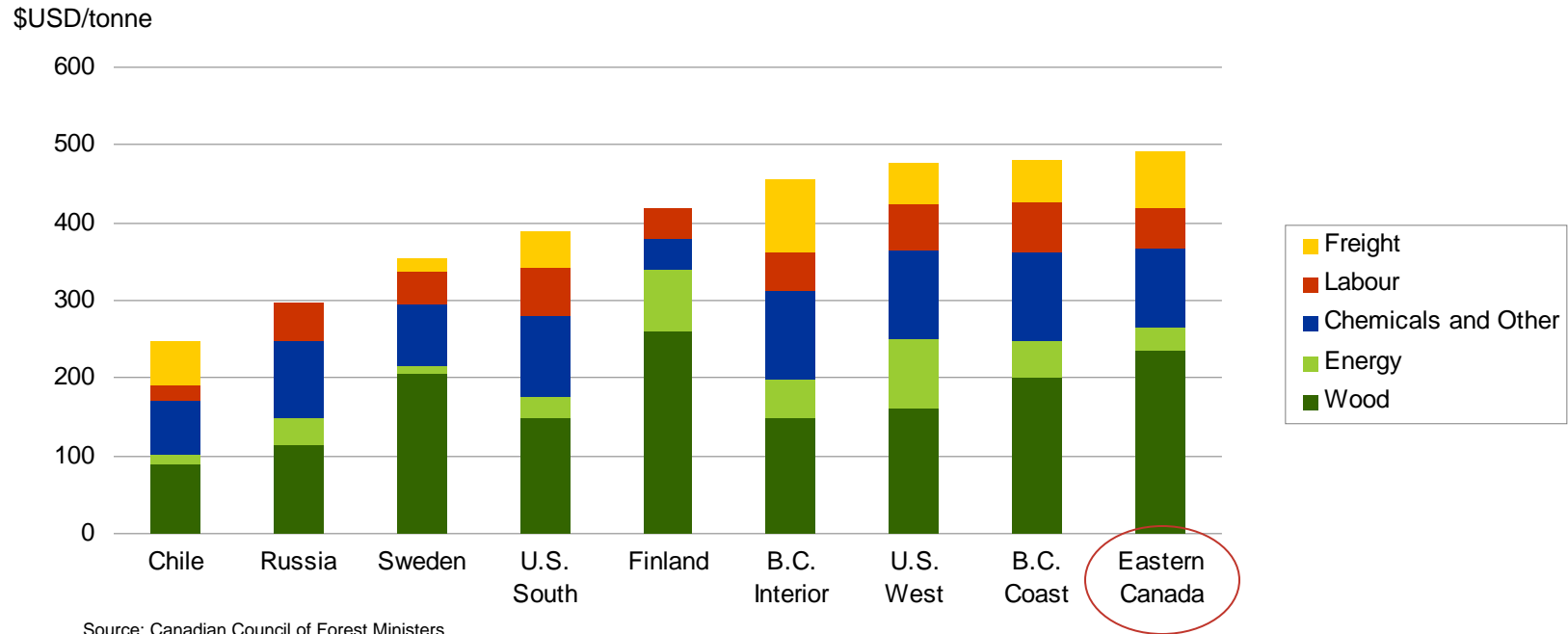


Source: RISI

**China is the fastest growing market – already the second largest behind the U.S.
– and its per capita paper consumption is less than a 25% OF THE U.S.**

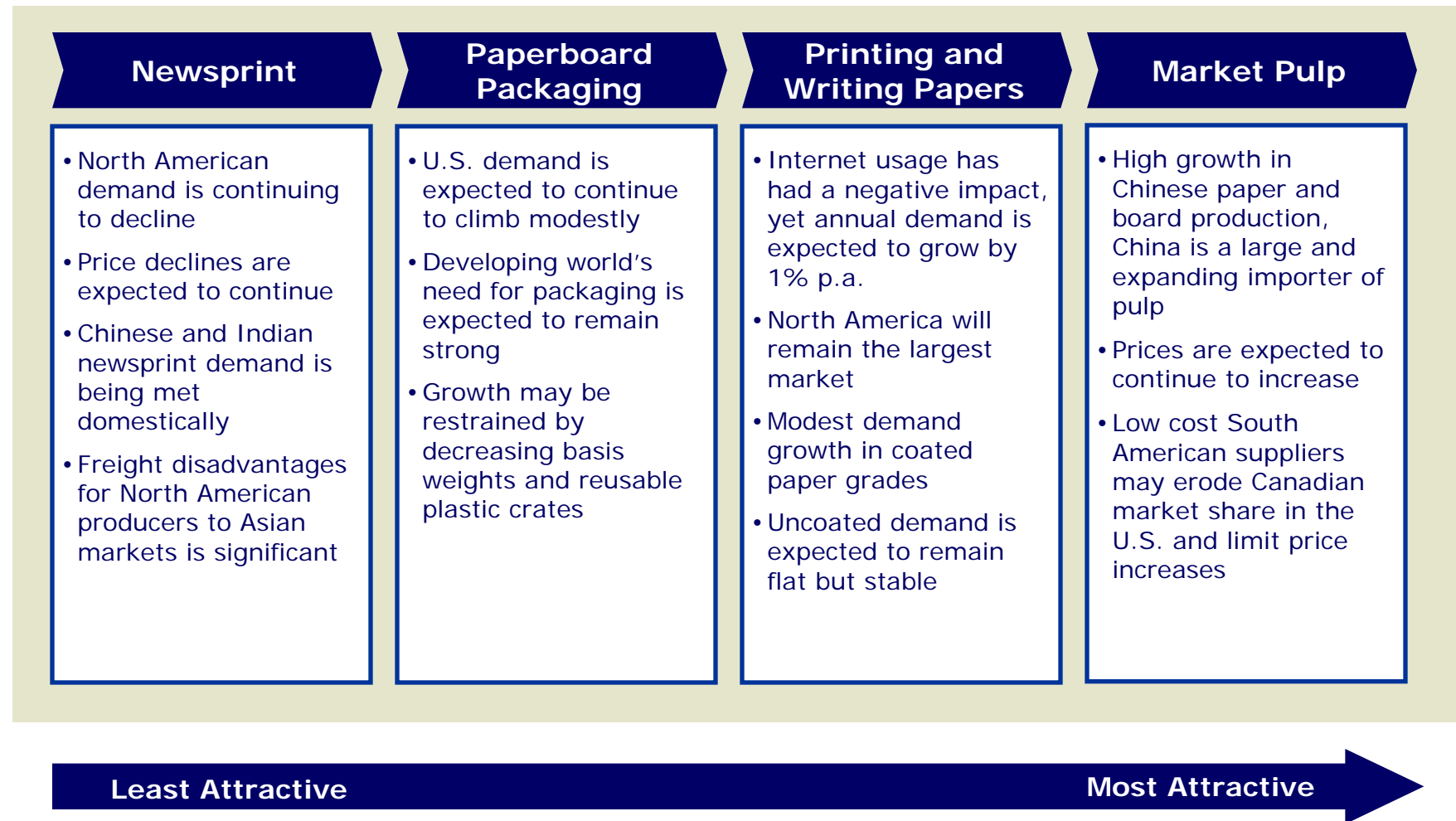
Pulp and Paper Markets

But Canadian pulp producers are at a cost disadvantage, especially in current USD terms



Offshore competition is generally lower cost, larger, more technically capable, and closer to expanding markets.

Demand Outlook by Product



Solid Wood



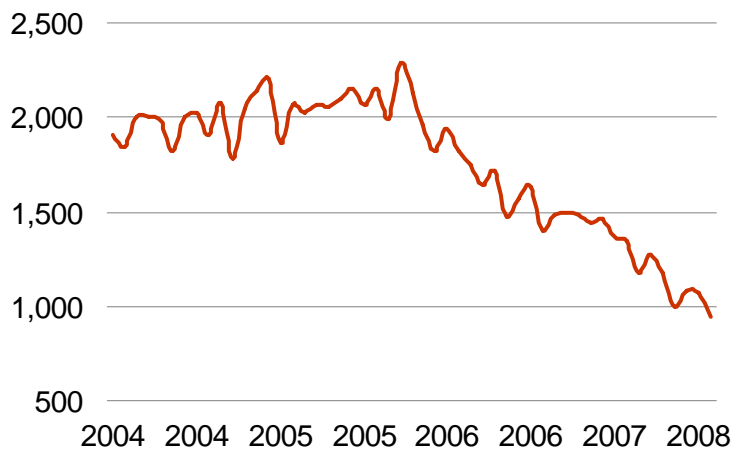
Canadian Solid Wood Overview

- Heavily exposed to the housing markets, especially the trade-protected U.S. market
 - 78% of North American lumber is used in housing construction
 - 80% of Canadian lumber is exported to the U.S.
 - 92% of Canadian panels are exported to the U.S.
- Canadian producers face growing competitive cost and operating challenges
 - Fibre: availability and quality
 - Labour
 - Transportation and energy
 - Canadian dollar
 - Access to capital

The U.S. Housing Market

U.S. housing starts in March 2008 matched a 17 year low.

Housing Starts



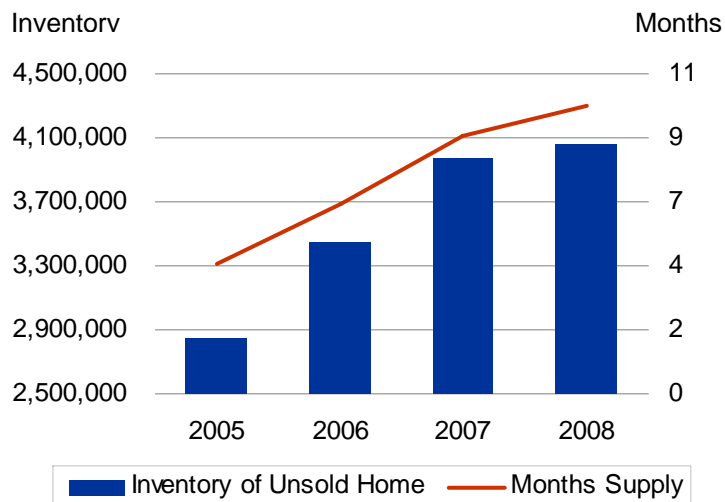
Source: U.S. Department of Commerce (seasonally adjusted)



The U.S. Housing Market

The U.S. housing market downturn is unlikely to recover soon

Inventory of Unsold Homes



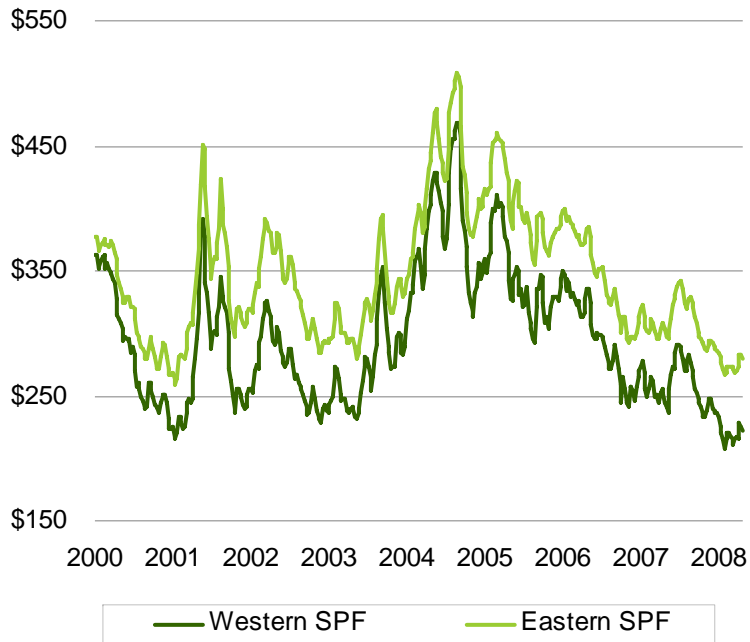
Source: National Association of Realtors



Solid Wood Prices

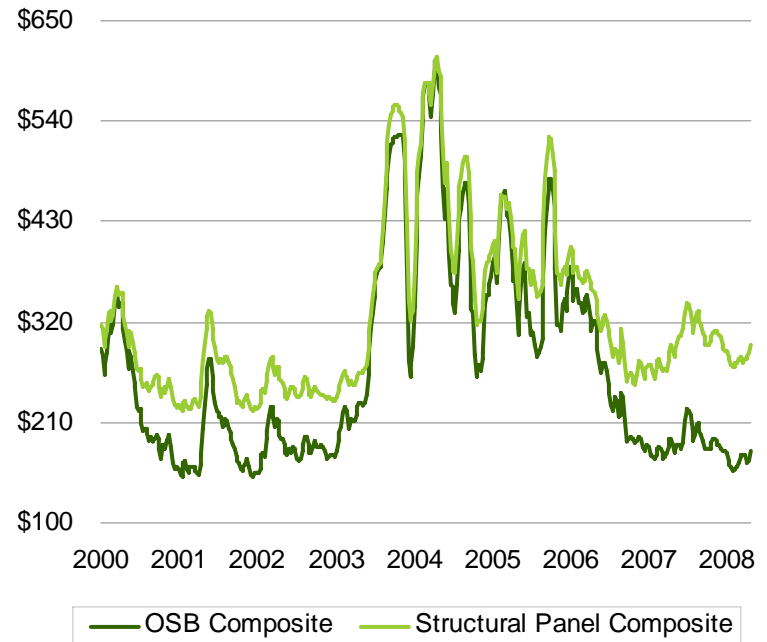
Lumber and Panel Prices Remain at Historical Lows

Lumber



Source: Random Lengths

Panels



Source: Random Lengths

U.S. Softwood Lumber

U.S. softwood lumber trade dispute is a continuing issue

- U.S. Congress moved again last month to hinder Canadian imports, passing a bill imposing additional red tape and potentially limiting imports by raising the cost of compliance
- East vs. West
- The result: Canadian market share of U.S. softwood imports is eroding, with Chile, Brazil, and New Zealand gaining ground.
 - Canada's share of U.S. softwood lumber imports declined from 98% in 1990 to 83% in 2006

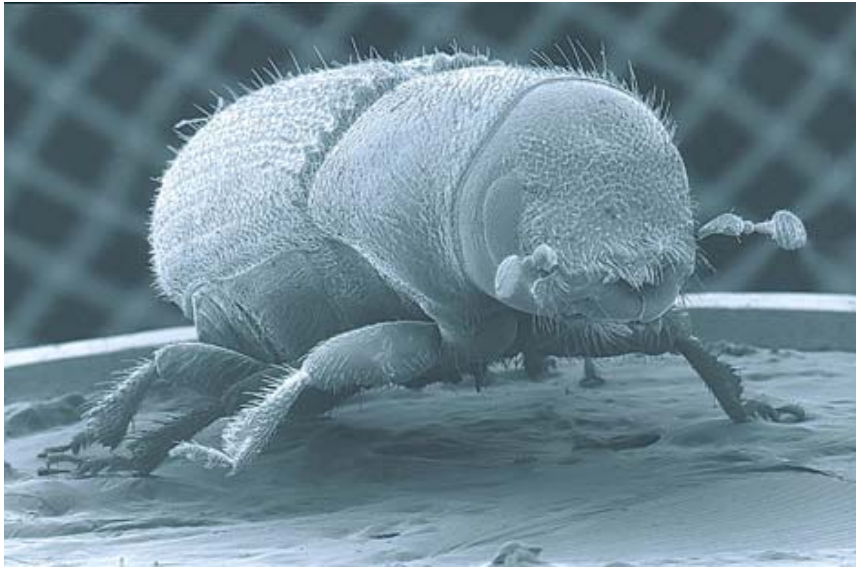
Lumber and Panel Mill Closures

| Selected Canadian Capacity Reductions | | | Selected Canadian Capacity Reductions | | |
|---------------------------------------|--------------------------|------------|---------------------------------------|---------------------|-------------|
| Tembec | Elko, BC | Sawmill | McBride Industries | McBride, BC | Veneer Mill |
| | Canal Flats, BC | Sawmill | Canfor | New Westminster, BC | Panel |
| | Bearn, QC | Sawmill | | Fort Nelson, BC | OSB |
| | Cochrane, ON | Sawmill | | Chetwynd, BC | Sawmill |
| | La Sarre, QC | Sawmill | | Vancouver, BC | Sawmill |
| | Senneterre, QC | Sawmill | Tolko | Williams Lake | Sawmill |
| | Cranbrook, BC | Planer | | 100 Mile House | Sawmill |
| AbitibiBowater | Dalhousie, NB | Mill | | Armstrong, BC | Sawmill |
| | Donnacona, QC | Sawmill | | Kelowna, BC | Plywood |
| | Mackenzie, BC | 2 sawmills | Interfor | Vancouver | Sawmill |
| Grant | Footner, AB | OSB | | Adams Lake BC | Sawmill |
| | Englehart, ON | OSB | TimberWest | Campbell River | Sawmill |
| Ainsworth | Footner, AB | OSB | Lytton Lumber | Lytton, BC | Sawmill |
| Louisiana Pacific | St-Michel-des-Saints, QC | OSB | North Okanagan | Enderby, BC | Sawmill |
| | Silsbee, Texas | OSB | Pope & Talbot | Grandforks, BC | Sawmill |
| Weyerhaeuser | Kamloops, BC | Sawmill | | Castelgar, BC | Sawmill |
| | Hudson Bay, SK | Sawmill | West Fraser Timber | Terrace, BC | Sawmill |
| | Miramichi, NB | OSB | | Quesnel, BC | Sawmill |
| Western Forest Products | Ladysmith, BC | Sawmill | Cascades | Lac-Saint-Jean, QC | Sawmill |
| | Vancouver, BC | Sawmill | | | |

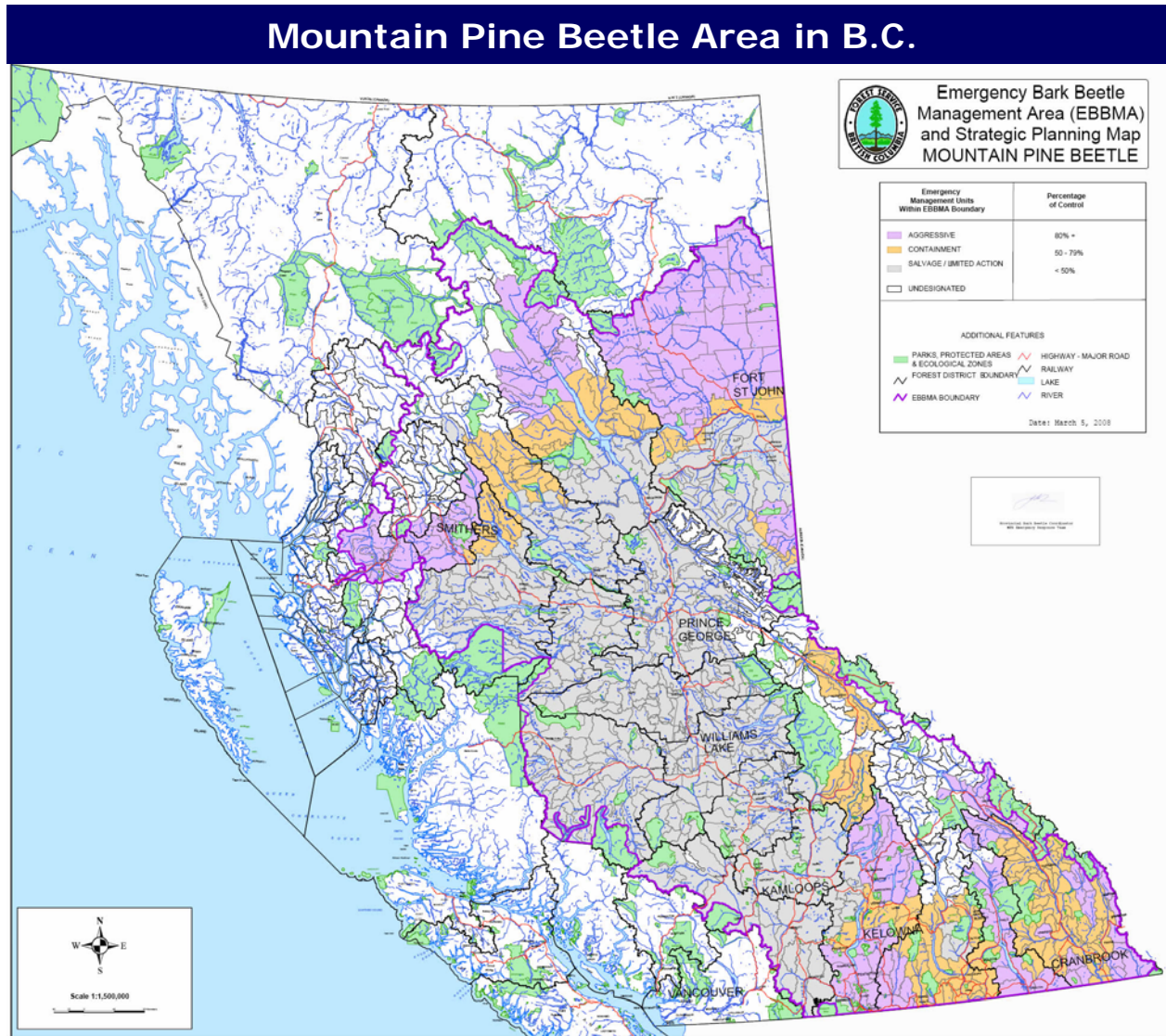
Since 2001, 46 sawmills have closed in B.C., resulting in the loss of 20,000 jobs – half of these in the last year alone.

Challenges

The Mountain Pine Beetle Infestation



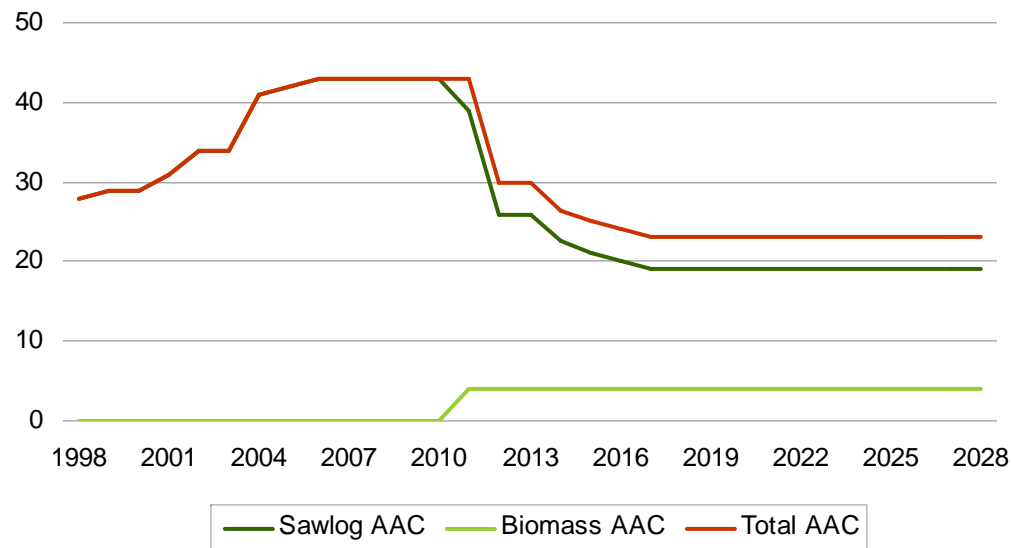
Challenges



Challenges

The Mountain Pine Beetle will profoundly affect fibre supply in B.C.

Annual Allowable Cut – Northern B.C.



Source: BC Ministry of Forests and Range

Excess Manufacturing Capacity Forecast

- Currently capacity insufficient to process available timber
- However, fibre supply will decrease substantially post 2010
- When supply reductions occur there will be significant excess capacity
- A dozen or more mills may close due to fibre supply constraints, with estimates of lumber production declines of between 3 -5 bbf

Challenges

Labour will increasingly be a challenge for the industry

- Aging Workforce
- Increasing competition for skilled labour in the remote areas of Canada
 - Oil sands and mining industries are targeting forestry workers with transferable skills
 - De Beers recently held info sessions and interviews in towns near mill closures in Northern Ontario to hire for its Victor Mine, 45 permanent offers were accepted the next day
- Attractiveness of the industry
- Workforce productivity
 - A bigger challenge in Eastern Canada than the West
 - Reflects scale and technology

Challenges

- Transportation and energy costs
 - Price of oil has doubled in last 12 months
 - Greater impact for those operations further from market
- Strong Canadian dollar
 - The increase in exchange rates since 2006 has cost the Canadian forest industry over \$2 billion in reduced annual revenues
- Access to capital
 - Size and condition of facilities
 - Industry ROI a serious impediment to gaining access

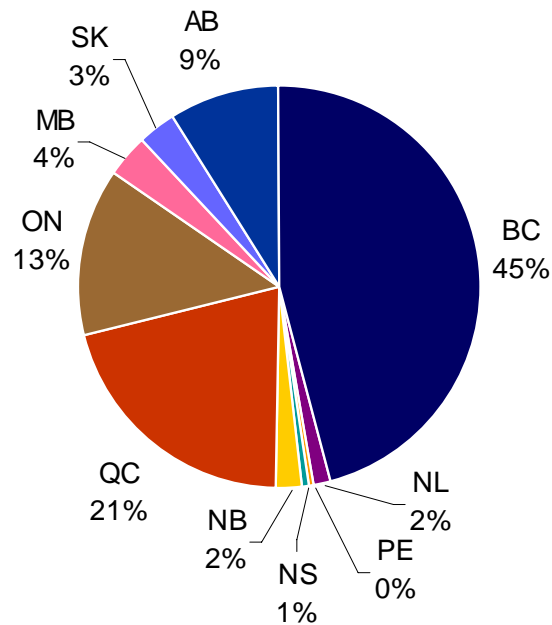
Opportunities and Challenges for Eastern Canada

1. Eastern timber supply
2. Changing dynamics in manufacturing and markets
3. Challenged by high-cost operations

What Does the Future Hold?

Eastern Canada's relatively stable timber supply will be a key advantage

Softwood AAC on Crown Lands



Source: National Forestry Database, 2005

Forecast Timber Supply

- Projections for Eastern Canada are relatively stable
- The forecast decline in B.C. will impact North American markets (10%-20% of B.C. AAC)

What Does the Future Hold?

Changing Dynamics

- Manufacturing
 - Reduction in MSR from B.C.
 - Reduction in wide width production and premiums
 - 10% - 20% decline in B.C. lumber production
- Markets
 - Move towards engineered products/smaller dimension lumber
 - Manufactured housing = tighter product specifications
 - JIT delivery (product and volumes)
 - Changes in packaging and distribution
 - Greater customer-specific requirements

The Future

Changing face of home construction

- The use of offsite construction is a growing element of residential construction industry
 - Considerably shortens construction days onsite
 - Decreases the cost of labour and materials
- Engineered wood products will be central to this strategy
- 25 years ago engineered wood products constituted less than 1% of the structural lumber market, in 2006 the amount was 7%

New Market Development

Potential development of offshore markets for lumber and panels

- Globalization has been easier in pulp and paper grades due to international standardization
- Potential for the development of non-traditional markets in lumber and panels exists
 - India and China's growing middle class are driving a residential construction boom
 - Although homes are generally constructed from non-wood materials, there is significant opportunity in some components (eg. window and door frames and roof systems)
- North American producers need to be proactive to develop these markets

In 2006, forest products were the leading Canadian export to India, China and South Korea.

Conclusions

- The current challenges in the forest products industry have and will continue to drive the need for change and improvement
- One time consolidations and restructurings will not provide lasting solutions for the Canadian forestry industry: fundamental changes are required
- At Deloitte, we will work with companies / stakeholders to:
 - address issues and challenges (financial, operational, structural) facing organizations
 - identify and analyze alternative solutions to meet business needs and requirements
 - identify opportunities for improvement and transformation
 - implement identified change initiatives

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