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Kim Inglis, BCom, CIM

Forestry may finally pay off for investors

Canaccord Genuity has a bullish outlook on the lumber market

Various analysts are saying the Canadian forestry industry is poised for growth. Although the industry has long been an underdog, many factors are converging to support higher prices in the years ahead.

Canaccord Genuity has a bullish outlook on the lumber market for mid - to late 2011 and 2012. They believe that supply side constraints, such as the implications of the mountain pine beetle in western Canada, will act as drivers for upward pressure on prices later in 2011.

The gradual U.S. housing recovery offers a source of export growth because 25% of the demand for our lumber is derived from U.S. home remodeling needs and that figure is expected to turn up sharply in 2011.

According to Canaccord Genuity, increased exports to Asia should also absorb available Canadian lumber. Government of B.C. statistics indicate that Canadian offshore export shipments this year are growing at a rate of 34%. China is one of the biggest drivers of Asian growth and, in January 2011, shipments of BC softwood lumber to China were double the volume shipped a year earlier.

TD analysts state that China has surpassed Japan as the largest export market for North American lumber; acquiring 46.3% from North American offshore exports. Although China primarily uses

lumber for industrial applications, TD believes there is significant room for growth in the wood-frame housing market.

Last month the BC Government was in Beijing showing an energy-efficient modular building to promote the advantages of wood construction in the mid-rise residential buildings that form 70% of China's housing development. In this walk-up apartment sector China averages up to 7 million housing starts annually.

According to RBC analysts, Canada was the largest supplier of lumber to Japan in 2010, with 38% of their total softwood lumber imports. The Japan earthquake and tsunami will also impact the industry. Japan will have to rebuild and their reconstruction efforts, while possibly long range, will include Canadian lumber. Wood frame construction has many earthquake-tolerant properties and wood is a material of choice for Japanese builders.

In their 2010 review, PriceWaterhouseCooper says the global forestry industry should see a rise in the number of mergers and acquisitions attuned to growth as markets evolve. They point to consolidation in the industry, geographical diversification into new growth markets, repositioning, and a flow of institutional money into timberlands.

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The forestry industry has direct benefits for investors. Timber has traditionally been a good hedge against inflation and has provided stable risk-adjusted returns. As well, many forestry companies offer decent dividends to their shareholders.

Investors wanting exposure to the forestry sector have a number of options. For broad exposure, they can opt for exchange-traded funds. The iShares S&P Global Timber & Forestry Index fund (NYSE: WOOD) provides diversified exposure primarily through the U.S. and Canada. For more targeted exposure, investors can look at individual

companies. Canaccord Genuity analysts prefer AbitibiBowater Inc. (TSX: ABH) and Fortress Paper Ltd. (TSX: FTP) in the pulp and paper sector, and EACOM Timber Corp. (TSXV: ETR) in the lumber sector.

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Kim Inglis is an Investment Advisor, CIM with Canaccord Wealth Management, a division of Canaccord Genuity Corp., Member – Canadian Investor Protection Fund. The views in this column are solely those of the author.