



## Industry news

- **SAPPI Slates \$2.5M for Coater Upgrade at Westbrook Mill.**  
In a signal of its commitment to the mill, SAPPI announced a new capital project to expand manufacturing capacity, diversify its sourcing, and improve its energy efficiency.  
— *PaperAge*
- **Long Recovery Ahead, Rough Prospects for Pulp and Paper.**  
Former Maine State Economist Charlie Colgan expresses long-term concerns about the state's pulp & paper industries and questions whether or not the mills can respond to challenges.  
— *Lewiston Sun-Journal*
- **Logging Towns Are On a Roll.**  
Several U.S. towns with traditional logging backgrounds are experiencing renewed economic and employment growth as a post-recession forest products industry ramps back up.  
— *Wall Street Journal*
- **Studies Commissioned By Quimby Show Economic Benefits of National Parks.**  
Two studies commissioned by philanthropist Roxanne Quimby's foundation suggest that a national park in northern Maine could boost tourism, jobs, and personal income in the region. Skeptics aren't quite ready to embrace the reports.  
— *MPBN News*

## Industry Overview

### Forestland Operations

Folks in the forest management and logging businesses in the Northeast tend to receive some pretty serious sideways glances when, after a long winter, we keep wishing for continued cold weather. If you're someone who depends on the cold like we do, we can mourn together the full arrival of spring. If you're someone who does not, we're pleased to report that our wishes don't appear to make much difference with Mother Nature.

The arrival of mud season signals an important shift in the pace and scale of forest operations in the Northeast. When winter's freeze melts and the ground softens, things come to an abrupt halt. In fact, folks in our industry plan for the wet weather season all year. Foresters plan so that sufficient protections are in place to apply proper silviculture and meet budgeted volumes; loggers and truckers plan so they can keep as busy as possible on dry ground and unposted roads; and mills plan to ensure adequate supply during a known widespread shortage. The mood of mud season depends on how well everyone did against their plans.

Fortunately, the Northeast had a fairly good winter in the woods. There were few significant snowfalls, and a mostly cool dry winter served to put oil in the gears of the forest products supply chain. This allowed for good logging conditions, high production, and mills with generally well-stocked inventories. While the woods operations and deliveries in the industrial forest have come to a halt, it appears all the planning has paid off.

Unfortunately, diesel fuel – a major cost driver for logging – remains near its 3-year high, despite a recent drop over the last month. Not long ago the New England market was buying diesel fuel at a full dollar less per gallon than it is today.

### NUMBER 2 DIESEL FUEL PRICES

3 YEAR HISTORICAL MONTHLY AVERAGES





These increased fuel costs make a big difference to loggers and eventually trickle down as a cost to the landowner. Although there's some talk of converting some heavy equipment to natural gas, we don't expect it to be widespread due to the high conversion costs, lack of distribution infrastructure, and general unfamiliarity with the fuel. That said, some regional mills have been converting from oil to alternative fuel sources – including natural gas – to run their heat and power systems. Even though most of them wind up bringing in natural gas using what they call a “virtual pipeline” (also known as, “trucking it in using a large fleet of diesel-burning tanker trucks”), the savings are significant.

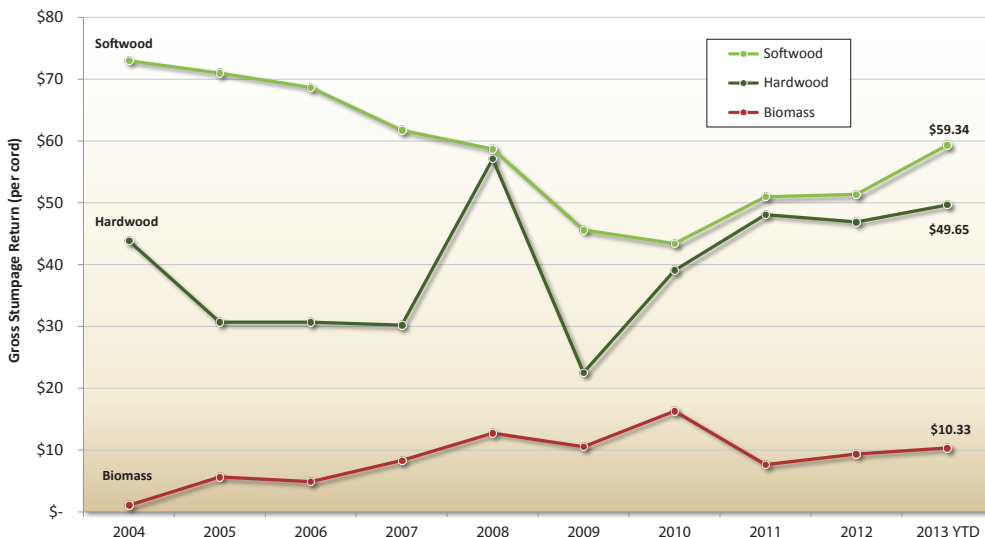
It is worth mentioning that landowners, loggers, and really anyone involved in forest operations recently had a very significant win in the Supreme Court. In March, the Court struck down a 2010 decision by the 9th Circuit Court of Appeals, which would have changed the classification of run-off from forest roads. We've reported on the implications of this in past newsletters – it would have complicated the permitting process and added a large cost burden to loggers and landowners. Interestingly, the EPA sided with industry, citing numerous studies that confirmed the run-off from forestry activities does not significantly overburden or add pollutants to waterways. Thankfully, the Court agreed.

## Stumpage Rates

Landowner stumpage returns for the quarter climbed upward, driven in large part to the growing overall optimism throughout the economy. Key markets are seeing rising prices on finished products and that is beginning to flow through to the landowner providing the raw timber. Some of these rises are seasonal in nature, but we've noted that the trend has now been apparent for several quarters.

### AVERAGE STUMPAGE RETURNS

2004 - 2013 YTD ANNUAL RATES PER CORD



Note: These rates represent a selected blend of the lands we manage, and do not include costs of marketing, harvest oversight, and roads- all of which can vary significantly.

Softwood in particular has been boosted by the Northeast's heavy component in spruce and fir. As we'll cover in the Markets section below, the demand increases for dimensional lumber have influenced the returns on logs.

■ **High Court Rules for Timber Industry Over Road Runoff.**  
In a 7-1 vote, the Supreme Court endorsed the Environmental Protection Agency's long-standing decision not to require Clean Water Act permits for stormwater that runs off logging roads.  
— *Thompson Reuters*

■ **Company Confirms Plans for \$120M Eastport Wood Pellet Plant.**  
Thermogen Industries has reported that it has signed a letter of intent with the port authority in Eastport, ME to lease space to construct a mill that could produce up to 300,000 tons of European-bound torrefied wood pellets.  
— *Bangor Daily News*

■ **Lumber Sector Enters 'Super Cycle' As U.S. Housing Recovery Gains Steam**  
Although still depressed, the U.S. housing market is expected to be a catalyst for rising lumber and oriented strand board (OSB) prices.  
— *Financial Post*

■ **Forest Products Company CEOs foresee a Bumpy Year Ahead.**  
According to a survey compiled by PricewaterhouseCoopers, the leaders of forest products companies are expecting tough times in the next 12 months, but expect overall revenue growth in the next three years. Most cite efficiency and R&D as top drivers of growth.  
— *Canada Newswire*

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# The Wood Markets

## Pulpwood Products

Demand for softwood pulpwood fell slightly this past quarter, although to put it into perspective we are well ahead of where we were last year. This holds true for Spruce & Fir pulpwood in particular, although we have been

<b>P&amp;C DEMAND INDICATORS</b> <i>Representing our take on the Northeast timber markets</i>		
	<u>Previous Quarter</u>	<u>Outlook</u>
<b>Sawn Products</b>		
Spruce & Fir	▲	▲
Pine Logs	—	▲
Hardwood Logs	—	▲
<b>Pulpwood</b>		
Hardwood Pulpwood	—	▲
Softwood Pulpwood	▼	—
Biomass	▲	—

able to move Pine and Hemlock pulpwood much better than expected. As I mentioned above, this time of year mills play a delicate balance between having too much supply in their yards and having too little. Last year in general the softwood markets overbought and held too much inventory for too long. Not only did this unnecessarily tie up working capital, it also brought on significant increased chemical costs to bleach and brighten the aging pulpwood held in inventory. This year, buying was held back for fear of repeating last year. With a few exceptions, inventories of the softwood mills in our operating regions remain comfortable but not overfull. This is a much better equilibrium for everyone.

Similarly, most of our hardwood pulpwood markets are in good shape coming in to spring. These mills tend to manage their inventory quarter-by-quarter and all indications so far point to good and increasing demand from hardwood chip plants and pulp mills. Poplar pulpwood, although a small component of the wood we deliver, remains in good demand from these mills.

In addition to managing their raw material inventories, pulp mills are currently focused on efficiency and cost management. This comes in the form of the fuel conversions I mentioned earlier, but also in the active management in their electricity usage and costs. This quarter, mills in the Northeast faced prevailing electric rates that were very high and caused quite a bit of nausea among mill managers. The costs were so high that, for a period of 3-4 weeks, one regional pulp mill stopped producing pulp during periods of peak electric demand, and instead produced electricity to sell on the grid. In essence, they temporarily became an electric mill, not a pulp mill, in order to offset losses on electricity and take advantage of pricing swings. Mills have always tried to sell their excess energy, but this is the first we've heard of a pulp mill alternating production of their core product in order to sell electricity instead.

## Softwood Sawstock

Spruce and fir dimensional lumber mills are enjoying good times due to substantial and steady increases in their finished product pricing. In our last newsletter, we mentioned that sawmills were experiencing pricing 20-25% over last year – this trend continues. According to data tracked by *Random Lengths*, in the past quarter alone, pricing on finished framing lumber was up some 10-12%. This kind of pricing has these mills running very much in the black and, accordingly, very hungry for wood. One regional sawmill told us that this past quarter was their most profitable quarter in 8 years. Considering most sawmills were on the proverbial ropes just a few years ago, this is a substantial turn-around.

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### ■ **The Fate of Quimby Land Remains In Balance.**

A shift in tactics by Quimby's charitable foundation may signal genuine interest in finding consensus regarding the future of the Maine woods.

— *Lewiston Sun Journal*

### ■ **Supreme Court Rules on forest roads: An Important Victory in an Ongoing Effort.**

The Court's recent reversal of a 9th Circuit decision is a critical win for landowners and loggers alike - but with the threats of future legal action, the issue is still not considered closed by either side.

— *NAFO Forestry Journal*

### ■ **Mill Officials Say LePage's Efforts to Change Renewable Energy Policy Could Hurt Paper Industry.**

Several representatives from Maine's pulp and paper industry criticized Gov. LePage for proposing legislation to remove the 100-megawatt cap on facilities that can be classified in the state's renewable energy portfolio standard.

— *Bangor Daily News*

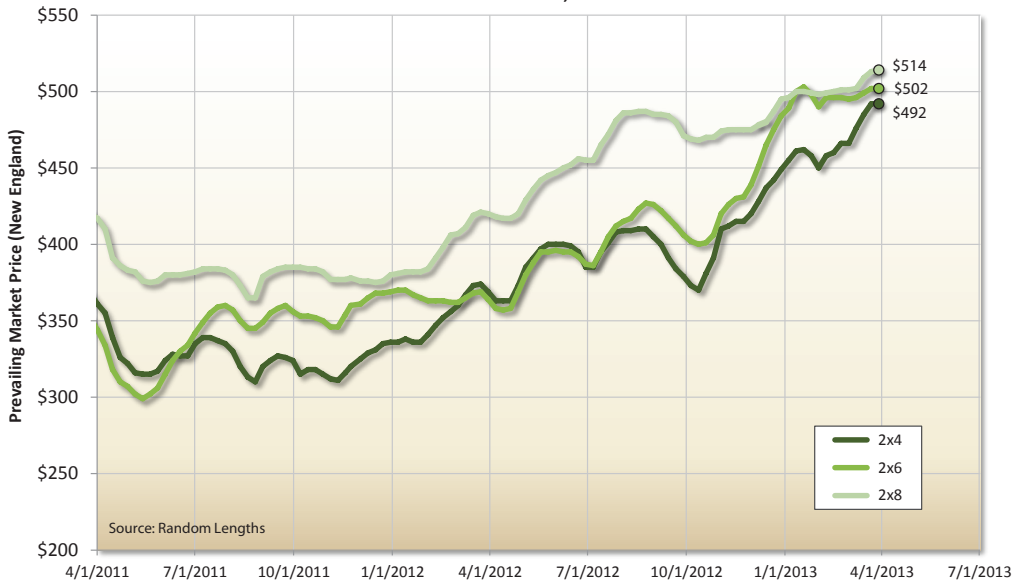
### ■ **Timber REITs Crush 2012 Estimates and Look to do the Same in 2013.**

Several factors, including the housing recovery, rising property values, technology advances, and alternative asset sales are making several timber REITs attractive investments.

— *Dane Bowler, Seeking Alpha*

## FRAMING LUMBER PRICING

2 YEAR HISTORICAL AVERAGES, #2 AND BETTER



Most spruce/fir sawmills appear to have planned their inventories well for springtime, although all things considered, if they had more volume available they would happily run more. With key economic indicators all pointing to signs of growth, we consider the short term outlook to be strong.

Our regional pine sawmills aren't operating under quite as good news, although there are similar signals of a demand turnaround. Most of these mills have taken extended downtime during the summer spoiling months and not run at all; this year we are hearing indications that some will be running, and buying wood, through the summer. Pricing on their finished product is 10-12% higher than this time last year. They won't be setting the world on fire, but these are encouraging signs about the market's health.

### Hardwood Sawstock

Similarly, there's a good amount of optimism talk regarding hardwood. For the most part, regional hardwood mills believe they are through the worst of it. Nearly every northern hardwood species except birch is moving northward on price. This includes both hard and soft maples as well as oaks. These types of hardwoods go into products like flooring, cabinets, and furniture – as you can imagine, demand for these products is correlated with construction and home improvement.

Both construction and remodeling activity is expected to grow substantially. According to the U.S. Census Bureau, housing starts over the last quarter came in at a healthy pace for both single and multifamily units. The long-term prospects of home building and home remodeling remain positive, and the demand at the mills is growing. Accordingly, we are expecting a small but measureable uptick for our clients' hardwood logs.

### Biomass

Biomass markets are very dependent on the weather. Early in the winter, snowfall served to insulate the ground, which required the biomass remain in the woods in order to protect the ground surface. This reduction in available mill supply served to boost the prices that mills were willing to pay for biomass. This is a fairly regular seasonal supply/demand imbalance, which will occur during mud season, and relax again in the summer.

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# update

1st Quarter 2013

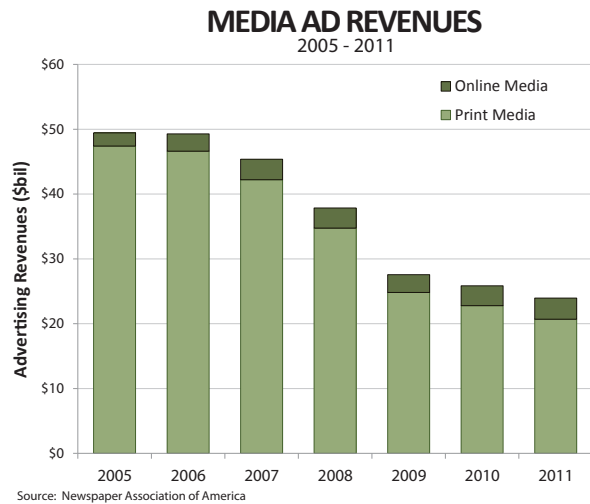
- **SFI Applauds EU's New Illegal Logging Rules.**  
New regulations that prohibit imports of products made from illegally logged timber into the European Union. Many managers of certified forests consider this a long time coming.  
— *Canada Newswire*
- **Timber Prices to Surge Following Beetle Epidemic.**  
The Campbell Group released a report suggesting that British Columbia will further reduce its allowable cut in response to damage done by the mountain pine beetle, which will cut available lumber supplies and impact price.  
— *DesignBuild Source*
- **Shell to Buy 500,000 California Forest Carbon Credits.**  
Michigan land is being proposed as one of the largest carbon offset projects as a way to generate credits for Shell's operations covered in California's cap-and-trade program.  
— *TrampCarbon*
- **Collins, King Seek to Level the Playing Field for Maine's Foresters.**  
The introduction of a new bill aims to expand the market for U.S. based forest products by labeling them as "biobased" in accordance with the USDA BioPreferred program.  
— *Saint John Valley Times*

# Market Outlook

## Longer Term: Pulp & Paper

We remain concerned about the overall health of the pulp and paper industry, and the challenges stemming from a capital-intensive, highly competitive industry with high fixed costs. As previously mentioned, the mills are surviving by doing what they can to diversify and manage their variable costs.

Newsprint demand continues to stress some regional mills. There are several reasons to be pessimistic about the U.S. newsprint market – both circulation and readership continue to be displaced by a generation more comfortable with on-line news and media sources. Furthermore, advertising revenues from print media has almost halved in just



five years, according to the Newspaper Association of America (see chart at left). We expect the primary growth in demand for pulp to continue to originate from Asia, but the worldwide production-consumption gap, combined with new plants coming online in South America, points to a longer-term oversupply. Once again, mills that can stay competitive and diversify will be the ones that survive long term.

The good news is that we believe the Northeast not only has a few of these pulp mills, but also provides very high quality fiber as a resource. This will provide a buffer for landowners in the region.

## Longer Term: Sawn Products

According to RISI, worldwide consumption of softwood lumber is forecasted to rise 9% in 2013. This is a trend that should lead to further increased pricing for the landowner. In the past 10 years, a significant portion of the available sawn lumber production capacity was mothballed, or in some cases closed entirely due to economic struggles. There is talk in the Northeast of this capacity being brought out of hibernation, and even some talk of new mill construction. Eventually, this will serve to flatten out the upward trend in pricing, but – as long as the economic turnaround continues – we believe demand will continue to outpace supply despite a growth in output.

A growth in sawmill output also means a growth in residual chip output – a problem we continue to see on the horizon. Sawmills are now a slightly less dependent on moving their chips for profitability purposes, but will have difficulty ramping up capacity if they cannot find ways to get rid of chips. This is obviously good news for chip buyers such as pulp mills, who have been paying less in the face of the oversupply.

## What to Expect Next Quarter

As you can tell, we are generally optimistic for next quarter. Although we have a long way to go for a full recovery, nearly every relevant economic indicator points toward growth, and the regional mills are feeling encouraged. In our last newsletter, we

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### ■ **Timber Industry Begins Rebound, Aided by Recent US Housing Recovery.**

According to NCREIF's timber index, total return for timberland holdings last quarter were the highest since the 4th quarter of 2007. The Pacific Northwest remained the strongest performing region.

— *World Property Channel*

mentioned the possibility of a wood products bubble forming, particularly related to sawn products. There was a question at the time of whether the indicators were pointing to real demand, and another quarter of good news has most industry analysts now believing that talk of a bubble was overblown. As stated in our prior newsletter, we agree.

Benjamin D. Carlisle  
PRESIDENT



update

1st Quarter 2013

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