

Forest industry faces major changes

Much of B.C.'s wood supply will be used for bioenergy instead of pulp and lumber, expert says

Gordon Hamilton, Vancouver Sun

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Natural Resources: The B.C. forest industry turned in one of the world's worst performances in 2006, but a transformation of historic proportions is just over the horizon, one of the province's leading industry consultants said Thursday.

PricewaterhouseCoopers partner Craig Campbell said traditional pulp and lumber production, particularly in the pine beetle-ravaged Interior, is going to give way to bioenergy, smoothing over the boom-and-bust cycles that characterize the industry today.

Campbell's forecast of a prosperous future comes at a time when the industry is the world's basket case. He said mountains of logs are piling up alongside forest roads today because companies cannot economically convert them to lumber.

The industry tumbled from the world's top performing region two years ago, when it had \$1.5 billion in profits, to the bottom of the heap in 2006, losing \$500 million, according to findings released Thursday by PricewaterhouseCoopers.

Further, return on capital employed -- a key indicator of financial health -- dropped to -1.8 per cent as the industry fought against the mountain pine beetle infestation, a depressed U.S. housing market and a soaring Canadian dollar, Campbell said at PWC's 20th Global Forest and Paper Industry Conference.

Lumber prices are bumping along the bottom but he said he sees no sign that they are going to improve soon.

Despite the bad performance, Campbell said huge changes are under way -- a consequence of the mountain pine beetle infestation -- that will transform the province's wood products industry from reliance on cyclical commodities to more stable energy production.

"The next five years in the B.C. forest industry are going to be without a doubt the biggest transformation we will ever see," Campbell told the 500 people attending the conference.

The pine beetle is the greatest challenge and, as wood quality deteriorates in the dead pine stands, less of it will be suitable for lumber.

"The outlook is very bleak for the Interior sawmilling industry. Dozens of sawmills are going to close."

He said that in the Interior, 15 million cubic metres of timber -- enough lumber to fill half a million logging trucks -- is going to waste in huge roadside piles because it cannot be economically converted to lumber.

Other factors driving the change include:

- Ownership of the industry is changing rapidly, with new investors buying stakes in B.C. companies.
- Softwood duty refunds injected a \$2.5-billion windfall that PWC did not include in its earnings report.
- Carbon credits trading is coming, adding a new source of revenue.

It all adds up to "big opportunities for biomass energy using beetle wood," Campbell said.

In a later interview, Campbell said the industry is buzzing over the potential of electrical generation. BC Hydro has committed to promoting bioenergy and the key question remaining is what kind of subsidy it will offer producers.

"We are getting phone calls to do studies for energy companies vis a vis the wood supply. There is a lot of momentum and interest. That's where I see we are going to shift: from traditional lumber to energy."

He sounded a note of caution on subsidies, however, saying that in Europe subsidies to energy producers lead to higher wood prices, forcing some traditional wood-products manufacturers out of business.

Mark Connelly, investment analyst with Credit Suisse, said diversifying into energy production looks like a smart move, but he questioned how ready B.C. companies are to diversify, noting many have not diversified out of the region, a basic financial strategy.

"One of the reasons B.C. wood companies have such a problem is that they are B.C. companies," he said.

"What you have here, in my mind, is an industry that locked itself into a region that now suddenly has a real problem," he said, referring to the beetle. "Every time you read a money- management thing, it says diversify. And B.C. didn't."

Both Campbell and Connelly noted that the face of the industry is changing as activist investors buy stakes.

Campbell singled out B.C. billionaire Jim Pattison, Montreal's Stephen Jarislowsky and New York-based Third Avenue Management, which has a \$800-million investment in B.C. companies.

He said the industry needs to consolidate beyond what has taken place already.

"The question looms whether Third Avenue will role its pulp assets all under one banner," he said.

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