



April Lumber Market Analysis

By Kéta Kosman

May 18, 2012

OVERVIEW

Structural changes to the North American forest products' industry discussed by Madison's for the past six months materialized in April. When other industry watchers and analysts will later this year look back on 2Q to make their reports, April will go down in history as the pivot on which the business of producing and buying lumber and panel turned.

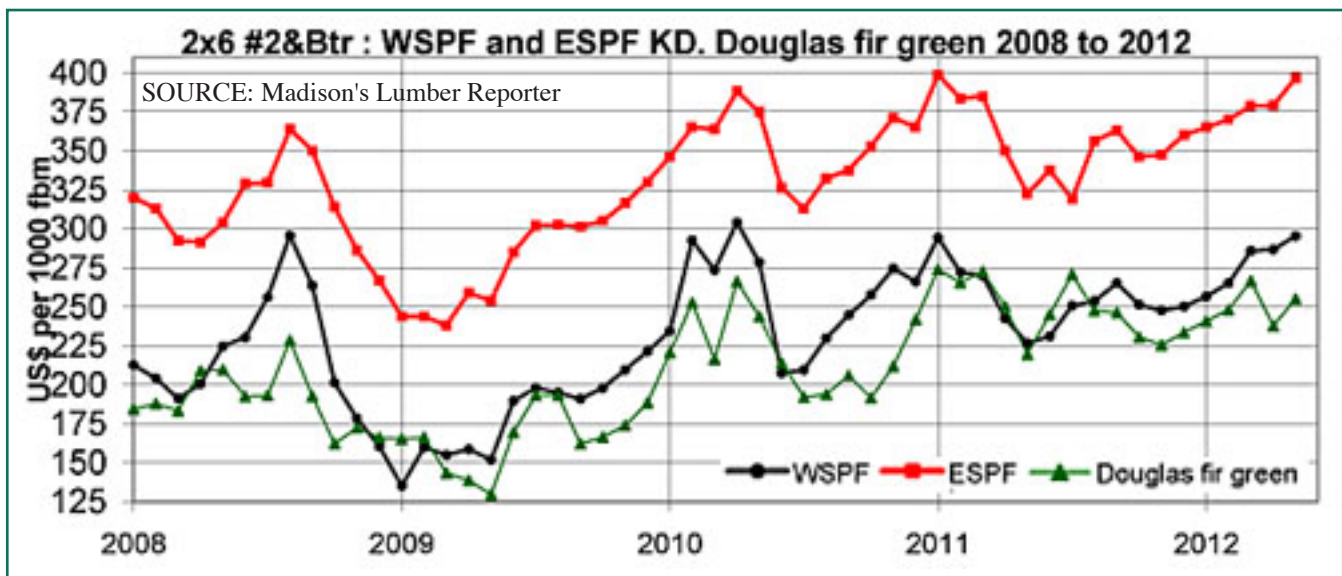
The solid wood industry is no longer at the mercy of timid customers unwilling to stock up on basic commodities for fear of another crash or downturn. For the past five years, conservative and bearish buyers maintained pressure to keep prices down as producers worked desperately to accept, and fill, whatever orders they could get. All while maintaining extremely low operating rates.

The supply-demand balance has officially shifted in favour of the sawmills.

As previously detailed by *Madison's*, whenever there is a cataclysmic event in the forest industry – be it wildfire, flooding, storms, labour disruptions, etc – there is an immediate effect on solid wood prices. However, whether that effect lasts for part of a day or through an entire season is uncertain. The second devastating sawmill explosion in British Columbia in the matter of months had such an effect. The loss of production at Sinclar Group's Lakeland mill in Prince George, being a stud mill, caused studs prices across all species to rise sharply in the week of the accident. Those price levels were not only sustained, but continued a slower but steady rise in the weeks following.

Studs buyers were unable to quickly find the specific items they needed in sufficient quantities. Within a matter of days, studs mills across North America received so many calls looking for wood that they had no need to entertain counter-offers.

- **Players took an Easter-rest and marshalled their strength for the following week.**
- **The vaunted post-Easter increase in activity turned out to be less flamboyant than expected.**
- **Trucks became scarce as many operators eschewed lumber in favour of moving produce items.**
- **Prices reacted with volatility following the second tragic BC sawmill explosion.**



Suspensions voiced toward the end April that the softwood lumber export tax could be reduced for June turned out to be fact. The trigger for a lower export tax was met effective June 1, due to firming lumber prices in April and part of May. In view of the delayed start to a wet spring, the possibility of US lumber demand remaining high well into summer can not be ignored. If this turns out to be the case, the export tax on Canadian wood being shipped into the US could drop even further in July.

Players took an Easter-rest and marshalled their strength for the following week.

MONTHLY RECAP

- In the first week of April, prices on all Western Spruce-Pine-Fir commodities came off modestly in what many referred to as "a slightly softening market". All players expressed their confidence that trading would pick up in the week following Easter.
- However, demand seemed to be going only skyward, and players in western KD fir trade weren't sure supply would match growing demand.
- Eastern stocking wholesalers on the shores of New Jersey had to contend with green Douglas fir prices which softened more than they would have liked.

SHORT TERM ANALYSIS

Douglas fir mills on the west coast of the US were unable to hold prices up as production continued to surpass demand. Small and medium-sized family-owned companies have been struggling to stay afloat since the US housing downturn in 3Q 2006. Many have not yet managed to achieve a satisfying supply-demand balance. As a result, wholesalers selling Douglas fir to loyal builders on the US eastern seaboard had not choice but to absorb the weeks-long price fluctuations.

For spruce mills in the west, it was more a situation of wood going out of the mill faster than fibre could come in. Still in April the timber harvest was uneven, with slushy snow-pack covering many of the logging roads.

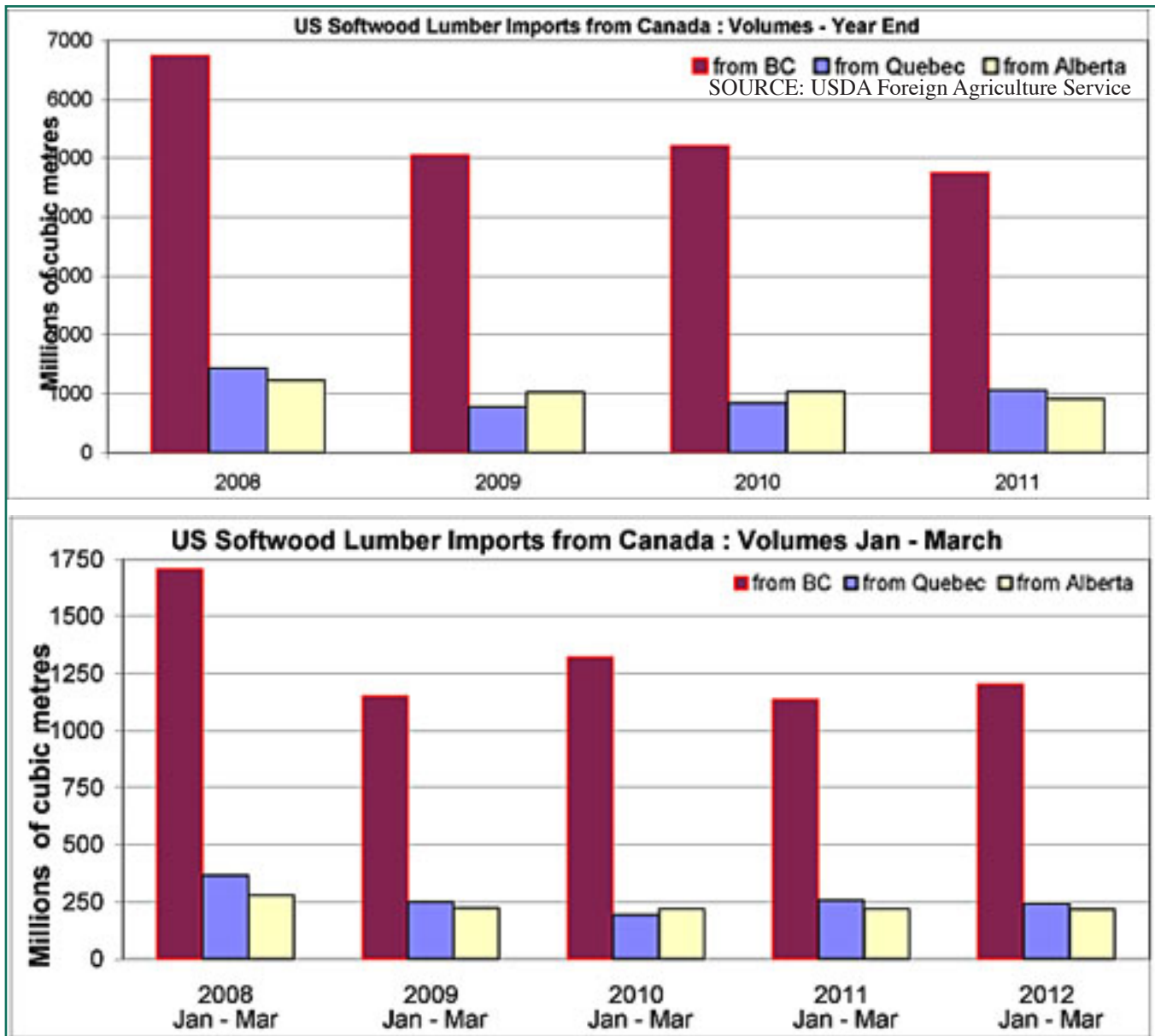
By the end of April, true spring-like conditions had arrived in most of North America, particularly in the west. Dark thoughts of the winter that had just passed flew out of people minds as they put their boots on and sloshed through log and lumber yards checking inventory levels. Were it still 2010 the meager log piles and dwindled lumber supply may have been enough.

The bottom of the lumber market is by now long behind us. In hindsight, that bottom was firmly passed in late autumn of 2011. Momentum in US and Canadian home building, and rising rates of home improvements, are serving only to drive lumber demand ever higher. Solid wood prices may be better now than they have been for two years, even longer on some items, but have not yet begun to reach the highs to come in the next year..

The vaunted post-Easter increase in activity turned out to be less flamboyant than expected.

MONTHLY RECAP

- While prices were flat or firmed up slightly, traders were adamant that further increases were inevitable.
- Studs producers expressed concern at this confidence when some studs prices actually backed off considerably despite the rosy outlook of traders.
- Sellers of KD fir, however, reported that inquiry and movement in general picked up.
- In mid-April, customers stuck to their just-in-time buying strategy. Prices could do nothing but flounder, vendors said.



SHORT TERM ANALYSIS

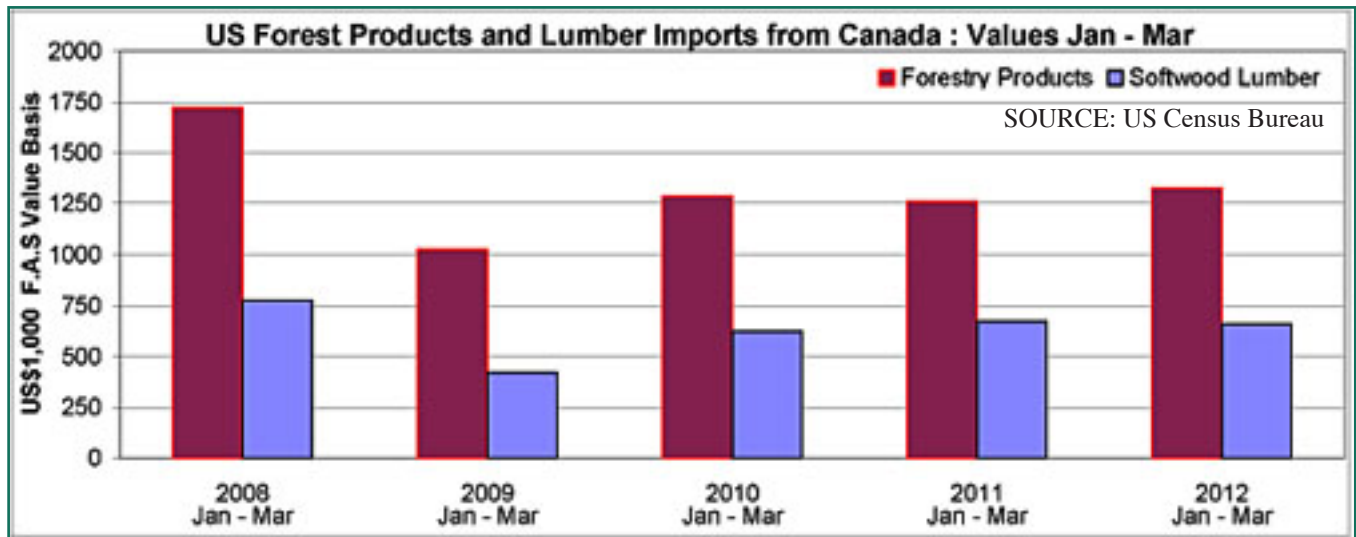
Who to believe? It's the same old story. Taking all the information together, the only reasonable conclusion to draw is that business is picking up. It just didn't pop up significantly directly following the Easter long weekend, as many had expected.

Producer warnings that prices will reflect the changing supply-demand balance further in favour of mills should be heeded. Especially as the US building season ramps up to whatever the 2012 version of full swing turns out to be. Stubborn customers stuck to their seeming belief that the downturn is somehow going to last forever and that there is no point in stocking wood should prices once again drop will be crying in their order books soon enough.

How could anyone possibly think demand will decline and prices with it? A quick look at the most basic numbers of lumber production, consumption, and export, clearly shows the direction is solidly moving up. Those mired in the doldrums, who point to 2005 and declare, "We're nowhere near the high!" are missing the point entirely. Business should never have been that high, such levels are not sustainable. The glut of homes pushed into the market caused problems the entire world is now dealing with.

It is more reasonable to look at a recent "normal" year, if there is a such thing as normal in the business of lumber. The graph on this page illustrates the last ten years of US forest products and softwood lumber imports from Canada. 2002 is probably as good a base year as any other, with 1999 running a close second.

It is important to note that the latest data released by the USDA Foreign Agriculture Service and the US Census goes only as far as March. Judging from the uptick in lumber demand, and prices, in April, there can be no doubt that the numbers for that month will be better still



Trucks became scarce as many operators eschewed lumber in favour of moving produce items.

MONTHLY RECAP

- Spiking fuel prices made hauling by truck more expensive, a circumstance that wore some traders' patience thin.
- As produce harvest season gets into high gear, transporting lumber by road in North America becomes increasingly difficult.
- By mid-April, eastern spruce mills were reporting palpable increases in activity in both high and low grade items.
- Inklings of a shortage in the wider dimensions, across regions and species, began to materialize.

SHORT TERM ANALYSIS

Canadian lumber industry players always complain about transportation costs. This culture may be the result of being stuck with whatever arbitrary and nonsensical edicts come down from whichever railroad monopoly serves their region. However, such an unfortunate position does not then excuse putting the screws on truckers. If there is a looming crisis for North America's forest products sellers and buyers, it will come from the transportation industry. Please refer to the March issue of your Madison's Investment Rx for a culmination of the various problems.

Summer is one of the busiest seasons for shipping goods in North America, along with the pre-US Thanksgiving/Christmas season. Expect things to come to a head, even if for a short term only, as temperatures across this continent heat up this year.

The long-anticipated scarcity of wide dimensions has arrived. Price volatility in the 2x8 to 2x12 sizes is going to be frightening into 3Q. Meanwhile, demand for 2x6, whether it be western, eastern, or southern dimension, whether it be green or KD, or whether it be framing lumber or studs seems like it will only to keep rising. If short-sighted

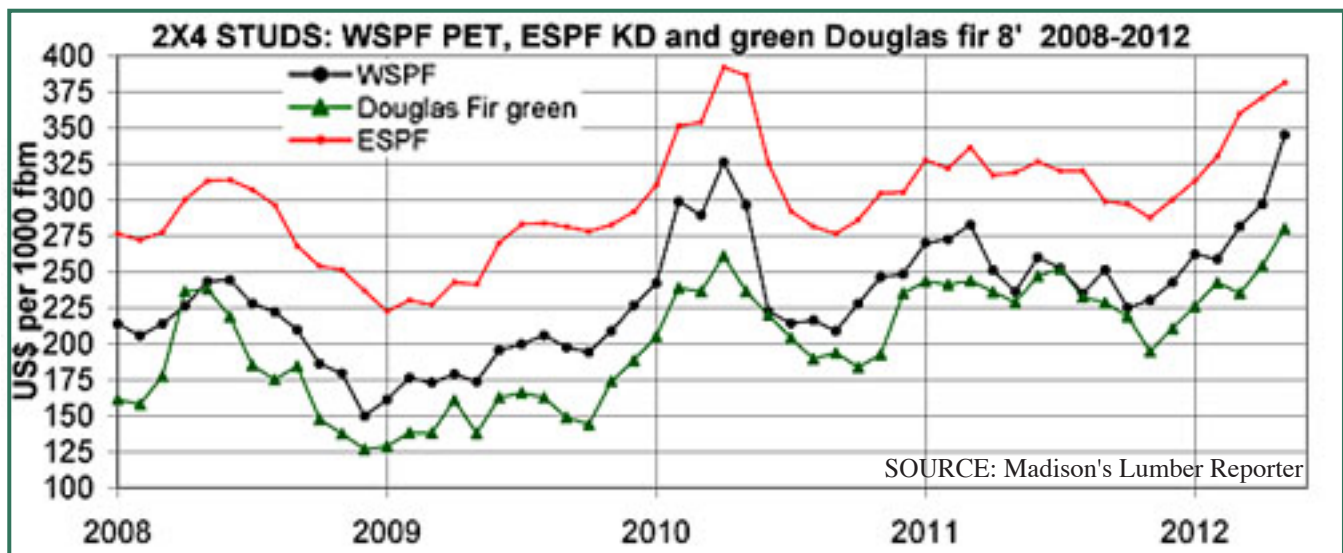
yards and wholesalers haven't even been carrying significant volumes of 2x4, it is doubtful there is a lot of 2x6 in the supply chain.

It is a very recent development, after all, that multi-family home building in the US leads all new housing starts by such a wide margin. Its no wonder very few are prepared.

Prices reacted with volatility following the second tragic BC sawmill explosion.

MONTHLY RECAP

- The market reacted with shock, both at the injuries and fatalities, and by a flurry of inquiries for all commodities.
- In the last week of April, many customers who had been waiting in vain for prices to drop came to the market to buy.
- Producers in the east with logs on hand to run were faced with a continuous stream of desperate buyers who had to buy at mill asking levels.
- Price movement in studs was so drastic that pinning down numbers was difficult for traders.
- Traders in regions and products other than studs warned that the trend in prices rising overall "will not last".



SHORT TERM ANALYSIS

Those naysayers are now eating their words. All while enjoying plush bottom lines, of course. That those \$50 and more price increases held, and even rose further, in the weeks following the second explosion says a lot about impending lumber supply issues for this summer. Solid wood prices did not drop in the week following the Lakeland stud mill disaster. Industry watchers rubbed the dust from their eyelids to stare in disbelief.

It does no one any good to look at hardly inspiring 1Q 2012 results then proclaim that recovery is still ahead of us. The recovery slowly approached in 3Q 2011 was a corner soundly turned after the end of 1Q 2012. By the time 3Q 2012 results are out, lumber prices will have gone higher than they were at the end of April.

And anyone who wasn't paying attention will be left wishing, "If only I knew then what I know now!".

CONCLUSION

At the PwC annual Forestry, Paper, and Packaging Conference last week in Vancouver, BC, Conifex CEO Ken Shields echoed *Madison's* sentiments about 2Q 2012 exactly. During the question and answer portion of the Executive Perspectives panel, Shields revealed which proportion of Conifex production goes to China.

"It is the Conifex lumber marketing strategy to target Japan, as the customer for our richest priced lumber," Shields said. "What doesn't go to Japan is sold to the US and China. In 2Q 2011, North American demand for our lumber was weak while buying from China was robust. In that quarter, 68 per cent of our products went to China. In 1Q 2012, 57 per cent of our products were sold into China, and in 2Q 2012 only 30 per cent is going to China while 40 per cent is being sold into the US."

The fact of this change in ratio will not be widely known until 2Q results come out. By then most wood needed for US construction projects will have been ordered and delivered, or in delivery. Lumber prices may climb a bit further in the coming weeks, then will stabilize into mid-summer. If there are significant forest fires, as have already started across North America this early in the season, fear of constricted supply may keep lumber prices up into autumn.

The issue will be that of volumes. Solid wood producers in Canada and the US are still running well below capacity. Even if prices continue to climb somewhat and the export tax is further reduced, it is not likely that capacity at a majority of mills will ramp up to full production, full time. This means that lumber prices will remain high but volumes actually sold will not be much more than during the same time period last year.

Company revenues will increase, certainly, but improving bottom lines will not reflect the sharp increase in lumber prices. Only when the supply-demand balance reaches the kind of stability that makes both producers and customers comfortable will higher prices stick for the long term. At that point production will increase to levels that companies can again post consistently positive earnings.

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