



May Lumber Market Analysis

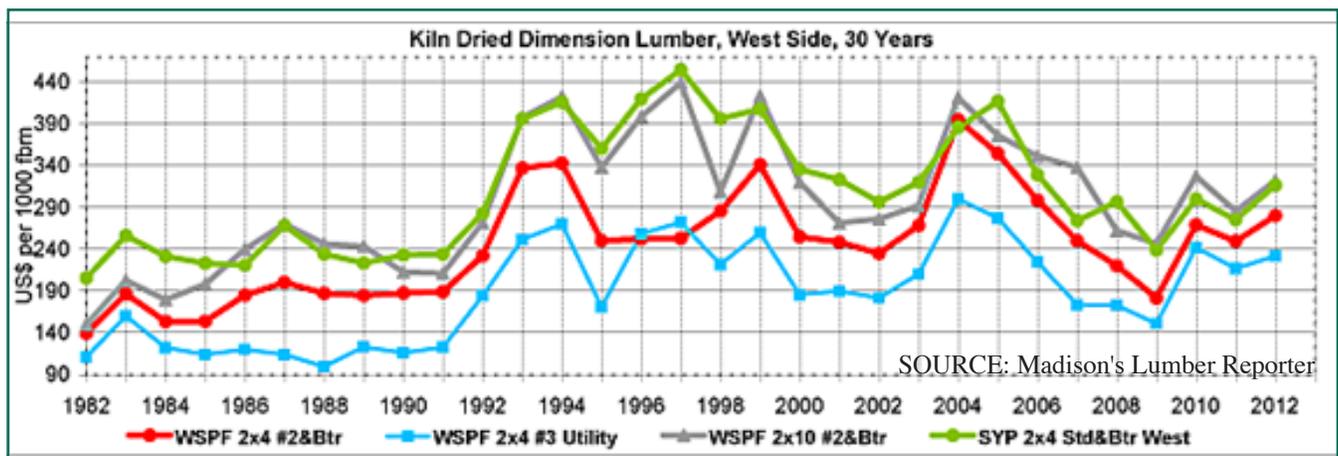
By Kéta Kosman
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OVERVIEW

Anyone not reading *Madison's* for the past four months was surprised by the significant upswing in North American solid wood demand in May. *Madison's* readers heeded the advance warnings of an impending supply crunch and bought early, before prices rose. Conservative players, and those who didn't trust the clear signs of market recovery, were left to scramble for suppliers of small fill-in orders and of prompt wood. This cycle fed on itself as May progressed: panicked customers called three or four mills requesting quotes, at each turn prices were up. Some grumbled but bought. Others thought it best to wait for the next day, only to find that unrelenting demand had pushed prices even higher.

While prompt delivery was still generally available, supply of some items became extremely tight and unprepared customers could do nothing but accept lengthening delivery times.

Since 2008 all eyes have been on the new customer base in Asia, specifically China. Industry watchers, some of whom ignored this important new destination for Canadian and US wood products until 2010, currently are looking to that region for increased buying. However this latest run on lumber is coming not from China, but from the US.



China's lumber import volumes levelled off in June 2011 due both to a sudden restriction of credit and to loads finally making their way to inland destinations. Prior to mid-2011, a large proportion of China's log and lumber imports were kept stockpiled at the ports. From June to July 2011, China's imports of BC lumber fell by 30.1 per cent in quantity and 38.3 per cent in value, according to Statistics Canada and BC Stats. June 2011 lumber export volumes from BC to China were 824.5 thousand cubic metres and values were \$127.2 million, while in July the volumes were 576.6 thousand cubic metres and the values were \$78.6 million. Since that time buying out of China has been maintained an essentially even keel.

Something interesting to note is that the latest data available from Statistics Canada shows BC's lumber exports to China for March 2012 up 9.3 per cent in value but down 13.7 per cent in volume compared to one year ago. In March 2011 China imported 625.4 thousand cubic metres, or \$101.2 million, while in March 2012 those figures were 688.9 thousand cubic metres, or \$87.3 million. WSPF KD 2x4 #3/Utility grade lumber prices have remained essentially flat for the past year, so its difficult to explain this wide discrepancy between values and volumes compared to those of last year.

- **Good weather and healthy demand created strong market-conditions.**
- **Lumber prices moved higher, with no signs of softening demand.**
- **Customers hesitated to buy even as inventories declined.**

As the month of May progressed, the full brunt of Sinclair's devastating Lakeland stud mill explosion in Prince George, BC, was felt throughout the stud market. Benchmark WSPF KD2x4 PET studs prices had climbed \$135 compared to one year ago, and \$73 compared to the previous month, to US\$360 mfbm. ESPF KD 2x4 8' studs similarly rose by \$100 compared to May 2011 and \$60 compared to April 2012, to US\$410 mfbm. Those higher price levels continued improving at time of writing.

Order files at studs mills across North America, regardless of region or species, whether green or kiln dried, grew to four weeks. Disbelieving customers who failed to see the plain truth in front of their faces could not deny that – obviously – the supply/demand balance must be incredibly tenuous if the loss of a single producer was enough to impact prices so sharply. Please refer to the analysis in your May issue of *Madison's Investment Rx* for a five-year graph showing price comparisons of several species of studs commodities.

Good weather and healthy demand created strong market-conditions.

MONTHLY RECAP

- In the first week of May, sellers of Western species indicated that prices were steadfast, and if anything would be gaining strength.
- By the second week of May, western sawmill order files, including KD fir, were three weeks or more. Price rose correspondingly.
- In mid-May, kiln dried fir producers in the west reported severely restricted inventories.
- Finally in the third week of May, strong selling in the west translated to higher prices in eastern dimension.

SHORT TERM ANALYSIS

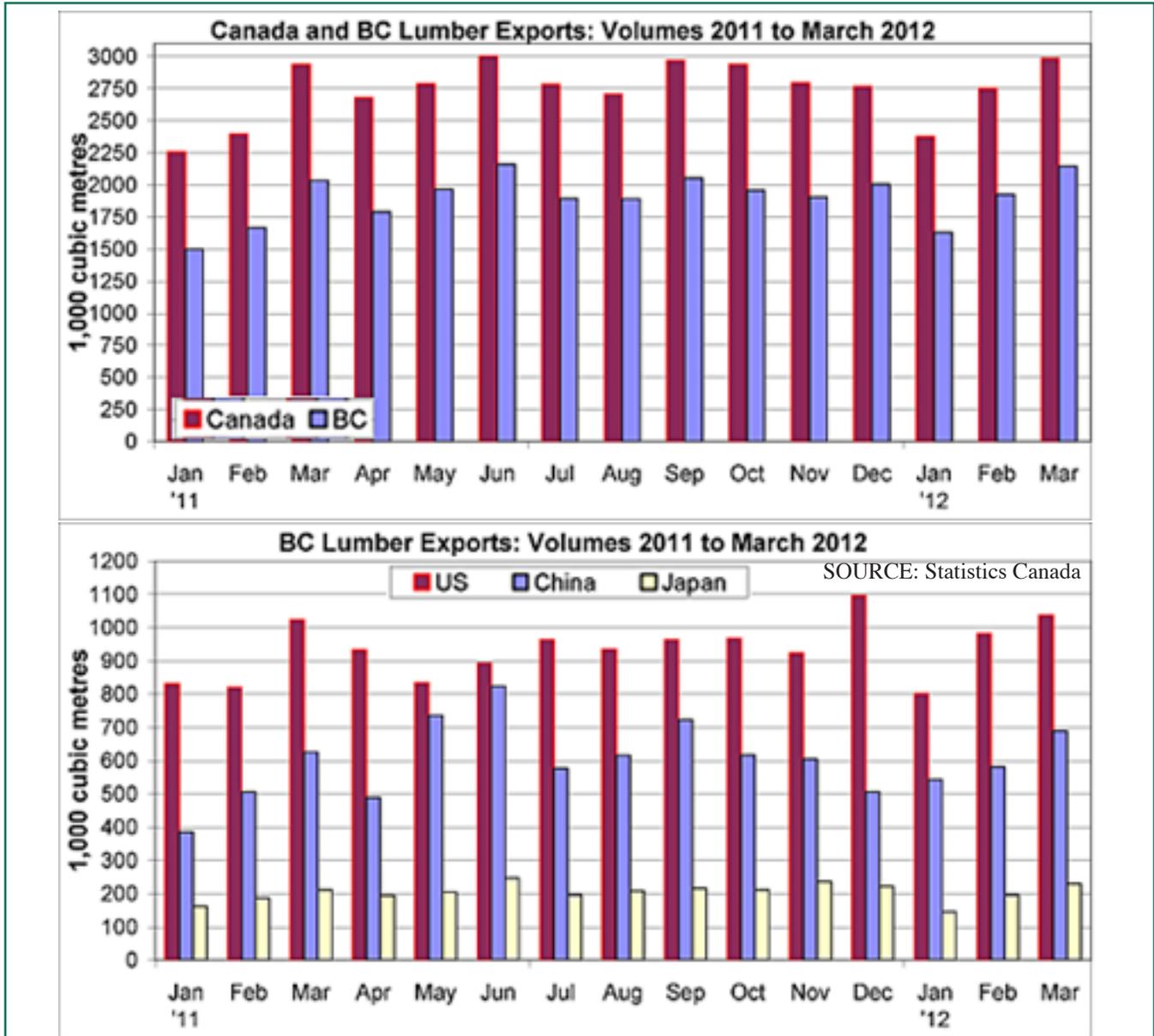
May 2012 marked the end of constant lumber prices fluctuation with a lot of pressure on the downward side. It was the beginning of a solid upward price march.

In mid-May, benchmark WSPF KD 2x4 #2&Btr prices had increased by more than 9 per cent over the previous month and by almost 32 per cent over the same time one year ago. In the past five years, rising lumber prices reversed back down within a few short weeks, but not this time.

Those who may celebrate these new levels are reminded that US\$310 mfbm on western 2x4s is hardly a historical high. The recent high for that dimension was US\$395 in 2004, and it was well above \$300 a few times in the past two decades, hitting US\$337 in 1993, US\$343 in 1994 and US\$341 in 1999. Of course the supply/demand situation is completely different now; back then the forest products industry was signified by growth, mergers, and consolidations, with companies focussing on becoming vertically integrated. Since 2006, companies have divested segments to become focussed on either the solid wood or pulp and paper side – depending on their strengths – and the industry in general has been signified by bankruptcies and permanent closures.

As May drew to a close, a burgeoning ESPF secondary market began to take shape, as some wholesalers were "sniffing around" for any wood that their competitors were hanging onto. ESPF customers kept coming back for just-in-time transactions, paying the least amount they could manage, which was still higher than the last time any of them had bought wood. Increased buying in the east, growing sawmill order files, and rising prices are all clear indications of rebounding US demand. Western mills can

choose between traditional customers in the US and new business in Asia, but eastern mills have only the US and Canada to sell to.



Lumber prices moved higher, with no signs of softening demand.

MONTHLY RECAP

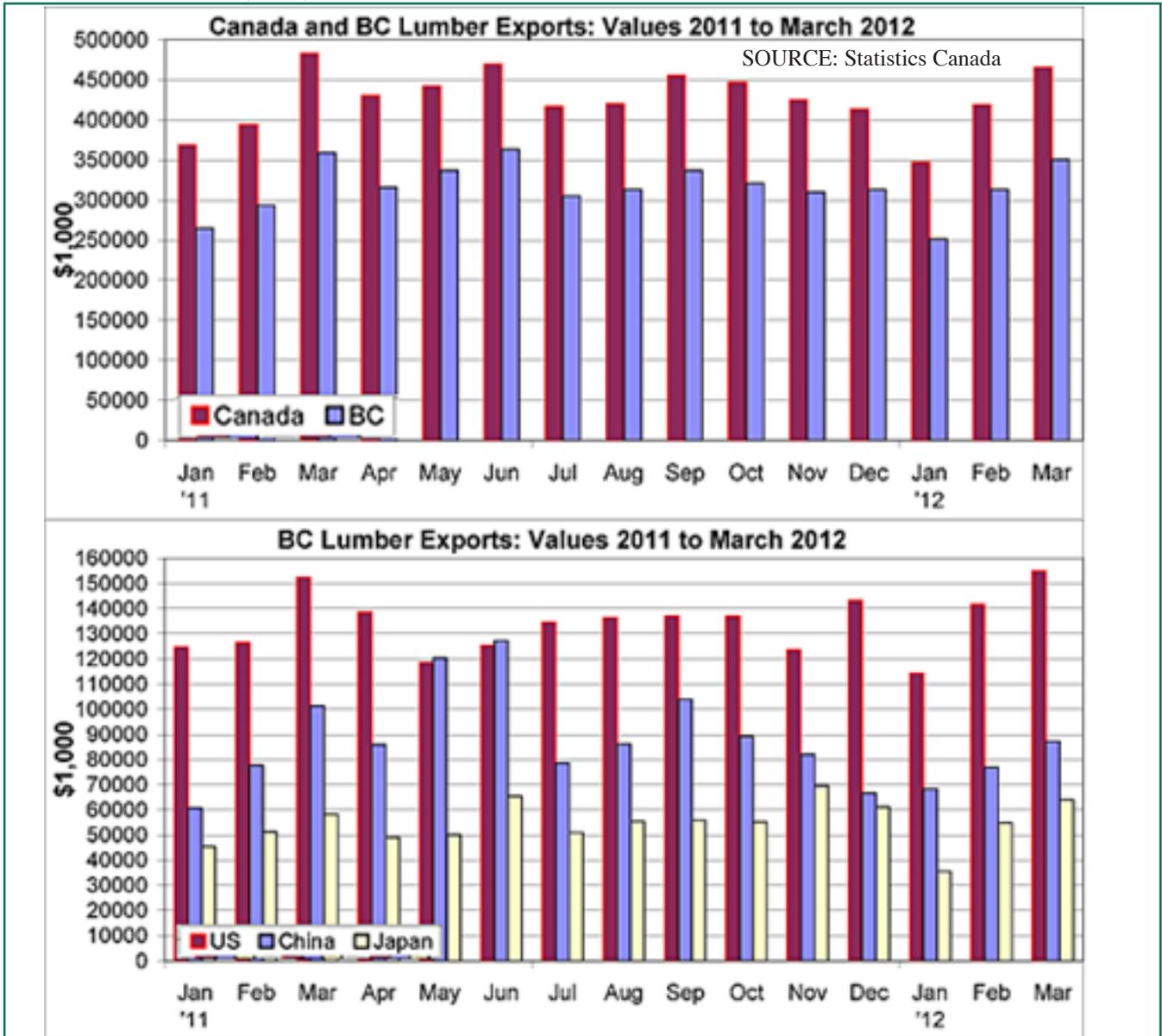
- Although May started off with uneven inquiry for kiln dried fir on the west coast, prices continued to strengthen. Every mill with a log deck ran overtime, if there were enough workers for the shift.
- Machine stress rated lumber producers described the second week of May as "terrifying", because MSR prices had reached levels rivalling the highest anyone paid in 2011.
- By mid-May western mills maintained a 2:1 ratio in demand vs supply.

SHORT TERM ANALYSIS

In the habit of keeping little to no inventories, buyers came to the table for deals out of necessity, but continued their pattern of frequent but small transactions. Buying just enough wood to keep afloat. Customers who sat on their 1Q inventories in an effort

to wait for prices to bottom out were not rewarded, and instead had to come back and enter the market more often, and at higher prices.

It will probably take the rest of this year for customers to adjust, to get out of the recent habit of ordering for immediate needs only directly from the mills. As order files remain strong, demand will naturally shift to secondary wood suppliers. These outfits have not been maintaining stocks over the past few years, and will be caught short. Prices will respond wildly. This will do no one good however, because there will be only very small amounts of wood to sell.



High prices but no volumes, how maddening. It will likely not be until the end of 2012 for wholesalers to get out of recent habits and get back into the normal business practice of storing wood. In the meantime, mills are going to have a field day charging premiums on wood that customers will have to wait four weeks or longer to receive.

What a change from 2008 to 2011 when customers could get precisely the product mix they were looking for in three days, at a price they were willing to pay.

Buyers are no longer in the driver's seat.

Customers hesitated to buy even as inventories declined.

MONTHLY RECAP

- By the end of May, western producers no longer had to worry about settling for short periods of good business followed by prolonged lulls.
- Some specialty stud sizes were becoming particularly difficult to source.
- As May closed, MSR sellers who had been enjoying some price increases braced themselves for a pushback from customers.

SHORT TERM ANALYSIS

After nearly five months of prices trending steadily upward, studs producers were delighted to find their segment was in a decidedly healthy state in early May. Buyers did not hesitate in making good on their orders, as their downstream distribution was actually turning a palpable profit.

As this year marches on, makers of other solid wood products will declare similar positive news. In the past five years, when prices in one region or product group strengthened customers simply shifted their demands. If #3/Utility grade on the west side was hot due to China, buyers started asking for southern yellow pine or for green wood. If wides in the east became difficult to source, customers switched to another species, such as Hem/Fir for example.

Mills similarly swapped out production, the classic switch being from MSR to KD fir. Machine stress rated producers are very disciplined and will simply cut production of that specialty product if they can't get the prices they want.

This game can only be played for so long. Sooner or later there materializes a situation where everything is scarce and there is nowhere to turn for alternatives. Mills will have to bring more production online, and customers will have to wait longer for the wood they needed yesterday. Prices will, of course, rise.

If that situation is not upon us already, it will be within the next several months.

CONCLUSION

In mid-May one eastern trader remarked that this summer will likely be tight on fibre supply in general.

It is difficult to visualize this burgeoning recovery for North America's lumber producers. There are several companies poised to ramp up production as soon as a true increase in demand materializes. As one example, Tolko has been keeping warm its recently upgraded High Level dimension lumber mill, curtailed in November 2009. Other companies do not have such a luxury of keeping some operations running while curtailing others. The abysmal record of Douglas fir prices in the past several years is a clear example of the limited options available to smaller companies with fewer mills.

Given all this, the response across regions and product lines will be bumpy at best. For the rest of this year some companies will make decisions based on continued conservative attitudes while others will choose to strike up production more quickly. It all depends on fibre supply, regional issues, proximity of demand, and flexibility of customers. By the beginning of next year, the business of lumber will more resemble a "normal" year like 2004 than the roller coaster ride, first shooting up for the moon in 2006 and 2006 then crashing down lower than the deepest ocean from 2007 onward.