

November Lumber Market Analysis

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December 18, 2012

OVERVIEW

November is the month that traditionally demonstrates the annual slowdown for the North American forest products industry. By November, the weather across Canada and the US is usually bad enough that home building and renovation activity grinds to a halt. Under the normal seasonal cycle, Labour Day signals the beginning of this slowdown, and US Thanksgiving marks the true drop in lumber demand for a given year.

Not so in 2012.

Large volume orders from China in 2009 and 2010 were enough to prevent lumber prices from softening to each of those respective years' lows. Last year those sizable orders did not materialize. However the supply-demand balance was already tenuous enough that lumber and panel prices maintained relative firmness, albeit still at quite low sales volumes.

This year, a combination of unprecedented US ordering for that time of year and similar volumes of buying from China as in 2009 and 2010 were enough to actually prop lumber prices up.

At the annual North American Wholesale Lumbermen's Association conference, which lately alternates between Las Vegas, NV, and Chicago, IL, traders talked of little else than this never-before seen circumstance and what it would mean for lumber prices to year end. The other main topic of discussion was the just-completed US election, as the overwhelmingly conservative group lamented another four years with a Democrat in the White House.

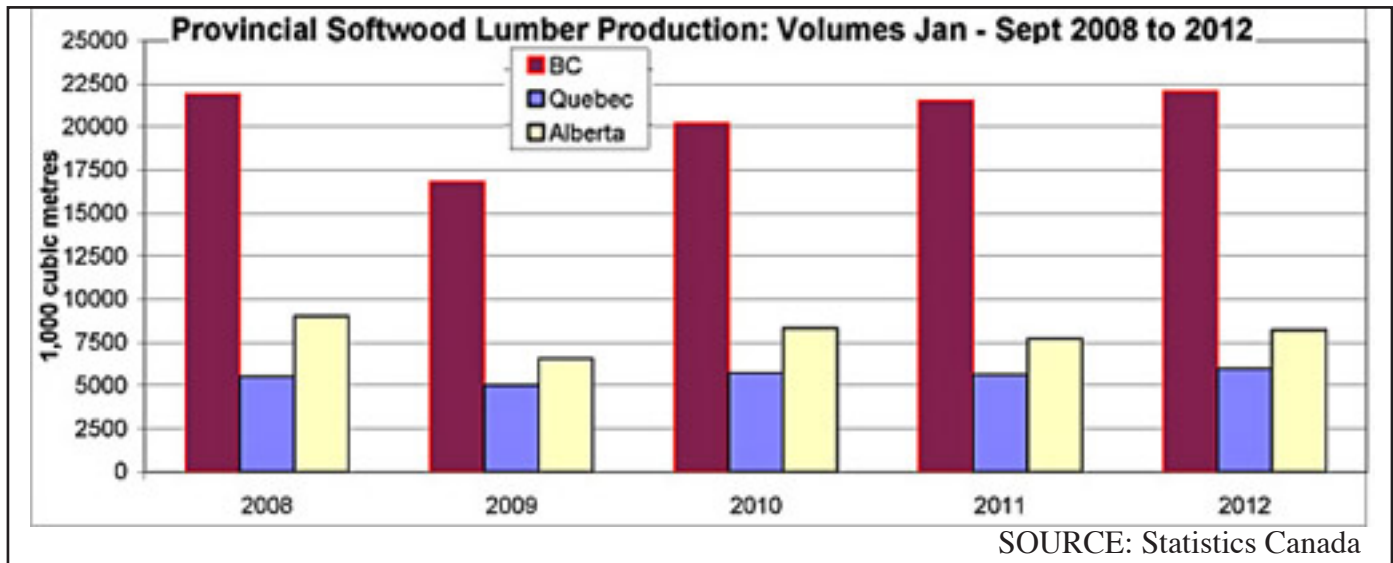
Key ideas for November 2012 lumber and panel markets:

- **Field inventories of every lumber product under the sun were underserved.**
- **Post-NAWLA hangovers and seasonal holiday lethargy kept lumber trading volumes low.**
- **American business dropped off the map for that country's Thanksgiving holiday.**
- **Trading was bolstered by a mid-week spike in lumber futures coupled with strong demand.**

The most recent statistics available on US and Canadian softwood log and lumber imports and exports at the time of writing is for October 2012. Given what has happened with prices in the past six weeks, both in the cash market and with futures, it is pretty clear that trade figures for November are going to be much stronger.

North American lumber shipments to China totalled 305.8 million board feet (mmfbm) in October, up 24 per cent from 232.7 million feet in September. From the US, shipments in October totalled 16.2 mmfbm, compared to 9.2 million in September, a 42 per cent improvement, according to the US Foreign Agricultural Service. Canada shipped 289.6 mmfbm in October, up 29 per cent from the September total of 206 mmfbm, according to Statistics Canada. Shipments from both countries were at their highest levels since March.

Very few lumber producers are prepared for sales to continue at these volumes. As December dawned, a latent sense of concern grew into full-blown panic as sawmills realized they were already sold out into January. In a normal seasonal cycle, demand in the forestry sector for building materials climbs by February. Clearly this winter will not have that usual slow-down and ramp-up around the holiday festivities. Producers are right now making decisions about calling in logging contractors to increase fibre supply as soon as possible in January. It is only now that the lack of timber harvesters with the requisite equipment on hand is being felt. The lag in time between finding people to get out to the forest and to properly stock sawmill log yards for what will clearly be a



very busy spring is going to be felt in rising lumber prices. Not to mention the question of who is going to haul the logs to the mills and the lumber from the mills, as truckers – and their trucks – have been lost in similarly large numbers since 2006.

In mid-December, order files at the sawmills were well past New Years. This time frame will inevitably stretch out longer as imminent supply chain issues get worked out.

Add to this the urgency of buying out of China in advance of that country's own New Years break in February and you have an epic January looming.

After years of ignoring the lumber industry completely or outright declaring it dead, economists and analysts of all stripes are coming out of the woodwork to declare a wild recovery. In November the Conference Board of Canada forecast profits in Canada's wood products sector to hit \$381 million in 2012, rise to \$787 million in 2013, and exceed \$1 billion in 2014. By comparison, profits were \$76 million in 2011.

Field inventories of every lumber product under the sun were underserved.

MONTHLY RECAP

- Right at the start of November, Western Spruce-Pine-Fir traders felt the extremely light inventories like the sting of a riding crop, urging them to the table to grudgingly buy at volumes they would have laughed at only months ago.
- As November came on, Douglas fir sawmills on the US west coast reported log supply will likely be very tight rounding the corner into 2013.
- In the first week of November, customers were already aware of how dangerously low dry Doug-fir supplies were, and naturally bought with feverish abandon.
- Studs producers referenced a tide of buying from China as buyers came back to the table in earnest.

SHORT TERM ANALYSIS

As November got started many customers continued with their wait-for-prices-to-come-off-before-buying attitude. That mentality as now soundly been beaten out of them by inexorably rising prices. The culture of just-in-time buying which has pervaded the lumber market since 2007 simply no longer works, as buyers have been consistently caught short of supply. The last six months of 2012 were signified by customers calling back suppliers every three days to order wood they should have bought on the previous call, when prices were that much lower.

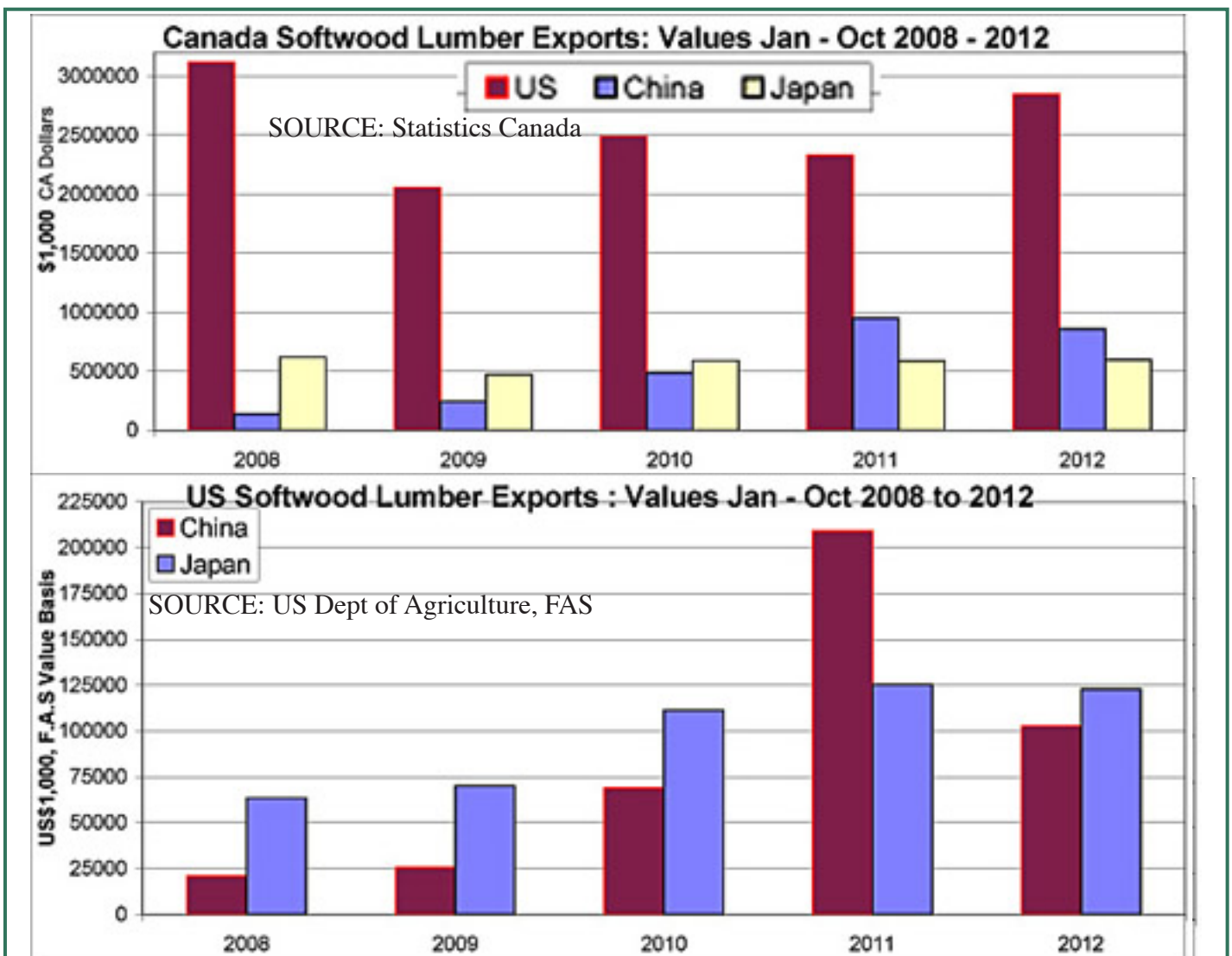
Seeming to not have learned anything by two solid years of autumn buying from China in 2009 and 2010, American traders were again surprised with the strength of dimension prices for such an unseasonable time of year. Canadian producers have been having a field day throughout 2012 in playing customers against each other; if US buyers won't transact at newly raised prices, sawmills make a deal with Asia, or simply go off the market. Someone inevitably calls the next day desperate for wood, and the mill ends up getting the price it wants.

What a departure from who held the cards in 2011!

Already in the beginning of November 2012, buyers were faced with prices they hadn't seen in years. Their stocks were so bare they had no choice but to buy. By the end of November, with their stocks still bare, they collectively wished they had replenished earlier when prices were that much lower.

Production capacity remains relatively low. Occurrences of a given commodity or dimension becoming unavailable are increasing. In the first week of November, for example, one large Canadian purveyor of WSPF sold out of 2x6s. Into November, 2x8s experienced significant price jumps two weeks running. That size can see a strong increase in demand when 2x4s become scarce or its prices jump. Customers will request mills and remanufacturers rip 2x8s down to 2x4s for delivery. The commodity loses a few centimeters in dimension but will still meet construction standards in a pinch.

As this recovery gathers steam, certain items will become – at various times – difficult to source. Manufacturers of those products will take advantage of the opportunity to raise prices by \$25 or \$50 mfbm in one go. Customers will be able to do nothing else but accept that.



Post-NAWLA hangovers and seasonal holiday lethargy kept lumber trading volumes low.

MONTHLY RECAP

- In mid-November, North American lumber-buying fell into a wee lull, while that from overseas was strong once again, as more inquiry and follow-up from Chinese customers came down the pipe.
- Canadian WSPF players reported stronger buying in the post-Remembrance Day week than for the entire season of autumn in any of the past five years.
- As November approached the mid-point, buyers from Texas suddenly snapped up load after load of green Douglas fir, taking advantage of low price points when compared to kiln-dried.
- Meanwhile, KD fir business was already being written for next year.

SHORT TERM ANALYSIS

Into mid-November, while mills tried to flesh out their inventories in preparation for year-end, customers nervously shifted their gaze from rising prices to their own dwindling stocks. The lack of supply throughout the market simply isn't funny anymore. It is becoming obvious to even the most bearish of players that this increase in demand is here to stay. Indeed, it is poised to grow further as 2013 gets going.

The next change will be a return to the old reality of secondary suppliers. The reloads, stocking wholesalers, and big lumber yards will again start carrying wood in earnest. Once that happens, the game will truly be afoot. Memories being what they are – short-term usually – a lot of people in the lumber business right now don't remember the days of two-tier markets, when wholesalers would undercut the sawmills, setting prices independently. Invariably, a frenzy among customers ensues. Or the reverse: when mills dump volumes of wood at a discount, sending buyers scurrying away from wholesalers.

Once secondaries replenish their yards, this scenario will again come about. But probably not until later 2013 at the earliest.

For the moment though, demand from all corners is still aimed squarely at the mills. For example, in mid-November Douglas-fir traders found themselves praying for a break from selling. They needed time to take stock of sales volumes which have become the new reality.

American business dropped off the map for that country's Thanksgiving holiday.

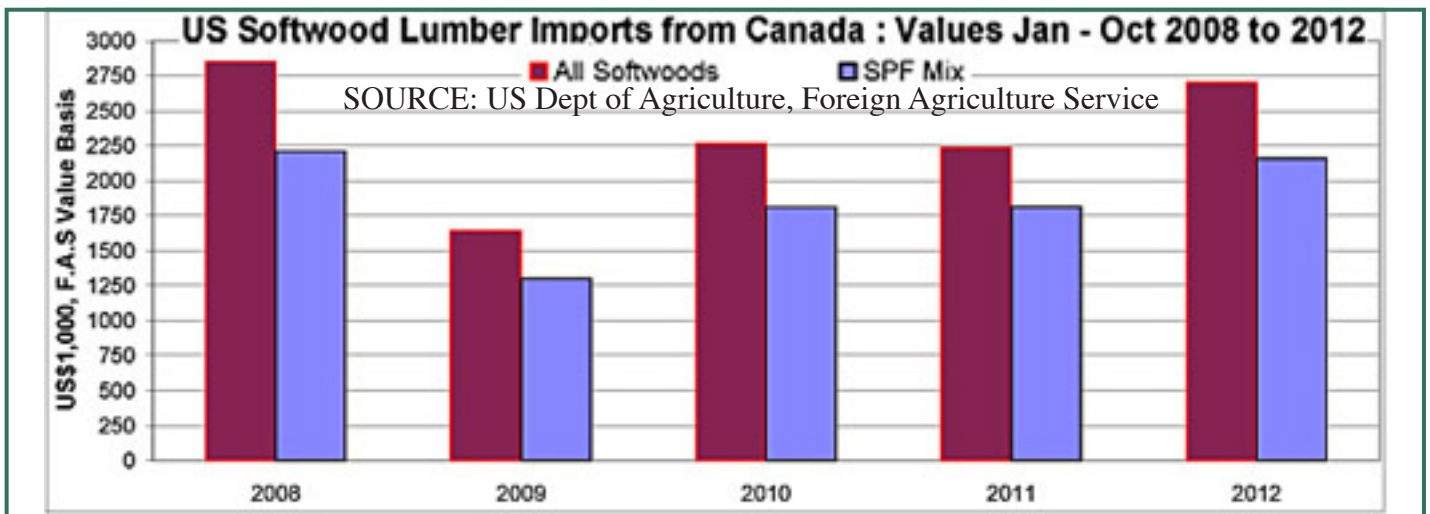
MONTHLY RECAP

- In the third week of November, the market-malaise generated by the Remembrance Day/Veteran's Day holidays in North America got even sludgier.
- Studs producers north of the border focussed on fulfilling overseas business and looking toward 2013.
- West coast Douglas-fir sawmills responded to the briefly softening demand by immediately cutting production so as to not kill the market.

SHORT TERM ANALYSIS

The US Thanksgiving Day break, usually the death-knell of lumber trading for any given year, was but a brief respite. The previous 45-days were such lumber-selling madness that suppliers had scarcely a chance to take stock. In that regard, owing to the lack of logs coming out of the bush, lumber supply looked tighter and tighter.

The Thanksgiving Day week followed the same rhythm of other years; busy to start then quieting down to barely a hush of sales. The following week however, the last of November, provided a sharp turn-around.



Trading was bolstered by a mid-week spike in lumber futures coupled with strong demand.

MONTHLY RECAP

- In the last week of November, following the combined NAWLA/US Thanksgiving absence of veteran players, traders were back at their desks wrestling with furious inquiry.
- American WSPF traders barely had time to breathe between phone calls.
- As November closed, eastern sellers were especially blown away by the vehement demand for panels, plywood in particular.
- Studs producers stuck to their defensive pricing positions at the end of November.

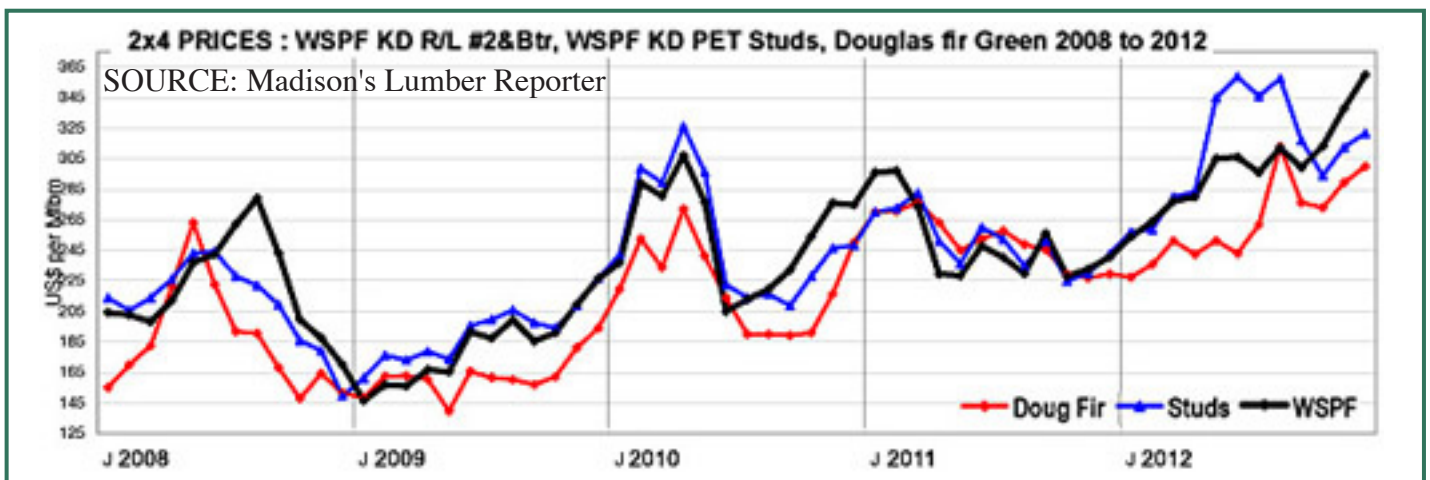
SHORT TERM ANALYSIS

This was the busiest November anyone could remember. Ever. Comparisons were drawn to the wild sales of 2004, but even that year the usual seasonal slowdown did occur.

It wasn't just dimension either, some plywood thicknesses sold at the highest volumes eastern traders have ever seen in November. Panel manufacturers are extremely disciplined and will not let volumes get to the point that prices sink below cost of production. At the same time, OSB and plywood customers are very savvy and will not easily be duped into paying high prices unnecessarily. For the past five years panel prices have been largely flat.

That 2012 ended with benchmark OSB 7/16" Ontario at C\$335 msf, \$140 above the close of 2011, is a solid indication of sustained demand.

Similarly, by the end of November studs mills had their order files out at least a month on most products. These producers have enjoyed sustained demand out of both the US and



China. Sellers greatly enjoyed being able to switch between prospective buyers as it suited them. Buyers couldn't even dream of throwing out counter offers.

This is a sharp reversal over the past five years, when customers had mills in their clutches and dictated both prices and terms of delivery.

CONCLUSION

Just to put some perspective on how wonky lumber buying and prices are in mid-December compared to the economy in general: since 2011, the value of lumber in crude oil terms has effectively doubled. For example, last year in November a thousand board feet of lumber could be traded for just over two barrels of crude. In November 2012, with lumber futures around US\$350 and crude oil futures around US\$86, that same MBF of lumber would buy four barrels of crude.

When customers were able to push back on prices a tiny bit with their meager counter-offers, Douglas-fir mills on the west coast simply proceeded to sell as much green Doug-fir to Chinese customers as they could to keep prices up. At the end of November, the result of this practice was a push of order files all the way out to January.

As producers continued to keep a sharp watch on supply, the quantity of buyers who realized they could no longer outwait the market to buy at lower levels increased.

The start of 2013 is going to be a shock to customers. Sawmills are absolutely in the driver's seat, and will remain there as critical supply chain issues get worked out. The only downside for producers will be the lag in time between when an order is placed and how long it takes for delivery. Prices are set at the time a deal is made, even with a six week order file, so everyone concerned knows it will take that long for the wood to arrive.

Therefore players will try to best forecast where prices will be at that time and to negotiate in their own favour. This strong ending to 2012 indicates that, once secondary suppliers re-enter the fray of lumber sales, producers will still likely maintain the upper hand in negotiations at least through 2013.



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