



March Lumber Market Analysis

By Kéta Kosman

April 15, 2013

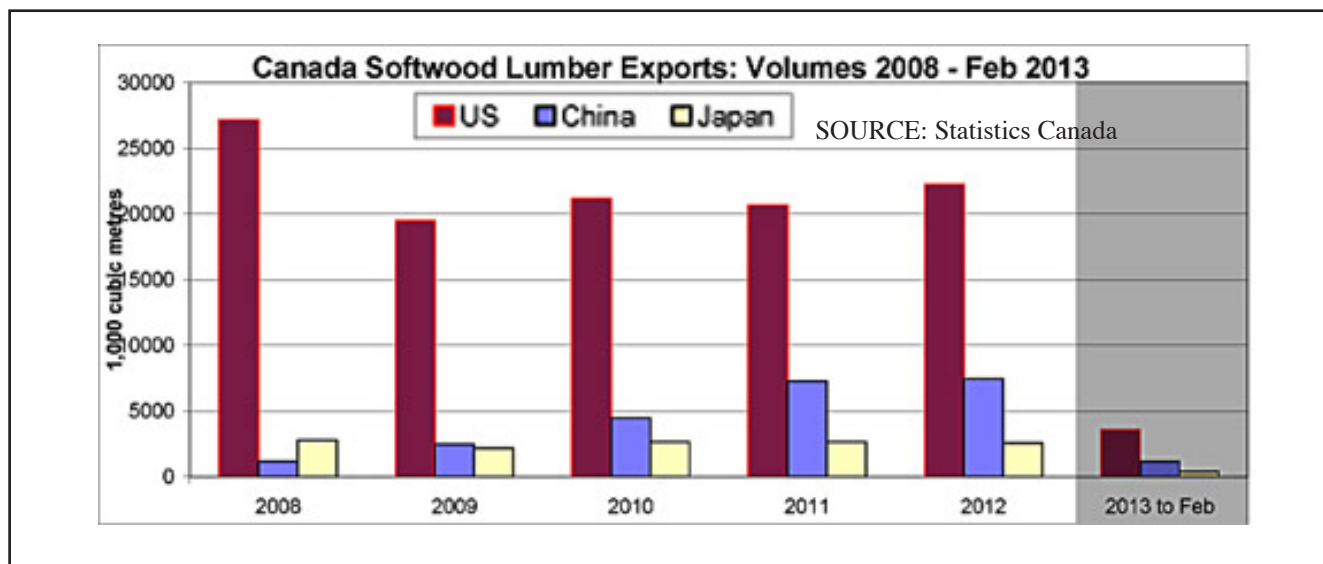
OVERVIEW

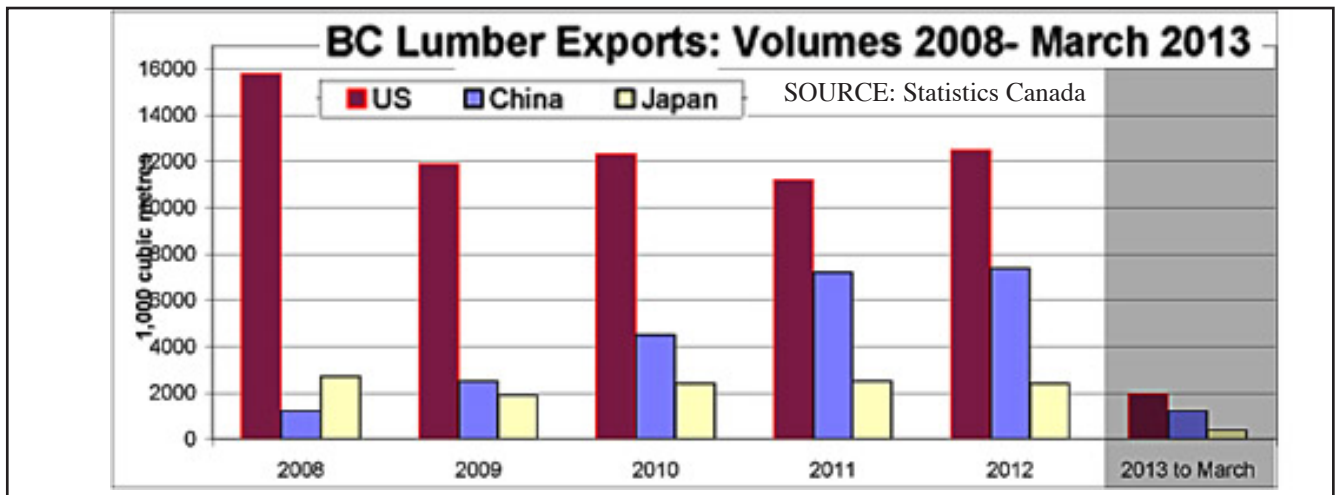
Just as January was the month of panel, OSB and plywood, March 2013 was the month of studs. Or rather the month when customers of all kinds, from US home builders to China's volume buyers, realized they needed studs. And needed them yesterday. The modest increases in studs production across North America so far this year were not enough to offset rapidly rising demand. Order files with Canadian stud producers were at about four weeks through most of March.

The divergence between Canadian and US lumber selling explained in the February 2012 issue of your *Madison's Investment Rx* has become even more marked. Throughout the history of North America's forest products industry, US and Canadian sawmills relied almost entirely on US home building and renovations. Housing starts in Canada amount to approximately 10 per cent of that in the US. Until 2008, the US bought 85 per cent of all solid wood products manufactured in Canada, so lumber price movement in both the US and in Canada reflected this reality.

Now that Canadian lumber mills have been able to foster a reliable customer base in Asia – specifically China–, US sales account for 60 per cent of Canadian lumber production. Meanwhile, US producers continue, by and large, to sell domestically only. This new difference between Canadian and US lumber sales was unexceptional when the market was down, when buying was soft, and when production was curtailed. But as US home building activity continues to increase, lumber buyers in that country are realizing some challenges in sourcing wood from north of the border.

Canadian sawmills are not easily, if at all, going to turn their backs on this new, growing, customer base in China. The hard lesson learned after the collapse of US home building in 3Q 2006, that relying almost entirely on one customer for the vast bulk of sales, will not be soon forgotten. In addition, the 2006 Softwood Lumber Agreement, already extended beyond the original deadline, expires in early 2015. The Canadian bargaining position is much stronger than it was during the first negotiation now that offshore markets make up approximately 30 per cent of total Canadian dimension lumber sales.





Key ideas for March 2013 lumber and panel markets:

- Framing lumber sales took a nap while studs continued bullish.
- Studs stole the show again as collective anxiety about low supply heightened.
- Studs sales charged ahead yet again. Dimension sales flagged slightly but prices remained firm.
- Sales of framing lumber kept up while studs posted impressive price hikes on most sizes.

At the beginning of March, cracks were appearing in the seemingly impervious strength of solid wood prices. Panel prices, which had skyrocketed to highs not seen since 2005, started a downward correction in the first week of that month. Benchmark OSB, 7/16" in the east, dropped by \$5 from the end of February to C440 msf. This is still a \$225 improvement, or 51 per cent, over one year ago, when that commodity sold for C\$215 msf. At the beginning of March, Canadian Softwood Plywood 3/8" was selling into the Great Lakes Zone for C\$423 msf, a \$10 drop over the previous week but a \$63, or 20 per cent, increase over the beginning of March 2012.

By month's end the correction period seemed to stabilize, with both OSB and plywood prices settling at levels still greatly improved compared to recent years.

At the same time, dimension lumber prices levelled off completely as producers and customers struggled to find a middle ground in the tenuous supply-demand balance. Excepting studs, which continued to jump week after week as mentioned above.

Framing lumber sales took a nap while studs continued bullish.

MARCH WEEK ONE RECAP

- At the launch of March, while WSPF dimension lumber sales were torpid, demand for studs of all stripes roared ahead with fervour.
- Studs producers were giddy about the level of buyer enthusiasm, and it showed in ever-climbing prices.
- ESPF framing lumber sales volumes dipped a little in the first week of March, even as mills were able to push prices on most dimensions.

SHORT TERM ANALYSIS

North American studs producers couldn't be happier with the business they received from overseas markets. They would never trade the steady contracts of today with the inconsistent, open-market spot buys of yesteryear. Chinese buyers have evolved their purchasing strategy and studs-makers are happy to oblige.

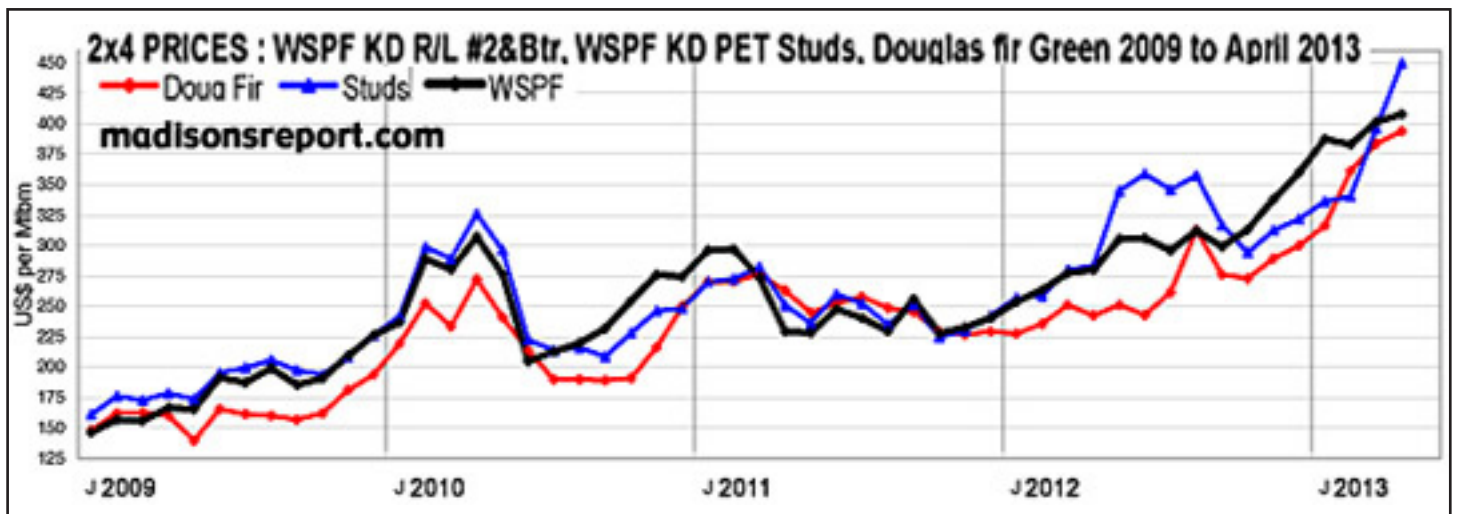
As well, if overseas customers continue their considerable buying of WSPF dimension lumber, which they probably will, there will be a welcome increase in the consistency of demand.

As the US home building season ramps up in earnest, stud sellers are going to be able to play customers against each other. The usual pattern of US buying will resume; a steady stream of rail cars and trucks will move out of stud and dimension lumber mills between US Memorial Day and Labour Day. However, added to that traditional mix will now be irregular large-volume purchases from customers in China. Reports of entire boat-loads being ordered all at once were not uncommon in 2012.

Producers relish the opportunity to serve both long-standing, regular-ordering customers, and new large-volume buyers. Traditional customers must become accustomed to sometimes having to wait for their weekly five or six rail cars.

Western dimension lumber producers did their best to process orders while managing the trickling flow of raw logs, in the face of consistently shocking levels of lumber takeaway. Log supply issues described throughout 2012 in both *Madison's Lumber Reporter* and *Madison's Investment Rx* continue to be a reality. The biggest problem is finding contract loggers who still have equipment to go into the forest, and finding truckers to haul both the logs to the mill and the lumber from the mill. Expectations are that current trucker shortages will continue at least through next year. As summer heats up and produce starts moving on North American highways, sawmills know they will have a problem getting trucks because farmers pay a premium to move perishables quickly.

There was a huge problem on the rails in Canada during March, which will take some time to unravel. CN Rail threw out every excuse in the book short of a plague of locusts to explain the dearth of cars. While rail car shortages in Canada are usual at this time of year, the severe lack cannot be blamed solely on the weather. Toward the end of March producers reported some movement with Canada's two national railways in providing the required rail cars on a semi-consistent basis.



Studs stole the show again as collective anxiety about low supply heightened.

MARCH WEEK TWO RECAP

- The overall lack of WSPF dimension lumber supply in the second week of March had traders gnawing at their lips and nervously tracking mills' dispiriting production levels.

- ESPF prices trudged up further as availability got even more tight.
- By the middle of the week all green Douglas-fir lumber was spoken for as soon as it was produced.
- Even veteran traders were having difficulty finding precut and nine-foot studs with any consistency.

SHORT TERM ANALYSIS

In the second week of March, the overall tone of the market continued to be bullish. One couldn't help but wonder when there will be a significant retracement of prices, and to what degree. In a circumstance that did not bode well for near-term lumber prices, in mid-March eastern stocking wholesalers were practically giving away wood. They couldn't get even close to replacement value on anything, as mills ran away with pricing and nursed the two-tier market to their advantage.

Lumber futures can no longer provide a meaningful indication of the market. The exit of the largest wealth funds in mid-2012, and the exit of actual lumber traders from the futures board in the past few weeks means that almost all activity in lumber futures is now speculators and robo-trades. For the time being lumber manufacturers can't look to futures for an indication of where cash prices might be going in the coming weeks.

Despite the hollow resistance of ESPF buyers to the new, higher prices, sales juddered along sporadically.

Some of the challenges being felt across North America, particularly fibre supply and transportation, are especially dire in eastern Canada. The upside of this is that producers were able to keep prices up precisely because there are log supply issues and transportation constraints.

Studs sales charged ahead yet again. Dimension sales flagged slightly but prices remained firm.

MARCH WEEK THREE RECAP

- WSPF studs were hotter than a neutron star in the third week of March. Sawmill order files were out a respectable two-to-three weeks on most items.
- Demand for studs was so extreme that producers on the west side were off the market on pretty much every dimension.
- ESPF dimension lumber wholesalers struggled to move their plentiful inventories, fighting valiantly to get at least replacement value..
- Sales volumes of green Douglas-fir ticked down a notch, but not enough to stem the tide of relentless price hikes.

SHORT TERM ANALYSIS

Despite the ability of secondary dimension lumber suppliers in the east to offer quicker shipments than sawmills, in addition to reluctantly discounting their asking prices, they found it difficult to move any serious volumes in mid-March.

As March passed the mid-way point, lumber traders began to worry that prices might soften. At best the market was described as in a "lull". Most mills found themselves in digestion mode; shipping wood already ordered to waiting customers.

Further to the rail car problem described above, loads of ESPF lumber were stranded everywhere in the middle of March. It didn't matter whether the wood was sitting on an A-frame rail car or on a big rig. One large Eastern producer had even stopped quoting car-loads until CN Rail catches up with belated cars.

The reaction time of Canada's national railways, particularly the CN, to resolve issues can

be maddeningly slow. Sawmills in the east particularly could do nothing but wait for long-delayed cars as the wood piled in their yards got only taller.

Sales of framing lumber kept up while studs posted impressive price hikes on most sizes.

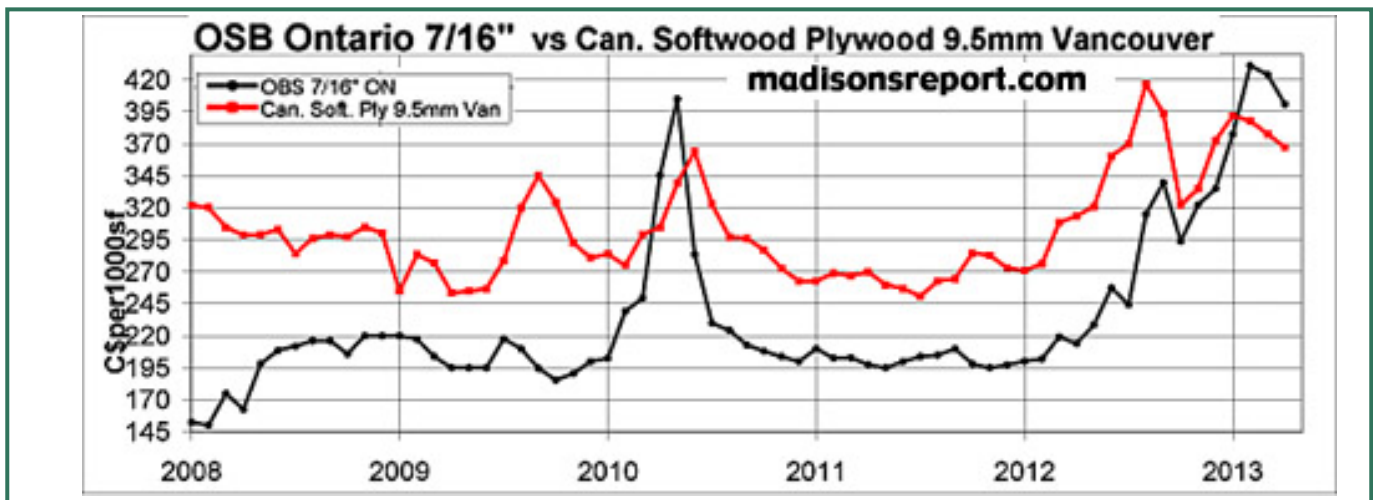
MARCH WEEK FOUR RECAP

- As March waned, prices on WSPF studs somehow pushed up again, to the flabbergastment of all.
- ESPF lumber mills were getting their asking prices with nary an eyelash batted.
- By the end of March, green Douglas-fir prices were just shy of kiln-dried on a delivered basis due in a large part to resurging demand from California.
- After reaching recent record highs in February, the price correction for all thicknesses of plywood finally found a bottom at the end of March.

SHORT TERM ANALYSIS

By the end of March, rail cars ran seven-to-ten days late if they arrived at all, and truck-availability tightened up a notch as well. Transportation is going to be a major bottleneck as spring buying revs up to redline, and players are going to have to adapt quickly and gracefully to somehow navigate these uncharted waters ahead.

Oranges from Florida and other seasonal delicacies have not yet even begun to move and already lumber producers are having terrible transportation troubles. What is going to happen come June, when the most perishable of produce starts moving? This is also the time when US building sites really start humming, and contractors expect large deliveries of wood to arrive as scheduled.



Suggestions that more capacity is immediately coming online might be exaggerated. Especially for specialty items. One large Western Canadian studs producer had enough trouble staffing just two shifts, never mind being able to find qualified staff to put more production online.



The lack of skilled labour is an ongoing problem for wood manufacturing. Existing staff, already at reduced levels, is mostly taken up with older, veteran workers. For these, retirement looms large. In the past five years enrollment at forestry technical and trade schools has been down markedly. The younger workers, those without seniority, moved into other regions and sectors during the downturn. Some of these have been, and are now, returning to their home towns. But there are still not enough workers and sawmills are very concerned about not being able to find enough staff to run their high-tech equipment for the next two years.

CONCLUSION

The importance of the example of skyrocketing studs and OSB prices to explain the tenuous supply-demand balance across North American solid wood commodities cannot be overstated. Prices of specialty items like studs, tricky to maintain in good supply during the best of times, also provide a solid insight into market conditions.

As this year's lumber production and sales ramp up, the price movements of panel and specialty items will lead that of regular dimension lumber. Industry and investors who receive weekly information about the state of solid wood producers will be well poised to make their business decisions for the coming quarter. In addition, historical price statistics will even better provide insight into lumber market machinations for the rest of this year.

This all, of course, is predicated on the lack of a critical event, like a major forest fire, or a labour dispute in BC.

	MADISON'S Investment  Rx	SPECIAL OFFER FOR IWPA ATTENDEES: ORDER NOW AND SAVE 35%! C\$935 per one year subscription
Yes, I want <i>timely information on the ever-changing lumber industry</i>. Please sign me up:		
_____ Madison's Monthly Investment Rx C\$935 + tax SPECIAL IWPA DISCOUNT RATE!		
Company Name: _____		
Attention: _____		
Address: _____		
Phone: _____ Email: _____		
Charge my VISA or MC: Card No. _____ Exp. ____ / ____		
Please bill me: (signature) _____		
Madison's Lumber Reporter, PO Box 2486, Vancouver, BC, V6B 3W7 or fax 604.984.6838		



**THE LUMBER AND PANEL CASH MARKET
TRACKED WITH A UNIQUE PERSPECTIVE!**

- North American lumber and panel cash prices to your inbox every Friday
- extensive coverage of Western and Eastern Spruce-Pine-Fir (SPF)
- a full page of Western Red Cedar

\$389 per one year subscription



**IN-DEPTH ANALYSIS OF NORTH
AMERICAN TIMBER COMPANIES!**

- get the scoop on lumber company assets and corporate policies that affect your investments
- the latest on North American solid wood and paper companies from histories to futures

\$475 per one year subscription