



September Lumber Market Analysis

By Kéta Kosman

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OVERVIEW

By the time the summer of 2012 ended, all players in North America's solid wood market were well aware that the horrible downturn of the past six years is over. Improving US home building and sales, continued buying from emerging markets, better lumber sales volumes and protracted discipline of production levels, all translated into increased demand and higher lumber prices.

As 2012 wanes, most eyes are turned toward the looming year with curiosity. What will the start of 2013 look like for solid wood producers? That remains the big question, the easy answer is: better than any of the past six years have.

Another question that comes up often: Are current lumber price levels normal? Well, what's normal? The last "normal" year would be 2004, before the run-up to massive US home building. Since 2005 nothing has been normal. Starting with the sheer scale of US overbuilding, through the prolonged and exaggerated downturn, into a burgeoning recovery, it is not possible to point at any one time and declare it "normal".

Key ideas for September 2012 lumber and panel markets:

- Buyers hesitated as the September 14th expiry on the current lumber futures option loomed.
- Prices moved little if at all, even while strong trading continued.
- As hesitation among buyers persisted, prices on most items came off once again this week.
- Mills focussed on moving select items in their inventories as prices continued their downward trudge.



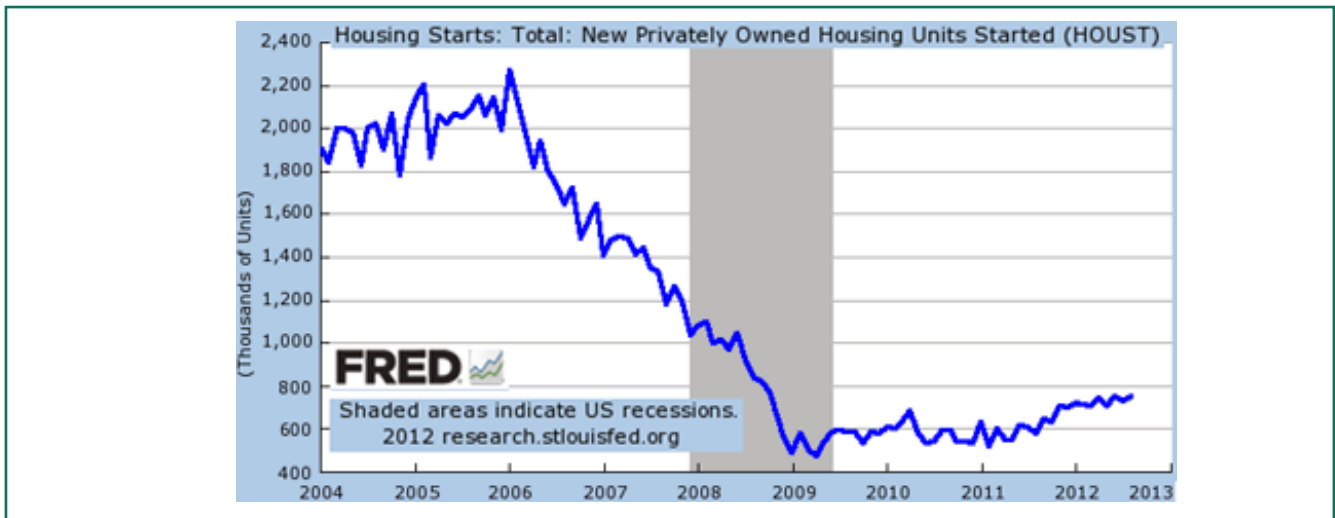
The critical unknown, and it is one that is not getting a lot of attention, is log supply. Since the sharp downturn in US home building of 2006, fully one-third of contract loggers across North America have stopped operating. They are either retired or have moved into other regions and sectors, their equipment sold or repossessed. Not only that, but the same ratio of truck loggers and lumber truckers – two different operations – have also disappeared.

How well will the supply chain be served, if early 2013 sees a spike in lumber demand, when there are few people to call to harvest and transport timber, and to transport finished lumber? Producers are right now grappling with this problem, to varying degrees depending on their individual situation. In the west of Canada and the US it is a big, big problem. Competition for experienced logging contractors is already very stiff.

The final outcome may well be, in the end, a significant lag in time between when orders are placed for manufactured wood products and when new operators can come onstream with newly financed equipment. Should lumber demand in early 2013 resume at even the slightly improved levels of early 2012, that time lag could stretch out several months. If this turns out to be the case, lumber and panel prices will rise week by week until that demand can be filled and digested.

If 2012 closes with benchmark WSPF close to where they are now, US\$290 mfbm, and should fibre shortage issues materialize as laid out above, it is possible there will be a sharp uptick in lumber prices into the beginning of next year. At the same time volumes will be good. This means that – despite a glut of orders and a dearth of logs – sawmills will have both high operating capacities and good returns for their product.

A monumental shift from the past five years, to be sure.



Buyers hesitated as the September 14th expiry on the current lumber futures option loomed.

MONTHLY RECAP

- In the first week of September, Western-Spruce-Pine-Fir traders spoke again of little inquiry. Everyone expected the Labour Day weekend holiday to shake things up, but instead activity was even more muted than the previous week.
- Purveyors of green Douglas-Fir products had as down a week as any in recent memory.
- Log decks at western studs mills were topped up nicely that week, and fire danger continued to decrease in the Pacific Northwest.
- KD Fir makers noted that whenever they lowered prices even a little, significant chunks of their inventories were moved off.

SHORT TERM ANALYSIS

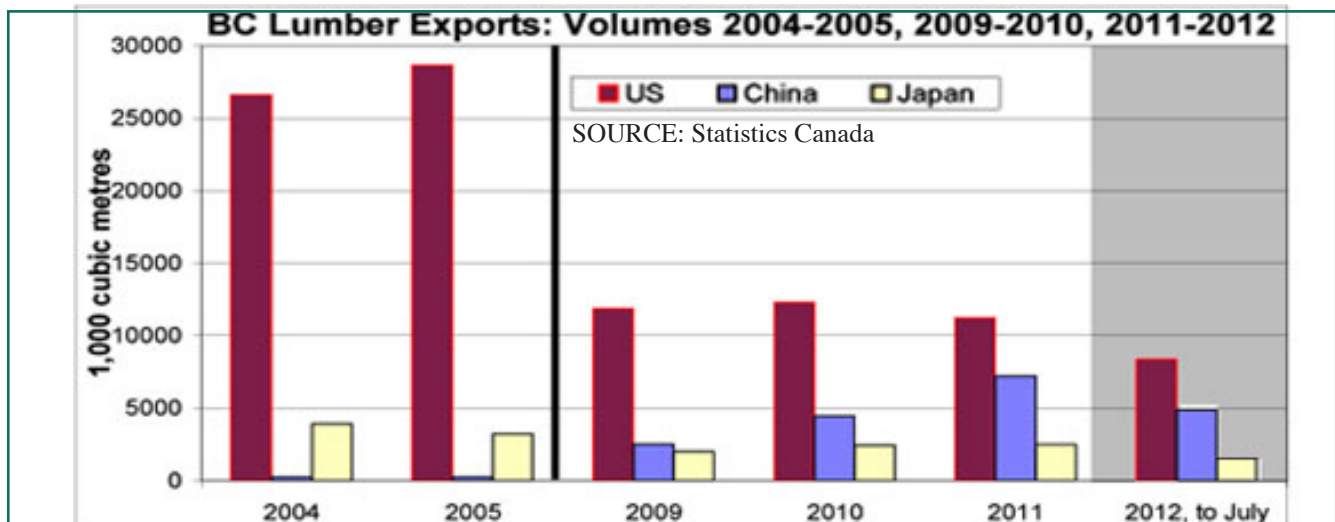
With framing lumber in the midst of a downward correction, players in the panel market expect there to be a downswing in sheet goods' prices as well. In a very general sense, plywood and OSB price changes will lag that of lumber slightly. This is, of course, not a hard and fast rule. The market for panel products operates in its own

right and is subject to its own set of circumstances. However, again very generally, both dimension and panel prices move up and down depending on what is happening with US home building.

This year the runup for framing lumber prices indeed preceded that of panel. The subsequent drop, at the end of the usual home building season, was similarly a few weeks later.

The smart individuals are making deals while there is wood to buy, rather than waiting doggedly for slightly lower prices.

The erstwhile game between producers and customers was in high gear; stubborn buyers who have become accustomed to dictating both price and delivery shouted counter offers down unresponsive phone lines. This summer, mills have been holding firm on asking prices, only offering discounts at carefully selected intervals. When they have, every stick of wood on their shelves has been snapped up. The following week producers could point to empty yards as proof of a supply crunch while pushing prices up further than they had been the week before.



Prices moved little if at all, even while strong trading continued.

MONTHLY RECAP

- In the second week of September, sawmills in the Eastern reaches of Canada again looked for any Pulp and Paper mills that could ease their burden of increasing residuals volumes.
- Stud mills reported decent order files on most items; stretching out two to three weeks.
- There was little trading activity in KD fir because so many customers, producers, wholesalers, distributors, and truckers scooted off to their last vacations before the end of summer.
- Eastern panel-traders were mum that week because there was such little actually going on in their neck of the woods.
- Two cedar mill-fires occurred that week at cedar facilities in BC and Washington state.

SHORT TERM ANALYSIS

Sawmill operators in Quebec were so hamstrung by the lack of places to sell their wood chips, hog fuel, and sawdust that several actually had to halt production this summer. It was a complete reversal over spring 2010 when chip and pulp prices were high, but lumber demand was extremely low, so chips were scarce. Pulp and paper mill closures in eastern Canada have created such a glut of sawmill residuals in Quebec at a time when lumber prices are strong that a number of eastern producers were forced to miss part of the hot market.

Until there is more biomass fuel manufacturing in the east of Canada and the US, this problem will remain.

As a specialty item, cedar demand and prices do not move with the rest of North America's solid wood market. Cedar dimension and roofing makers know their products are at a premium, a fact that is not lost on customers. Cedar mills took a hit to their bottom line when the rest of the lumber market crashed, but only because there was less demand for high-end products. This demand already recovered at the end of 2011, and continued to be a nice financial boost for cedar makers this year.

The loss of two cedar mills, one dimension and one shake and shingle, within a single week in August, will be felt throughout that species' marketplace for the next year or two (until those mills can be rebuilt). The timing of this sudden reduction in capacity is not good, coming just as demand for the premium products begins to resurge.

As hesitation among buyers persisted, prices on most items came off once again this week.

MONTHLY RECAP

- At mid-month, WSPF trading was muted due to the expiry of the current lumber futures option. Buyers were assiduous with their unwillingness to transact, paralyzing the market further.
- ESPF producers were starting to entertain reasonable counter-offers, after desperately resisting lowering their asking prices for so long.
- The inevitable price drop in green Douglas fir of the past few weeks finally arrived.
- Studs players were happy with sales volumes and movement, if not prices, in the third week of September. Sales of the industrial export side were apparently very strong as Chinese buyers came to the table en masse and made numerous deals.
- Eastern stocking wholesalers in New Jersey reported Mills were apparently taking steep counter-offers on some KD fir items just to keep wood moving.
- Most panel customers were waiting doggedly for some form of adjustment before buying. The pace of sales had slowed considerably this week, but mill asking-prices remained high.

SHORT TERM ANALYSIS

All hope of sustained high lumber prices evaporated by mid-September when the usual seasoning softening materialized. Canadian players, however, were buoyed by news that the softwood lumber export tax would be reduced to 5 per cent for Option A provinces, BC and Alberta, starting October 1. The tax is based on the most recent four-week average of lumber prices that is available 21 days before the beginning of a month. So for the tax to be reduced October 1 means prices were strong for most of August.

This reduction in payments owing to Revenue Canada are particularly welcome at a time when the Canadian dollar is essentially on par with that of the US. In the past, Canada's producers have needed the US dollar, the currency of choice for almost all of

North America's solid wood sales, to be at a premium to offset higher costs north of the border. With both energy and labour costs higher in Canada, mills there find their margins impacted by a rising Canadian dollar.

Transaction levels remained high even as lumber prices softened significantly.

MONTHLY RECAP

- As September ended, Western-Spruce-Pine-Fir log supply issues worried producers as weather continued to be unseasonably hot and dry in the Northwest.
- While ESPF traders didn't get the sense that mills were necessarily desperate for more action, they noted that producers were certainly looking for business.
- Despite the fact that WSPF studs were in short supply, pushing some Northwestern mills' order files out to the first week of October on some products, stud items dropped in price again that week.
- KD Fir producers cursed and muttered, but ultimately were thankful for how 2012 has turned out so far.
- The wave finally broke this week in Eastern panel trading. Prices dropped considerably.

SHORT TERM ANALYSIS

Even as September was winding down, producers were able to keep prices relatively high. The just-in-time buying that has become habit in the past five years came back to bite customers this year. Where buyers were previously able to call back to mills every few days for tiny, highly specified orders, and get what they wanted for the price they wanted, this year they have been told they will have to wait, and that prices are up. Customers have not yet made the adjustment back to simply ordering ten or so rail cars a week as they did until 2007. As mills continue to see two to four week order files, even during the usual seasonal downturn in lumber buying, they are encouraged to keep prices high. Customers, having no recourse to buy from secondary sources, may complain but can't really do anything about it.

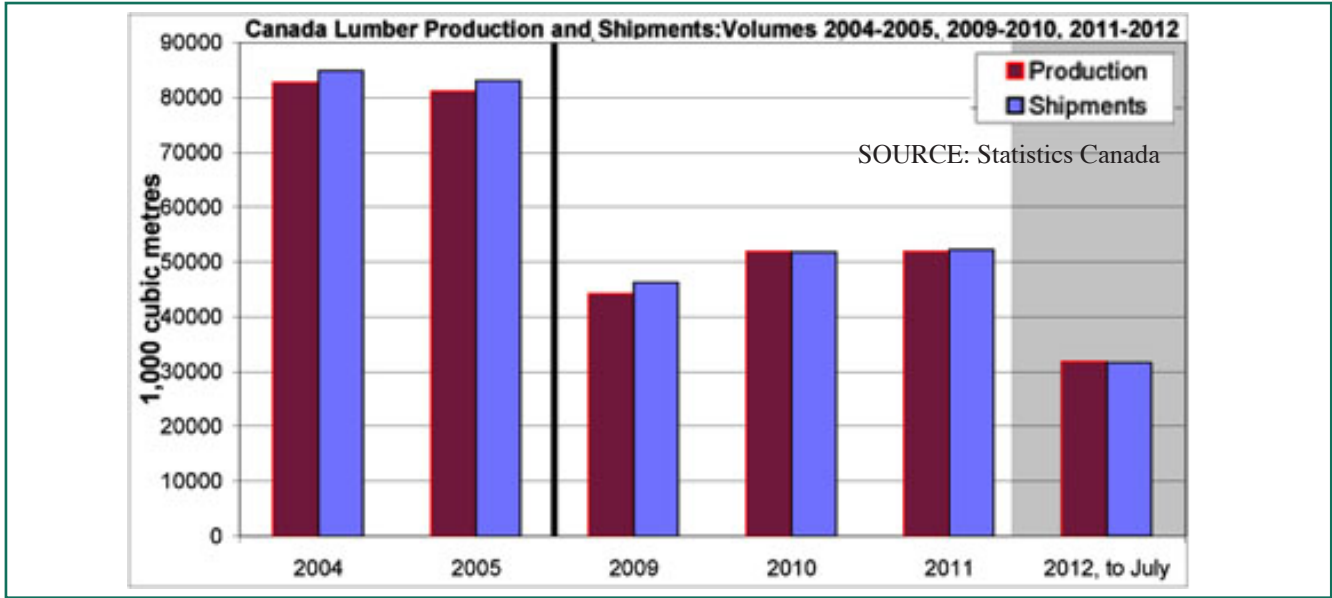
CONCLUSION

The short answer to the questions posed on Page 1 is: no one knows. The facts are that:

- due to sustained demand, depleted inventories, and stable order files, sawmills are only becoming more bold in sticking to higher prices;
- the lack of secondary wood through the supply chain is forcing customers to keep calling producers, which only puts them more firmly in the driver's seat;
- a spurt of buying from China is by no means assured for this autumn, but is looking increasingly more likely;
- the lack of logging and transport infrastructure has the potential to hit mills very hard in spring.

Combined, these circumstances have the potential to put great pressure on supply. Apart from the huge reduction in timber coming out of British Columbia for the next 25 years due to the devastation following the mountain pine beetle infestation, there doesn't seem to be a lot of attention paid to supply. Meanwhile, a lot of wisdom is available on what various analysts and economists think is going to happen with demand, based on projections for US home building in 2013 and beyond.

There is a very real possibility that North American lumber and panel mills simply will not be able to serve the upcoming demand, at least in the short term. As producers



scramble to find contract loggers and log and lumber truckers, customers will only have to wait longer for their wood. The days of just-in-time buying running smoothly are already over. Come spring, unprepared customers could very well be in for a great shock.

Should circumstances unfold as described above, producers will be receiving orders in larger volumes. The time lag between ordering and getting logs in from the bush will serve to drive sawmill order files to ever greater lengths of time, which means each successive week will end with higher prices. Volumes, in the meantime, will come off historic lows as capacity ramps up to full.

It could take through summer 2013 for supply issues to be worked out, by then the vast majority of wood for US home building in that year will have already been ordered. Customers will be stuck with whatever prices they negotiated in the two months previous, regardless of where prices might land in August. As a result, lumber and panel mill profitability will skyrocket.

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