



March Lumber Market Analysis

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OVERVIEW

Natural disasters around the Pacific will run the market through spring.

The market for softwoods in the past six months, including southern yellow pine and hemlock, has grown at an unprecedented rate with no signs of slowing before autumn. Dismal US housing performance aside, the demand pressures on logs and North American-made lumber are multiple and increasing. Earthquakes in Chile, Haiti, New Zealand and Japan, and storms in Australia have shaken the infrastructures of those countries to their core.

An estimated 1.5 million structures were destroyed by the tsunami that followed the 9.0 Tohoku Pacific Off-shore Earthquake. A Japan construction organization is preparing to build 4,800 temporary housing units, and the Ministry of Land, Infrastructure, Transport and Tourism will supply 30,000 units of temporary houses within two months at the Fukushima, Miyagi and Iwate prefectures.

Each of the disasters around the Pacific will have its effect on the lumber market through 2011.

- **Natural disasters around the Pacific will run the market through spring.**
- **Logs are tight and a delayed spring will further push the already severe competition for logs.**
- **Expanded wars and unrest in the Middle East will drive oil prices and transportation costs higher than had been predicted.**
- **“Less is more” applies to art. In lumber, less is less.**
- **Customers can't get what they want, when they want, at a price they are willing to pay.**

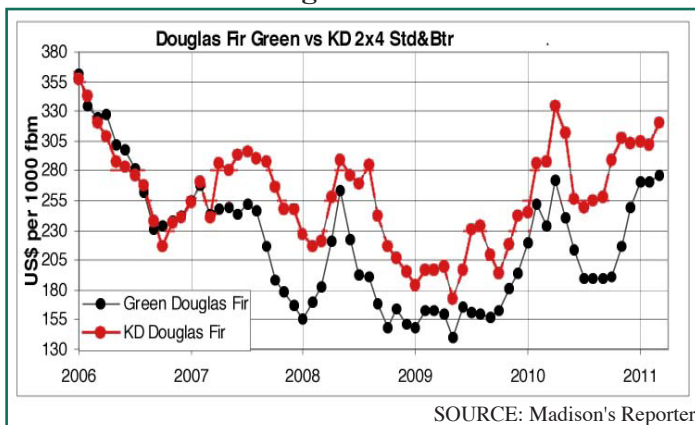
There is beginning to be discernable effect from the devastation in Japan on eastern panel. That is sure to become more apparent as supply constrictions on the west coast force demand into central North America. Vancouver sellers are already deluged with inquiry for plywood to supply Japan's immediate need for temporary shelters and quake / tsunami damage repairs. As a result, western plywood climbed a combined four per cent on both fir and spruce sheathing by the end of March.

OSB was less active than plywood but also was stirred by Japan's disasters.

Logs are tight and a delayed spring will further push the already severe competition for logs.

MONTHLY RECAP

- A prolonged cold spring on the west coast has delayed normal seasonal buying of green Douglas fir lumber.

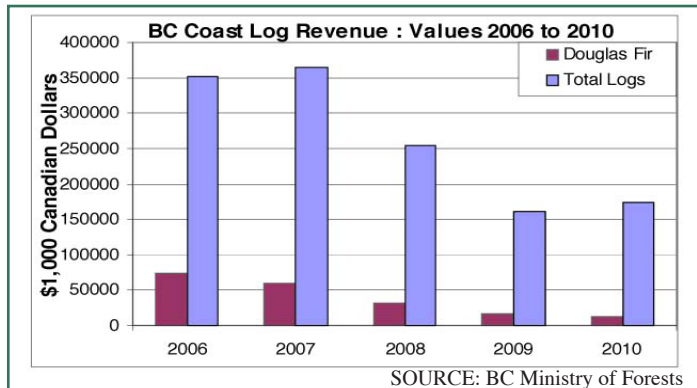


- Fir lumber, both green and KD, is and will be supply side driven again this year with a global twist. At present there is not much more demand than supply but that balance is soon to be tipped sharply.
- Most green fir mills are sitting right on the line where the lumber sale price is equal to their magic shut down number. If they can't get the logs, why would they continue to run below their pain point?
- Some mills already are running stripped down production due to the shortage of fir logs.

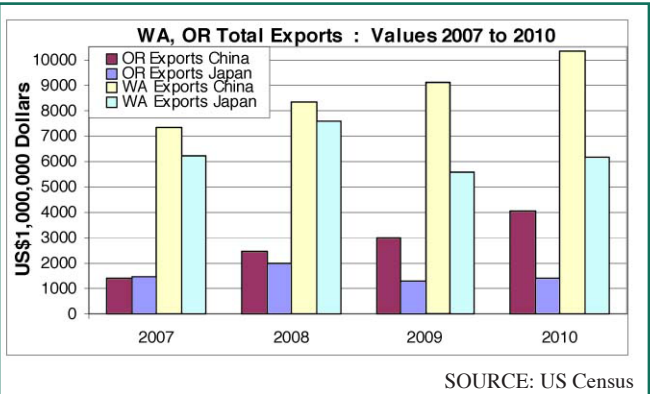
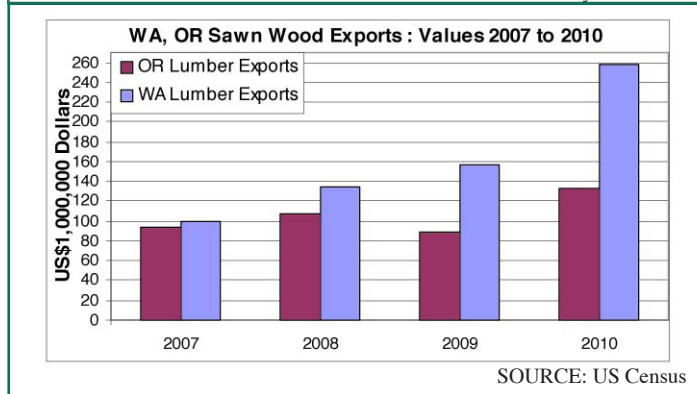
- Countries with high value currencies and robust building markets are driving this bus. In spite of low US housing starts, the offshore log market is scooping up all the sticks it can source. Export agents are hot on the log auctions where, regardless of how high the numbers go, they will still be cheap to buy with off shore currency.

SHORT TERM ANALYSIS

US\$700 and higher on the Scribner's scale for #2 Douglas fir sawlogs out of Oregon and Washington State with Doug fir lumber prices far below normal levels even for a depressed market means sawmills in the US



Pacific Northwest are in the untenable position of having fostered an emergency prop-up business of selling logs during the downturn. Savvy Asian log buyers are outbidding domestic Douglas fir producers with every block that goes up for sale. Rumours abound that companies are poaching each others' logs with higher bids. Weyerhaeuser, for example, is struggling to harvest enough logs to run the two token mills it has left after converting to a REIT and proceeding to sell off real estate in the latter half of 2010.



Expanded wars and unrest in the Middle East will drive oil prices and transportation costs higher than had been predicted.

MONTHLY RECAP

- Trucks will become more troublesome in Canada through spring. A follow-up to Christmas retail stocking, spring brings a tidal wave of stock turnover in every industry from retail shoes to picnic supplies. Competition for trucks heading north from the distribution centres in Vancouver, BC promises to cause difficulties for forest companies attempting to send anything to their operations in the north. This condition will also affect short hauls from Vancouver into the Pacific northwest.
- Lumber traders battled railcar supply problems to get their orders out. Trucks are carrying the bulk of stock to the Port of Vancouver for shipment overseas.
- The number of flat bed trucks has been reduced by at least one company sidelining its stock. As rates continue to rise, producers pray for rail cars to free up and arrive on time.
- Transportation for cedar is plagued with over the road back haul problems, particularly through Canada and into the Pacific northwest.

SHORT TERM ANALYSIS

Praying for rail cars won't help, as the rail monopolies in Canada show little to no true desire to serve customers' immediate needs, never mind the increase in volume that is sure to come as summer approaches.

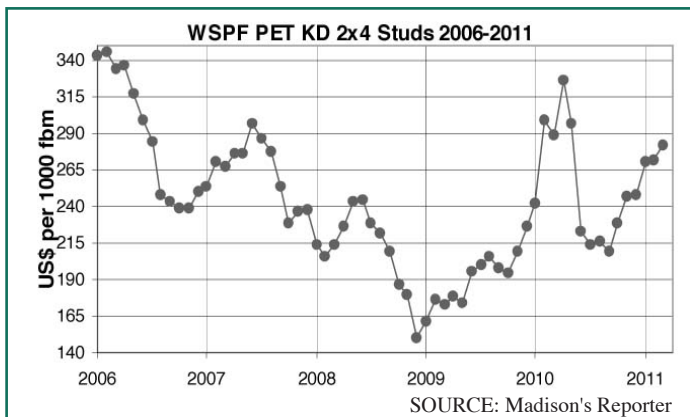
A recent announcement by CN that "it will act quickly to address deficiencies in rail service" caused guffaws and eye-rolling among veteran lumber producers, especially in remote areas where the CN has a total monopoly.

Major trucking companies that went out of the lumber business entirely at the end of 2009 have left a huge hole in the supply chain as 2011 progresses. Arrow Transport famously stranded truck drivers just before Christmas in 2009, just before declaring bankruptcy. There has been no move by anyone to increase the number of trucks on the road. In fact the reverse is true.

"Less is more" applies to art. In lumber, less is less.

MONTHLY RECAP

- Export orders for studs to the Pacific Rim are smashing former records set only the previous year.
- Utility lumber was the babe on the block in all species as long as it was soft, white and dry. Before the end of May, users must pursue low grades and buy as much as they can source.



- Many of the big mills in Canada have converted to the metric sizes specified by customers in Asia.
- Eastern wholesalers report that plywood orders are well into April on strong demand. Export demand to Japan is steadily moving order files out on plywood.

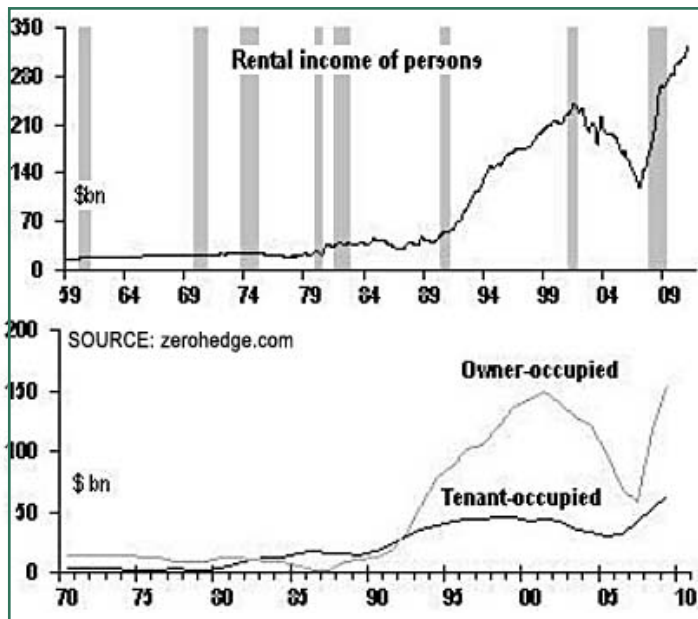
SHORT TERM ANALYSIS

With continued mill curtailment due to weak demand from the US, lumber producers are missing the point that the future short-term spurt in buying is coming from Asia. All of the six BC sawmills that have come back online since 2Q 2010

are now re-configured to metric sizes for export solely to Asia. These producers will not switch those mills back to North American dimensions. While there is a sizable chunk of capacity still curtailed, offering significant room to increase production, with mill workers having moved on and a frightening dearth of logs, reaction-time to even a small uptick in US demand at the sawmill level must be very slow.

Customers can't get what they want, when they want, at a price they are willing to pay.

MONTHLY RECAP



- When mills get short on Douglas fir logs, as they are now, they don't want as many customers. As a fix to the situation, they either: 1) raise prices or 2) limit new orders. Coastal mills put the cap on order files at around one week's production, forcing customers to source Douglas fir lumber from wholesalers.
- These conditions are inevitably going to get worse through the year, not better. Mills are trying to make finished lumber for the same selling price that they got when transportation was 25 per cent less and logs were more than \$100 less per unit.
- While mill prices indicate that the market should move higher, wholesalers are fighting for lower prices simply to squeeze their replacement cost out of each sale.
- Field inventories are low, indicating that sales

will be good when the mood strikes. Eastern stocking wholesalers are prepared with plenty on hand to fill orders.

SHORT TERM ANALYSIS

The old games of jockeying for position in a down market and shorting prices to try to outlast the competition have already been proven to be miserable failures during this extended downturn for the lumber industry. It is self defeating, now that demand has begun to rise but capacity remains curtailed, that traders are relying on old tricks.

A double-dip in housing could stamp out demand for homes this year. National home prices are only 1 per cent above a new "post-crash low," according to MacroMarkets, formerly the Case-Schiller Home Price Indices, in its March 2011 Home Price Expectation Survey. Analysts and housing experts interviewed for the survey varied on how much they expect home prices to decline in 4Q 2011. The sliding scale of predictions runs the gamut, from Dean Baker, co-director at Center for Economic & Policy Research, predicting an 11 per cent decline year-over-year in home prices to National Association of Realtors Chief Economist Lawrence Yun predicting prices will remain flat year-over-year in 4Q. Other analysts include Chris Whalen with Institutional Risk Analytics, who expects prices will drop 10 per cent year-over-year and IHS Global Insight chief economist Nariman Behraves, who is predicting a 6.7 per cent drop in 4Q 2011. None of these sources predict home prices rising in 2011.

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