MADISON'S Investment Rx

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# June Lumber Market Analysis

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## OVERVIEW

From the weather to other natural disasters to the US politicos being unable to find their back ends with both hands, America's building industry is in a dither.

Between deep losses on the NYSE and many down-limit days on the lumber futures board, confidence was clearly the issue for buyers. Futures bottomed hard in mid August. Customers were unsure that what they were doing would contribute positively to their bottom lines. The storm from the financial markets held a dark cloud over every category. Businesses using bank financing were particularly nervous.

With further criminal acts in the mortgage banking system now coming to light, only cash investors want to buy homes, with remaining homes left for others to rent. New building is in limbo. It's not a question of quality – it's a question of confidence. Builders aren't rushing out to nail up new houses because they have no confidence that the US government is going to come up with a quick fix for the economy.

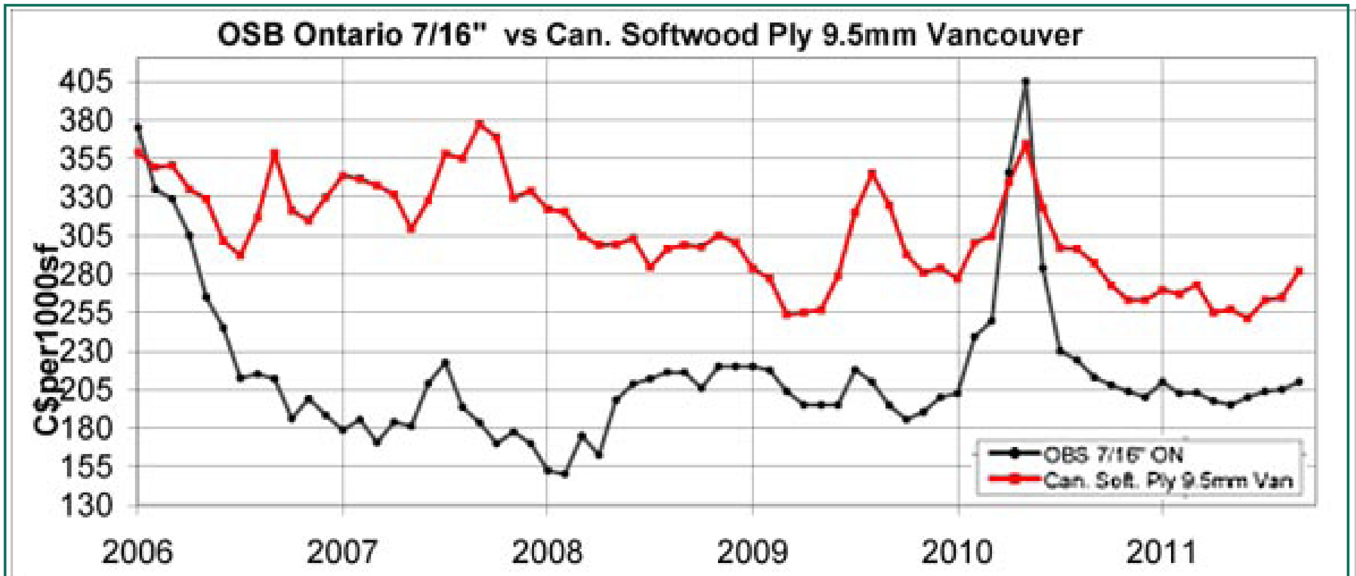
- **Hurricane Irene shook up the analysis paralysis.**
- **The lack of trucks put truckers in charge and shippers went begging.**
- **One source called it a "picky-roc-racy" where those with a modicum of confidence dictated which way the market would go.**
- **Volumes sat on the edge where production meets demand.**

There is no part of the lumber business that was not dominated by the fact, fiction, worries and realities of the New York Stock Market. When Toronto starts wearing its britches two sizes too big, thinking that the effects of its transactions make a difference in the world, the TSE should remember mid-August 2011. It's the NYSE that people in Kowloon look to, not Toronto.

*Hurricane Irene shook up the analysis paralysis.*

## MONTHLY RECAP

- At the end of August, US plywood was in a percolator, popping up where it was least expected. Now BC makers are not putting out enough to keep up with demand. The lack of availability has pushed order files out three weeks.




SOURCE: Madison's Lumber Reporter

- Just before Labour Day, prices on all panel items in the Toronto market were up, especially Canadian Softwood Plywood where mills pushed their numbers up 18 per cent. Order files surged to the end of September on the strength of new orders.
- In time for the Labour Day long weekend, eastern stocking wholesalers were rewarded for following the Boy Scout oath and being prepared with a good range of dimension lumber stock on hand. Finally on Thursday, fence sitters jumped into the fray.
- Prior to Labour Day, Southern Yellow Pine sales are weak thanks to southern alarmists having stocked up prior to the hurricane. Now, with temperatures heating up in the deep south, forest fires will stop action until the smoke lifts.

## SHORT TERM ANALYSIS

An unusually late, wet spring has been followed by hot, dry weather in the east and south of North America. Initially hit by floods from a combined melting deep snowpack and spring deluge, in late summer entire regions of the US braced first for Hurricane Irene then for tropical storm Lee.

Luckily both weather systems proved to be less severe than expected. However a significant amount of infrastructure damage did occur, particularly due to extreme flooding.

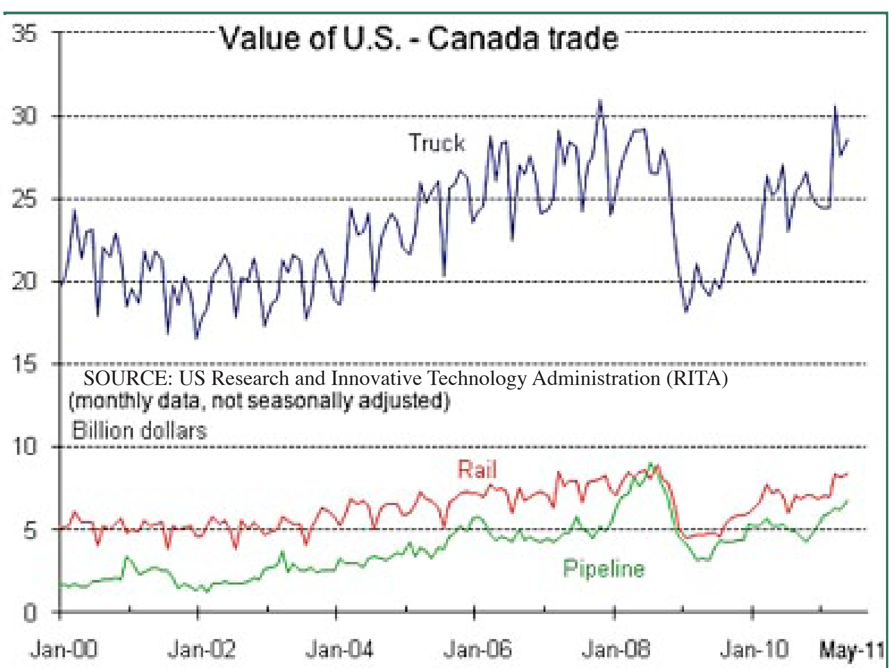
A rush of orders for panel from eastern producers will quickly be absorbed by repairs from storm damage. Plywood and OSB delivered to the Great Lakes Zone is moving well and mills are working hard to fill orders. This demand is slowly filtering over to the west coast, where mills are having a hard time finding material to fill the spurt of orders, at the same time struggling with multiple transportation problems.

Historically, post-storm buying lasts three weeks or so then demand starts to normalize. As yet lumber and panel producers have not increased production significantly due to the likelihood that this rush of buying will be a short-term event. Second-tier sources for wood, stocking wholesalers and reloads, remain extremely conservative with their inventory levels, which may come back to haunt them as this year comes to a close and mills remain curtailed at current levels.

Evidence of supply shortages have already begun to appear in this uncertain market. Volumes remain low. Demand for highly-specified loads remains the name of the game; it will be the mill or wholesaler that can drum up the required mix of commodities quickly that will win out over slower-moving competitors.

*The lack of trucks put truckers in charge and shippers went begging.*

## MONTHLY RECAP




- Early in 2011 *Madison's* predicted transportation would be a ghoulish issue over the summer and autumn; true to form, prices are up on trucks and there is no relief in sight.
- In early August truck transportation in the east ran about one week behind time.
- Trucking presented the main problem for those shipping out of the US into Canada. As has been the case all season, truckers are picky about where they will deliver, even with inflated rates.
- Meanwhile, rail transportation was again hitting shippers with bad order cars on the west coast; rail car conditions have not beenchecked by the railroad before loading causing maintenance delays.

## SHORT TERM ANALYSIS

The long-dreaded situation of truck loggers and lumber truckers having gone out of business is upon the North American forest products industry. With so few truckers available to transport so many goods over


far-ranging distances, transporters are in the unusual position of being able to dictate not only prices but also routes. The more remote, cumbersome, and less glamourous regions are getting passed over for quick-and-easy American highways.

Already lumber traders are reporting difficulties making sales once the five day or longer transportation delay is mentioned. The approaching pre-Christmas deliveries are an annual bane to the lumber industry, with truckers for two months focussed on bringing expensive items from west coast docks to retailers across the US.

The reduction in available transporters is only going to exacerbate in 2012. Starting up a trucking business, financing the big equipment, and establishing a network of customers does not happen in the matter of a few weeks. There is sure to be a significant time-lag from when mills and shippers start screaming for more trucks and new transport businesses are launched.

As lumber production begins its expected recovery by spring of next year, it seems inevitable that mills will have trouble both in getting enough logs for ramped-up capacity and in shipping out product. Meanwhile, second-tier suppliers will only be beginning to realize they are woefully undersupplied. A flurry of orders to fill-in inventory, likely still at smaller volumes than were normal in 2004/05 but higher than the past three years, is going to catch the entire supply chain by surprise.

*One source called it a "picky-roc-racy" where those with a modicum of confidence dictated which way the market would go.*

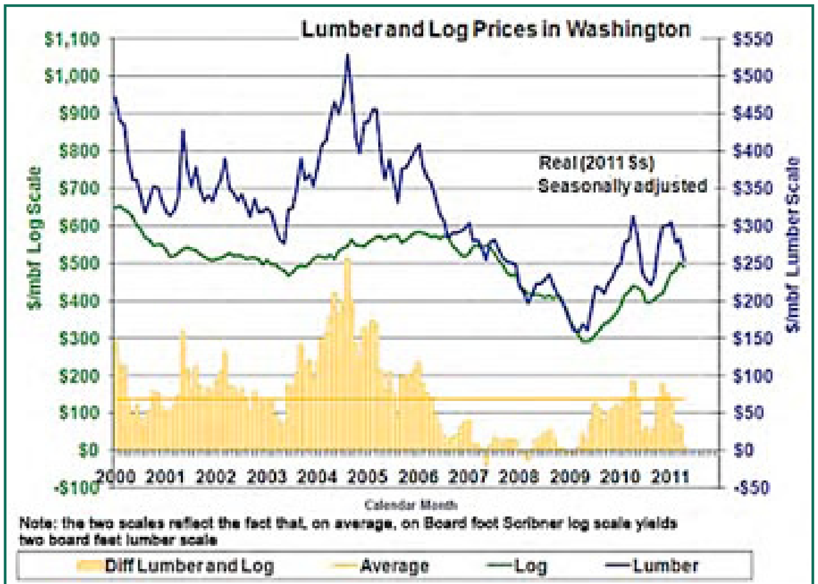
## MONTHLY RECAP

- In the third week of August the mood in the eastern spruce market changed remarkably from the previous weeks when people bought for their immediate needs; now they were uncertain what constituted immediate needs.
- Brokers in some of the southern reloads including Texas were selling douglas fir out of their inventory rather than taking the chance of having the wood in stock.
- The Wednesday before the Labour Day long weekend was the turning point on most species when they took off to stem the slide. Prices were corrected upward as wholesalers came in to buy from the mills, as did distributors.
- At the end of August, offshore activity was sucking up product, particularly 2x4 straight lengths. High quality lumber is finally becoming more popular with Pacific Rim customers.

- At the beginning of September, drops in eastern spruce pricing were particularly localized to mills and specific items. Order files were not where makers would like them. There is prompt wood in certain categories while others are up to 10 days production time.

## SHORT TERM ANALYSIS

Fear of the uncertain market conditions since 2006 has become so entrenched that lumber producers, traders, and wholesalers no longer trust their hard-learned instincts and hardly know where to turn in making future business decisions. Razor-thin margins and difficulty accessing credit continue to plague established players.



SOURCE: Washington State Dept of Natural Resources

As 2011 winds down and all thoughts turn to the run-up to the spring 2012 building season, with its expectation of steadily increasing new home building, still no one can be sure what the market will do.

For the past two years Asian buyers came in powerfully enough in November to actually raise lumber prices significantly, at a time of year unheard of for most of the history of North American lumber production. It is possible the level of lumber demand out of China this winter may  not match the past two years, as there are indications of tightening credit in that country and of supply moving at a healthy pace to its intended destination. Regardless, new demand out of China is still an increase over traditional North American lumber buying toward the end of a year.

Mills have reported for the past two years that they saw of their biggest orders in November and December. Even if these big orders from China shrink somewhat in 2011, they are still more than what the US and Canada will be hoping for.

*Volumes sat on the edge where production meets demand.*

## MONTHLY RECAP

- By the first week of September the western spruce market finally got a break-away week that pushed order  files out to September 19 (three weeks' production). Much of the buying had to do with repairing the aftermath of Hurricane Irene..
- In the second week of August, douglas fir customers admitted they were only buying for replacement materials and nothing for stock.
- Meanwhile in KD fir there were more sellers than buyers, and traders were calling around to try to unload prompt wood.
- Traditionally, as summer wears on, the entire supply chain runs short-handed during vacation season. Even among traders, people would rather take time off than take orders.
- After the export market upheld volumes in studs for months, finally at the end of August it was North America, specifically US building customers, that turned it around.

## SHORT TERM ANALYSIS

The normal seasonal ups-and-downs of the lumber market evaporated more than three years ago. At times when mills would normally be investing in their timber supply, many players have stepped back for fear of a continued downturn. Similarly, stocking wholesalers refuse to keep more wood on hand than they think they can unload in a couple of weeks. This circumstance only serves to give credence to lumber producers' overly conservative attitude. A risky cycle of keeping production and inventory minimal has manifested. Caution while the downturn played out was certainly warranted, but now too many players are looking back in making their decisions about the next quarter rather than seeing realistically what 1Q 2012 is going to look like.

When US builders launch into their previously-announced large projects but find they can't get the wood they want for the brief window during spring when they can break ground, their howls of discontent will be heard loud and far.

A severe supply constriction will be upon us next spring if there is not a visible increase in the flow of logs to mills, production at mills, and the volume of wood coming out of North America's solid wood producers within the next four months.