



# MADISON'S TIMBER PREVIEW

PO Box 2486, Vancouver, BC V6B 3W7 ✦ Tel: 604-984-6838 ✦ Email: madrep@shawcable.com ✦ Web: www.madisonsreport.com

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As lumber prices experienced a wild ride through the first several months of 2013, economists, analysts, and anyone with a calculator, weighed in on what was happening and what that can mean for stock prices, timber prices, company valuations, the price of tea in China, the circumference of the moon, and anything else they can think of to possibly relate to this obviously hot topic.

Lumber prices rose sharply at the beginning of this year because demand had been ticking up steadily through 2012, largely due to a slowly-awakening US home building industry. Meanwhile production levels remained approximately the same as they had been in 2011, so naturally a supply squeeze occurred. Because field inventories were so low throughout the supply chain, when the true seasonal demand started to pick up in February -- which is exactly the month for lumber prices to start rising traditionally -- the lack of immediate supply sent prices sharply up. Producers were able to keep increasing prices simply because customers kept ordering: anyone ordering a load of wood in February paid the current price but didn't get delivery for four or six weeks.

As long as sawmills have an order file out that far they can confidently fend off counter-offers. But eventually the push-back from customers will take hold, as it did in April. So prices fell to well below the high.

Currently though benchmark WSPF KD 2x4 #2&Btr prices are around US\$340, \$36 or 10.6 per cent, higher than they were in early May 2012. This week Madison's Lumber Reporter is this Friday printing that commodity up \$1 over last week, to US\$341 mfbm. This is an excellent recovery. Producers and customers have found a floor they are comfortable with just in time for bad spring weather to move off and the ground to dry out in aid of both home building and timber harvesting activity. The expectation with lumber prices, especially, is that there will be further increases as this year's building season really gets going. This will also be true for panel prices but to a lesser degree because these experienced a similar bounce with a much shallower correction. In fact OSB prices in the east already started rising again last week.

It is not inconceivable that 2x4 prices will settle up around an average of \$400 mfbm mark for this year. There are a lot of variables, that many industry watchers are not taking into account, which can constrict lumber supply and drive prices up further, if only for the short term.

The most important of these is that this year the United Steelworkers are negotiating another three-year contract with forest industry employers in British Columbia. The union gave up a lot of concessions in the last contract, including cuts to pay and benefits and accepting shorter weekly work hours, on the understanding that when lumber prices, and thus the business of lumber, improve those concessions will be removed. The USW will, without a doubt, this year be arguing that not only should all those concessions have already been removed, but there should be pay increases because the outlook for lumber prices over the next three years is very rosy indeed.

For their part the employers will argue that the companies are only just now beginning to emerge from five straight years of losses, the mills are in dire need of upgrades and investments, not to mention the pressing need to source logging contractors and truckers to serve future mill capacity. The employers will surely say that everyone's belt needs to remain tightened because right now is the time to address long-standing maintenance and upgrade needs and to make investments to take advantage of a still-muted marketplace.

The union will surely have none of it, as the current leadership is largely of the opinion that the profit-sharing concept touted by industry in the mid-2000s never properly came into effect because the US housing market crash hit directly in September 2006.

It will be very interesting to see how this plays out. It is wise to expect some kind of labour dispute, whether lock-out or strike, around June or possibly July when it usually is in BC. Those are traditionally the months with an interruption at the sawmill gates. In all likelihood the USW will bring up massive employer expenditures like the Interfor purchase of three sawmills from Rayonier in Georgia for \$80 million, and a further announcement Wednesday of another Interfor purchase "using existing lines of credit" of the Keadle Lumber lumber operation, also in Georgia.

Other issues looming this year include: serious log supply constraints in some regions as the lack of experienced contract loggers hit home, continued problems with transportation, and the very real danger of an extremely bad forest fire season in BC.

The slew of articles and analyses written in the past week alone would be comical if the topic were not so serious. Not more than one month ago these voices were trumpeting lumber as an "unknown" value, now they once again turn their backs due simply to a normal price correction downward after a remarkable ascent.

"*Timber! Watch out for Falling Lumber Prices*", screams an all-caps headline Wednesday by Chad Karnes, Chief Market Strategist, at *ETF Guide*.

"*Death Cross on Lumber Chart Signals Decline: Technical Analysis*", writes Joe Richter of Bloomberg Tuesday, quoting Paul Kavanaugh at *FuturePath Trading*.

"Lumber may be below \$300 by the end of the month," Kavanaugh, the director of business development at FuturePath in Chicago, said to Bloomberg in a telephone interview. "The cross of the 50- and 100-day moving averages is validating the trend lower."

The commodity hasn't traded below \$300 since mid-October."

"*Housing Data Remains Strong, but Lumber Prices Suffer*", posted Daniela Pylypczak on *Commodity HQ* Wednesday.

"In 2012 alone, lumber futures shot up over 38 per cent, leading many to believe 2013 would be a promising year for the commodity. Recent price movements, however, have raised some red flags for the commodity as well as the housing industry as a whole."

As if to cover all eventualities, Pylypczak adds at the very end, "And while lumber prices continue to struggle, homebuilding and construction stocks have flourished - a positive sign for the overall industry."

Last week came this headline by *MNI US Data Watch*, "*Reality Check: US Lumber Prices Off Highs After Supply Surge*".

And finally, *Madison's* personal favourite, "*Lumber price weighed by output glut*", by Jamie Chisholm at the *Financial Times*.

"Since hitting eight-year highs near \$400 per 1,000 board feet in the first few months of 2013, lumber [futures] has entered a "bear" market with a 20 per cent slide to about \$320 by Wednesday's open. [ . . . ] "But since that surge in production, concerns have emerged about waning exports to China as Beijing tries to contain house price inflation," Chisholm declares.

By the end of May when lumber prices experience their usual seasonal higher price cycle, expect these same analysts to somewhat reverse their positions..

Keta Kosman  
Publisher  
Madison's Lumber Reporter  
Madison's Timber Preview  
Madison's Investment Rx  
www.madisonsreport.com  
604 984-6838