



MADISON'S TIMBER PREVIEW

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The extreme volatility of lumber prices in 2013 to date, especially on the futures board, has prompted analysts and pundits to weigh in on whether the commodity is indeed recovering from the recent downturn or if prices are headed downward once again. At the same time, others are warning of possible impending doom by saying that prices bounced too high early this year and will not be able to rebound from the subsequent sharp correction until next year's building season. Yet others are proffering theories that lumber is the new 'leading indicator' for stock market movement and the economy in general.

Of these widely varied opinions, which are most valid? A quick way to instantly eliminate oneself as a worthwhile source of information on this subject is to confuse 'lumber' with 'timber', which Madison's finds happens more often than is acceptable with supposed experts.

Despite the current confusion about the state of the cash market and what exactly is going on with the futures, consensus is that the mid- to long-term outlook for lumber is bullish indeed.

A new report released by TD Economics Wednesday predicts the recent slump in lumber, which has seen prices drop 25 per cent in the past two months, will reverse course by next year.

“While several commodities have been in the spotlight in recent months, lumber has not been one of them,” said Dina Ignjatovic, an economist at TD Economics to the *Financial Times*. “However, some light should be cast on the market given that prices have been tumbling quite rapidly over the past nine weeks.”

The recent price crash, said Ignjatovic, is not due to macro-fundamentals, and that's why she expects prices to rebound soon and continue their upward climb next year.

"The sharp drop in lumber prices seen over the past two months has been largely due to market-specific fundamentals, in contrast to the global and macroeconomic-induced decline seen in industrial commodity prices," Ignjatovic said.

The recent run-up in prices has increased output at many lumber plants, which unfortunately coincided with a sudden drop in demand. Bad spring weather in many regions of the US delayed a number of housing projects, causing a drop in single-family housing starts in March and April, explained Ignjatovic to the *Financial Times*.

Elsewhere, analysts at RBC Dominion Securities are quoted in Monday's *Globe and Mail* saying that a lumber “super-cycle” will be arriving sooner than expected thanks to the brisk upturn in the US housing market.

“While some in the industry (and a fair share of our sell-side counterparts) have been talking about an ‘imminent’ super-cycle in lumber since 2008, prosperity has always seemed just around the corner,” said the RBC analyst Paul Quinn. “We had been believers that the ‘super-cycle’ would eventually come, but only in the 2016/2017 time-frame. Given the acceleration in the US housing recovery, we now believe conditions will be ripe by the end of 2014.”

Also noting the confusion regarding the recent sharp drop in lumber prices, Aaron Levitt of *InvestorPlace* noted Monday, "Futures contracts for both Chicago-traded random-length lumber and oriented strand board

have plunged during recent weeks despite the gains in housing stocks. Is there something sinister going on here ... or are investors being given a great opportunity to load up on timber-producing players?"

Like most economists and analysts, Levitt details that solid wood products from February to this week experienced the deepest streak of losses in nearly a year-and-a-half. Regardless of how many people point out this fact, those in the business of making, selling, and buying lumber are well aware that currently benchmark WSPF KD 2x4 #2&Btr prices are exactly where they were at this time last year. So even given the losses since the spike in February, price levels right now are certainly encouraging.

Levitt rightly mentions that despite the drops, investors might have a nice buying opportunity on their hands. He says that shares of the big timber real estate investment trusts — Weyerhaeuser, Plum Creek Timber, Rayonier, and Potlatch — have all dipped pretty hard over the past few weeks as lumber prices have tumbled. However, the futures pullback could be viewed simply as correction rather than a fundamental change in lumber pricing trends.

"Both the Royal Bank of Canada and CIBC now expect prices for lumber to average around \$360 per thousand board feet in 2013. That's still about \$70 above current levels and makes the big drop in the timber REITs potentially unjustified, given the longer-term rosy picture," Levitt correctly points out.

Victor Lai of *Motley Fool* also recommended Plum Creek and Weyerhaeuser in his own note Monday. However he cautions, "Something I would be more concerned about is the amount of financial leverage Plum Creek uses. Its most recent balance sheet shows almost US\$2.6 billion dollars of long-term debt. Compared with Plum Creek, Weyerhaeuser is less leveraged in relative terms, its D/E ratio is approximately 0.9 versus 2.4 for Plum Creek. The industry average D/E is 2+."

Forbes contributor DividendChannel, owned by BNK Invest, posted June 7, "Shares of Acadian Timber crossed above their 200-day moving average of \$13.79, changing hands as high as \$14.24 per share. Acadian Timber shares are currently trading up about 8.7 per cent on the day. The company's low point in its 52 week range is \$11.10 per share, with \$16.11 as the 52 week high point — that compares with a last trade of \$14.30."

On Monday Tom Kametz of *Seeking Alpha* described Acadian Timber as "an under the radar timber investment."

"Acadian pays a quarterly dividend of \$0.20 giving it a yield of 6.3 per cent. Its PE ratio is 10.24, so Acadian is relatively cheap compared to the US timber REITs at this time. Free cash flow per share last year was \$0.84 so nearly all free cash is being paid as dividends. Average volume is only 9,538 shares so it is somewhat narrowly traded. Acadian's 52-week trading range has been from \$11.07 to \$15.76. Acadian has \$72 million in long-term debt and a debt to equity ratio of 38.6 per cent," details Kametz.

When lumber prices manage to achieve some semblance of stability, whether in 2014 or 2017, those who took positions with any of the above-mentioned companies stand to be rewarded handsomely.

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