



MADISON'S TIMBER PREVIEW

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The annual *Who Will Own the Forest?* summit was held this week at the World Forestry Centre in Portland, OR. One only needed to look around at the various attendees to know that investment in the forest industry is raring to go. This year attendance was up by more than a hundred people over last year's record-breaking crowd. The presenters were once again excellent, running the gamut from log and lumber industry analysts to timberland appraisers as well as big banks, pension funds and private investment firms.

As always, the WWOTF conference started with a broad overview of the US economy, as well as other countries, before moving into specifics of forestry and timberland values. The topic for the first session was *Economic Drivers and Wood Demand*.

Timothy Leach of US Bank kicked off the day speaking on "*How Goes the Recovery?*"

"At US Bank we are predicting no American recession over the next few quarters," Leach began.

"In equity markets, US corporate profits in 2011 were at 13 per cent, which is back to pre-crisis levels," said Leach. "In commodity markets, demand from the emerging world is solid. Commodities are not signified so much by trade on consumption, rather are trading on concern of financial systems globally.

"In the housing market there is consumer deleveraging, and house values are deflating. Home affordability is working its way back to pre-crisis levels but there is still a lot of inventory. Probably about two years worth."

Next, Brendan Lowney at Forest Economic Advisors tackled difficult questions in his talk, titled "*Timber Demand Drivers -- Who's Buying Wood?*"

Running available data through several calculations, FEA analysts examined the US home inventory in detail.

"In normal times there is a housing inventory overhang of 1.9 million homes, plus a few hundred thousand multi-family units, in the US," explained Lowney. "Right now there is 3.7 million units. At a minimum there are 1.5 million homes for sale, currently listed, plus the shadow inventory of homes owned by banks but not yet on the market.

"From the point of view of delinquencies, excluding Florida and California, 4.4 per cent of US homes are in foreclosure. That comes out to about 2.2 million properties. A further 20 per cent of all home loans are at 90 days or more delinquent and will foreclose, which adds about 350,000 more homes, for a total overhang of 2.5 million."

However, Lowney and his colleagues came up with some interesting conclusions on supply and demand.

"Between 2007 and 2011, 2 million US households 'doubled-up', with kids moving in with parents, or siblings living together, or otherwise a mix of adult members," said Lowney. "Between 2010 and 2020 headship rates, the inverse of the number of people living per household, will decline. As all other variables remaining equal, like immigration and demographics, it will take until 2015 to absorb the inventory overhang. Taking the most conservative of each of these figures, and drilling down, we come up with demographically-based underlying demand for US housing at 1.6 million homes annually from 2010 to 2020.

"Once the overhang is worked off, there will be a sharp rebound in housing demand.

Next was Dennis Neilson, Director of DANA Ltd, out of New Zealand, an always entertaining speaker. Neilson's presentation, "*Wood and Wood Fibre Demand Overseas: All Roads Lead to China*", examined China's timber deficit and softwood log imports among other things.

"China's timber deficit has been increasing by 16 per cent per year since 1997," began Neilson at his usual super-speed. "Through the first six months of 2011, China's timber supply deficit has increased by 33 per cent over 2010. China's softwood log imports continue to balloon, especially from the US, Canada and New Zealand, while those from Russia have dropped from 91 per cent of total in 2007 to only 44 per cent in 2011.

"While China's import of logs has risen nicely, that of lumber has been even greater, and is projected to rise sharply again in 2011. Most of this lumber is coming from Canada.

"China's next Five Year Plan is asking for 40 million hectares of increased forest cover by 2015. They will really struggle to get anywhere near that. In China the provincial governments report to Beijing what the central government wants to hear, rather than what is reality."

Interestingly, Neilson pointed to India's increase in lumber imports, saying that country will be a major lumber importer especially from Canada. Subscribers to *Madison's Lumber Reporter* please see Page 8 of this week's issue for the latest data on India's imports of softwood lumber from Canada.

The next session involved a panel discussion focussed on "*Perspectives on the Wood Industry*". Panel participants were Mike Clutter of the University of Georgia, Tom Beck of the Beck Group, and Daryl Swetlishoff of Raymond James.

Clutter spoke first, drawing a relationship between timberland ownership and mill profitability.

"At the University of Georgia we found a correlation coefficient of -0.7 on the US west coast between timber support and mill profitability," explained Clutter. "The cost of logs is having an impact on raw material costs and therefore an impact on asset allocation. Facilities on the west coast are not as up-to-date as is needed for the current level of timber costs."

Tim Beck's analysis covered the US south and east.

"New timberland owners in these regions are mainly publicly-traded REITs which are somewhat earnings-driven," Beck detailed. "Recent timberland sales deals have involved timber supply agreements. We are troubled about the current infrastructure of loggers, as there needs to be a certain amount of log buying and selling going on to keep these companies in business.

"Given the new lumber market of China, the mountain pine beetle threatening timber supply in British Columbia, and the slow recovery of US housing starts in 2012, lumber prices will go up and so will logs, and therefore timberland. The deferred harvest in the US is one year or more. There will likely be a six-month or one-year lag between the recovery of lumber prices and that of logs."

It was gratifying to hear such an esteemed speaker, with thirty-five years of experience in the forest industry, tell the room full of forestry executives and large investors what *Madison's* has been saying since 2Q 2011.

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