

MADISON'S LUMBER REPORTER

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News & Updates

US Proposal for Log Exports to China

The current requirement of debarking or fumigating raw logs and drilling for nematodes, to prepare for export from the US into China, may soon be extended to include keeping logs from resting directly on soil.

In an effort to facilitate lifting China's ban on all hardwood and softwood log exports, including southern yellow pine, out of South Carolina and Virginia put into place in April 2011, APHIS – the Animal and Plant Health Inspection Service of the US Department of Agriculture – in early August sent a letter to China's Department for Supervision on Animal and Plant Quarantine.

In the letter, APHIS proposes new requirements to reduce pest risk on raw logs imported by China from the US. [READ MORE](#)

Housing Starts, US

The US Commerce Department said Tuesday that builders began work on a seasonally adjusted 604,000 homes in July, a 1.5 per cent drop from June. Single-family homes, which represent 70 per cent of home construction, fell 5 per cent. New apartment building rose more than 6 per cent.

The number of homes under construction is the fewest in 40 years., at just 413,000 homes, after accounting for seasonal factors. A decade ago, roughly 1.6 million homes were built.

Though new homes represent just 20 per cent of the overall housing market, they have an outsize impact on the economy. Each home built creates an average of three jobs for a year and about US\$90,000 in taxes, according to the National Association of Home Builders. [READ MORE](#)

Conifex Posts 2Q Loss

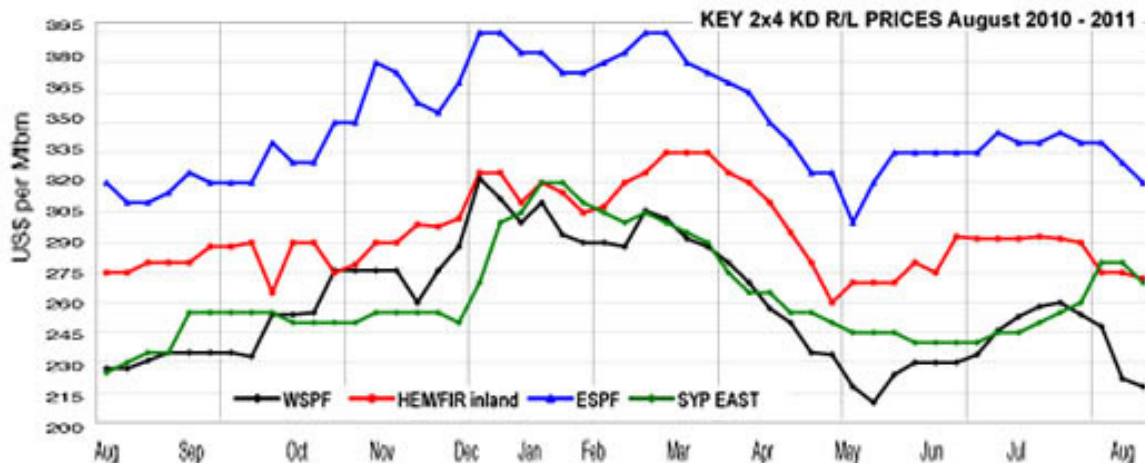
Conifex Timber had a \$3.6 million net loss in 2Q, up from a \$2.4 million loss a year earlier. Revenue was \$26.9 million, a 27 per cent increase from \$21.2 million in the 1Q of 2011, and more than double the \$12.6 million achieved a year earlier.

The company's lumber segment, which contributed most of the revenue, shipped 81.5 million board feet — up 138 per cent from the same quarter last year. However, lower unit prices limited the increase in revenue to 105 per cent.

2006 Softwood Lumber Agreement, Arbitration

The full scope of the Office of the United States Trade Representatives' claim against British Columbia's timber pricing policy specifying alleged breaches under the 2006 Softwood Lumber Agreement was publically released this week by Canada's Department of Foreign Affairs and International Trade. It is not pretty. At a full 97 pages of arguments, some of it censored by Canada, assertions by the US of the BC government providing benefits to the lumber producing industry in that province are greatly detailed.

[CONTINUED PAGE 6](#)



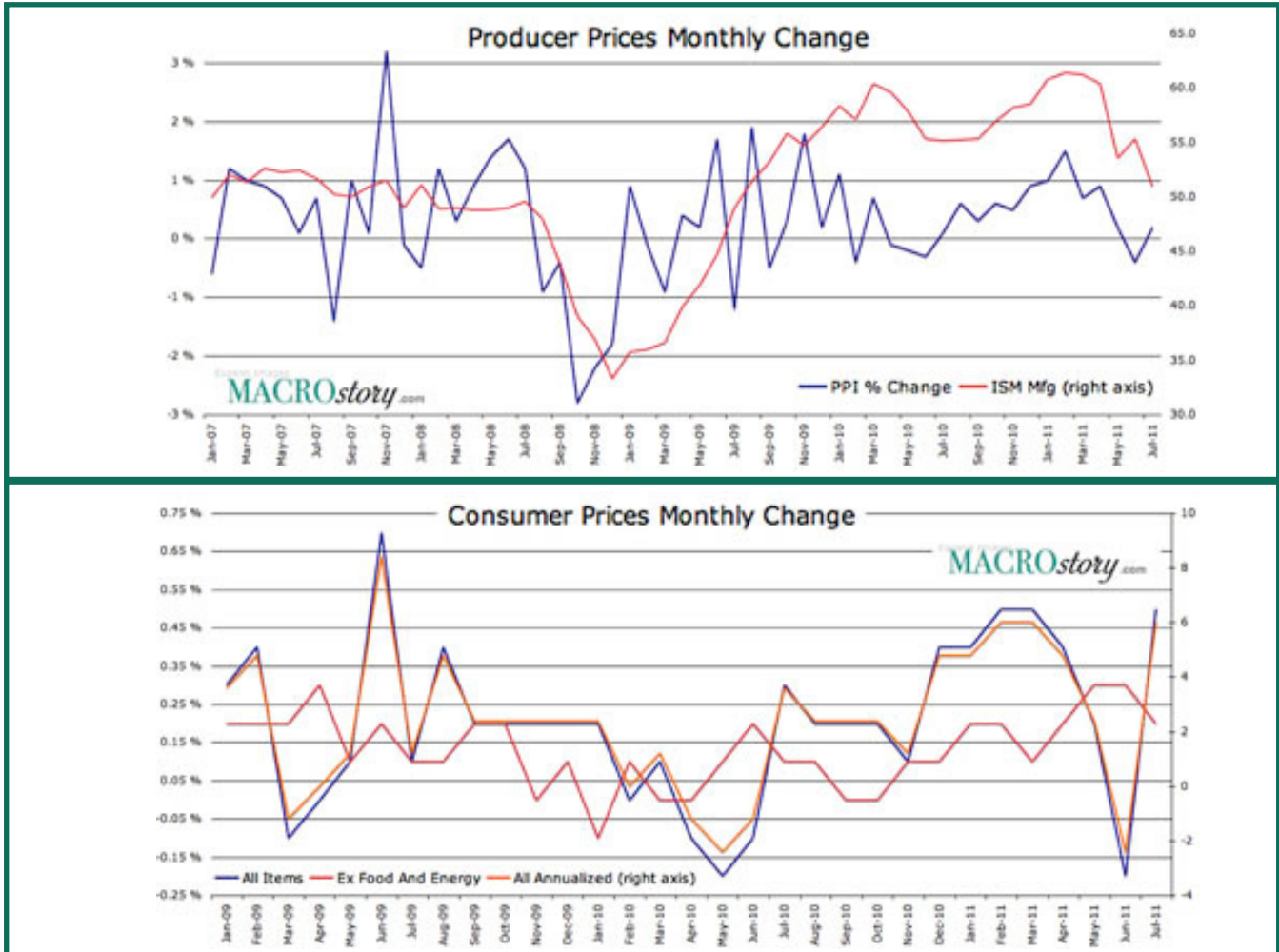
US PRODUCER PRICE INDEXES - JULY 2011

The Producer Price Index for finished goods rose 0.2 per cent in July, seasonally adjusted, the US Bureau of Labor Statistics reported Wednesday. This advance followed a 0.4 per cent decrease in June and a 0.2 per cent rise in May. At the earlier stages of processing, prices received by manufacturers of intermediate goods moved up 0.2 per cent in July, and the crude goods index declined 1.2 per cent. On an unadjusted basis, prices for finished goods moved up 7.2 per cent for the 12 months ended July 2011.

The index for finished goods less foods and energy moved up 0.4 per cent in July, the eighth consecutive rise. Nearly one-quarter of the July advance can be attributed to a 2.8 per cent increase in prices for tobacco products. The indexes for light motor trucks and pharmaceutical preparations also contributed significantly to the rise in the finished core index.

Analysts at the National Association of Home Builders said Wednesday: The PPI for July was too early to capture the crisis of confidence in response to slowing domestic and global demand, and renewed concerns of Europe's sovereign debt crisis that led to the recent stock market turmoil. Based on the sharp decline in oil prices in the first two weeks of August, falling prices of oil and other internationally-traded commodities are likely to drive a decline in the PPI in coming months.

Analysts consensus in general is that: with a Fed inflation target of 1-2 per cent the risk of deflation is "off the table" and so is another round of quantitative easing.



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Softwood Lumber Arbitration

Timelines of changes to the timber pricing system, log grading, and the practical application of log scaling are all examined, concluding with the claim that these changes are not grandfathered in the SLA.

The US is asking for C\$499 million in penalties from the LCIA, the international arbitrating body chosen by both sides to hear SLA disputes. This figure is based on real data from BC's timber harvest plus projections to March 2012, the date of the LCIA hearing on this issue.

The US representatives have used data out of BC Timber Sales, Forestry Innovation Investment, Forintek, and other BC forest industry agencies and companies to make a comprehensive case. To Madison's informed, eye, there are several areas of serious concern in this claim.

The basis of the US argument rests on the timing of changes to BC timber pricing policy, particularly with respect to changes that occurred during negotiations for the terms of the SLA. In the claim, the US details BC log grading prior to April 2006, at which time sawlogs deemed to be "dead and dry" were Grade 3 and charged a minimum stumpage rate, usually the \$0.25 'salvage' rate used for beetle-kill.

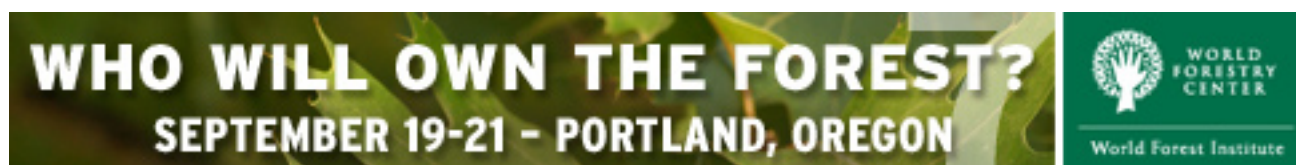
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Prices are in U.S. dollars per 1,000 fbm.

Key Prices

	This Week	Last Week	Change	Month Ago	Change	Year Ago	Change
WSPF KD R/L 2x4	218	222	-4	260	-42	223	-5
WSPF KD R/L 2x6	254	252	+2	260	-6	232	+22
WSPF KD R/L 2x8	275	275	0	285	-10	273	+2
WSPF KD R/L 2x10	280	282	-2	290	-10	314	-34
WSPF KD PET 2x4 Stud	220	220	0	260	-40	215	+5
Douglas Fir Green R/L 2x4	245	250	-5	250	-5	200	+45
Douglas Fir Green R/L 2x10	290	300	-10	295	-5	285	+5
ESPF KD 2x4 8ft Stud	310	320	-10	330	-20	270	+40
OSB Ontario 7/16" (CDN\$)	205	205	0	205	0	225	-20

Weekly News



US Log Exports to China

CONTINUED Alyn Kiel, Public Affairs Specialist at the USDA, explained to *Madison's* in a phone interview Friday that "for now this is a just a proposal which would apply to all log shipments" from the US to China.

"Industry is required to follow those mandated by China. At the moment we are waiting for a response, China may accept our proposal or may come back with a different set of requirements. Our goal at the USDA and APHIS is to mitigate pest risks into China," detailed Kiel.

US Plant Protection Service officers on the west coast are scrambling to clarify a change to phytosanitary rules after a new "Excerpt" was posted on the Chinese government website August 4.

Intrepid US customs broker Michael Jones, of Jones & Jones Custom Brokers in Blaine, WA, provided *Madison's* with a contact at the Washington State Department of Agriculture.

"The Excerpt indicated that logs can not be placed on the ground; they must either be lifted on skids, or stored on asphalt or concrete. Logs can't have any dirt on them when loaded on a ship. They must also be tarped," explained the US Plant Protection Officer who did not want to be named, referring *Madison's* to a media representative at the WSDA.

"Our goal at APHIS is to reduce the number of pest interceptions in China," concluded Kiel. "We are expecting a visit by experts from China in September, when we will take them on a tour of our

ports so they can see for themselves the process US logs undergo.

"Once there is agreement on any new requirements, the USDA will outreach with industry and look at the ports to make sure that logistically any changes are possible."

US Housing, Real Estate

CONTINUED Building permits, were also down in July – an annual pace of 597,000 compared to 617,000 – but also above the six-month trend and 3.8 per cent up from a year earlier.

The regional breakdown saw huge swings among two of the four areas. Starts plunged 38 per cent in the Midwest and jumped 35 per cent in the Northeast. They rose 5.6 per cent in the South and fell 3 per cent in the West.

Housing starts so far this year are running on a 566,000 pace, according to *Bloomberg* calculations. The result compares with last year's tally of 587,000 starts, the second-fewest on record. Home construction totalled 554,000 units in 2009, the lowest since record-keeping began in 1959. During the past decade's housing boom, starts reached a peak of 2.07 million in 2005.

Meanwhile, existing-home sales declined 3.5 per cent from a month earlier to a seasonally adjusted annual rate of 4.67 million, the National Association of Realtors said Thursday.

The median existing home price in July was US\$174,000, down 4.4 per cent from US\$182,100 a year earlier. Housing continues to be more affordable than it has been in years.

Calendar

September 2011

Wood Week 2011

September 9 - 10 – Quebec City, QC
<http://www.masterpromotions.ca/Previous-Events/wood-week-2011/>

COFI Annual Convention

September 15-16 – Prince George, BC
http://www.cofi.org/whats_new/default.htm

Alberta Forest Products Association 2011 AGM

September 28 - 30 – Jasper, AB
<https://albertaforestproducts.ca/registration/>

Who Will Own the Forest? 7

September 19 - 21 – Portland, OR
<http://wwotf.worldforestry.org/wwotf7/index.html>

National Hardwood Lumber Association Annual Convention

September 21 - 24 – Nashville, TN
<http://www.nhla.com/>

Softwood Lumber Agreement

US Claim Against BC

CONTINUED FROM PAGE 6

Reforms put in place in April 2006 changed the method of grading good sawlogs and beetle-affected sawlogs by refining the calculation determining what percentage of a log could be milled into lumber and what percentage of that lumber was deemed 'merchantable'. This method was loosely referred to as the 50/50 rule, because if 50 per cent or more of a log could be made into lumber and 50 per cent or more of that lumber was merchantable, that log was a #1 or #2 sawlog and not eligible for the \$0.25 'salvage' stumpage rate. The April 2006 reforms retained the 50/50 rule but replaced the "dead and dry" Grade 3, and automatic \$0.25 'salvage' stumpage, with a standard based on each log's suitability for making merchantable lumber.

This pricing method is grandfathered into the SLA, according to the US. It is the later changes that are the basis for this current arbitration.

The US maintains that in April 2007 BC "quickly abandoned the new reforms beginning in early 2007" but doesn't explain this alleged abandonment in the same way that both the pre- and post-April 2006 timber pricing methods are detailed. There are, however, startling figures provided about the timber harvest, and which percentage of that harvest was deemed Grade 4 thus charged the \$0.25 'salvage' stumpage.

It is both the speed with which the amount of beetle-kill was harvested and the scope of that increase that has the US concerned. The US repeatedly couples this marked change in the ratio of good sawlogs to beetle-kill with the sharp decline in US home building rates, seemingly in an effort to make the BC government policy more deliberate. The fact is that US housing starts began crashing in mid-2006, actually the month after SLA was signed. By mid-2007 problems with US home building rates were obvious to everyone, but for the lumber industry that had already been old news for over half a year.

Using basic math the US claim says that the sheer increase in the volume of BC's beetle-kill graded logs during such a short time period points to non-compliance with the SLA. The US claim states on Page 18 that, prior to April 2006, "[BC] priced all 'dead and dry' timber (Grades 3 and 5) at the minimum stumpage rate". Under the pre-April 2006 timber pricing policy, 43 to 52 per cent of BC logs were

Grade 3 thus were automatically charged the \$0.25 'salvage' stumpage rate. From the April 2006 reforms to spring 2007, between 5 and 19 per cent of BC's logs were charged the \$0.25 'salvage' stumpage, while approximately 17 per cent fell into the Grade 4, or less than 50/50, category.

The claim then cites BC Ministry of Forests statistics, after early 2007, 20 per cent of BC logs were rated Grade 4 and by 2008 that number shot up to 44 per cent. Between 2008 and 2010, 55 per cent of all Lodgepole Pine harvested in BC was Grade 4, the US claim determined using BC's own statistics.

The US maintains that, within these 'salvage' grade logs, there were "large volumes of lumber-quality timber" which should have been charged the full #1 and #2 market rate for sawlogs. The US then uses the volume of perfectly good lumber produced in BC during that time to back up its claim that the supposedly 'salvage' logs were indeed "misgraded". The US claim also points out on Page 37 that the value of good lumber produced in BC during that time did not decline significantly compared to its neighbour, Alberta, a province of similar timber species with – at that time – little beetle-kill harvesting.

Further, data is taken from a series of BC Forestry Innovation Investment reports examining the lumber recovery factor of grey logs at several mills throughout BC. At sawmills in Princeton, Quesnel, Prince George, and a Vanderhoof stud mill, Forestry Innovation Investment found that there was between 87 and 98 per cent lumber recovery from grey, or dead, logs compared to green, or live, logs. From these logs the value of lumber was between 77 and 94 per cent of lumber from green logs.

In an interview Thursday August 18, Pat Bell, BC's Minister of Jobs, Tourism and Innovation, responsible for trade agreements including the 2006 SLA, told *Madison's* that "all of these reports point to grandfathered features" of the Softwood Lumber Agreement. "BC's grading rules, standards, and procedures are in compliance. The US is twisting the facts. The things they have articulated are not based in fact."

While the C\$499 figure is "outlandish", Bell went on to say that, "the fact that the penalty requested is not higher

proves that the US undoubtedly has a weak case."

The requested penalty is itself a complicated calculation, based on the amount of "misgraded" beetle-kill logs added to an "average market price" [AMP] effect. This "feedback effect", the US says, artificially drove down the price of those sawlogs that were graded #1 and #2. The penalty request asks C\$268 million for "misgraded" beetle-kill, plus C\$231 in AMP effect on the price of good timber, running from May 2007 to March 2012, the full date range of the claim.

On the assumption that the SLA will be renewed to 2015, the US divides this requested C\$499 million penalty by the remaining 43 months' duration and comes up with an additional 13.5 per cent export charge to BC lumber going into the US. Added to the existing 15 per

cent export charge, this proposed penalty would bring the total duty for BC to 28.5 per cent, as long as the composite price remains below US\$315 mfbm. At the very worst of US/Canadian softwood lumber disputes, back in 2002, the duty charged on Canadian lumber exported to the US was 27 per cent.

Zoltan van Heyningen of the US Coalition for Fair Lumber Imports explained to *Madison's*, also on Thursday, the US method of calculating BC's alleged breach:

"Every quarter the US gets a spreadsheet from BC's Ministry of Forests, showing how the AMP for that quarter was calculated," van Heyningen said. "To get this part of the remedy, we simply plug in the correct figure for what should have been the volume of Grade 4 on each cutting authority in the spreadsheet, and see how the AMP changes." The Grade 4 level from April 2006 to March 2007, he added, would be the starting point for estimating the correct amount of Grade 4.

Canada has 90 days, or until November 9, to file its defense. *Madison's* will report on the public document issued from either the Canadian or US government websites in the week following this deadline. Pat Bell assured *Madison's* that "there is virtually nothing in this claim that we didn't expect".

Madison's awaits a similarly well-documented response from the Canadian side in the coming six weeks.

From a broad overview, it is difficult to see how BC will explain charging 'salvage' stumpage rates on 44 to 55 per cent of the Interior harvest while making an average of 92.5 per cent of those logs into lumber, which averaged out at 85.5 per cent of lumber value made from #1 and #2 Grade sawlogs.

Data displayed on Page 48 of US Statement of Case available here:

http://www.international.gc.ca/controls-controles/assets/pdfs/softwood/LCIA111790_SOC.pdf