

# The North American Hardwood Marketplace: 2013 Mid-Year Update

*Editor's Note:* The following is reprinted with permission from the HMR *Executive*®, August 2013.

## Supply

June was billed as the turning point for U.S. hardwood supplies this year (see June 2013 HMR *Executive*®). The marketplace was content to step back at the end of the second quarter to see how sawmill production would respond to rising demand. Depending on the results, buyers would then decide how to proceed with purchasing for the remainder of summer and possibly beyond.

As it happened, U.S. hardwood sawmill production did not change much in June from May – certainly, not at the same rate as demand. However, supplies of kiln dried and “kiln ready” lumber did improve. One contributing factor was the push to saw through whitewood logs this spring. As a result, there is better availability of kiln dried Maple today. The other factor contributing to improved (and still improving) kiln dried supplies is faster drying times for lumber during late spring and summer. In essence, there is more usable lumber available now than earlier in the year, but total volumes available are nearly the same.

## Perception

Total production and its relationship to total demand provide a high-level view of market direction for U.S. hardwoods. This is very useful information to detect trends, as excesses and shortages are preludes to price pressures. But, the hardwood marketplace incorporates a variety of species and qualities that can differ from total production at times. Supply imbalances pop up in such situations. Consequently, supply can be a matter of perception to the buyer or even an entire market sector.

More than ever before, businesses avoid carrying too much inventory – this after redefining what “too much” means. For some it is an issue of management principals; for others, the issue is cash. Pressure to concentrate raw material purchases around short-term needs has created a mindset that having access to enough supply for immediate use is all that matters. Businesses have been quick to cut pur-

chases when lumber availability improves.

In contrast, businesses have been unmoved by projected supply shortfalls and slow to react to developing shortages. Supply strains must turn chronic before serious efforts are made to reverse the situation. The flooring industry’s approach toward lumber purchases last year is a prime example of a market delaying the inevitable.

In this post-June period, there are sales operations and buyers that have experienced improved supplies. Gains have been reported for some Maple and selective Oak items – part of which has to do with production mix and drying times, but from seasonal slow-downs in business and the wait-and-see approach from some buyers, as well.

Also in this post-June period are sales operations and buyers facing lingering shortages. Growing demand across most all market sectors has increased competition for developing supply. Approximately the same amount of sawmill production as last year is being reapportioned in the marketplace.

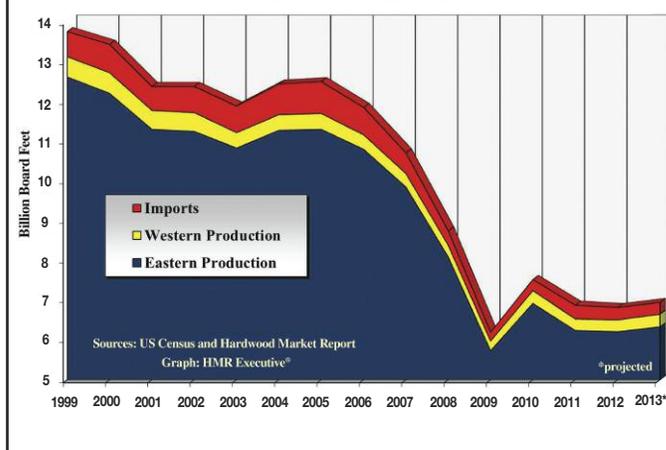
The railway tie industry is one market, in particular, that has had volume pulled away from other industries (flooring and board road/crane mats). Again, there has been no definitive movement to date by railroads to stem the potential shortfalls, likely because they are now only “potential” shortages. After all, there still may be enough time during this peak logging and production season for sawmill output to rebound.

## Hope

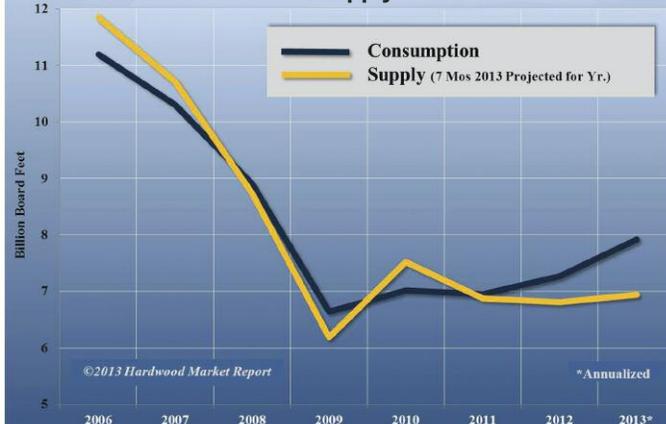
... enough time for sawmill production to rebound. The tie industry has a lot of company sharing this view. Kiln dried grade lumber markets around the world are basing purchasing on the idea, or hope, that U.S. hardwood sawmill production will spike this summer and lumber supplies will greatly improve. Many are counting on the production run up as a normal, cyclical event. It has happened before. Why wouldn't it happen this year?

The approach is legitimate. Given normal weather conditions for summer and fall, there is enough time for sawmill production to ramp up sharply. We know the hardwood timber resource is there to support the kind of increases needed to accommodate global demand for

**FIGURE 1: Hardwood lumber supply available to the U.S. Market from all sources**



**FIGURE 2: Consumption of hardwood lumber by major U.S. markets and total supply of hardwood lumber**



U.S. hardwoods. We also believe there is enough sawmill capacity in place, in terms of equipment, to elevate supplies. Certainly, the potential for profit has improved. The only missing components needed to increase lumber supplies are additional human and financial resources.

This is where the wait-and-see approach for purchasing lumber may lose its validity. What will change after the mid-point of summer to cause sawmill production to increase? Equally important, will the change come soon enough for logging and sawmill operations to capitalize on peak weather conditions? Even then, can production support growing demand *and* replenish inventories stripped clean this past winter and spring? What is it about business conditions that will put people and money in place today that did not exist last quarter or even last month? Patience has its virtues, but hope is not a business strategy. In between are where business leaders must make some very tough choices.

### Supply Status

Back to a high-level view of supply. **Figure 1** depicts estimates of Eastern and Western US hardwood sawmill production and imports of hardwood lumber. Any reference to 1999 should be limited to comparisons with the period of peak housing construction; there is no correlation between then and today. By presenting supply from the previous housing market boom (2004-2007), we can appreciate the influence housing has on our hardwood industry.

Ultimately, supplies are determined by demand. The rate of sawmill production and supply levels are meaningless until they are measured in context of the market's needs.

**Figure 2** maps the supply and demand trend lines together to show the relationship. From 2009 through 2011, sawmill production responded rapidly to disparity with demand – contracting too much in 2009, overshooting the slight business upturn in 2010, and then contracting again to catch demand in 2011.

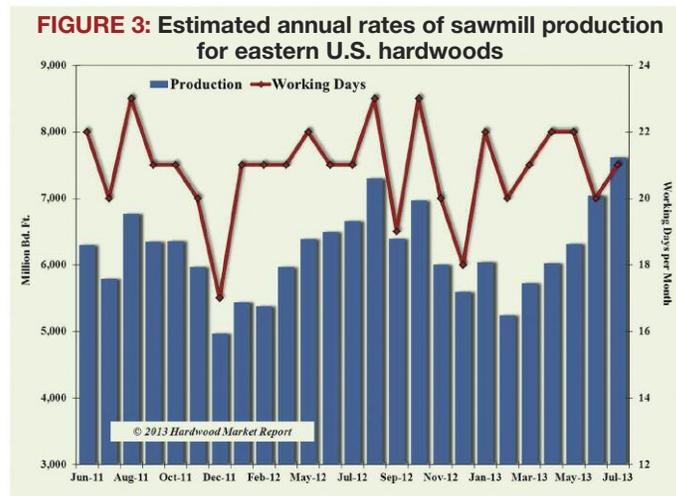
Sawmill production and imports were flat in 2012 despite the rise in demand. Inventories and imports of manufactured parts filled last year's void in sawmill production and lumber imports. Before the start of this summer, sawmill production still sputtered to gain traction, and kiln dried lumber inventories were depleted.

The trajectory of sawmill production averaged for the first half of this year is only up about 2% from 2012. However, the red graph line in **Figure 2** shows there are improvements in sawmill production during summer when market conditions are right. This is the result buyers anticipated for summer.

The second half of last year has supplies trekking much closer to consumption than the

average annual figure for 2012; the deficit between the supply/demand estimates was a little more than 1%. Through the early part of this summer, the rate of sawmill production is, again, trekking close to demand. The June/July average leaves a little less than 1% deficit from demand. But, the higher rate of production in June and July does not compensate for the double-digit shortfall in supplies in the first half of the year. To restore inventories needed for the coming winter and spring, sawmill production must surpass demand in the second half of 2013.

**Figure 3** on page 17 also shows the reality of increased sawmill production when market conditions are favorable during summer and early fall. May through October production carried last year. Production during the month of May was nearly equal in 2013 to that in 2012. In June, Eastern US hardwood ►



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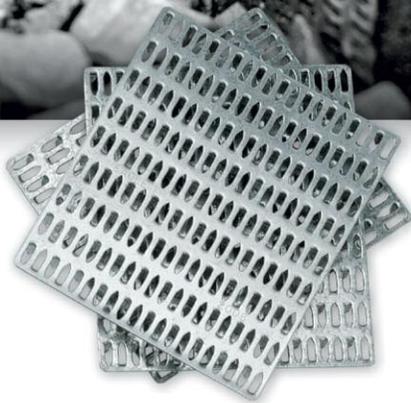
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sawmill production exceeded output in the same period last year by 8.5% and did so with 5% fewer working days.

The measurable gains in sawmill production are encouraging to those buyers and markets staring at potential shortfalls. It is possible total supplies could cover the volume projected for total consumption. It is also possible, if not likely, certain items will be in ample supply.

However, it is just as likely some market sectors, and certainly some companies, will miss their target for supply. There is tremendous competition for mid- and low-grade lumber coming from the flooring, tie, and board road/crane mat markets. Demand is growing for each of these sectors, but not necessarily at the same rate, nor at the same rate as supplies. There also are differences in manufacturing costs for the lumber and heart dimension product heading to each sector, as well as limits on how aggressive markets can be for purchasing raw materials.

One of the biggest unknowns about supplies moving forward this year is how demand might change. **Figure 2** on page 16 shows an upward trend in consumption, but China could become a much greater force in the marketplace than is factored into the estimates. As in the US, Chinese distribution yards have waited to see how US sawmill production would develop this summer before making long-term commitments.

The potential of the Chinese market is tremendous. Should consumption increase or a move toward inventory-building take place, the additional business could easily stretch US hardwood supplies under normal circumstances. Now that demand is growing in US grade lumber markets – something that has not occurred since the last housing market boom – a significant upturn in Chinese business could severely strain US hardwood supplies.

There is a lot at stake for hardwood companies. Hedging against supply shortages contradicts strategic planning for most businesses. At least until now, having cash has been considered more valuable than having an inventory buffer. But running the risk of missing new sales or even fulfilling orders with established customers may put inventory investments in a different light. ■