IT'S ROSEBURG

By
Henry Spelter

> Roseburg's lumber output at its Dillard, Ore. mill last year was tops in the nation, surpassing seemingly perennial number one Hampton-Willamina.

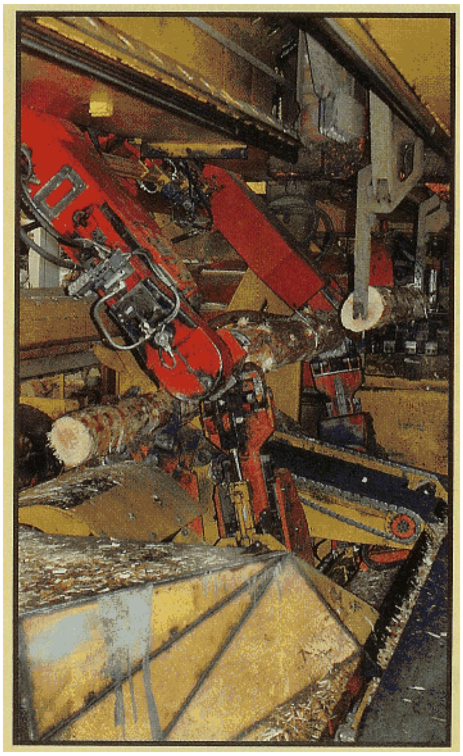
U.S. softwood lumber production was 35.2 billion BF in 2007, off 13% from its 2005 high, according to Western Wood Products Assn. Based on our tabulated capacity of 43.7 billion feet, that means the industry utilized 80% of its potential.

The utilization rate of our top 200 U.S. producers for 2007 was at a similar 83% while among all our respondents it was 82%. It is hard to generalize but, among our sample, board mills tended to do a little better than those tied mainly to framing/construction lumber, as did mills focused on treated wood, a market with stronger links to the more stable remodelling sector. Mills with their own fee timber also tended to operate at higher levels than those dependent on market purchases.

Reflective of the difficult economy, last year's highest production figure was lower and we also had a change at the top. Roseburg Forest Products' mill in Dillard, Ore., which converted from a large log dimension mill to studs in 2003, beat its own prior high and ended up as number one. If not for extra downtime taken at year end its output would have exceeded 400 million feet. Hampton's Willamina, Ore. two-line complex still has the most capacity, but it bowed to the economic headwinds and cut back output by 45 million feet, taking silver.

The Hampton-Willamina site owned the top spot for many years. At one time we thought the Simpson operation in Shelton was bigger, but that actually consists of two physically separate units, thus strictly speaking not constituting a unified complex. Together, those mills would rate third now, but separately they are 27 and 46. Instead, a Weyerhaeuser mill in Cottage Grove, Ore. ranks third, while Sierra Pacific's recently built Aberdeen, Wash. mill is fourth.

For a while last year it appeared that a new production high-water mark would soon be set as German lumber giant Klausner Gruppe filed applications with Georgia and Alabama environmental agencies for pemits to construct two lumber mills with capacities of 800 MMBF each. However, financial difficulties at home apparently dissuaded the company from pursuing the projects. This was probably just as well given the market collapse and the dubious choices selected as the entry points into North America



The applications listed Homerville, Ga. and Cusseta, Ala. as the sites. At first blush these may appear opportune as there is no woodworking mill in Cusseta, while Homerville has only the Little Suwannee Lumber Co., a less than 10 million feet, 25-employee operation.

However, within a 200 kilometer (125 mile) radius around the sites, the combined sawmill and plywood capacities add up to about 2.85 billion feet at each. On a spectrum of 100, where 100 is the most crowded and 0 the least, that puts these places fairly high at the 64th and 67th spots from the bottom, or, conversely, 36th and 33rd from the top. Furthermore, these sites are just below the middle in terms of available volume of softwood sawtimber within the same radius, at the 45th and 47th spots from the bottom, according to U.S. Forest Service inventory data.

Consequently the ratios of billion board foot of timber inventory to billion board feet of capacity within the circles are 15.0 and 143 for Homerville and Cusseta (i.e. the timber there now would be exhausted in 15 and 14.3 years, respectively, if the industry continually ran at full capacity). That places them at the 24th and 18th spots from the bottom using this metric. With the proposed mills, they would have dropped even lower to the 1-2 percentile range, just a few sites ahead of Jackson, Ala., which is dead last in this league and, not coincidentally, where Boise Cascade downsized and then abandoned a mill a couple of years ago.

These proposed mills would have dwarfed any in North America and radically altered the fiber demand/supply environment in their neighborhoods. Southern hospitality notwithstanding, Klausner would probably have been as popular among the lumber community as a swarm of mosquitoes at a nudist colony.

Nevertheless, several large new mills are on the way.Weryerhaeuser is building two 500 million +/- mills in Lebanon, Ore. and Longview, Wash., while Sierra Pacific's two new mills in Washington have ramped up and could attain new output records when the market recovers. Thus, we may soon see new candidates vying for the top spot, but also a fair number dropping out. Notable casualties include Potlatch's Prescott, Ark. 230MMBF dimension mill, which closed in April 2008, Portac's 100MMBF dimension mill in tacoma, Wash. (February '08), Sierra Cedar's board bill in Marysbille Calif. (March '08), Welco Lumber's cedar mill in Marysville, Wash. (August '07), Stimson's Coeur d'Alene, ID and Bonner, Mont. stud mills (mid '08) and Boise Cascade's Medford, Ore. boqrd mill (first quarter'08).

Clearly the industry faced challenging times in 2007 as demand for its products fell. As a whole, its failure to make timely and adequate supply adjustments cost it millions. It took prices falling below costs and remaining there for the year to constrain output to what buyers were willing and able to absorb (Figure 1).

One reason for that failure is that curtailing or idling operstions carries a risk that key skilled employees, who are vital to running a modern sawmill, will go elsewhere. As one attempt to cope with that dilemma we can cite a Canadian program that eases the predicament of workers and firms in cyclical industries exposed to periods of chronic oversupply. Rather than having to shut down entirely, Canadian mills can apply for a "workshare" arrangement whereby operations run only part time while the government makes up 55% of employees' lost earnings, up to C$413 per week. This keeps everyone at least partially employed, maintains incomes closer to normal while still enabling firms to adjust their supply to demand. A U.S. version of such a program would surely be helpful in down cycles.

Another factor that was supposed to brake supply was the 2006 Softwood Lumber Agreement with Canada. For the most part it accomplished that, but the years of litigation honed British Columbian sawmillers skill at reading legal documents with a fine tooth comb. They disc overed that, as written, the document actually placed a higher limit on exportable volumes than a cursory examination might lead one to believe. The Canadian position was upheld in arbitration, giving BC sawmillers a small tactical win. However, tactical success seldom trumps strategic miscalculation. The choice by BC and Alberta to go with the no quota, high tariff option over the quota, low tariff alternative has proved in my opinion to be a mistake. Recent data show imports falling to the lower Option B limits anyway even as mills pay the maximum 15% duty rather than the 5% they could have had they gone with the alternative (Figure 2). By the terms of the treaty they cannot change this until January 2010.

In depressed times this industry often casts longing glances at markets where increased use of wood could help alleviate the demand shortfall. One current promising area is in construction on flood plains where many of our countrymen choose to live but build their homes on slab-on-grade or fill. Building codes and the National Flood Insurance Plan do require that such homes be built at or above base flood elevation, a benchmark where floodwaters have only a 1% expected chance of rising in any year, but that is often inadequate when hurricanes charge ashore or levees break. Homes built on raised treated wood foundations would increase the margin of safety and should be an easy sell with a little missionary work among insurance companies and zoning boards. Southern Forest Products Assn. is active in these efforts.

Finally, as a culture we tend to extol advances but sometimes a well organized retreat is just as noteworthy. The English evacuation of Dunkirk and the Japanese escape from the Aleutians are two examples that come to mind where something was salvaged from imminent disaster. In that vein we can cite International Paper for its well managed strategic withdrawal from the difficult 2007-08 lumber market.

IP was one of the main underwriters of the Coalition for Fair Lumber Imports that tried to constrain Canadian softwood lumber exports to the U.S. When that effort began to flag, a compromise agreement was reached resulting in a nice payoff to the U.S. lumber industry, but an even bigger one to Canadian firms. Sensing an opportunity, IP then negotiated the sale of 13 of its mills to newly flush Wesrt Fraser for approximately $325 million in the first quarter of 2007. It followed this up with a deal to sell Georgia-Pacific five more at an additional $237 millions in 2007s first half, then cut a deal to sell three others to Simpson Timber for an undisclosed sum in the first quarter of 2008. finally it found a buyer for its last remaining mill in Chapman, Ala. in the form of the Smith Family Companies, a large cut-to-size Alabama panel processor.

So, as we salute International Paper for its timely lumber exit and bid it farewell, we also welcome the Smith Family to the never dull lumber business and hope to see them on some future top 200 list. TP

Timber Processing *mailed surveys or otherwise contacted 260 top lumber producing mills.* Timber Processing *thanks management and staff who responded with information on 185 plants. The outputs of the remainder were estimated from previous production and capacity information. Corrections or contacts for future surveys can be sent to rich@hattonbrown.com.*

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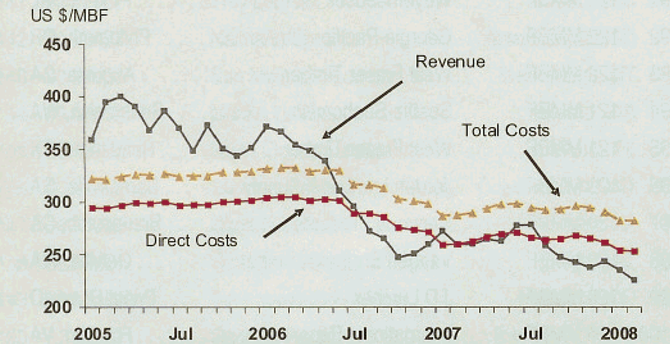
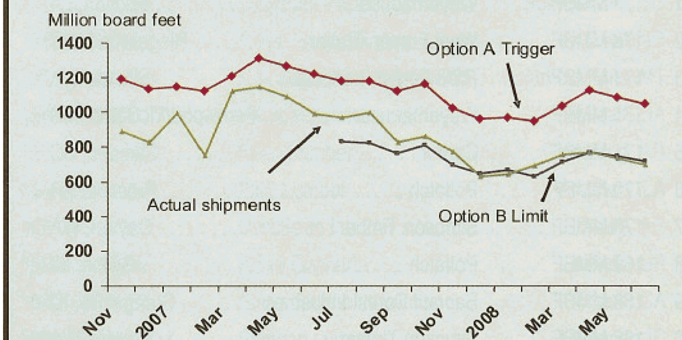
Figure 1. – Estimated Monthly Variable and Fixed Costs and Revenue – North American Composite



Source: Spelter estimates based on seven regions

Figure 2. – BC & Alberta U.S. Lumber Exports Versus Options A & B Trigger/Limit Points



Source: DFAIT, Spelter calculations