

ROSEBURG

REPEAT

By
Henry Spelter

Roseburg Forest Products' sawmill at Dillard, Ore. was the biggest producer in a year that ended with a whimper.

A vintage year for sawmilling 2008 was not. In an industry strongly driven to produce, we were apprehensive that firms would be more shy than usual about divulging their 2008 activities. So this year we cast a wider net but, in the end, 149 out of the 200 mills appearing on the Top 200 list, and 48 out of the top 50, volunteered their numbers. For the remainder, capacities usually serve as a good proxy because most mills strive to operate near their limits in good years. This year, however, that approach was unreliable because operating rates varied widely. Among our respondents they ranged from 17 to 107% with an average of 72% (Figure 1). By contrast, 2008 data from the Western Wood Products Assn. (WWPA) implied a 68% U.S. utilization rate. Therefore, to more realistically represent non-respondents, I applied the 68% factor to their capacities, modified by whatever information was available about downtime at specific mills during 2008.

Based on the above, this year's highest producer, operating near 90% of its capability and exceeding last year's tally, was



Roseburg-Dillard kept pumping despite sour economy.

again the Roseburg mill in Dillard, Ore. Asked about the reasons for their success or, alternatively, for their ability to defy economic gravity, the answer was "continuous improvement. We would have been at over 400MMBF had we not curtailed around the holidays." Having a private source of timber to draw upon may also have helped cope with the economic headwinds. In any event congratulations to the team at Roseburg for their achievement. They were in select company, but not alone, in being able to operate at high levels despite the worst lumber market in several generations.

Coming in second and running at a similar capacity utilization rate was the Weyerhaeuser Cottage Grove, Ore. facility. Two new Weyerhaeuser mills, one in Lebanon, Ore., the other in Longview,

Wash., will be elbowing their way into the top tier in coming years as they hit their strides after mid-year 2008 startups.

Sierra Pacific's Aberdeen, Wash. dimension mill was third. Its sister mills in Burlington and Centralia, Wash. were also among the top 15, the former a candidate for a future top spot as it operated at around only one half of its potential.

In fourth was the Hampton two-line operation in Willamina, Ore. It still has the highest rated capacity in the U.S. but the burden of low demand and weak prices made it operate below its potential.

Hardly skipping a beat at nearly 90% of capacity and coming in fifth was the Weyerhaeuser mill in Dierks, Ark.

It is hard to overstate the difficult operating environment the sawmilling industry faced in 2008 or, for that matter,

is dealing with in 2009. A consolidated overview of how different segments of North American sawmill producers dealt with conditions in 2008 is contained in Table 1. The most stress appeared to fall on firms in Eastern Canada, as indicated by the four corporations whose combined output fell the greatest. They also shuttered the most capacity of any producer class.

U.S. and BC corporate firms showed production declines similar to each other but capacity loss was greater in BC.

The “non-corporate” sector, which runs the gamut from small single-mill firms to large privately owned, multi-mill-corporations, downshifted slightly less on production. Their capacity utilization appeared lower, but that may be due to some closures of smaller firms that escaped my notice.

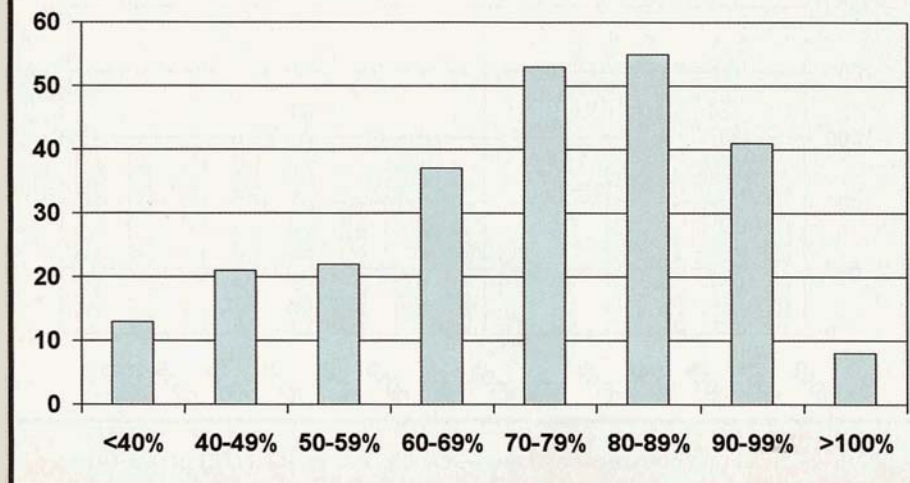
This is an industry that has geared itself for 2 million housing starts but is now dealing with a quarter of that. As a result the gap between production capacity and take away is wide and that between revenues and costs narrow if not negative. In such circumstances, some attrition is inevitable. Ten mills, marked by a single asterisk, will not appear on this list next year due to closure in 2008 or this year.

The remaining firms are scrambling to find various strategies to remain afloat. Those attending the Ligna Fair in Hannover, Germany this spring may have picked up on the word *Flexibilität* as the implied theme of this year’s fair. High volume production of standard pieces has cost advantages, but when orders shrink, forcing volume onto the market anyway is an invitation to a wreck. In such circumstances the ability to switch from a high piece count to a high value mentality can help carry a firm through.

Among our smaller sized correspondents many hewed to such tactics. Their ability to accept non-standard, specialty or low volume orders for such items as half-round log siding, appearance and vertical grain lumber, pallet stock, special order cuttings, metric sizes, paneling and the like kept many going when others faltered.

Executing some of these tactics depends in part on the available raw material. For many that limitation constrains options. However, even large volume commodity producers processing lower grade timber can accommodate disparate domestic and global markets if their sorting capacity, at both the input and output end, is large. The increased ability to trim for a wider range of grades and sizes can snatch niche orders when de-

Figure 1. – 250 respondents by 2008 capacity utilization



mand for the main items flags. Being vertically integrated, from owning timber to having remanufacturing facilities, was another arrangement that helped some mills run.

But even with good strategies, conditions were challenging and surviving the slump was a main goal. This meant controlling costs and volume to match lower orders. Employment numbers for sawmilling in general reflected this. As recently as five years ago, 122,100 people found employment in the sawmilling and wood treating sector. The latest number for May shows 30% fewer workers at less than 87,000.

Looking ahead, the prospects for a turnaround in sawmilling depend in large part on a recovery in construction. We can take some comfort from the continuing population growth and the conse-

quent need for housing. The best available insight into that comes from the Bureau of the Census whose most recent projections of the U.S. population were released in November 2008. Their analysis indicates an increase of 15 million people over the next five years, a little over half from natural growth, the rest from immigration.

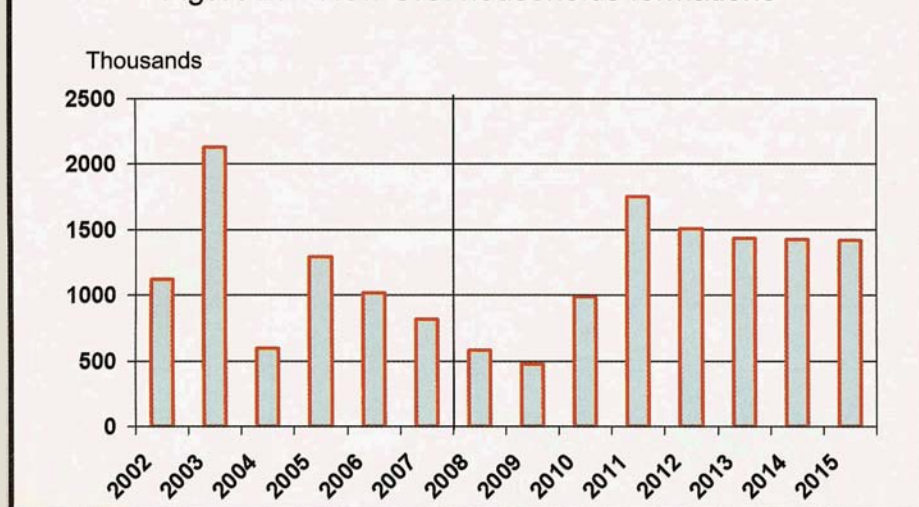
This contains several uncertainties, such as the numbers of births and inflow of immigrants, but embedded within that is a less speculative estimate of the population that already exists and will move through time into the age classes that happen to be the source of most of the demand for homes, condos and apartments. People within the ages of 25 and 70 show a growth of over 9 millions between now and 2015.

Within each age class a certain number

Table 1. – 2008 sawmill production and capacity by region and ownership class.

	Production (mmbf)	Y/y % change	Capacity (mmbf)	Y/y % change	Utilization %
Corporate, public					
BC	7953	-19%	10192	-11%	78%
E. Canada	3444	-26%	5187	-20%	66%
U.S.	8922	-19%	11333	-5%	79%
Total Corporate	20320	-20%	26711	-11%	76%
Total N. America	52818	-19%	74594	-6%	71%
Other, private	32498	-18%	47882	-4%	68%

Figure 2. – New U.S. households formations



qualify as the head of a household and the ratio of household heads to the total is called the headship rate. Multiplying recent headship rates by the projected populations in their respective age classes gives a handle on the likely formation of new households (Figure 2). By these calculations, growth in new households starts to recover in 2010 and reaches trend level of 1.5 millions by 2011. Current housing starts are below that level so a growing backlog of unmet demand should exert pressure on new starts.

Unfortunately for the timing of this we need to account for the considerable over-building that took place in the late real estate boom. This is reflected in the numbers of homes that are currently vacant, either because they are used only part of the year, such as second homes, or are in between occupants. Vacant units relative to the total stock of homes have risen well above their historical norms (Figure 3). Until this build-up is worked off, it will be hard for underlying demographic factors to gain traction in new starts. In most previous recoveries, cutting interest rates by the central

bank (Federal Reserve) greased the skids for a prompt rebound. But in prior slumps the overhang of vacant and unsold, unrented homes was not as large. Even though interest rates are historically low this time, starts are sputtering. Thus the growth in households is likely to manifest itself first in the reduction of the vacant home inventory before it transfers to new construction.

For illustration, I have posited a path of vacant inventories back to their normal levels along the lines shown in Figure 3, reaching equilibrium by 2014. This results in a base projection of new housing starts depicted in Figure 4, showing activity below par through 2012 and a rather drawn out recovery achieved only by 2014-15.

Other views in the industry show a stronger recovery as illustrated by a recent similar but more V-shaped forecast from the American Plywood Association. Various government incentives that may be developed or added to the current \$8,000 credit for some buyers could certainly boost activity, but likely at the expense of activity later when the incen-

tives expire. The immigration element is also uncertain because, in a weak economy, the inflow may not expand as fast as the Census projection assumes. Thus, under either scenario, maintaining supply discipline in the medium term will likely be necessary to keep lumber markets balanced.

Finally, we are nearing the end of the third year under the Softwood Lumber Agreement. In 2008 the quotas and caps on exports were hardly relevant as actual shipments were far below those in most months. Canadian market share has fallen from 33.3% in 2006 to 25.5% through April. Accordingly, the U.S. share rose from 64.1 to 72.4% in the same time frame. The 5-to-15% tariffs on imports and the recovery of the Canadian dollar, to parity at one point, combined to make imports less viable. An added temporary surcharge of 10% on Eastern Canadian mills is depressing 2009 imports from there even more. Such shifts would have been significant in normal markets, but the hole left by the housing implosion was too great for these to have made much impact.

Still, amidst all the woe, hope flickers. Its latest manifestation was the re-opening of the Pope & Talbot mill in Fort St. James, BC by industry newcomer Conifex.

Likewise, in the U.S. another former Pope & Talbot sawmill and pellet plant in Spearfish, SD was bought by Neiman Enterprises. These opportunistic purchases reflect the saying that the time to be buying is when everyone is selling. We wish them well and hope they found the right recipe to prosper amongst the current challenges.

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Figure 3. – Ratios of vacant U.S. homes to total homes, 1989-2015

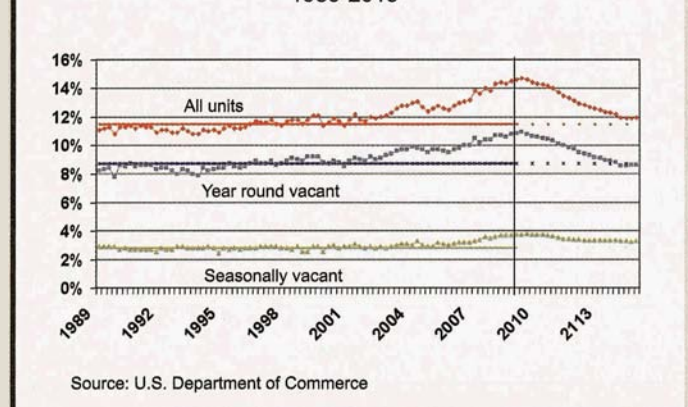


Figure 4. - Total U.S. home starts, 2000-2020

