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## Wood Products Sector Update: The Recovery of Lumber

Equity prices of companies in the wood products industry were hit hard by the pandemic. The S&P/TSX Forest Products sub-index declined by 58% from mid-February to late March as deep recession fears took hold and building sites were forced to shut down. But a recovery in wood products demand in late spring and summer led by a resumption in home renovations has since sent stock prices sharply higher. The price of lumber has tripled since April and the Forest Products sub-index is up 173% from its low point. The speed and extent of these movements have been remarkable.

North American demand for lumber and wood products is driven by housing construction (30%), repairs and renovations (40%), and industrial applications and exports (30%). Letko Brosseau has a positive long-term view on the wood products industry. The major reasons supporting our investments in this sector are economic growth, positive demographics with millennials at an age to purchase a first home and low mortgage rates. Additional factors include an aging housing stock which favours demand for repairs, and new advances in construction of multi-storey buildings with wood. Industry dynamics are also providing a positive backdrop. Low lumber prices in 2019, and fiber constraints in some regions like British Columbia, led to capacity rationalization, suggesting a favourable supply and demand balance for lumber in the years ahead.

In late 2019 and early 2020, just before the pandemic hit, housing data and demand for wood products were very strong. Indeed, U.S. housing starts, which were running around 1.3 million homes (seasonally adjusted) during 2019, accelerated in the second half of the year to reach 1.6 million on average for the December 2019-February 2020 period. Lumber prices climbed to \$440 per 1,000 board feet in March 2020, a 54% increase from the June 2019 trough. The COVID-19 induced lockdown and slowdown of the economy initially had an adverse impact on demand for wood products. U.S. housing starts declined by over 40% to 934,000 in April. The prices of lumber and OSB collapsed by around 35% in a span of four to five weeks to reach a trough of \$280 and \$220 respectively (Table 1).

TABLE 1

Recent Lumber and OSB Prices

Period	Lumber	Oriented Strand Board (OSB)
	\$U.S. per thousand board feet	\$U.S. per thousand square feet
Peak June 2018	\$655	\$445
Trough June 2019	\$286	\$175
Average 2019	\$359	\$210
Trough April 2020	\$280	\$220
End-August 2020	\$935	\$645

Source: Random Lengths

However, after a brief slowdown, demand for wood products rapidly picked up. Many individuals spent more time at home and received financial support from the government, prompting them to go ahead with home renovations and outdoor projects. Housing starts in the U.S. also rebounded quickly, reaching 1.5 million in July, helped by attractive mortgage rates and buyers' desire to move to larger spaces, farther away from cities.

The combination of a tight supply and demand balance and lean inventories led to a strong rally in wood product prices, which have tripled from their recent trough. Both lumber (\$935 per 1,000 board feet) and OSB (\$645 per 1,000 square feet) currently trade at all-time highs (Table 1).



## Impact on Canadian Portfolio Holdings

Companies with exposure to lumber and OSB markets should generate strong financial performance during this period of high prices. Assuming lumber prices remain at their current levels, a Canadian producer such as **Inferfor** could generate around \$1.70 of earnings during the current quarter. This would exceed their record full year earnings of \$1.64 in 2018. At this rate, the company could be net debt free by year-end. In addition, **Norbord**, the largest OSB producer in the world, could generate earnings of U.S.\$2.25 or C\$3.00 in the third quarter, for a run rate of C\$12 per share. **Canfor Corp.**, a producer of lumber and pulp, should also benefit from strong business conditions. **Western Forest Products**, a supplier of specialty lumber based out of British Columbia, should generate good earnings, although value-added lumber prices have not increased to the same extent as commodity lumber, and export markets have been flattish.

TABLE 2

Forest Products Share Prices

Company	Ticker	Share Price (C\$)		
		Peak 2018	Trough 2020	End August 2020
<b>Inferfor Corporation</b>	IFP-CA	\$27.27	\$4.75	\$17.10
<b>Norbord Inc.</b>	OSB-CA	\$58.92	\$13.01	\$44.60
<b>Canfor Corporation</b>	CFP-CA	\$34.04	\$6.11	\$17.01
<b>Western Forest Products Inc.</b>	WEF-CA	\$2.95	\$0.58	\$1.18

Source: [Factset](#) financial data and analytics

Share prices for these companies have rebounded strongly from their March lows, much more quickly than most investors may have expected. Most still trade below their 2018 highs (Table 2). The global economy continues to recover from COVID-19 and the positive fundamentals underpinning the building materials industry remain intact, suggesting these share prices may have further room to run.

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