<u>News Release</u>

Record high U.S. clearwood pine prices to erode in 2005 as surging imports create a more balanced moulding market

Release of the 3rd Edition of the *Global Clearwood (Pine) Lumber, Moulding & Millwork Sector: Outlook to 2008 Report* profiles the pine market dynamics and projected impacts on both U.S. producers and offshore importers

For Immediate Release **September 21, 2004**

Vancouver, BC — The release of a five-year outlook report profiling the global pine moulding and millwork industry suggests that the party in the U.S. market will be over soon and it will be back to more competitive prices and normal margins. The rapid run-up in U.S. moulding prices in 2004 broke all records – a result of exceptionally strong demand but also horrendous ocean transportation problems in getting Southern Hemisphere lumber and mouldings to the U.S. market. Soaring shipping rates and shortages of ships came at a time when U.S. housing and repair/remodeling activity was hitting all-time highs, causing prices to spike by 50% to 100%, depending on the product.

The third edition of the ***Global Clearwood (Pine) Lumber, Moulding & Millwork Sector: Outlook to 2008*** report by R.E. Taylor & Associates Ltd. / WOOD Markets profiles the expanding offshore plantation pine supplies, the U.S. industry and market demand trends, the new threat of MDF substitutes to solid pine products, as well as emerging offshore pine suppliers that could potential displace U.S. producers.

"The past year has seen truly exceptional prices for an industry sector that is technically flush with excess raw material supplies and industry capacity," said Russell Taylor, co-author of the 200-page Clearwood Report, President of wood products consulting firm R. E. Taylor & Associates Ltd. (and Publisher of *WOOD Markets Monthly* newsletter and the landmark report released earlier this year, *Europe & Russia: Wood Products Industry – Trends & Issues*"). But when offshore supplies were delayed, a mad scramble started to try and find available products and that caused the prices to soar."

With about 75% of all U.S. moulding and millwork consumption tied to either imported raw material inputs used at U.S. processing plants or as imported finished products, the

Southern Hemisphere timber harvest, wood processing and exports have become very close coupled to the U.S. market. "The plantation pine harvests in the Southern Hemisphere could easily over-supply existing markets (especially in the case of New Zealand)", added Taylor, "But recent timberland ownership changes, currency exchange rate differentials and shipping issues helped to create U.S. market shortages in 2004."

According to the report, the outlook to 2008 will be spotty and not nearly so rosy for the pine clearwood lumber and moulding sector as it was in 2004. A slower rate of growth in U.S. consumption coupled with an expanding industry in the Southern Hemisphere is setting the stage for an over-supplied market situation at some points over the next five years. "The capacity of sawmills, moulding plants, door factories, furniture plants and other facilities in the plantation pine growing regions of Chile, Brazil, Argentina, New Zealand and South Africa are expanding dramatically," said Peter Butzelaar, co-author of the report and a consultant with R.E. Taylor & Associates Ltd. "Imported finished pine products are forecast to expand across the board into the U.S. market putting domestic U.S. producers at risk in a number of sectors. Our forecasts also recognize the potential impact of two other new suppliers – Siberia (high quality red pine lumber) and China (currently the fastest growing exporter of mouldings to the U.S. market)."

The report profiles how truly global the supply of U.S. mouldings has become, as over 25 countries now supply the market. "Chile and Brazil are the dominant moulding suppliers - together they account for 75% of imported U.S. mouldings in 2003," commented Taylor. "Brazil should overtake Chile as the largest U.S. pine moulding supplier in 2005, but other countries appear to the have the U.S. pine market in their sights, including edge-glued panels and furniture, stile & rail doors and even window components."

In the U.S. paint-grade moulding sector, finger-joint mouldings have the largest market volume. But things are also changing here, explains Butzelaar. "The fastest rate of U.S. market growth has been (and will continue to be) MDF mouldings – a lower priced alternative to solid pine mouldings. The technical aspects and consistency of primed MDF mouldings have created the biggest change in the moulding industry in the last five years. From nowhere, MDF now has a one-third share of the U.S. moulding market and should continue to grow each year to 2008."

The impacts on supplying countries to the U.S. market as well as five-year supply, demand and price forecasts on clear pine lumber and mouldings are featured in the report.

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(Note: See following pages for more highlights from the *Global Clearwood (Pine) Lumber, Moulding & Millwork Sector Outlook to 2008* report.

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Our team of professionals delivers expert consultative services in global markets to an extensive client base in Canada, the United States, New Zealand, Australia, Chile, Brazil, South Africa, Japan, China, Europe, Russia and other countries. Our ability to conduct in-the-field investigations coupled with our global network of contacts and comprehensive data-base delivers strategic results for clients. Strategic business assessments matching the timber resource to the global wood products market coupled with our feasibility analyses of timber processing options are trademark skills of the firm.

Our affiliated company, **International Wood Markets Research Inc.**, publishes a number of strategic industry reports including:

- ***WOOD Markets Monthly*** newsletter;
- ***WOOD Markets '96, 2000, 2002 & 2005*** (*WM 2005* is scheduled for early 2005);
- ***Global Lumber (Sawnwood) Cost Benchmarking Report: 2002 Basis*** (2004 is underway);
- ***Europe & Russia Wood Products Sector: Trends & Outlook***;
- ***Global Clearwood (Pine) Lumber, Moulding & Millwork Sector Outlook to 2008*** (Bi-Annual Report);

Highlights: 3rd edition, ***Global Clearwood (Pine) Lumber, Moulding & Millwork Sector: Outlook to 2008*** report by R.E. Taylor & Associates Ltd. / WOOD Markets

1. Plantation Pine Timber Harvest Highlights:

- The plantation timber harvests for the seven major Southern Hemisphere countries (Brazil, Chile, Argentina, Uruguay, South Africa, New Zealand and Australia) are projected to increase slowly, growing by another one-third by 2020 from the levels in 2003. Similarly, plantation pine sawlogs from these same regions are expected to rise by over 25% by 2020.

- The development of significant areas of "pruned" pine plantations has increased the harvesting capacity and clearwood output throughout the Southern Hemisphere especially in New Zealand, Chile and South Africa, as these countries dominate clearwood production from pruned forests. The pruned pine timber harvests from the U.S. South plantations have been delayed but are expected to start increasing significantly by around 2008.

- The potential spoiler for plantation pine producers may be New Zealand, as its domestic capacity is only processing two-thirds of its current log harvest with one-third (7.5 million m3 in 2003) being exported offshore (in most cases to lower cost manufacturers).

2. Clearwood Pine Product Trends:

- Globally, there remains no other market willing to pay a greater premium for clear pine fibre and in large volumes as the U.S., and this should help America to retain its position as the preferred destination of countries exporting clear pine. The current pace of growth in available offshore clear fiber is projected to more than make up for anticipated future reductions in domestic supply and projected growth in U.S. demand.

- While periodic shortages and surpluses are systemic in the U.S. millwork sector, our five-year forecast assumes that, over the next five years, the market will more often than not be in a balanced to oversupplied situation (the second half of 2004 and early 2005 will continue to remain very robust and exceptions to the general rule). However, steady demand growth and logistical issues will keep the U.S. moulding market more finely balanced.

- Exporters of imported clearwood pine have benefited from the declining availability of U.S. pine lumber over the last ten years. The three largest lumber producers today, Brazil, Chile and New Zealand, are all expected to increase their lumber output. However, the annual growth rate of imports is expected to slow down in the next decade but should still be favorable.

- Our projections are that the potential volume of shop/clearwood pine lumber available for exports and/or as finished products (mainly solid lineal mouldings and boards) could generally exceed the projected size of existing markets, even when growth rates are factored in. Managing the plantation pine timber and lumber supply relative to overall U.S. and global demand and expanding product and/or markets will be key objectives to prevent soft prices from becoming the trend as a result of over-production of commodity items in established markets.

- One more supply factor that should be recognized relative to clear pine lumber is that of Siberia. Extensive field work conducted by R.E. Taylor & Associates Ltd. since 2001 in Siberia coupled with discussions with U.S. importers and remanufacturers indicate that high quality, fine grain red pine from Siberia is slowly becoming an increasing source of clear pine lumber for the U.S. market, including red pine mouldings produced in China from Russian wood. Siberian red pine is considered to be the closest substitute to the prized (and expensive) ponderosa pine.

- All clearwood pine lumber prices (moulding & better and shop grades) will move off of their record high prices by the end of 2004 or early 2005 to move back into step with more historic price levels. However, prices are expected to decline slowly over 12 to 18 months before they reach these lower levels.

- Between 2003 and 2008, domestic consumption forecasts of moulding and millwork products are expected to rise steadily. Domestic conversion of clearwood lumber into finished product, however, is expected to decline marginally. In contrast, imported moulding products produced from clearwood should rise at favorable rates. And, even more significantly, products made from MDF and other substitute materials are expected to make even greater inroads over the next five years.

- Our analysis indicates that U.S. consumption trends in the next five to ten years may not likely be quite as robust as they were in the last ten years. However, this is becoming a tougher call given the strong demand in 2004 and some of the longer term consumption outlooks that seem to indicate a decade of almost sustained demand levels. In our analysis, however, we have indicated that increases in U.S. consumption are not expected to “save” Southern Hemisphere plantation pine exporters with excess volumes as occurred in the last ten years.

- As a result, the clearwood pine industry will be facing some challenges. While we recognize that some of more progressive companies are already addressing these over-supply issues, most of the smaller and mainstream offshore players are still taking a followers’ role and these companies will be facing the greatest problems when price cycles hit their lows.

- Over the next ten years, the U.S. moulding and millwork market for clearwood products should still expand, but at about half the rate as compared to the previous decade’s average growth rate. Moulding and millwork producers in the U.S. are expected to increase their consumption for clear pine lumber over the next ten years, bucking the decreases that plagued the industry over the previous decade (mainly as a result from declining supplies of ponderosa pine from National Forests).

3. Pine Moulding Trends:

- In terms of U.S. moulding consumption, we project a significant market share decline for domestic clearwood products (solid pine) while imported mouldings also decline slightly as well. The big winner is MDF (and other substitute products) where their market share is expected to double up to 30% of the total moulding market. In all cases, however, volumes will be higher in all product categories but the battle for market share will see MDF as the big winner.

- The U.S. moulding market has enjoyed more than a decade of steady (and sometimes spectacular) growth, with each year exceeding the previous year’s record high. Riding on the coat tails of a strong economy in 2004, U.S. moulding consumption is projected to reach a new high in 2005. This mark should be surpassed in every year to 2008 as steady increases in U.S. consumption are forecast (but tied to forecast economic drivers).

- U.S. production of mouldings (finger-joint and solid combined) has been flat since 1999. Diminishing supplies of domestic clearwood pines has forced them to increase their dependency on offshore supplies (now accounting for approximately 60% of their raw material requirements). At the same time they are being challenged by increasing supplies of imported pine and MDF mouldings where the bulk of increased volumes is coming from the countries already supplying their domestic producers with their raw material – Chile and Brazil most notably.

- Continued volume growth in the U.S. paint-grade moulding sector is led by finger-joint mouldings. However, the fastest rate of growth has been (and will continue to be) MDF mouldings. Taking advantage of its stable pricing and smooth finishing properties, MDF has progressively taken a greater share of the paint grade market forcing some timber and processing operations to reconsider their focus on wood moulding exports to the U.S. market.

- Throughout the five-year forecast period, North American production is expected to remain the largest source of MDF mouldings. However, despite increasing output in

North America, its share of the U.S. MDF moulding market is expected to erode sharply as greater volumes of imported MDF mouldings soar.

- In addition to clear pine-producing countries exporting product to the U.S., shipments of softwood mouldings from China have increased dramatically. U.S. import data shows that between 2000 and 2003, China's softwood moulding imports increased over eight-fold (1.27 million lineal meters to 12.3 million lineal meters) making it the eighth largest moulding importer in 2003. Following the example set by China's wooden furniture sector, a growing number of fledgling businesses are diversifying into moulding and millwork products. By taking advantage of their comparatively low manufacturing costs, Chinese producers are importing raw material from Russia, New Zealand and Chile, and then exporting finished product to the U.S. and elsewhere. At present the volumes are considered minor, but our forecast model assumes that this trend will begin to have a more measurable affect in the later years of the five-year outlook.

- As much as the industry is reported to have greater discipline through the consolidation of players, we expect that once the market turns downward sometime in the second half of 2005 or in early 2006 from the current record high moulding prices, the momentum will steam-roll prices towards the cost levels of the highest cost producers. This will create another shake-out in the industry to eliminate some of the excess industry capacity that has been building since 2001.

4. Pine Door & Window Trends:

- Brazil, South Africa and Chile collectively increased capacity and exports of solid stile and rail pine doors to the U.S. by a whopping 50% between 2002 and 2004. The only other region that appears poised for significant volumes of pine door exports to the U.S. is China (the 12th largest supplier in 2003), which is also considered to be the lowest cost supplier of pine stile and rail doors to the U.S.

- Our overall view of imported plantation pine's product potential in the U.S. residential window industry is favorable, but it will still require perseverance and patience by exporters since volumes are currently low. As producers of radiata lumber and cut stock work to build their market share, it is expected that radiata and other plantation pine species will likely continue to sell at significant discounts to ponderosa shop lumber and cut stock in the window sector.

5. U.S. Distribution Trends:

- New trucking regulations, fuel costs, ocean shipping rates and the availability of ships are all major trends impacting the balance between supply, demand and prices. Caught in the middle is distribution, as this segment is becoming more critical to meet the needs of JIT deliveries as well as to prevent stock-outs. Shippers and distributors will need to adjust their business models to accommodate these new and emerging constraints/opportunities.

- This third edition of our report features original research on the distribution strategies of various offshore and domestic producers of mouldings and millwork products. A detailed survey of many of the largest companies was conducted that addressed U.S. regional consumption trends by product, distribution channel trends by moulding producer, and expected strategic initiatives and plans by the major channel players.