

Logging

Industry Snapshot

January 2011

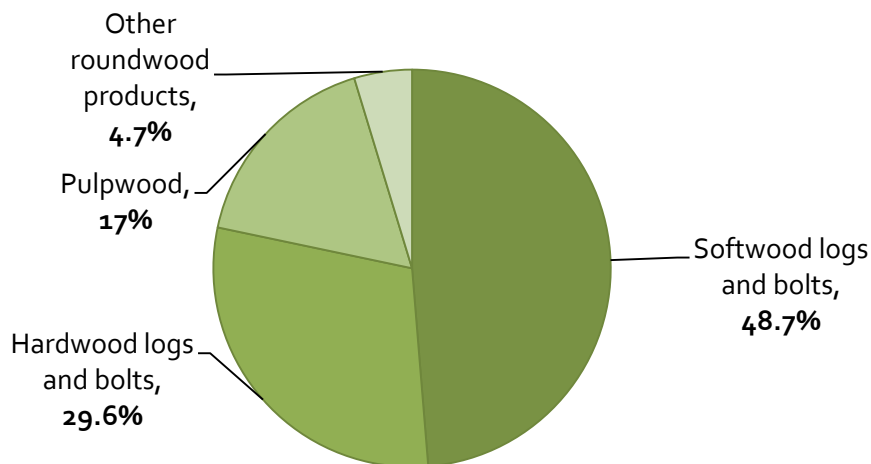
US Industry Overview

The logging industry consists of tree harvesting that provides logs for sawmills and wood chips for pulp mills. Since 2005, it has been hard hit by a number of factors, namely a decrease in residential construction, which a large portion of the timber goes towards. The reduced downstream demand from residential construction has caused the industry to experience negative average annual growth of -4.7% from 2005 to 2010. Declining log and pulp prices coupled with increasing fuel and transportation costs, have also caused profit margins to drop from 5.5% in 2006 to 4.5% in 2010. The weakening economy and financial hurdles have caused 4.1% of logging companies to exit the industry, leaving 8,351 companies in 2010.¹

Some important 2010 national statistics concerning the US logging industry are listed below:²

- **Revenue:** \$9.8 billion
- **Average Annual Growth ('10 to '15):** 3.0%
- **Profit:** \$440.4 million
- **Exports:** \$1.8 billion
- **Businesses:** 8,351

Additionally, the chart below shows the major product segmentation for this industry. Almost fifty percent (48.7%) of the products produced fall into the softwood logs and bolts category.³



¹ IBISWorld Pty Ltd., "Logging in the US." New York: IBISWorld. December 2010. <http://www.ibisworld.com>.

² Ibid.

³ Ibid.

Trends

Although the logging industry has seen hard times in the last five years, the coming five years (through 2015) are expected to be a slightly different story. With a strengthening economy and a drop in unemployment, along with steady interest rates, residential investment is expected to increase. It takes an average of 14,000 feet of lumber to build a house, so it is clear to see why residential construction drives much of the demand of the logging industry. Although residential construction will not immediately return to pre-recession levels (mainly due to stricter lending practices), it is expected to grow at an average annual rate of 3.0% through 2015.⁴

The growing demand for timber products will lead to higher profit margins for loggers, with an expected profit margin of 5.3% by 2015 (opposed to 4.5% in 2010).⁵ This is affected by the forecasted increase in timber prices, partly because the mountain pine beetle outbreak in British Columbia has reduced supply from our neighbors to the north. However, the higher prices will be somewhat offset by rising fuel prices, which will in turn increase transportation costs in this highly fuel reliant industry.

Lastly, a weakening US dollar will continue to make US goods more affordable to other countries. This will drive exports of US timber products to countries that find it less expensive or necessary to import timber from outside their own borders. With the recent outbreak of mountain pine beetles in Canada, a higher demand is expected for US timber products in the north.

Success Factors

Industry sources have identified the following as critical to the success of the timber industry:⁶

- **Downstream ownership links:** *Integration into other timber-based operations will strengthen the viability of a logging operation.*
- **Must hold quota:** *Loggers must comply with appropriate quotas and adequate timber allowances in order to ensure their licenses are renewed.*
- **Having a good reputation:** *Since communities often oppose logging operations, maintaining a good public image will allow loggers to continue and expand their operations.*
- **Appropriate physical growing conditions:** *Since some loggers own or manage forests, they need to select the right biophysical conditions for the species chosen for growing and harvesting.*
- **Understanding government policies and their implications:** *Since this varies by state and even by county, management of a logging operation must be aware of these issues.*
- **Automation:** *reduces costs, particularly those associated with labor: The degree of mechanization used in the logging process can be important to reduce labor costs.*
- **Ability to accommodate environmental requirements:** *Meeting environmental requirements is becoming increasingly important as native forests become progressively depleted.*
- **Appropriate climatic conditions:** *Weather conditions may constrain the amount of time for which logging is possible.*

⁴ IBISWorld Pty Ltd., "Logging in the US." New York: IBISWorld. December 2010. <http://www.ibisworld.com>.

⁵ Ibid.

⁶ Ibid.

Risks and Challenges

Although Canada's timber industry has recently been crippled by mountain pine beetle infestations, it still provides much competition to US logging. The US imports about one-third of its timber consumption from Canada, while Canada exports about two-thirds of its timber.⁷ The lack of domestic timber in the US and the excess in Canada gives Canada the ability to price their timber products very competitively. This has been somewhat managed by a trade agreement between the two countries regarding lumber exports.

Since 2006 there has been a lumber quota between the two countries called the softwood lumber agreement (SLA) that expires in 2013, with an option to extend until 2015.⁸ The agreement outlines a pricing structure that defines when a quota and a tax will be applied to Canadian lumber entering the US. Details of this agreement are provided by the Government of British Columbia at:

<http://www.for.gov.bc.ca/het/softwood/Negotiated.htm>

Lastly, as previously mentioned the logging industry is highly dependent on residential construction and investment. This means that demand for timber can easily fluctuate with the changes in residential building, which is strongly tied to the state of the economy and interest rates.⁹

Logging in Washington State

Washington State has about 21-million forested acres, of which 18-million are classified as "timberland." Of that 18-million, 2-million acres are reserved for parks and habitats, leaving around 16-million acres of "unreserved" timberlands that hold potential to be managed as working forests. Of those 16-million acres, 9-million are private, 5-million are federal, and 2.5-million are state or locality managed.¹⁰ It is important to note that not all of the 16-million acres can be harvested for trees; there are federal and state laws and policies that protect lands from being logged. A breakdown of the timberlands is illustrated on the graphs on the next page:¹¹

Please note that Western and Eastern regions are determined by the county lines along the crest of the Cascade Mountains. Also, the numbers displayed are in millions of acres.

⁷ Hajdu, Csaba. "The US-Canada Softwood Lumber Dispute." Fraser America. Web. (Accessed January 3, 2011). http://fraseramerica.org/Commerce.web/product_files/US-CanadaSoftwoodLumberDispute_US.pdf.

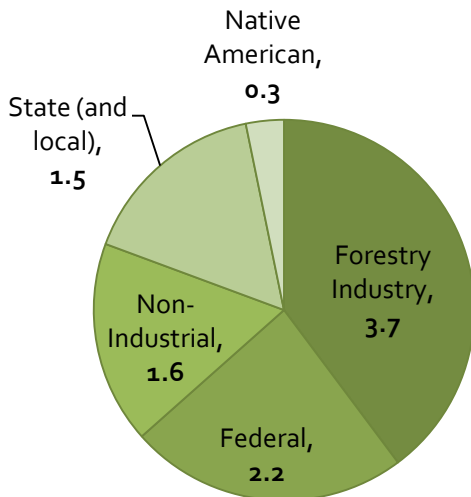
⁸ "Softwood Lumber." Government of British Columbia, October 26, 2006. Web. (Accessed January 3, 2011). <http://www.for.gov.bc.ca/het/softwood/Negotiated.htm>.

⁹ First Research, "Industry Profile; Timber Operations." New York: IBISWorld. December 13, 2010. <http://access.firstresearch.com>.

¹⁰ "Washington's Forests, Timber Supply, and Forest-Related Industries." Washington State Department of Natural Resources. Web. (Accessed January 6, 2011). http://www.dnr.wa.gov/Publications/em_fwfeconomiclow1.pdf.

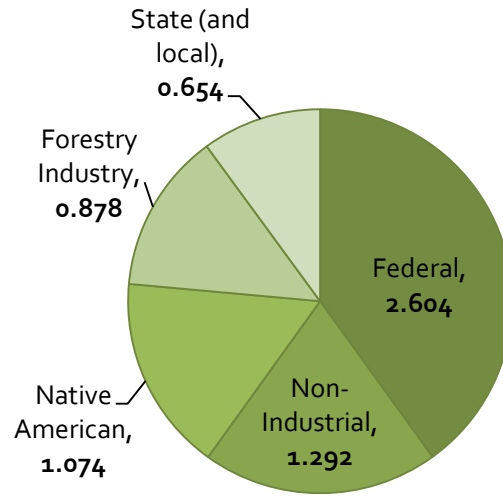
¹¹ Ibid.

Western Washington



9.5 million acres total

Eastern Washington



6.5 million acres total

Washington State faces the same challenges as the industry as a whole, namely a lack of new residential construction. The Washington State Department of Natural Resources (DNR) predicts that in the coming two years it is unlikely that construction will rebound partly because two million houses currently oversupply the market. Additionally, housing prices are once again beginning to fall after a period of modest growth, discouraging residential investment.¹²

On the other hand, timber prices in the state have grown at higher rates than expected. For example, actual DNR timber sales during September and October of 2010 averaged \$319 per million board feet (mbf), almost \$70 (or 22%) higher than what was forecasted for September.¹³ This increase in price is in turn putting upward pressure on log prices, which are also expected to rise, although not as much as timber.

To gain some perspective on the current trend of timber output in Washington State, the table on the next page displays the logging harvests for the past five years:¹⁴

¹² "Economic and Revenue Forecast." Washington State Department of Natural Resources, November 2010. Web. (Accessed January 6, 2011). http://www.dnr.wa.gov/Publications/em_forecast_second_quarter.pdf.

¹³ Ibid.

¹⁴ "Washington Timber Harvest Report." Washington State Department of Natural Resources, 2009. Web. (Accessed January 4, 2011). http://www.dnr.wa.gov/Publications/fp_hcp_annrep09_ch16.pdf.

Annual Timber Harvest (mbf ¹)

	2005	2006	2007	2008	2009
Private Lands ²	3,024,000	2,946,000	2,685,000	2,067,485	1,423,091
DNR ³	594,000	404,000	448,000	515,107	641,449
Federal Lands	81,000	75,000	95,000	104,373	100,876
Other State ⁴	32,000	59,000	36,000	71,123	51,895
Western Region ⁵	2,959,000	2,720,000	2,613,000	2,328,188	1,914,264
Eastern Region	772,000	764,000	651,000	429,900	303,047
Total Volume	3,731,000	3,484,000	3,264,000	2,758,088	2,217,311

¹ Million board feet on the Scribner log scale

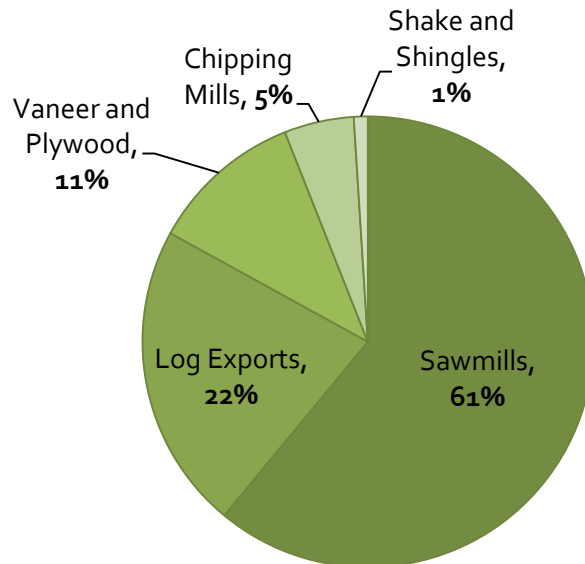
² Private includes large forest landowners, small forest landowners, industrial timber, owners, and Native American.

³ Harvests from lands managed by the Washington State Department of Natural Resources (DNR).

⁴ Includes public lands owned by cities, counties, public utilities, and state agencies other than Department of Natural Resources.

⁵ Boundary between the two regions is the county lines along the crest of the Cascade Mountains.

Additionally, the graph below shows the uses of industrial roundwood in Washington State:¹⁵



Financial Information

The following financial benchmark information is for logging and forestry companies in the US. The data is based on the financial statements of 114 companies, 29 of which are small businesses. A small business is defined as having annual sales below \$1,658,372.¹⁶

¹⁵ "Washington's Forests, Timber Supply, and Forest-Related Industries." Washington State Department of Natural Resources. Web. (Accessed January 6, 2011). http://www.dnr.wa.gov/Publications/em_fwfeconomiclow1.pdf.

Income Statement		
	<i>Aggregate</i>	<i>Small Company</i>
Net Sales	100.0%	100.0%
Gross Profit	58.4%	58.4%
Operating Income	3.5%	3.6%
Net Profit After Tax	1.1%	2.1%

Balance Sheet		
	<i>Aggregate</i>	<i>Small Company</i>
Cash	5.7%	4.9%
Accounts Receivable	4.4%	0.0%
Inventory	0.0%	0.0%
Total Current Assets	12.0%	6.2%
Total Fixed Assets	50.6%	38.4%
Other Non-Current Assets	37.3%	55.4%
Total Assets	100.0%	100.0%
Accounts Payable	1.7%	0.0%
Total Current Liabilities	31.2%	1794.3%
Total Long-Term Liabilities	12.7%	10.8%
Net Worth	56.0%	-1705.0%

Financial Ratios		
	<i>Aggregate</i>	<i>Small Company</i>
Quick Ratio	50.0%	70.0%
Current Ratio	96.0%	146.0%
Current Liabilities to Net Worth	25.5%	27.5%
Current Liabilities to Inventory	325.0%	0.0%
Total Liabilities to Net Worth	61.0%	62.5%
Fixed Assets to Net Worth	60.0%	66.5%
Collection Period	1070.0%	10.0%
Inventory Turnover	NA	NA
Assets to Sales	46.0%	51.0%
Sales to Working Capital	0.0%	230.0%
Accounts Payable to Sales	1.0%	0.0%
Return on Sales	2.0%	3.0%
Return on Assets	4.0%	5.5%
Return on Investment	20.0%	16.0%
Interest Coverage	230.0%	160.0%

¹⁶ First Research, "Industry Profile; Timber Operations." New York: IBISWorld. December 13, 2010. <http://access.firstresearch.com>.