

The Forestry Source

Interview with Brooks Mendell published in June 2020

Coronavirus Questions and Concerns from Forest Owners and Timberland Investors

Editor's note: For a look at how the forest products industry is faring thus far during the COVID-19 pandemic, I asked respected analysts for their view. In this article, you'll find answers to my questions from Brooks Mendell, president and CEO of Forisk Consulting (www.forisk.com). Mendell has over 25 years of experience in the forest products and timber industries. Forisk specializes in analysing forest supplies, wood demand, and timber pricing to develop forecasts and strategic guidance for clients.

Brooks, what are forest owners and timberland investors worried about?

Mendell: We entered 2020 expecting to navigate the tradeoffs of a slowing global economy, disruptive trade policies and a surging U.S. housing market. However, as we spoke with industry contacts, the tone started to shift. With market volatility and coronavirus uncertainties, firms started taking a hard look at expectations for the year.

Clients talked about the struggle of managing short term cash flows versus long-term capital investments. Company owners and general managers are worried both about payroll and projects that are supposed to generate income in the future. Fortunately for some, timber sales and wood flows continue. One operating executive noted that, "with oil prices falling, it's cheaper to haul logs so it provides a kind of cushion for the supply chain."

However, the impacts on capital investments, for 2020 at least, are real and significant. To quote one timber industry executive, "Investing is on hold. Just look at our stock price." Forest industry firms in the U.S. and Canada reduced capital investments and curtailed dozens of facilities. In fact, by mid-April, public firms alone including West Fraser, Canfor, Interfor, Louisiana-Pacific, Weyerhaeuser, Boise Cascade and Norbord reduced planned 2020-2021 cap ex by \$470 million (so far).

Are some sectors of the forest-products industry affected more than others?

Mendell: Yes. We can see this in how capacity reductions started reshaping North America's productive profile. While reductions occurred across North American regions and forest industry sectors, analysis by firm and by mill highlight a continued shift in the balance of where we produce wood products from Western Canada and neighboring regions to the U.S. South. In fact, the capacity reductions across sectors also speak to the relative strength of the pulp and paper sector during this pandemic (Figure). Of all the sectors, it reduced production the least.

North American Forest Industry Capacity Reductions, YTD 2020 thru April

Sector	Capacity Reduction	Unit	Sectoral Reduction (%)
Softwood Lumber	13,355	MMBF	18.7%
Plywood/Veneer	2,304	MMSF	15.2%
OSB/Panel	3,661	MMSF	14.9%
Pulp & Paper	4,715	M Tons	5.3%

Sources: Q2 2020 Forisk Research Quarterly (FRQ); North American Forest Industry Capacity Database

And what do you hear from timberland investors and forest owners?

Mendell: For current forest owners in the current crazy environment, the risk profile of timberland looks strategic in its ability to preserve value, diversify portfolios and generate cash. Based on the fundamentals, it's hard to make timberland look bad in a volatile world. While short term cash flows and returns are and will be down in 2020, other questions become central to tracking and testing the timberland thesis through this recession. For example, when does housing return and how robustly?

As forest analysts, our team at Forisk can see how the underlying demographics, the older housing profile and latent demand for new homes offer a story for a profound bounce when coming out of this. Home construction, which accelerated in late 2019, is positioned to help drive economic recovery as housing is severely under built in the U.S. The housing stock in the United States is as old and in as need of repair as its ever been. And household growth in 2018 reached its highest-level since 2006. Yet, new construction continues to lag underlying demand.

What does your team see for housing in 2020?

Mendell: For 2020, Forisk projects a 14% decline in housing starts relative to 2019 actuals. We still believe underlying demand—based on demographics and household growth, second home ownership, and net replacements of existing housing stock—will carry our “Base Case” housing to a long-term trend of ~1.50 million starts over the next ten years.

So, with housing looking stable over the next decade, are timberland investors content?

Mendell: Let's put it this way. The S&P 500 dropped 20% during the first quarter of 2020. Pension funds and institutional investors saw their stock portfolios crater during this time, while their timberlands and other hard assets held firm. Timberland investments benefit from the fact that they comprise a diversified bundle of businesses. A given forest can serve multiple, often countercyclical, markets including hardwood and softwood, grade and pulpwood, along with non-timber markets such as recreation, minerals and cell towers.

Though questions remain, the underlying thesis for timberland holds as well as ever for long-term investors: stability, diversification, and security.