

Diving In With Both Feet

The last five editions of *View From The Stump* were an experiment to test the receptiveness



to such a newsletter and I am pleased to say feedback has been very positive.

It is my plan to continuously evolve this newsletter into a product that fulfills your needs. Please join me in looking forward to

changes in this newsletter's appearance and data presentations in upcoming editions.

A new feature included in this edition, is the addition of a guest contributor, which will rotate in future editions as stories arise. Also, after having many of you say there is value in this newsletter, I will be transitioning the newsletter to a paid subscription with a

committed publishing schedule and advertising. I am excited to jump into this with both feet – thank you again for your support!

In this issue, long-time friend, Russ Taylor, of his newly formed firm, *Russ Taylor Global – Wood Business and Market Consulting*, adds his poignant commentary on stumpage – raise your hand if you are feeling the pain of the 2018 and 2019 rollercoaster all over again!

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To start, the following story points out what is likely obvious about this year's wildfire season – the new definitive trend in wildfire activity in British Columbia.

BC Wildfires – Definitely A New Trend

The last few years of wildfires in British Columbia are more than just grey skies, a red sun and scratchy eyes for lower mainlanders, wildfires are a concern for all, particularly those who rely on BC's interior forest.

In 2017, wildfire burnt a record 1.2 million hectares, which stunned everyone, including a fledgling NDP government. While unique in occurrence (at that time), having not experienced that shear amount of area of fire in one season, the Province responded with the [BC Flood and Wildfire Review](#) to review the 2017 wildfire season.

Little did anyone know then, that 2018's wildfire season would surpass 2017's.



With 2.6 million hectares burnt in these two years, was this a new trend in wildfire activity?

Total area burnt in 2017 as a datapoint certainly did not make a trend, instead it would have been seen as an outlier, given the wildfire activity of the preceding 26 years. Then there was 2018, which made two consecutive datapoints of a million plus hectares burnt each year. BUT, two years still does not make a trend.

The following two years, 2019 and 2020, were essentially no shows in terms of wildfire activity – maybe don't worry...

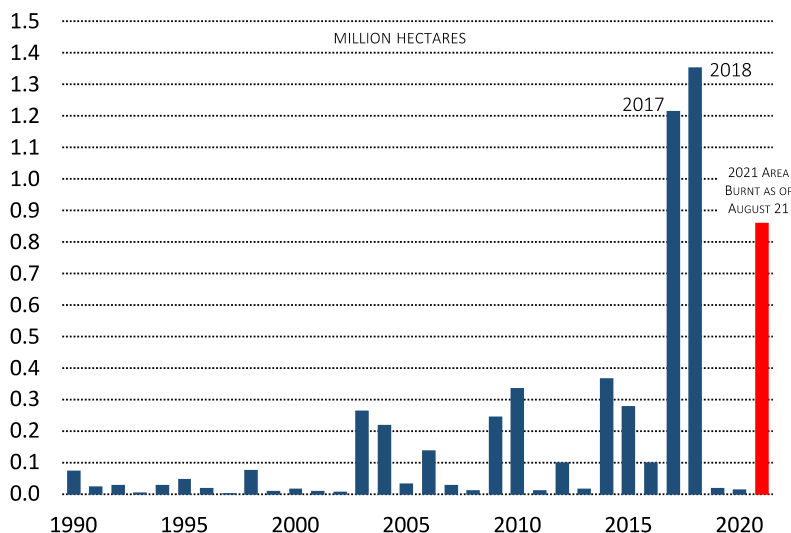
Then came 2021, with 862,992 hectares estimated as burnt so far - the third greatest amount of area burnt, at least in the last 30 years. The last five years of area burnt has exceeded the prior 25 years by 37% with almost 3.5 million hectares (or 694,000 hectares on average per year over the last five years) of forest and grass lands burnt – an area greater than the size of Vancouver Island. Between 1990 to 2016, on average 94,000 hectares were burnt per year.

Astoundingly, these three standout years had a total area burnt that was approximately 1% of the entire province for each year – three occurrences so close together, now that makes for a *bonafide* trend.

With this new trend established, the Province should be modeling impacts to timber supply and communities on a regional basis (and making the results publicly available), reviewing how wildfires are budgeted for, reviewing how wildfires are fought, reviewing how they are dealt with afterwards, and to seek a massive boost in investments for mitigative treatments and infrastructure.

With regards to the supply chain, wildfires are often cited as catalysts for higher lumber prices; however, this is not the case (i.e., SPF prices collapsed this summer). The potential

BC WILDFIRES - AREA BURNT



SOURCE: BC WILDFIRE SERVICE, NATIONAL FORESTRY DATABASE, SPAR TREE GROUP

for wildfires to impact sawmills is anticipated every year and as such are usually prepared with built-up log yard inventories.

Unfortunately, in areas with repetitive intense wildfire activity, sawmills (along with other forest product producers) will have their long-term timber supply reduced and may become the ones with some of the highest probabilities of closure in the province.

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Provincial Stumpage Rates In Canada: A Perplexing Puzzle

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As a forest industry analyst for over 30 years that has worked within the global industry for over 45 years, it is evident that some elements of public forest management can be quite different to how private forests operate. When it comes to trying to analyze how public timber stumpage prices (or returns to the standing trees for the forest owner) are set by some provinces in Canada for companies holding forest licences, this can be a real puzzle. Three provinces, **British Columbia, Alberta and New Brunswick**, have different methodologies of calculating and setting stumpage rates for provincial sawlogs that can disproportionately impact sawmill operators, as summarized below.



New Brunswick has held its rates at the same level as was set six years ago. Despite skyrocketing lumber prices in the first half of 2018 and then the super-cycle price rally from the pandemic starting in 2020-Q3, New Brunswick has held rates steady for sawlogs and stud logs at about C\$27/m³. While a flat stumpage price may work in normal market conditions, recent lumber price volatility suggest that, in hindsight, this may not be an equitable approach. Consequently, the provincial government may have foregone millions of dollars in public timber revenues in the last four quarters.

Alberta has taken the other extreme where timber stumpage prices are tied in a formula to

monthly lumber prices for the previous four weeks. This means that during the recent lumber price surge, sawmills in Alberta paid huge stumpage rates – as high as C\$166/m³ in June 2021 just after lumber prices peaked. Alberta's system also includes a lower rate (by about 50%) for smaller timber sales that are below 107,296 m³. In contrast to New Brunswick, Alberta appears to have captured its fair share on the value of its crown timber.

In the middle is **British Columbia** with a third approach on stumpage, and one that has turned out to be messy at times for forest operators when lumber prices are volatile. Like Alberta, stumpage rates in the BC Interior are tied to the lumber prices as well as several other variables (including competitive log sale prices from BC Timber Sales), but the stumpage formula features what is a problematic three-plus month lag to lumber prices. This means that when lumber prices are rising, stumpage lags and companies can benefit with reduced delivered log costs (along with favourable lumber prices). But when lumber prices quickly move lower for longer periods, stumpage rates can keep going up for three to even six months due to the lag effect built into the formula. This was the case in the second half of 2019, where dozens of BC Interior sawmills had to curtail as lumber prices slumped, but stumpage prices kept going higher.

This is now a similar situation now facing the BC Interior industry in the third quarter of 2021, as stumpage rates are reported to be increasing by about C\$30/m³ starting on July 1 for timber, just as lumber prices had crashed by a whopping 75% from all-time highs. These increases will start to hit sawmills as they bring new logs to their mills. And stumpage rates are

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forecast to move even higher in October – by another C\$10/m³. Then in December, the US import duty is expected to double from 9% to 18%.

Sawmill curtailments are all but inevitable in the BC Interior (and some are now occurring). The estimated EBITDA breakeven lumber price resulting from rising stumpage prices for many sawmills is moving well above US\$550/Mbf (on a 2x4 #2&Better price basis) in 2021-Q3 where SPF 2x4 #2&Better lumber prices have recently (late August) moved below US\$400/Mbf. In 2021-Q4, the breakeven EBITDA price (on a 2x4 #2&Better price basis) for BC mills could be over US\$600/Mbf as higher stumpage rates and the US import duties kick in.

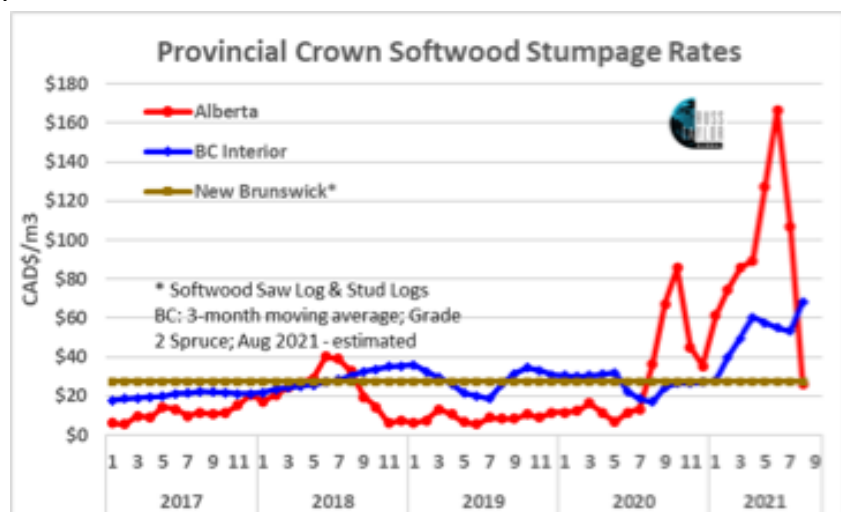
Meanwhile, Alberta mills seem to be doing fine and unlikely to curtail due to the flexibility and responsiveness of log prices to lumber prices within its stumpage system. And New Brunswick mills can simply carry on as they have.

What happens in BC during the rest of Q3 and the next quarter remains to be seen: will sawmill keep operating with huge cash losses (using up the windfall gains from the first half of 2021), or will they curtail for periods of time? Higher lumber prices would be one part of a solution, which will definitely occur, but will they be high enough? Market forces cannot guarantee breakeven lumber prices at all.

Nevertheless, BC's stumpage dilemma continues to be somewhat of a complicated mess with no easy fix. BC politicians and bureaucrats administer or tinker with the formula as they can – one that was developed to appease the Americans - with the adage that

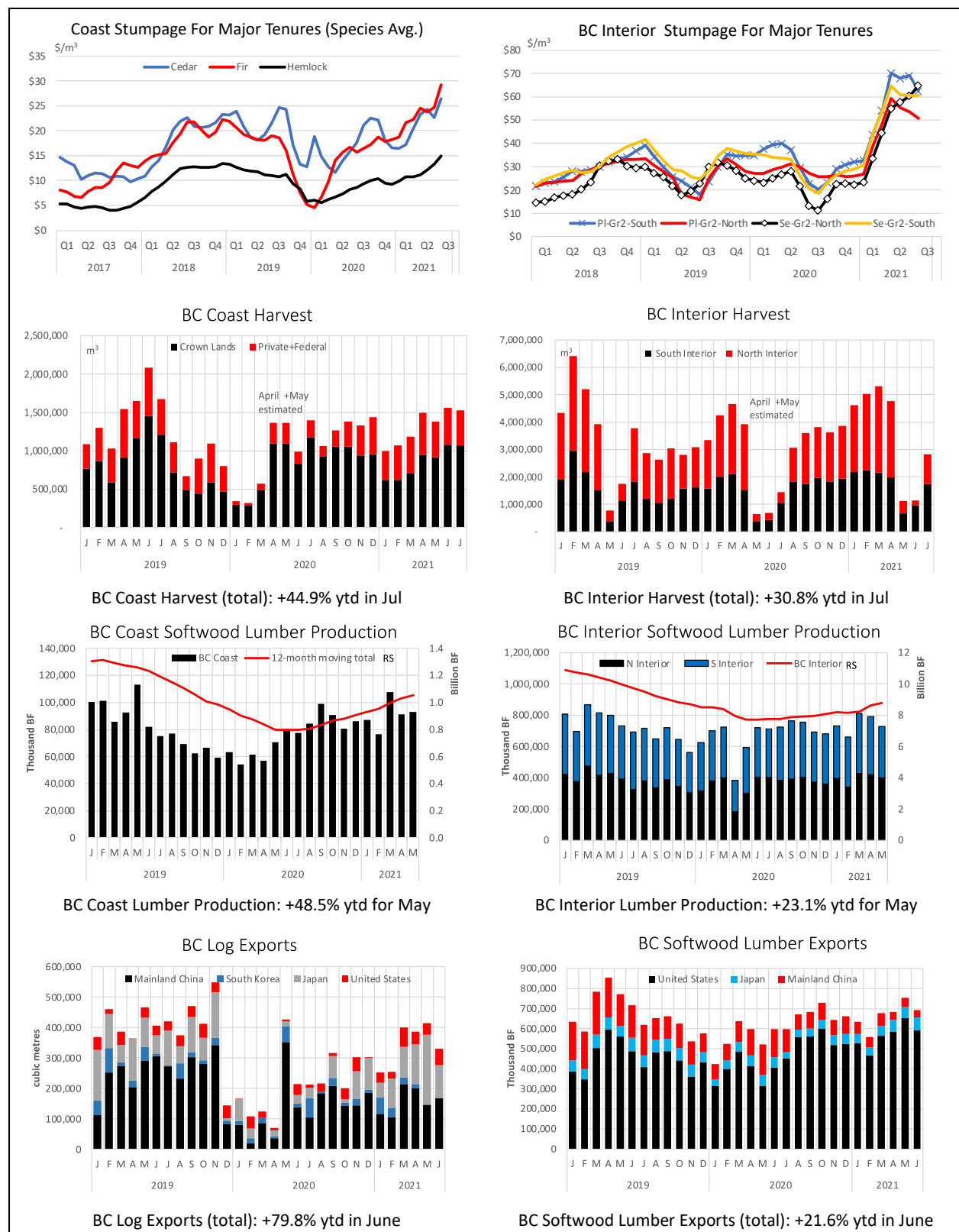
“things will eventually average out.” However, if BC mills do curtail, sawmill workers, contractors, suppliers and those in smaller communities all take a direct hit, so things do not ever “average out” for everyone.

The outcome of public forest management and policy changes in BC, coupled with the devastating mountain pine beetle epidemic, is that BC operators have found other operating areas outside of the province where they can grow their business in transparent or more stable price environments – typically where sawlogs are priced to more current market or anticipated conditions with little to no lag.



Pricing timber on public forests does not have to be complicated for forest operators and sawmills, as Alberta and New Brunswick demonstrate. Why these three provincial stumpage systems are so widely different – and why BC's timber formula lags the reality of lumber market prices – is a real puzzle. How then are the Americans supposed to assess these different provincial stumpage formulas as all being equitable, especially when the negotiations on the next US-Canada softwood lumber agreement take place?

BC Forest Industry Metrics



The Radar Screen....a summary of announcements including new government policies that you must have on your radar screen as they will affect the BC forest sector supply chain:

Modernizing BC's Forest Sector – recent announcement outlining the Province's intentions for future forest policy change.

Contractor Sustainability Review – on June 10, 2021 changes were finally announced to the Timber Harvesting Contract & Subcontract Regulation (aka Bill 13).

Old Growth Strategic Review – the report is now public! Upon release of the report, the BC Government moved immediately to defer harvesting of nine areas around the province. The number of **deferrals** are increasing with total area of old growth forests at 196,000 ha.

Softwood Lumber Dispute – on May 21, 2021 the U.S. Department of Commerce released its preliminary determination for the Second Administrative Review (AR2) in antidumping duty (AD) and countervailing duty (CVD) investigations of imports of certain softwood lumber products from Canada. The preliminary combined rates vary for selected companies, with non-selected companies facing an AD+CVD rate of 18.32% effective November 24, 2021, when the final determination will be made for AR2, which was for the period of January 1, 2019 to December 31, 2019 (when lumber prices were substantially lower). This preliminary rate is double the current rate.

Support for Coastal and Interior Forest Workers – Programs are now in place to support contractors, workers and communities impacted by indefinite

and permanent mill closures in B.C.'s Interior and Coastal region.

Coast Logging Equipment Support Trust – offers bridge financing from a \$5 million fund for coastal contractors – the majority of funds remain unused.

BC Carbon Tax – carbon tax increased effective April 1, 2021 rates of 9.969 ¢/litre for gasoline and 11.71 ¢/litre for diesel.

BC Increased Employment Incentive – as part of the BC Economic Recovery Plan, a tax credit for businesses hiring new employees in 2020. Deadline for applying December 31, 2021

BC PST Rebate on Select Machinery and Equipment – as part of the recently announced BC Economic Recovery Plan, a 100% PST rebate on equipment purchases – ends September 30, 2021.

Russia To Ban Coniferous Log Exports – Putin requested a complete ban effective January 1, 2022. As well, he has ordered a subsidization program for wood processing facilities effective January 1, 2021. *CAUTION - unverified Russian tariff increases on log exports back in 2008 triggered China to look to BC for logs and lumber.*

FEDERAL ELECTION – September 20, 2021

Platforms:

Liberals

NDP

Conservative Party

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