



Coast Forest Products Association Submission Budget 2009/10

**Presented to:
Select Standing Committee on
Finance and Government Services
Surrey, B.C.
October 15, 2008**



Lumber Market Conditions

- **U.S. Structural :**
 - housing starts at 17-year low;
 - sub-prime mortgage crisis explodes into global financial meltdown;
 - new and resale house inventories double normal levels – will stall US recovery;
 - consumer confidence low, unemployment rate rising;
 - US recessionary economy will have global impact especially China and Japan;
 - August lumber price recovery eroded - rebound in volumes and price not forecast until 2010.
- **U.S. Appearance:**
 - cedar market stalled because of the prolonged poor U.S. economic performance and curtailments due to log prices/supply;
 - industrial whitewoods in decline.
- **Europe/Australasia:**
 - Europe in recession demand flat or declining.
- **Japan :**
 - wooden housing starts declined 7.5% y/y (2006);
 - lumber inventories in Japan at historic lows;
 - hemlock shipments increasing but still below historic levels;
 - price for baby squares holding at mid \$700 range.
- **China/Korea:**
 - rising ocean freight rates impacting sales to China;
 - total shipments have increased, buying higher grade products – CLS shipments shift from US to China;
 - demand in Korea weakened substantially.

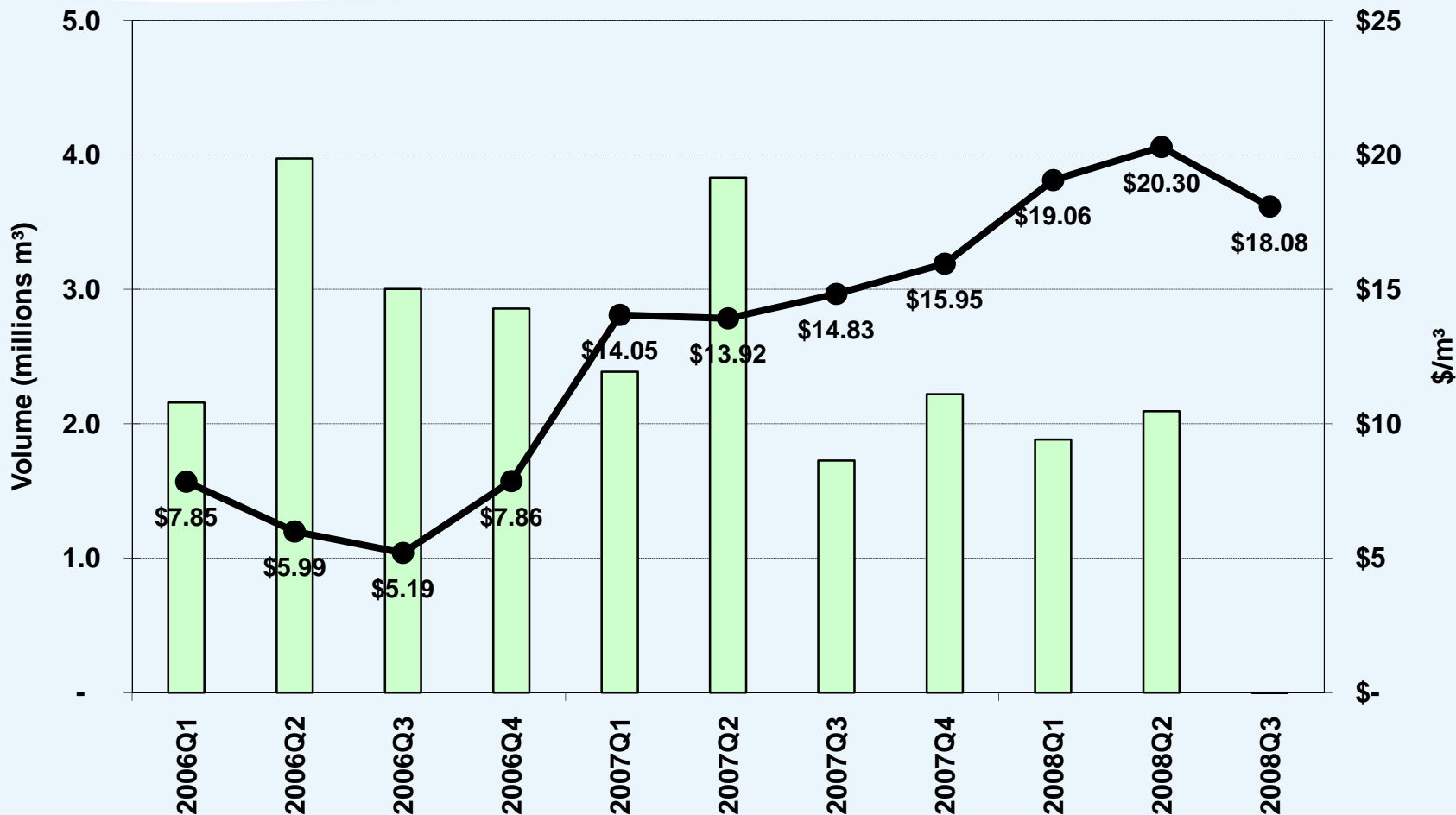


Financial Conditions

- **ROCE negative for coastal lumber producers in 2007 notwithstanding duty refunds – 2008 will be worse.**
- **Negative earnings/returns across the business:**
 - primary sawmills, P&P and reman. sectors;
 - Q2 results illustrate trend continuing for 2008; 2009 projected to be worse;
- **Financial Crisis has made Credit Difficult to Access**
- **Return to log** providing no return for manufacturers, especially for small log sorts.
- **Harvest Trend:**
 - January to Aug. 2008 33% drop in Crown harvest at 7.15 million m³ vs. 9.49 million m³ 2007 (strike year)
 - private land harvest for same period down 70% at 2.91 million m³ vs. 4.96 million m² 2007
 - BCTS billed volume down 60% y/y (1.02 million m³ vs. 1.65 million m³)
 - BCTS waste increased from 10 to 20% while licensee waste remained steady at 11%.
- **Lumber production:**
 - 2008 coast lumber production projected to be under 1.5 Bfbm vs. historic shipments of 2.2 – 2.5 Bfbm.
 - Y/Y drop in lumber production 22.1%; 24.3% drop in shipments to US Y/Y
- **Companies in survival mode:**
 - curtailing production thru reduced shifts, indefinite closure and permanent closures to reduce total \$ losses;
 - reducing cash costs to reduce\$/Mfbm or \$/tonne losses;
 - operations that are running are running to produce cash flow and/or maintain markets/customers.



Coastal Crown Stumpage



MPS is capturing too much of the value at certain cycles – need to get the formulas and mechanics right
2008 YTD Stumpage \$152 million vs. \$155 YTD 2007 despite 33% drop in volume



Future of the Coast Industry

- **Huge stock of Cedar**
 - Long-term continued business in this unique product / market
 - Over time less clear, more TK
- **OG Hem-fir continue to dominate inventory**
 - Hemlock was the foundation of the Coast business
 - Critical mass in Japan is an issue
 - Industrials likely to remain in niche markets
- **“Over abundant” stock of magnificent second growth**
 - Fir, Hemlock & Cedar
 - Opportunity for small log mill(s)
 - Opportunity for engineered products
 - Opportunity for export (Russia export tax)
- **Bottom line**
 - We are drowning in a sea of trees
 - Our success (or lack of) is rooted in competitiveness



Future of the Coast Industry (cont'd)

➤ **Short term**

- US housing recovery 1.5 – 2 years away
- Global economic slowdown underway
- We can expect continued financial issues
 - Cash positions critical
 - Tight log supply
 - capital scarce
- Question is who will weather the storm and what can gov't do to assist

➤ **Med / Long Term**

- Right hosting conditions will attract capital
- Huge opportunities
- Diversification of products and markets
 - Old growth
 - Second growth
 - Variety of Species
- Move to pre-fabrication/pre-cutters

- Russian log tax
- Forest damage related to CC
- ↓illegal logging ↑sustainability
- ↑ forest conservation
- Permanent closure of capacity
- Emerging carbon credit markets
- Expansion of bio-energy
- Supply/demand imbalance in Asia
- ↑ demand for green construction
- Crop switching South America

- Appearance
- Shop & Industrials
- Structural
- Engineered
- Treated
- P & P



Recommendations

1. Taxation Measures

- Taxation measures which can assist the forest products and manufacturing sectors in addressing the competitiveness and market challenges facing the export sectors while assisting the government in meeting its economic and environmental objectives.
 - Immediately introduce legislation to specify maximum ratios between municipal property taxes on residential property compared to the various classes of business properties
 - Commit to a full scale review and overhaul of the property tax regime to be completed in 2010;
 - Introduce a “refundable plant modernization” tax credit (with carry forward provisions) to attract investment by manufacturers in productivity-enhancing equipment and technologies. Apply towards investments in Capital Cost Allowance asset class 43.
 - Continue to work with the federal government to enhance and expand application of Capital Cost Allowances to increase investments in capital and productivity.
- Reduce marginal effective tax rates to stimulate investment in new machinery, equipment and technologies required to increase manufacturing sector productivity by:
 - Lowering B.C.’s corporate income tax rates; and
 - Reducing sales taxes on business inputs, by expanding the list of exempted inputs or by harmonizing the GST and PST (export industries cannot pass sales taxes on to customers).
- Provision of direct Research and Development grants or refundable tax credits to fund business R&D and its commercialization with a focus on the fields of bio-energy, bio-fuels and greenhouse gas and energy reductions.



Recommendations

2. Carbon Tax

- The carbon tax will cost the forest sector \$35 million in 2008 increasing to \$100 million in 2012 and is not revenue neutral to the forest industry. We recommend that the Carbon Tax be frozen at the current rate until further analysis is undertaken to assess the economic impact on the forest sector and until effective carbon tax offsets can be developed. We recommend that government implement effective carbon tax offsets including:
 - Provide company specific refunds of the carbon tax for capital projects that reduce emissions, reduce energy consumption or improve productivity or accomplish this goal through refundable tax credits;
 - PST exemption on purchased hydro-electricity for industrial purposes;
 - Ensure PST and GST is not applied against the carbon tax;
 - Reduce BC Hydro water rental rates across industries.

3. Program Spending

- Continue funding Forest Innovations Investment (FII) for market access and market development activities.
- Government and industry develop plans and allocate funds to promote increased use of wood in both residential and non-residential construction.
- Government fund targeted research and development of the new generations of forest products and technologies in concert with industry and the strong cadre of research institutions in British Columbia (UBC, UNBC, FPInnovations, CFS, etc).



Recommendations

4. Economic Policy

- Development and implementation of a “productivity agenda”, including creation of a senior position in the Premier’s Office to inform future provincial budgets on measures to improve productivity and ensure sustainable economic performance for the British Columbia economy, and drive the productivity and economic agendas in concert with other government objectives.
- A review of the impacts of the implementation of the Energy Plan and BC Hydro’s Plan to assess the impact on British Columbia’s competitive position and to ensure they are aligned with the Climate Action Plan.
- The Province create a gatekeeper process and policy to track the cumulative impacts of land use decisions and provide advice to delegated decision makers to inform their land use allocation decisions.
- The continuation of the regulatory review process on an ongoing basis to identify and eliminate regulatory induced costs.
- Application of a regulatory impact statement to all new legislative, regulatory and policy initiatives.