

Monitor

Building Materials

VOLUME
377



AN UNCERTAIN MARKET

MIXED SIGNALS

Despite modest momentum in the spring, high mortgage rates negatively impacted the residential construction market in the first half of 2023

SLUGGISH DEMAND

The softwood market remains relatively saturated, as producers look to curtail production to combat cautious purchasing

MARKET SATURATION

Foreign and domestic demand for hardwoods has fallen, leading to slightly over-inventoried positions

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MONITOR BUILDING MATERIALS

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JULY 2023

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VOLUME

377

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Deals are a moving target with a constantly shifting mix of people, numbers and timing. We are here to simplify this process for you. Our associates are experts at analyzing situations and quantifying values you need on the most complex deals, so you can leverage our extensive industry knowledge to close the deal.

Trend Tracker - Inventory

	Lumber	Building Materials
NOLVs	Decreasing ▼	Mixed ◆
Sales Trends	Mixed ◆	Mixed ◆
Gross Margin	Mixed ◆	Mixed ◆
Inventory	Increasing ▲	Mixed ◆

	Market Prices	
	Three Months	Year
Softwood	Decreasing ▼	Decreasing ▼
Hardwood	Decreasing ▼	Decreasing ▼

NOLVS

- **Lumber:** A slowdown in the housing market and sluggish demand, combined with high labor costs and log prices, have led to declines in lumber prices and NOLVs.
- **Building materials:** A slow housing market has negatively impacted sales for building materials and has led to cautious buying, negatively impacting NOLVs. Conversely, lower weeks of supply and locked-in higher pricing to customers have positively impacted NOLVs in other cases.

SALES TRENDS

Sales trends were positive in early and mid-2022 amid buoyant demand and high material prices but have generally cooled more recently amid less favorable market conditions. In other cases, inflation and relatively high market prices have positively impacted sales dollars.

GROSS MARGIN

- **Lumber:** Gross margins declined at the mill level and were mixed at the distributor level. Mills were plagued by falling market prices and selling prices, combined with higher labor and material costs that could not be passed through to customers. Distributors benefitted in some cases, particularly in the multifamily sector, by selling prices being locked in when market prices were still buoyant.
- **Building materials:** Similar issues have plagued the building materials market, with higher-cost inventory being

sold in a declining price environment, though favorable locked-in pricing benefitted margins in other cases.

INVENTORY

- **Lumber:** Lower demand has led to a buildup of inventory, which has been exacerbated by higher log prices in Canada stemming from stumpage fee increases and fewer cutting permits being granted, resulting in more aggressive purchasing.
- **Building materials:** Lower market prices for lumber and plywood have kept the cost of inventory down, which has been offset in some cases by general inflationary pressures. Safety stock levels have also increased due to lingering supply chain uncertainty.

PRICING

- **Lumber:** A somewhat sluggish construction market has led to slower demand and more cautious purchasing, resulting in bearish pricing.
- **Building materials:** Lower levels of building activity have limited demand and purchases, driving prices down, but general inflationary pressures have kept prices buoyant in some cases.

Trend Tracker - M&E

	Woodworking/Sawmills/ Furniture
Used Pricing	Increasing ▲
Used Trade Movement	Consistent —
OEM Pricing	Consistent —
Technology Advancement	Consistent —
Auction Activity	Consistent —



- **Used Pricing:** Long OEM lead times have led to higher pricing for late model sawmill equipment and late model woodworking machinery, particularly CNC machines.
- **Used Trade Movement:** Used trade movement remains strong, which is consistent with trends from 2022. There has been limited availability of equipment on the market, and available goods have been sold through quickly.
- **OEM Pricing:** OEM pricing continues to stabilize, especially in the U.S. and Europe. However, Asian machinery continues to put pressure on OEM pricing, especially with regard to European manufacturers. Imports from China and Taiwan appear to be increasing, but it is expected that businesses will look to reduce reliance on foreign suppliers in the future.
- **Technology Advancement:** Consistent with recent trends, many companies continue to spend investment dollars to automate with upgraded CNC controls and software, as well as more affordable 3D prototyping, to maximize efficiency returns.



Overview

According to the U.S. Census Bureau, the seasonally adjusted annual rate for privately owned housing starts reached 1.63 million units in May 2023, 21.7% above the revised April estimate of 1.34 million units and 5.7% above the May 2022 rate of 1.54 million.

Single-family building permits in May 2023 reached 1.5 million, 5.2% above the revised April rate of 1.41 million but 12.7% below the May 2022 rate of 1.71 million.

May's rate reflected the third straight monthly increase in single-family building permits and solidified relatively positive homebuilding sentiment in recent months. However, single-family home completions fell to a 15-month low, signaling that headwinds for homebuilding persist. Builders have cited shortages of transformers and other building materials as factors. Recessionary concerns and elevated mortgage rates also continue to weigh on the housing market, despite the average rate of a 30-year fixed mortgage declining slightly from a peak of 7.08% in November 2022 to 6.35% in May. November's peak was the highest since 2002.

Softwood lumber prices have been essentially flat or deflated in 2023, despite slight gains in the first quarter of 2023. High interest rates and inflationary factors have had a cooling effect on the housing market, leading to less vigorous rates of new construction and remodeling. Additionally, the reluctance of distributors to stock up on inventory due to lumber futures

presenting less downside risk has exerted further downward pressure on pricing. Inventory levels at mills have remained high, resulting in mills curtailing production in an effort to keep prices steady.

The U.S. Department of Commerce made a preliminary determination in February 2022 to lower duties on imports of Canadian lumber into the U.S. from 17.9% to 11.64%. The new duties from the U.S. Department of Commerce's third administrative review took effect in August 2022 at an overall rate of 8.59%. Since then, a fourth administrative review was conducted in January 2023, with results issued in March and April. The most recent review affirmed the previous conclusions put forth by the U.S. Department of Commerce that countervailing and anti-dumping duties are necessary and their revocation would likely result in the recurrence of an imbalanced trade market, but the review does not impact the rates currently in effect.

KEY FACTORS

Homebuilding indicators in May injected some much-needed optimism into a lackluster first half of 2023.

Lumber prices have remained relatively depressed since mid-2022, and the slow start to construction in 2023 has led to unimpressive demand and cautious buying.

Softwood Lumber and Panels

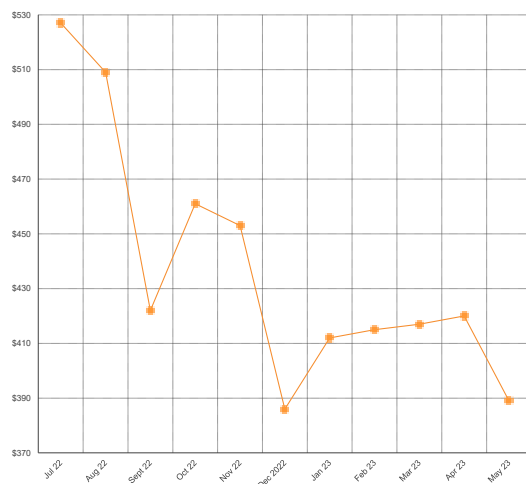
Softwood lumber and panels are produced from gymnosperm trees, such as Pine and Spruce, and are typically used for structural building purposes, as well as millwork.

The first half of 2023 was characterized by cautious buying shortly after a period of historically high pricing. Record highs in the beginning of 2022 dissipated throughout the second half of 2022 and into 2023. Although slight gains in prices were evident in the first quarter of 2023 coming off the lull of winter, high interest rates, inflationary factors, and fewer new construction and remodeling projects have kept prices mostly flat to down in 2023. In addition, distributors have been reluctant to stock up on inventory due to lower downside risk based on lumber futures. Contrary to mill positions in early 2022, mill inventories have been healthy, having caught up to the significant upticks in demand from 2021 and aftermaths of transportation issues that slowed production in Canada in the early parts of 2022. This has continued to put pressure on prices as buying has slowed among homebuilders and distributors, keeping inventory high at the mill level. In response, mills have curtailed production, preventing prices from heading further south amid modest demand. Prices have remained mostly flat in the second quarter of 2023, moderating back to more normalized, pre-

COVID-19 pricing. Despite the sense of normalcy, the lack of a major uptick in price is unusual in the first half of the year, as prices tend to trend upwards during the start of the spring. As such, uncertainty continues to surround the softwood market in 2023. In June, pricing showed signs of modest upward momentum due to supply concerns stemming from Canadian wildfires.

Appraisal trends have generally been negative in the first half of 2023 in the softwood lumber sector, with most appraisals being compared to favorable pricing periods in early 2022. Mills have faced the headwinds from falling market prices due to construction slowdowns and interest rates that have remained high, cutting into housing demand, which has been exacerbated by high labor costs at the mill level that have cut into margins. In addition, log prices continue to increase, driven by the Canadian government continuing to enforce environmental policies, leading to mills purchasing more logs from private landowners at a higher cost. In addition, weeks of supply tied to lumber mills have primarily increased, negatively affecting NOLVs, as many companies have returned to normal operating levels after strong market conditions in prior appraisals saw companies running with minimal safety stock. At the distributor level, locked-in contract pricing to customers cut into lumber margins due to high inflation, raising costs that could not be passed onto customers. In addition, many distributors have cut back on their lumber purchasing, resulting in a less favorable mix of inventory.

1 Softwood Lumber Futures - Price per MBF



Softwood panel pricing traditionally follows a similar trajectory to that of framing lumber. At the time of the prior Building Materials Monitor in December 2022, prices exhibited a downward trajectory which has carried over in the first half of 2023. Similar to softwood lumber, cautiousness continues to be a theme as pricing has remained modest with only slight upticks tied to the spring building season. Distributors remain reluctant to purchase high volumes of paneling, putting pressure on prices; however, less mill production has kept prices in check and mostly flat in 2023.

Hardwood Lumber

Hardwood lumber is used in a number of manufacturing settings, including interior building products such as flooring, cabinets, panels, and doors, as well as furniture, boats, and other industrial applications. Although the market for hardwoods is tied to domestic housing demand and remodel activity, downstream applications in homebuilding, diverse uses in other industries, and export outlets have historically provided some additional protections against sharp changes in pricing, but recent market conditions have bucked that trend.

An unexpected surge in U.S. residential housing start data for May infused some optimism into what has been a lackluster start to the 2023 housing market. The decline in production levels among hardwood mills since the end of 2022 has helped hardwood lumber prices remain relatively firm in the face of soft demand. However, builders, lumber product manufacturers, and furniture producers have exhibited caution in hardwood purchasing, as uncertainty surrounds the economy. Industries such as cabinet, upholstered furniture, and millwork manufacturing appear to be well stocked with both finished goods and hardwood materials, limiting the purchasing to immediate replenishment needs. Uncertainty remains the theme, as many question the sustainability of the recent housing start increase. Demand is contingent upon the constricted housing inventory offsetting higher borrowing costs and lingering inflationary impacts. This would be a welcome occurrence, as recent housing completion data has indicated that contractors are working through existing backlogs, and an increase in in-progress projects will be needed to sustain demand and pricing. Single family home completions were down 14% through April, although the May figure of 1.52 completions represents a 9.5% increase over April.

Repair and remodel activity remains at historically high levels, although spending data through May 2023 indicates a decline of about 5% over the prior year. In addition, after an extended period of continued projected increases, the

Leading Indicator of Remodeling Activity (LIRA) published by the Joint Center for Housing Studies of Harvard University estimated a contraction in spending by Q1 of 2024. The release pointed to downturns in homebuilding and existing home sales in early 2023 that would lead to sluggish remodeling activity through the end of 2023 into 2024. This would directly impact a number of interior and exterior hardwood product markets.

Export activity, a significant driver in North American hardwood log and lumber prices, has been slow in 2023. Worldwide economic uncertainty is weighing heavily on spending and purchasing decisions. China has historically been the largest buyer of North American hardwoods, and after strong export activity in early 2023, its economic challenges have led to sluggish lumber purchasing more recently. Like U.S. secondary wood product manufacturers, export partners like Vietnam and Mexico are oversupplied, as hardwood lumber exports were down 7% and 15%, respectively, through the first quarter. Globally, hardwood lumber exports through March of 2023 are 18% lower than 2022. It has been an extended stretch of depressed shipment volumes, and there is no indication of a turnaround in the near future.

Appraisal values have remained stable to slightly down since Q3 2022. Generally, hardwood producers have been able to maintain pricing in the face of a slightly saturated market, but a further decline in demand could lower market prices and negatively impact short term margins. As noted, the over-inventoried nature of secondary wood markets has led to cautious purchasing. Despite pullback in production from the mills, oversupply remains a risk. Projecting the direction of the hardwood lumber market remains challenging. Conflicting residential construction indicators, lingering inflation, and stagnant export activity are elements that create a difficult environment for hardwood lumber. The ability to balance inventory levels in the face of an unstable demand and pricing environment will determine the appraisal results for the remainder of this year.

Lumber and Woodworking Equipment

The machinery and equipment involved in woodworking can be divided into two main categories: furniture manufacturing and lumber production. While both industries are tangentially related to both the residential and commercial construction industry, both categories respond differently regarding elasticities.

The sawmill and lumber production machinery industry has been relatively stable, though there has been a modest increase in new machinery, especially in the Southeast. Investment has bolstered secondary pricing of used machinery as lead times from OEMs have grown longer. Activity surrounding closures, consolidations, and restructurings amongst producers and wholesalers appears to be minimal at present. Although less frequent, most of the closures have been single-location operations, which cannot operate with the economies of scale of larger operations and comprise the majority of industry participants. B. Riley continues to monitor liquidations in the sawmill and furniture manufacturing spaces, and this trend does not seem to have changed substantially thus far in 2023.

B. Riley saw a reduction in mill auctions throughout 2020, a trend that began in 2019 but intensified due to the COVID-19 pandemic. In 2021, a rebounding economy, combined with high lumber prices, caused the demand for good quality used equipment to increase, although availability on the market was scarce. This has led to values for used equipment holding steady or in some cases increasing. Softwood mill equipment fared better than hardwood mill equipment due to its primary use in the building materials market. In mid-2022, lumber prices declined back to more traditional levels. Higher mortgage rates have caused new home sales to slow, which has increased lumber inventories and decreased prices. This, combined with the ever-increasing potential for an economic recession, has caused uncertainty in the market. With limited



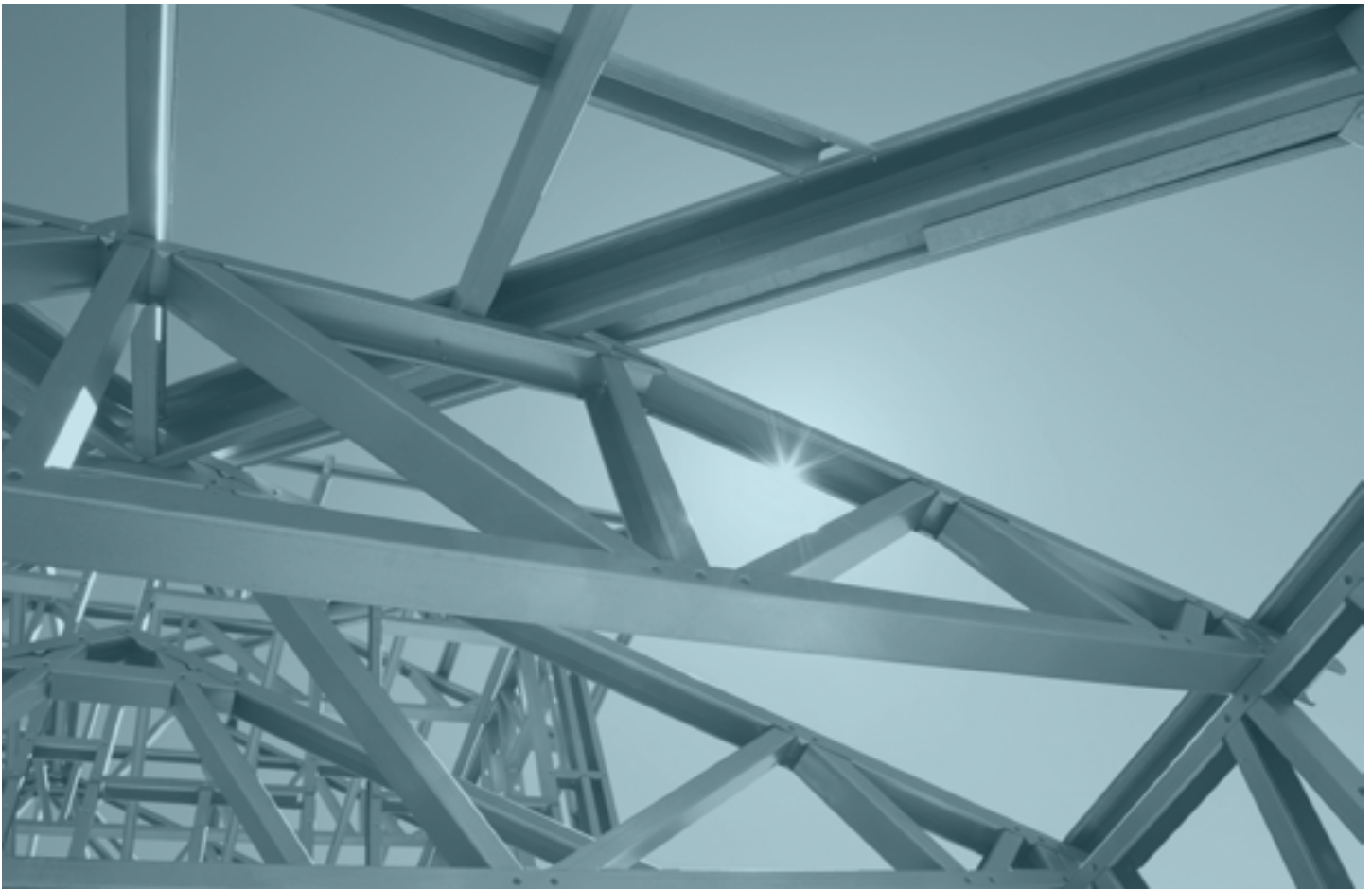
amounts of good quality used equipment available, this has not affected pricing yet, but it must be closely monitored.

The woodworking and furniture manufacturing industries have enjoyed modest growth in recent years due to the improved housing market and an increase in disposable income. During this time, the furniture industry has seen an increasing demand for customized furniture. Woodworking and furniture manufacturers are investing in automated smart woodworking machinery to respond to quick-changing customer demands with shorter product changeovers while maintaining efficiencies. These equipment changes are also needed to remain competitive with foreign import products. In the first half of 2023, although new housing construction has slowed, the market for late model woodworking equipment has been strong. While older equipment has been relatively flat for several years, recent trends show late model equipment, especially CNC machinery, generating strong values. B. Riley has seen a reduction in the frequency of auction events, which has limited the amount of used equipment available over the past several years, a trend that has continued into 2023. Lead times for new equipment are still long, in many cases up to a year, also helping to bolster values for used equipment.

Monitor Information

The *Building Materials Monitor* relates information covering most building projects, including industry trends, market pricing, and their relation to our valuation process. B. Riley Advisory Services internally tracks recovery ranges for specialty and exotic hardwoods and softwoods, building product retailers and wholesale distributors, and specialty building products, but we are mindful to adhere to your request for a simple reference document. Should you need any further information or wish to discuss recovery ranges for a particular segment, please feel free to contact your B. Riley Advisory Services Business Development Officer. The information contained herein is based on a composite

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Experience

LIQUIDATIONS

B. Riley Wholesale & Industrial Solutions has been involved in the liquidation of three National Home Centers building products locations, the liquidation of inventory and fixed assets across eight North Pacific Building Materials distribution centers, and the auctions of various woodworking companies, including Woodworking IVA, The Truss Company, Lux Cabinetry, LLC, and Graeber's Lumber & Millwork.

APPRAISALS

In addition, B. Riley Advisory Services has worked with and appraised numerous manufacturers and distributors within the building materials, lumber, and woodworking industries. While our clients remain confidential, they range in scale from smaller, more specialized regional businesses to major global and national industry leaders, and include the following sampling of companies:

- The nation's largest supplier of building materials for home building, as well as professional and contract builders.
- One of the largest roofing products distributors in the U.S., with locations throughout the country and sales exceeding \$2 billion annually.
- Global leaders in home fixtures and plumbing products, including faucets, sinks, toilets, and bath tubs, with presence in over 40 countries.
- Leading manufacturers of HVAC systems, serving residential, light commercial, and commercial applications, with annual sales exceeding \$1 billion.
- The largest publicly-traded roofing distributor in the U.S.
- One of the nation's largest producers of OSB, siding, and engineered wood products.
- The largest independent distributor of wallboard, acoustical, and other specialty building materials in the U.S.

- One of the world's leading manufacturers of windows and doors.
- Regional sawmills, log processors, and producers of green and kiln-dried lumber.
- Manufacturers and distributors of fasteners and bolts used in light and heavy construction.
- Suppliers of iron and wood building components utilized in stair construction.
- Specialty producers of custom interior wood doors for the education, commercial, health care, institutional, and hospitality industries.
- A leading distributor of roofing materials with 60 distribution facilities nationwide.
- A manufacturer and distributor of exterior residential building products, primarily servicing professional contractors.
- Distributors of exotic imported hardwoods utilized in high-end building projects.
- Independent building material and plumbing product retailers and wholesalers, each serving distinct regional customer bases.
- A diversified holding company operating in the building materials supply industry, with a focus on more specialized supply services.
- A manufacturer and distributor of metal roofing and accessories for residential, light commercial, and agricultural applications.
- Various companies' woodworking machinery and equipment, including producers of dimensional lumber, hardwood lumber, plywood, and fiberboard.

In addition to our vast liquidation and appraisal experience, B. Riley Advisory Services maintains contacts within the building materials and lumber and woodworking equipment industries that we utilize for insight and perspective on recovery values. B. Riley Advisory Services is a subsidiary of B. Riley Financial, Inc., whose affiliate B. Riley Securities, is nationally recognized for its highly ranked proprietary equity research.

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