

Forestry & Timber Winter 2023



Sector Overview

Across recent years, the forestry and timber industry has faced unprecedented supply chain challenges stemming from volatile economic cycles, demand and supply disequilibrium and an unhealthy reliance on international markets.

Following the government intervention (through furlough, state-backed funding and energy relief schemes) and freight shortages propelling pricing in 2021, the market has seen prices transition to a downward trajectory amid deteriorating macroeconomic sentiment and fears of a looming recession. This comes as a key end market in construction has been squeezed by spiralling inflation and consistent interest rate rises, which have induced uncertainty and adversely impacted the affordability of mortgages by eroding the value of real incomes. Other end markets including furniture, which benefitted from working from home practices and excess savings post lockdown have weakened, which when combined with declining construction activity has led to lower imports throughout 2023.

Despite short term fragility in several end markets, longer term outlook remains buoyant with timber inscribed as an industry with substantial growth potential and a supply chain already valued at over £10bn.

With demand expected to quadruple over the course of the next 27 years, the market is well poised to exploit its environmental advantage and become a driving force spearheading the transition to a circular economy.

Economic Data

> **ONS** - Total monthly production output closed at 94.8 in August 2023 and represented a 0.7% reduction on the prior month. As an industry, the classification of wood, paper products and print achieved output of 84.5, which is the second highest month for the category in 2023. However, this remains much below the pre-pandemic annual production output of 100 achieved in 2019.

> Forest Research

- Coniferous Standing Sales Price Index (Figure 1) - Average price in real terms of £29.02 per cubic metre overbark at March 2023 compared to £42.26 at March 2022.
- Softwood Sawlog Price Index (Figure 2) - Average price in real terms of £48.85 per cubic metre overbark at March 2023 compared to £75.03 at March 2022.
- Small Roundwood Price Index (Figure 3) - Average price in real terms of £35.45 per cubic metre overbark at March 2023 compared to £36.40 at March 2022.
- Total UK consumption of wood products - Apparent consumption in 2022 included 9,061 thousand cubic metres of sawnwood, 6,151 thousand cubic metres of wood-based panels, 7,819 thousand tonnes of wood pellets and 7,227 thousand tonnes of paper. All categories were down on 2021, with the largest decrease being seen in sawnwood which fell 21%.

Forestry & Timber - Winter 2023

Strengths

- > **Sustainable alternative to traditional construction materials** – The construction industry is responsible for 36% of worldwide CO2 emissions. The need for greener sustainable practices is therefore paramount as we continue to make inroads on achieving our 2050 net zero commitments. The much-anticipated release of a timber in construction roadmap, outlining a defined path to reducing barriers to wood-based construction, is one means this can be achieved. The framework will likely centre around timbers thermal properties (10 times more insulating than concrete and 400 times more insulating than steel) and its carbon sequestration estimated to capture a net 1,700 kg of CO2 compared to traditional materials omitting anywhere between 159 kg to 9,300 kg of greenhouse gases.
- > **Industry destocking phase commenced** – Following the demand and supply imbalances unfolding over recent years, many businesses within the sector proactively started right sizing their inventories during H2 2022 and are subsequently better positioned to navigate the challenging economic environment ahead from a working capital perspective.
- > **Normalisation of international shipping rates** – Since the pandemic container shipping rates have exhibited significant fluctuations with the global freight rate index peaking at a staggering \$10,361 US dollars in September 2021. A key catalyst behind this increase was the resurgence of consumer demand post lockdown coinciding with restricted port, labour and shipping capacity. As we move into 2023 however, inflationary headwinds and the subsequent tightening of monetary policy have applied downward pressure on worldwide shipping rates leaving the index at \$1,740 in August 2023. The cost to importers and end users has hence reduced on 2021 pricing and will likely remain depressed by dwindling demand and targeted investment in carrier capacity over recent years.
- > **Fast-approaching UK general election** – The next general election will need to take place by January 2025 and will map policy directly influencing the timber industry. In recent conferences all major political parties have proposed initiatives around relaxing planning regulations, encouraging modern methods of construction (for which timber is the most prominent material) and fast-tracking investment in brownfield developments. Such discussions highlight a clear intention for fiscal supply side stimulus and therefore represent hope of spearheading one of timbers key end markets back to growth.

Gazette

Overall insolvencies in England & Wales rose 17% on the same position last year with a total of 1,967 businesses collapsing in September 2023. Of these failures over 80% were creditors' voluntary liquidations (CVL) but the largest percentage change by insolvency type was in administrations, which are up 47% on an annual basis. Year-to-date insolvencies within forestry, logging and sawmilling and planning of wood totalled 13 in 2023 representing a 7.1% decline on 2022 but a 62.5% increase on the equivalent eight-month period in 2019.

During 2023, the sector has seen some notable insolvencies with failures such as:

- > **Snug Shack Limited (January 2023)**
Upholstered furniture and floorings retailer – Equity £1.6m
- > **Timber Angel Ltd (January 2023)**
Timber merchant – Equity -£12k
- > **Shopfit UK (Hull) Limited (March 2023)**
Carpenter and joinery – Equity £154k
- > **Robinson Manufacturing Limited (May 2023)**
Frame and truss manufacturer – Equity £2.7m
- > **FR Jones and Son Limited (July 2023)**
Arborist equipment – Equity £1.4m
- > **JAS Timber Limited (September 2023)**
Doors, window and staircase manufacturer – Equity £341k
- > **Timber Stair Manufacturers Ltd (September 2023)**
Staircase manufacturer – Equity £312k
- > **D&J Timber Buildings Ltd (October 2023)**
Panel and landscape products – Equity -£41k

Forestry & Timber - Winter 2023

Challenges

- > **Short term downturn in UK housebuilding** - With the Structural Timber Association (STA) claiming timber frames are utilised in over 85% of new builds in Scotland and 23% of new builds in England, the residential market is undeniably a key driver behind timber demand and prices within the UK. According to the latest CPA forecasts, short term outlook for the sub-sector remains subdued with increased mortgage rates set to drive a 19% reduction in completions this year, with no return to growth expected until 2025. There does however remain substantial build targets set at 300,000 homes per year by the UK government, which provides optimism for recovery.
- > **Turbulent geo-political landscape** - Spill over of geopolitical tensions represents a substantial risk, threatening the longevity of woodlands and continuity of upstream and downstream supply chains. The timber market was rocked by the ongoing Russia-Ukraine war which saw international sanctions enforced on Russia and Belarus. Russia is the world's largest exporter of softwoods and together with Ukraine and Belarus they accounted for 25% of global timber trade in 2021 and were home to around 35% of Forest Stewardship Council (FSC) certified forests. A key impact of this conflict has been damage to a combined 4.24 million hectares of Ukrainian forest and nature reserves. Whilst having a modest impact on global supply, rising geopolitical instability (as highlighted by BlackRock in Figure 4) further exacerbated by recent events in Israel and Gaza create uncertainty around UK supply lines from Europe and the Middle East.
- > **Reduced purchasing power of a depreciating sterling** - With the UK being the second largest net importer of timber, the cost of wood-based products throughout the country remain highly sensitive to volatility in foreign exchange rates. The Pound has seen some recovery in 2023 after a record low in September 2022 (see Figure 5) but it has remained subdued owing to the economic outlook. Importers will therefore have pressure on margins in the absence of effective hedging strategies.
- > **Combating illegal logging trade** - Protecting tree species by ensuring due diligence and regulation is stringent and fit for purpose in tackling the trade of illegally sourced timber, which is a market reportedly valued in excess of \$51bn.

Underwriting Approach

- > **Case-by-case risk approach** - Entities continue to be reviewed on their individual merit, with focus upon smaller players with little diversification outside of residential construction.
- > **Continued importance of visibility outside of statutory filings** - Given recent downward pressure on prices, dialogue with businesses to obtain an understanding on current trading and liquidity remains desirable for large credit exposures.
- > **Reviewing bank facilities and leverage** - Given utilisation of stock and invoice financing across the industry, obtaining an understanding on cash cycles, headroom and covenants is critical in our assessment of solvency.
- > **Understanding buyout structures** - With a number of high-profile buyouts taking place in recent years, obtaining clarity around ownership changes remains standard practice.

Figure 1: Coniferous Standing Sales Price Index, Great Britain, 1985 to 2023

Index (September 2021 = 100)



Sources: Forest Research

Figure 2: Softwood Sawlog Price Index, Great Britain, 2012 to 2023

Index (September 2021 = 100)

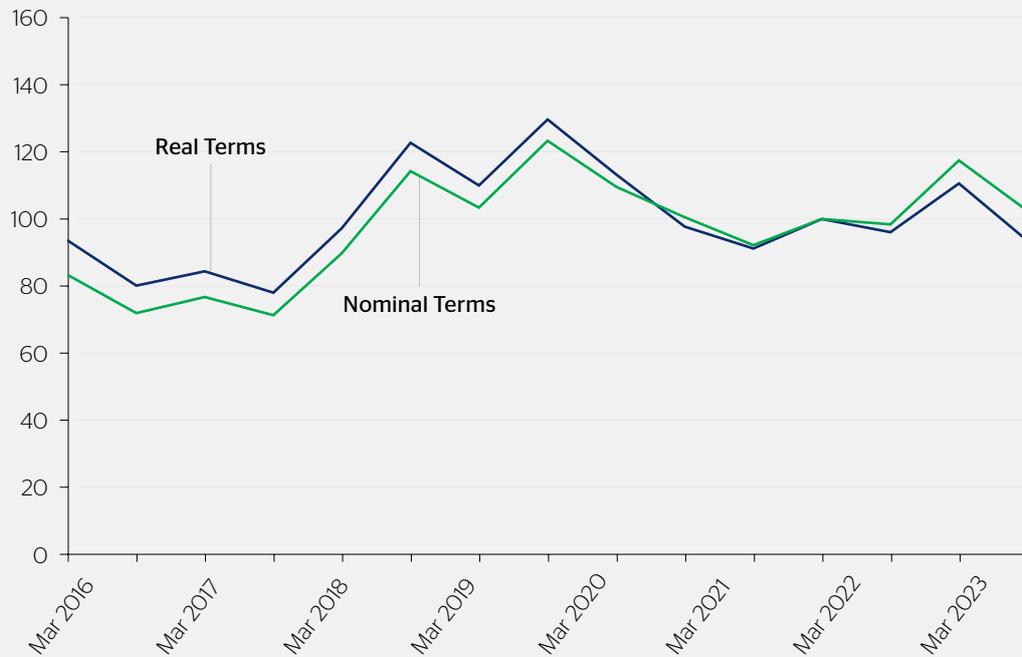


Sources: Forest Research

Forestry & Timber - Winter 2023

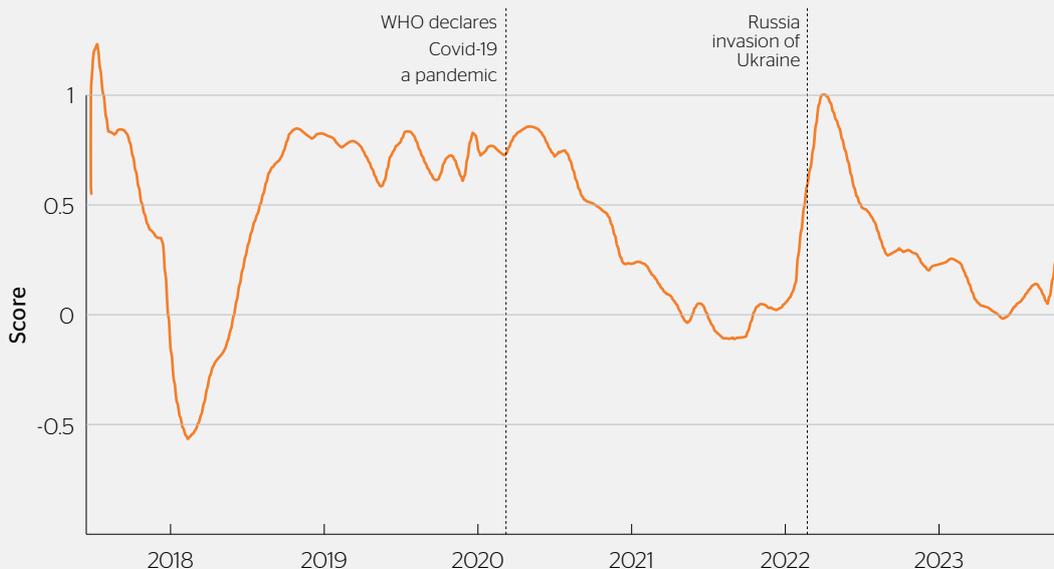
Figure 3: Small Roundwood Price Index, Great Britain, 2016 to 2023

Index (September 2021 = 100)



Sources: Forest Research

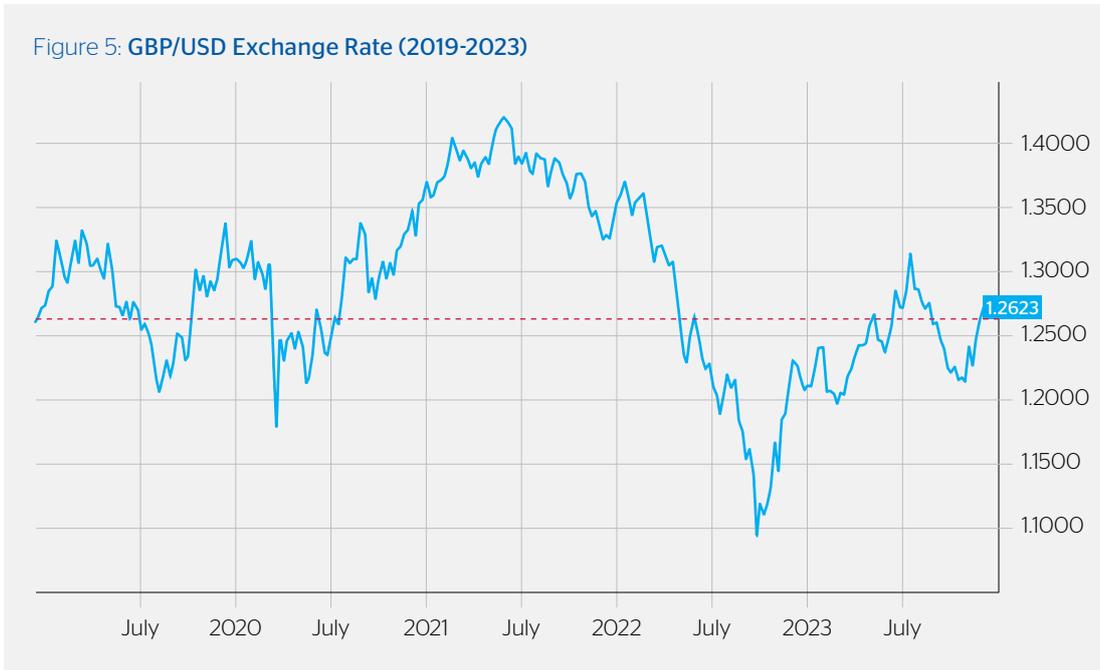
Figure 4: BlackRock Geopolitical Global Risk Indicator (2018-2023)



Sources: BlackRock

Forestry & Timber - Winter 2023

Figure 5: GBP/USD Exchange Rate (2019-2023)



Sources: [CNBC.com](https://www.cnbc.com)

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