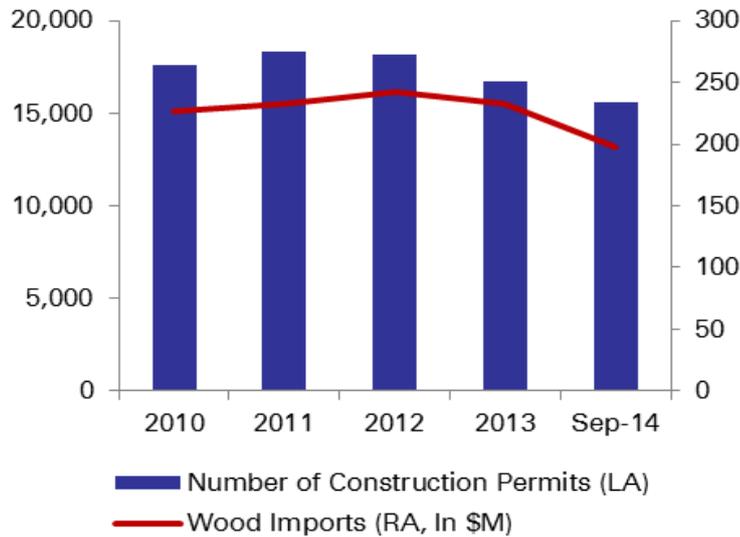




Construction Activity and Wood Imports



December 05, 2014

Contact Information

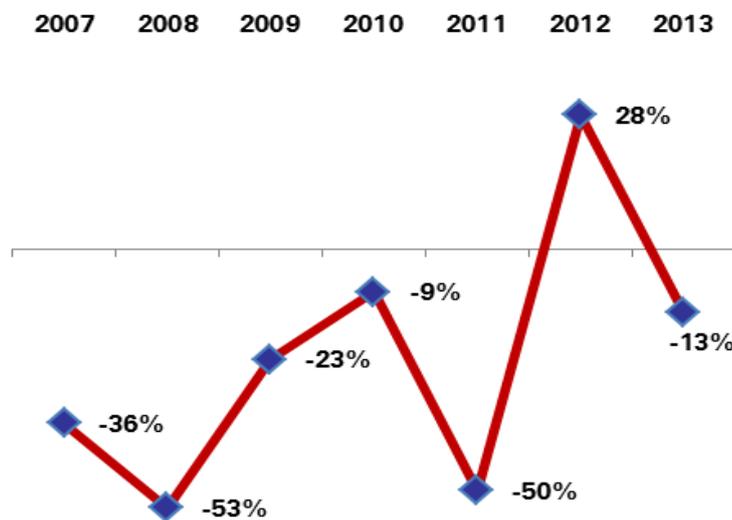
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Source: The Lebanese Customs and the Orders of Engineers in Beirut and Tripoli

Yearly Change of the Rogers International Commodity Index – Lumber Total Return (In %)



Source: Bloomberg

Shaping earlier civilizations, wood is one of the oldest industries and one of the most valuable and monitored commodities in our modern world. Wood is very well recognized for its many uses starting with the commodity being a source of heat, handmade and art products, as well as being an important construction, floor and furniture material.

Knocking on the timbered gates of the Lebanese wood industry opens doors to the market's critical standing, given its high dependency on imports. Ironically, our ancestors the Phoenicians, the first master shipbuilders, were experts in cedar wood production and design.

The era's builders used Tyre's Melqart Temple as a prototype for designing and building Solomon's Temple.

However, the "extremely skilled in cedar wood" society failed at transmitting its legacy and no actual production within the sector is nowadays existing. Contrastingly, finished and semi-finished products are imported to be directly sold and distributed to local wholesalers and retailers or to be transformed and reshaped into new wood products such as furniture, doors, houses etc...

Despite its small market size, wood sector still attract lots of ambitious investors aiming to clutch a market opportunity and realize profits in the small immature market. Given the sector's full reliance on imports, market size is estimated around \$240M. Furthermore, the last ten years rarely saw new entrants to the market that became more rigid with more difficulties and obstacles. The wood market in Lebanon is highly vulnerable to regional shocks, local uprisings and international trends. Noting that companies and households are the end users of wood products, any change in their habits or economic status will directly impact their demand.

Specificities of the Lebanese Wood Market

According to the gathered information from different market players, the wood market in Lebanon is an open market where there is no oligopoly. Several local wood providers and distributors are present in the market with competition occasionally intensifying. However, and even though there is no consensus over wood prices, there is no big price gap between traders as an increase in sales volume due to reduction in prices will lead to a price war. This would not be beneficial for any one of the parties involved, and would result in losses for all of them.

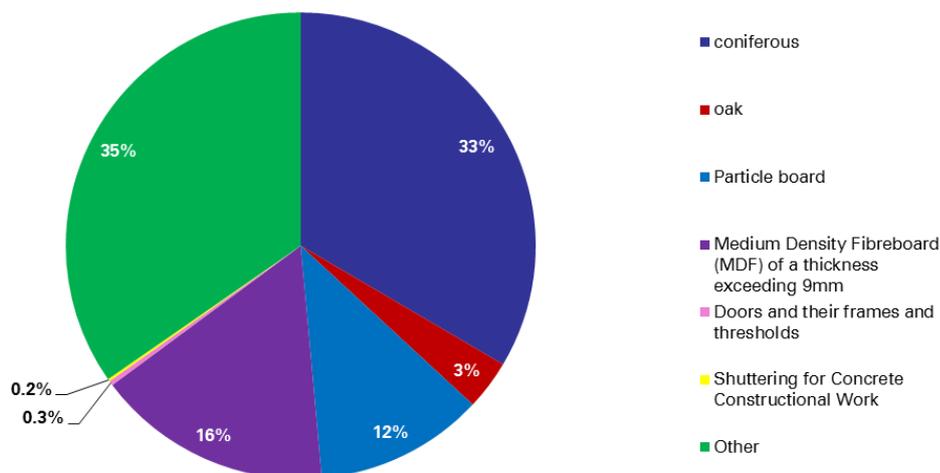
Several providers are present on the field with no accurate statistics on their market shares. However, Jabwood, United Timber Corporation SAL – Sinno, Anklis Timber and ITCO are among the top importers and distributors of timber and wood in Lebanon. According to the majority of market players, those distributors constitute near two thirds of the whole market, while the remaining one third is served by numerous other corporations that are fragmented.

Jabwood is the leader in the market and trades soft woods, hard woods and wood based panels. According to Mr. Mahmoud Jabado, CEO of Jabwood, the company focuses on vertical integration from importing wood products to wholesale activity and retail outlets over 3 different regions. Similarly, Anklis Timber and ITCO also provide the market with similar products and sells to wholesalers all over Lebanon.

Domestic manufacturers of wood based products profit from the government regulation related to wood imports that aim to protect the locally transformed wood products from foreign competition. In details, the government has imposed high tariffs on imports of some wood products that can reach up to 25% for some carpentry woodwork (windows, doors etc...) and 5% for wood charcoal, blockboard, wooden frames etc...According to Ms. Nadine Sinno, P.R. Officer at ITCO, "The legal protection in the trade of finished wood products such as furniture is not enough to let the industry benefit from it. Our advantage is that our sister company Unitco is a vertically integrated timber concern, involved in activities ranging from forest harvesting to delivering finished products to its end customers. We have therefore more leeway on the fixing of prices".

As previously mentioned, wood companies in Lebanon mainly import semi-finished and finished products. Coniferous wood that is renowned as softwood tops the list of Lebanese wood imports with a 33% of the total. Softwood is mostly used for construction purposes and furniture crafting. Medium Density Fibreboard (MDF) of a thickness exceeding 9 mm followed with a 16% stake of total wood imports. MDFs are used mainly for the furniture industry, packaging material, in the door industry etc...

Breakdown of Wood Imports in Terms of Volume (In %)



Source: the Lebanese Customs

Particle board, which is a composite material pressed and manufactured from wood chips) takes the third place with almost 12% of total wood imports to Lebanon. Particle boards are best used to make furniture, install cabinets, add home accents, roofing and flooring and even sound proofing. It is also famous for being inexpensive and easy to work with. Oak wood or Hardwood stood fourth with a slight 3% share of total wood imports and can be found in decks, fine furniture and cabinet making.

Given the country’s considerable reliance on wood imports, Lebanon suffers an ongoing structural deficit on its wood trade balance. In this context, trade deficit stood at \$212.50M in 2013, widening from 2012’s deficit of \$220.98M. Exports reached 19,626 tons worth \$20.57M in 2013 comparing to 18,346 tons worth \$20.80M. At the same time, Lebanon imported 383,686 tons worth \$233.07M of wood products in 2013, compared to the 404,248 tons imported in 2012 priced at \$241.78M. Accordingly, imports were about eleven times the value of exports, while the exports cover ratio stood at 8.8% in 2013 barely changing from the 8.6% recorded in 2012.

Arab countries are the main destination countries of Lebanese wood exports, with Iraq standing first. Trade agreements between the latter and Lebanon were of a great benefit to the wood sector that almost exported 28% of its total exports to its Iraqi trade partner. Saudi Arabia comes second (around 17% of total exports), while Jordan almost imports 11% of the Lebanese wood products.

Between 2010 and 2013, wood exports dwindled mainly due to the spillover effects from the neighboring Syrian crisis that has heavily weighed on trading activity. Thus, wood exports posted a decrease of 6.0% over the mentioned period to stand at \$20.57M by the end of 2013. In this context, Mr. Jabado stated that “2013 was one of the darkest years in the wood market’s history as it was heavily impacted by the Syrian war that disrupted transit routes hampering wood exports towards Syria itself, Jordan and Iraq”.

Main Drivers of the Lebanese Wood Industry

With no accurate statistics available, assessing the market’s performance and status remain challenging and not fully precise.

The activity of the real estate and construction sectors is the main internal factor to determine the wood market’s performance. Besides tourism, those two sectors are the most to suffer from the shaky situation of the country, directly impacting the wood industry. The considerable impact

resides in the fact that most wood products are either used as building materials or as furniture and kitchenware. Accordingly, any loss of investment appetite in the real estate sector will narrow the number of projects to be built thus deteriorating demand for wood materials.

On the external front, and due to their high inventory levels, the Lebanese wood suppliers have to bare the declining international prices as well as the changes in exchange rates. In details, and contrastingly with some other industries, one of the operating requirements of wood providers is to always keep their inventory levels sufficient to promptly satisfy orders. For this purpose, several companies are heavily investing in their warehouses such as Anklis Timber or planning to open new warehouses such as ITCO. This could be distressing at times when global wood prices are on a declining trend or exchange rates fall. In details, traders will be forced to sell their inventories at lower prices than cost prices, in case of a persistent bearish trend.

Wood Industry over the past 7 years

Between 2007 and 2010, the wood market underwent the negative effect of the global financial crisis of 2008 that was more than offset by the real estate booming demand.

On one side, global prices witnessed a considerable slump of around 20% that was followed by the deterioration of lumber prices. This was reflected in the performance of Rogers International Commodity Index - Lumber (total return) that tumbled at a CAGR of 31.3% between 2006 and 2011. In Lebanon, several wood importers suffered the falling international prices of wood and were obliged to liquidate their inventories at lower prices. Unfortunately, several wood traders were also pushed out of business. However, this opened doors to new investment opportunities in times where real estate and construction activities were witnessing a booming period.

On the other side, 2007-2010 was a prosperous period for the Lebanese economy and real estate. Lebanon managed to avoid the global financial crisis, recovered from the Israeli war of 2006 and ended the presence of Syrian troops in April 2005. The real estate market was characterized by a pent-up demand with real estate transactions jumping by a yearly 11.3% in 2010. This has more than counterbalanced the declining wood prices hence increasing demand for wood. In this context, the 4.2% growth in construction permits during 2011 was mirrored by a 2.6% annual growth in wood imports to \$232.55M.

Stepping to 2011-2012, wood prices started to stabilize and real estate supply adapted to the previously increasing demand.

First, international wood prices started showing timid increases to rise at a CAGR of 3.5%. Worth noting that the United States of America (USA) tops the list of countries producing timber and ranks fourth in the world in terms of wood exports. Accordingly, the negative repercussions of the financial crisis in the USA directly impacted the global wood industry in 2007-2008. However, efforts to recover from the crisis seemed to finally bare fruits in 2013, even though at a slow pace.

Second, the Lebanese real estate demand was hindered starting late 2011 due to the eruption of the Arab Spring, the emergence of the war in Syria and the fragile domestic situation that continued through 2013. However, real estate supply improved during 2011-2013 as it took time to adapt to the high real estate demand levels reached between 2007 and 2010. In addition, and noting that construction permits are usually issued six months after applications are filed, numerous building projects were initiated in 2012 which explains the 4.0% y-o-y rise in wood imports in 2012 to \$241.78M.

2013 was the beginning of the downturn in the wood industry. The market started revealing signs of deterioration, highly influenced by the persisting political stalemates that were governing the country, the slowing economic growth and the security developments on the local and regional fronts. The sluggish performance in the real estate market, where construction permits and real

estate transactions respectively declined by nearly 8.1% and 16.9% y-o-y, was reflected on the wood market that posted a 3.6% downtick in the value of Lebanon’s wood imports to \$233.07M.

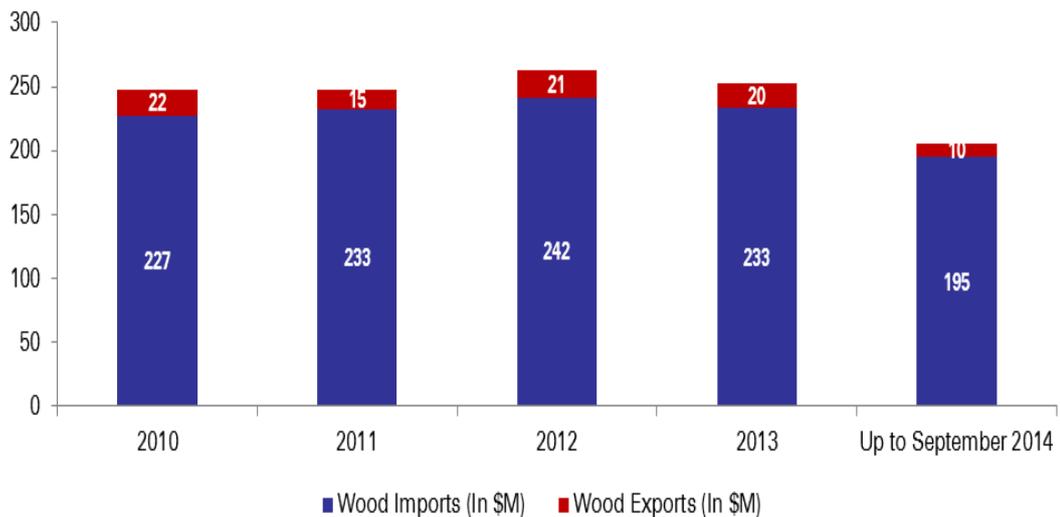
Consequently, demand for real estate properties faltered in 2013 severely impacting the wood industry in the country. Real estate consultant, RAMCO, stated that Beirut residential projects completed in 2013 showed that 277 new apartments remained unsold in 2013 compared to 217 units completed during the course of 2012. Unsold apartments in 2013 represented an 81,773 SQM of built-up residential area worth \$437.58M.

In another context, wood traders mainly importing from European countries saw their losses broadening due to the weakening of the euro against the dollar. Worth noting that Lebanon mainly imports wood products from Romania (around 20% of the total) followed by Russia and China that posted a similar stake of 12% of total wood products. This was the directly linked to the wood importers strategy as they are usually keen on retaining in their inventories adequate level of wood products in order to instantly meet customers’ orders. Accordingly, the price of products bought in euros decreased, negatively impacting numerous market players mainly due to their large existing stock of imported wood products.

On another note, Tripoli constitutes the heart of the Lebanese wood industry hosting the majority of timber warehouses. The security developments that lingered in the northern region of the country hindered activity within the wood market. In details, the transportation of products was interrupted each time roads were closed leading to delays in delivery. As for Jabwood, the company’s proximity to the security incidents threatened the working force’s security and wellbeing.

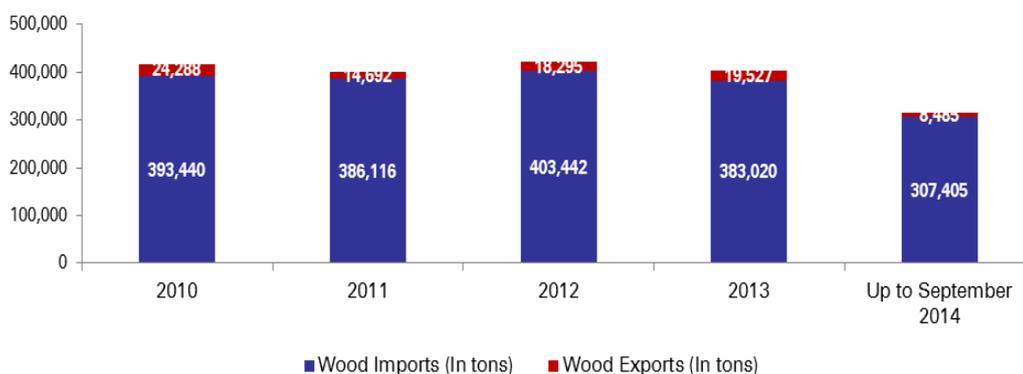
Lebanese wood traders therefore were facing challenging obstacles in 2013 to liquidate their products as security developments in Tripoli and Syria severely hit the transportation of products to both the domestic and Arab market. The majority of companies were having trouble in maintaining their profits and many of them sold at a loss. Some of the frailest wood companies went bankrupt leaving space to other players to survive and satisfy the formers’ demand. However, some other companies have made strategic partnerships allowing them to ship directly to the Levant and the Gulf. This is for instance the case of ITCO who ships to clients in the Middle East, the Gulf and the Far East.

Value of the Lebanese Wood External Activity



Source: Lebanese Customs

Volume of the Lebanese Wood External Activity



Source: Lebanese Customs

What about 2014 and the coming period?

The first half of 2014 showed bright results when it comes to real estate activity, while the second half embedded a bunch of security and political developments overshadowing H1's progress. Up to September 2014, wood imports stood at \$195M, up from \$179.82M recorded a year earlier.

While evaluating the performance of the wood sector in 2014, dissimilar answers were provided. According to Ms. Sinno, "2014 has been a better year than 2013". However, Mr. Jabado claimed that 2014 showed no improvement from 2013 but witnessed a stop and go activity.

The Lebanese wood sector will remain highly impacted by the economic and political situation of the country. As for 2014, BLOMINVEST Research department estimates total imports of Lebanon's wood products to improve compared to the previous year to possibly settle at \$256M. Jabwood is currently postponing any future plan of expansion and has consolidation objectives. However, and besides opening new warehouses, Ms. Sinno revealed that ITCO has plans to expand but the company is "waiting for the outcomes of the regional political situation".

Finally and despite the several challenges faced over 2013 and 2014, the Lebanese wood sector is still able to survive thanks to the strong fundamentals and the high level of expertise of the existing players. Hopes remain high about a flourishing Lebanese building materials industry once the war in Syria ends and the reconstruction phase begin there. The demand for wood products in Syria will be then satisfied by imports from neighboring countries, mainly Lebanon and Jordan.

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