

was “You have probably the highest level of experience for the operational size of any forest office in New Zealand — go forward and create forest more profitable than New Zealand has ever seen.” I am happy to report that the team eagerly picked up the ball and is running with it.

Summary

This paper mentions some outstanding advantages of being in the New Zealand forest business. It also outlines many issues that are hampering wood processing in New Zealand. The silviculture of yesteryear is haunting us today, and the sometimes sloppy silviculture of

today will hamper our future again as sure as those trees are harvested.

New Zealand's wood will be in great demand in years to come. The way forward is to process that wood into high value products, and manage a range of cost factors. Logs are and will remain the most significant cost input to processing plants.

The more fit for purpose and uniform we can make them, the more success and value we will all extract. With the Kiwi “can do” attitude, growing industry and Government cooperation, and a dash of leadership we should go profitably into the future.

Get on with it!

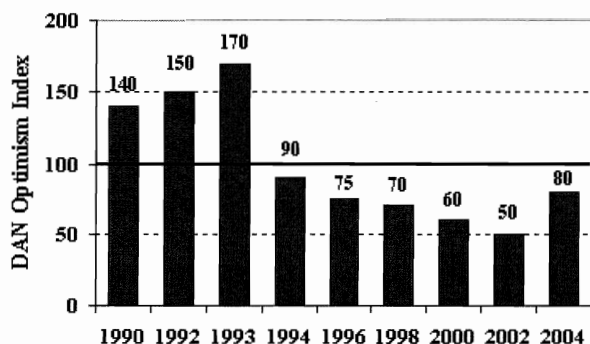
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Time for Optimism?

If we look back to 1993 there was a lot of optimism about forestry. The world was running out of trees. The harvest of forest on US public land had been dramatically reduced because of the spotted owl. Asian wood-buyers were concerned about the future wood supply and log prices were sky-high. Global population was increasing rapidly and New Zealand was seen to be a place where radiata pine could be grown cheaply to produce big trees. So buying trees or investing in processing would be a sure thing.

But soon after, and to the present, the story has looked increasingly tattered. The DAN “Optimism Index” has been on the decline since 1993 (Fig. 1) but the good news is that it has just started to increase. After a decade or so of increasing pessimism about the industry it is probably time to get out or get on with it. And maybe, just maybe, the tide is beginning to turn.

Fig. 1: DAN Optimism Index is at last starting to show positive signs.

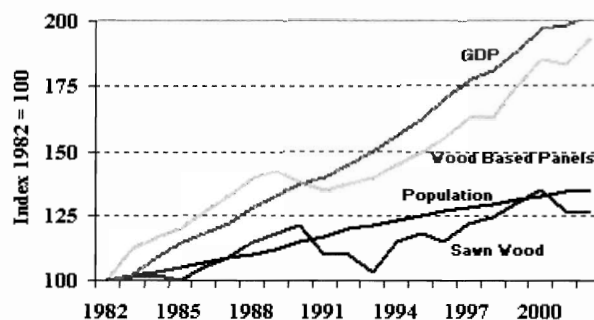


Trends in some important areas

Wood demand

Wood demand is increasing – a good thing – but we need to watch where it is going and act accordingly. Sawn wood demand is barely keeping pace with population growth. However the demand for wood-based panels is increasing at a much higher rate and is matching GDP growth (Fig. 2).

Fig. 2 World demand for sawn wood and wood-based panels relative to population and GDP. (Source: Jaakko Poyry Consulting, Helsinki).



Wood supply

We have learnt that shortages can, by definition, never be chronic (unlike what we thought in the early 1990s) but:

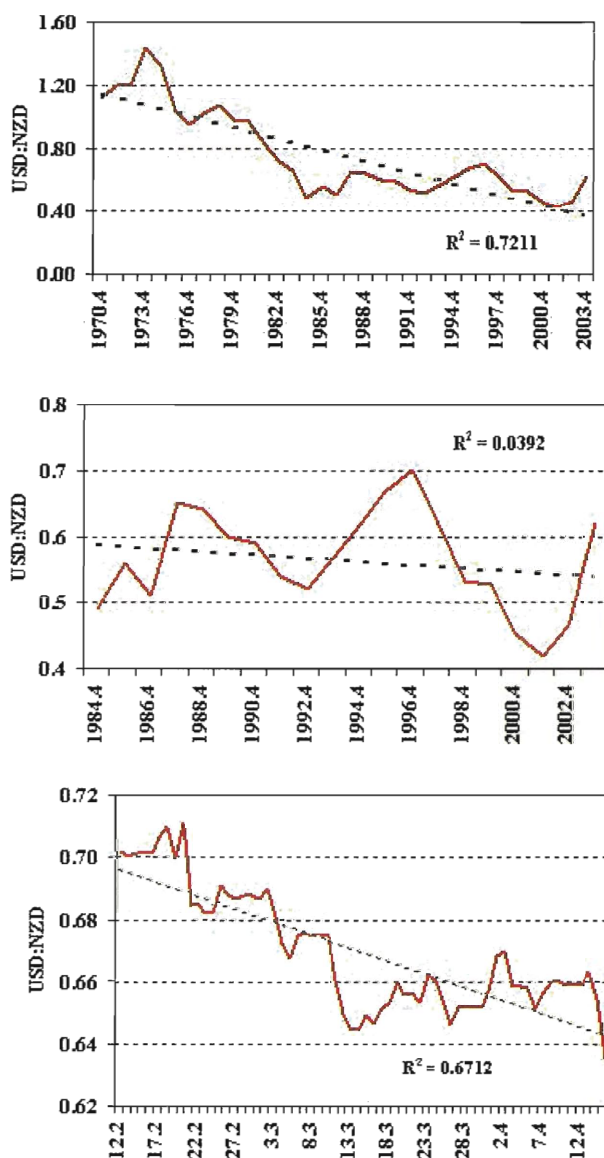
- Tropical wood supplies are really getting closer to running out.
- Softwoods are substituting more and more.

New Zealand radiata pine costs are still reasonably good in world terms. Growing costs for New Zealand radiata pine were 22nd lowest out in 96 sawlog case studies in a recent DANA/Manners review (Table 1).

Table 1: Growing costs for selected sawlog case studies (Source: DANA/Manners Review)

Crop	Growing cost (2002 \$US/m ³)
Fiji Caribbean pine	11
NZ radiata pine	21
China <i>Pinus elliottii</i>	32
Australia NSW radiata pine	49
Scotland Douglas fir	146
USA PNW Douglas fir	262
Estonia Norway spruce	646
Japan hinoki	3001
Austria Norway spruce	19567

Fig. 3: USD:NZD exchange rate (a) from 1970, (b) from 1984, and (c) from February 2004.



Attitude is important. We should be celebrating the reduction in new planting here (from 98,000 ha in 1994 to about 10,000 ha in 2004), not bemoaning it. Perhaps we may avoid the common oversupply problems that have beset the agriculture producers in the past; e.g. Australian and New Zealand grape growers.

And finally, most of New Zealand's forests may now be owned by equity-rich (and better informed) investors who will actually be able to reverse the damaging harvest age reductions of the last 5 to 10 years. This may better control supply balancing. At least two companies are already "getting on with it" and increasing harvest age, while a few like Juken Nissho have been quietly doing this for a decade.

Foreign exchange

The forestry/processing industries have been agonising over foreign exchange rates recently, but can we even begin to predict the future trends?

For connoisseurs of long-term trends the signs are promising - we are in a temporary blip on the way to a 30 cent dollar (Fig. 3a). But if you believe the experts, who say a valid trend should only start in 1984 when the NZD was floated, then it has been a pig in a poke (Fig. 3b). And for short-term optimists (from February to April 2004), the trend is sound and favourable (Fig. 3c).

My conclusion is that there is no conclusion about foreign exchange. Take your pick and get on with it. Jump ship if you think the FX pain will be chronic or invest if you think the opposite. Your choice will have statistically as high a chance of being right as the experts.

Energy

If you believe the experts you will be nervous about New Zealand's future energy needs (Fig. 4). But another view is that the people of New Zealand will not let the government run us out of power for years on end. Long before that happens, those who resist reasonable progress

Fig. 4: New Zealand's energy demand relative to supply. (Source: Energy Data File, McDouall Stuart).

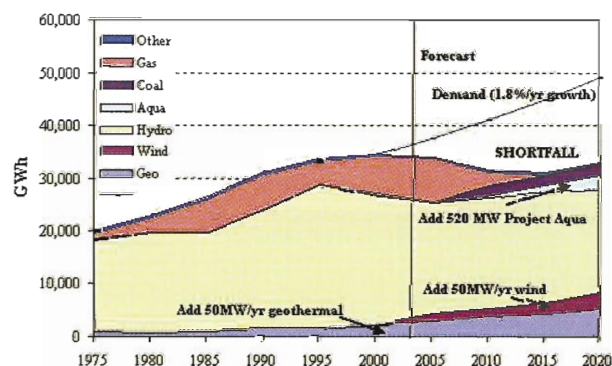
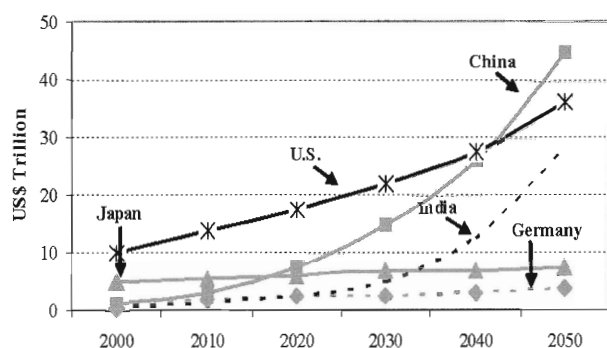


Fig. 5: GDP projections for key world economies. (Source: Goldman Sachs Economics).



will be biffed out of office. "We are inevitably heading towards major coal development" (Keith Turner, CEO Meridian Energy, March 31 2004). Get on with it!

And we will not be alone. In 2003, 51% of US power generation came from coal (with another 20% coming from nuclear). Whereas in 2001 less than 12 new coal plants were being planned, in 2004 over 100 additional coal plants are being planned.

Macro growth projections

GDP projections for China, India and the US (Fig. 5) should provide some comfort. For patient tree farm investors, this should encourage you to get on with it. In addition, perhaps we will have a cycle of sustained high energy costs which will favour wood usage.

The two major New Zealand forestry companies are finally "getting on with it" after five years or so of soul searching - and with investor approval. Tenon has been a real winner recently, and CHH is behaving OK too.

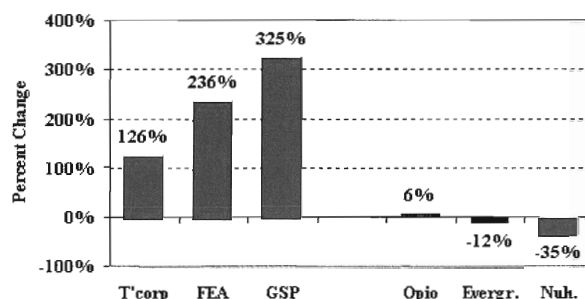
Investment opportunities in New Zealand and elsewhere

Remember, those people who want to be in forestry do not have to be limited to New Zealand. This is only a mindset.

New Zealand forestry-specific company performance has been disappointing, but those investors who "got on with it" and put their money into Australian tree farm companies have done extremely well in 2003-04 (Fig. 6).

And if investors are not happy about investing in New Zealand processing, there are about 20 sawmill expansion projects in Australia, which will transform the lumber supply-demand balance in Australasia by 2005/06. About one million m³ of extra softwood lumber may be on the market by then compared to 2002. Perhaps joining the action is smarter than competing with it - a number of New Zealand investors are already

Fig. 6: Performance of share price change in Australian and New Zealand pure-play forestry companies from 1 January 2003 to 15 March 2004.



involved in Australian sawmill expansion.

And some New Zealand investors are looking at the US for sawmilling investment - and well they might, with huge support structures and good returns. One company has announced it is going to build a major new OSB plant in Alabama. Its location awaits the "struggle" between different counties and towns as to which one offers the best incentives to build the mill in their patch. Contrast that with the attitude of most New Zealand local authorities.

And please do not overuse this complaint which we all used to use about every problem we ever faced: "Government blamed for forestry decline" (National's forestry spokesman, April 2004).

Governments will do what Governments do. If you are happy with the industry and Government support, run with expansions. If not, sell down your forestry investments (plenty are, but on the other side of the ledger there are buyers). Instead invest in Navarre (NAVR) or telecom shares.

Conclusion

We have had almost a decade of slow (and sometimes quick) deterioration in the fortunes of New Zealand forestry. This has forced some to "get on with it" and is encouraging others to do the same. There are plenty of green forestry pastures. If they are in New Zealand so be it, but

We could do worse than heed Tony Neilson's advice (Inwood January 2004) and make 2004 the "International Year of Optimism".