Who owns what, now?

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Introduction

Forest ownership in New Zealand has changed significantly in the last couple of years. International investment funds, particularly TIMOs (Timber Investment Management Organizations), have featured as significant purchasers of New Zealand's forest estate. This paper addresses:

1. Who owns what now?
2. Who are the "new" investors?
3. What are the driving factors of their purchases?
4. What are their strategies for the next ten years?
5. What has changed to make them want to purchase New Zealand forest assets?

1. Who owns what now?

Statistics that summarize ownership of New Zealand's forestland holdings typically do not distinguish between management and ownership, where ownership is defined by having equity capital at risk. For example, the New Zealand Forest Industry Facts & Figures (Table 1) lists area by owner/manager. As a consequence, area is commonly attributed to the manager rather than the owner of the estate. In the case of Joint Ventures (JVs), one of the partners typically manages the estate on behalf of the joint owners and area is typically attributed to that partner. This is the case for example in the JVs that Global Forest Partners (GFP) have with CHH in Northland (Mangakahia JV) and with Weyerhaeuser NZ in Nelson.

Table 1: New Zealand planted forest ownership statistics as presented in NZ Forest Industry Facts & Figures 2004/05.

Owner/Manager	Planted Area (ha) - round figures	% of Total
Carter Holt Harvey	315000	17.2%
Kaingaroa Timberlands	165000	9.0%
PruTimber	66000	3.6%
Weyerhaeuser New Zealand	64000	3.5%
Ernslaw One	56000	3.1%
Juken Nissho	55000	3.0%
Rayonier New Zealand	50000	2.7%
Crown Forestry	42000	2.3%
Hancock Natural Resource Group	41000	2.2%
Pan Pac Forest Products	32000	1.8%
Blakely Pacific	28000	1.5%
Global Forest Partners[1]	27000	1.5%
Hikurangi Forest Farms	27000	1.5%
Timberlands West Coast	27000	1.5%
Wenita Forest Products	25000	1.4%
Roger Dickie New Zealand	24000	1.3%
Forest Enterprises	22000	1.2%
Evergreen Forests	21000	1.1%
Winstone Pulp International	17000	0.9%
GMO Renewable Resources	15000	0.8%
City Forests	15000	0.8%
GSL Capital	11000	0.6%
Other (includes Farm Forestry	682000	37.3%
Total	1827000	100.0%

1. Figures for GFP exclude interests in Mangakahia JV with CHH, Nelson estate with Weyerhaeuser, and interests in Evergreen and Wenita

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Based on presentation to 2005 NZIF Conference.

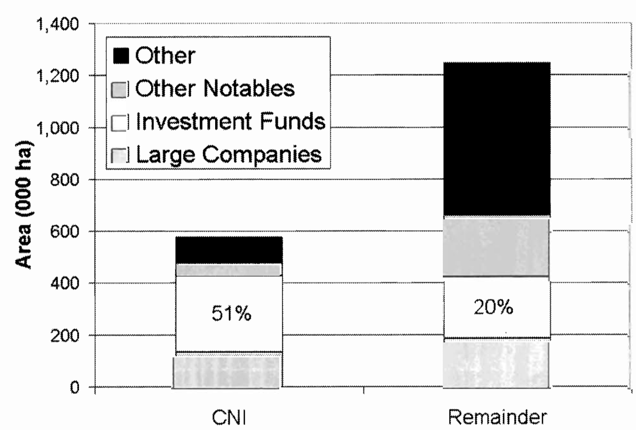
Consider the four ownership types in New Zealand:

- Large (by New Zealand standards) forest product companies integrated with processing plants and with more than 50,000 ha of operable forest. Examples are CHH, Ernslaw One and Juken Nissho.
- International Investment Funds. These take a number of forms:
  - o TIMOs such as GFP, GMO, and Hancock.
  - o Institutions that invest directly such as Harvard.
  - o Private equity funds.
  - o Real Estate Investment Trusts (REIT) such as Rayonier.
- Other Notables with between 15,000 and 50,000 ha. Examples are Blakely Pacific and Oji Paper.
- Other small owners.

Table 2 summarizes the ownership of New Zealand plantations on the basis of these ownership types. Investment Funds now collectively own more forest than either the Large Companies or Other Notables groups.

Investment funds have the most concentrated ownership in the Central North Island (CNI), with their share much lower in other parts of the country (Fig. 1). This concentration reflects a number of factors including the functioning market for logs that exists in the region

Fig. 1: Regional ownership (equity basis) of New Zealand plantations



Note: CNI defined per NZ Forest Industry Facts & Figures (i.e. excludes Hawkes Bay and Auckland regions).

However, TIMO investment in New Zealand is not a recent phenomenon. The first fund investment was made in 1992 in the Nelson region by Resource Investments (now GFP). In the case of New Zealand, though, it is worth noting that the share held by investment funds has increased tremendously over the past three years (Fig. 2). Ownership of New Zealand's plantation estate by investment funds is a greater share than in Australia, Chile or Brazil. The high share is due to lower state involvement (as in Australia) and low concentration of industry (as in Chile). Investment fund ownership share in New Zealand is similar to Uruguay.

Table 2: Ownership of the New Zealand plantation estate (as at 30 September 2005) by ownership type.

Ownership type	Owner	Area (ha)		
Large companies	CHH	208,000		
	Ernslaw One	86,000		
	Juken Nissho	55,000		
			349,000	19%
Investment Funds	Harvard Management Company (Kaingaroa Timberlands)	165,000		
	Rayonier/DBRREEF Trust JV	145,000		
	Hancock Funds (Incl Prutimber)	102,000		
	GFP Funds	79,000		
	GMO Funds	48,000		
			539,000	30%
Other Notables	Crown Forestry	42,000		
	Weyerhaeuser NZ	33,000		
	Oji Paper	32,000		
	Blakely Pacific	28,000		
	Timberlands West Coast	27,000		
	Sam Ling (Hikurangi Forests)	27,000		
	Roger Dickie Investors	24,000		
	Forest Enterprises Investors	22,000		
	Budima/Sulistyo (Winstone Pulp)	17,000		
	Sinotrans	16,000		
	Dunedin City Council	15,000		
			283,000	16%
Other			652,000	35%
Total			1,823,000	

Notes:
a. All investment-fund interests stated on an equity basis. Data as at 30 September 2005.
b. Kaingaroa Timberlands (KT) identified separately from GMO, although GMO does have involvement in the investment management of KT.

2. Who are the "new" investors?

To understand the "new" investors it is useful to consider how the interest in plantation forestry investments differs for each industry stakeholder (Table 3). Unlike integrated forest products companies, professional investment managers are not concerned about fibre security or business scale.

For professional investment managers, the key attractions to the asset class include:

- Historically strong risk-adjusted returns.
- Forests are a growing renewable resource with global scale.
- Biological growth that underpins value appreciation.
- Low re-investment is required relative to revenues.
- Stable to rising long-term real US dollar price trends.
- Capability to build well-diversified portfolios.

Table 3: Different types of owners have different reasons for investing in plantations.

Wood Processing Company	Government	Individual or Family Investor	Professional Investment Managers
Fibre security Scale of NZ business	Rural economic and infrastructural policy tool Provider of erosion control, desalinisation etc. Environmentally acceptable source of wood	Tax "angle" Diversification (farm forestry) Savings scheme	An asset class providing superior risk adjusted returns No concern about fibre security or business scale

Fig. 2: New Zealand plantation ownership (equity basis) over time.

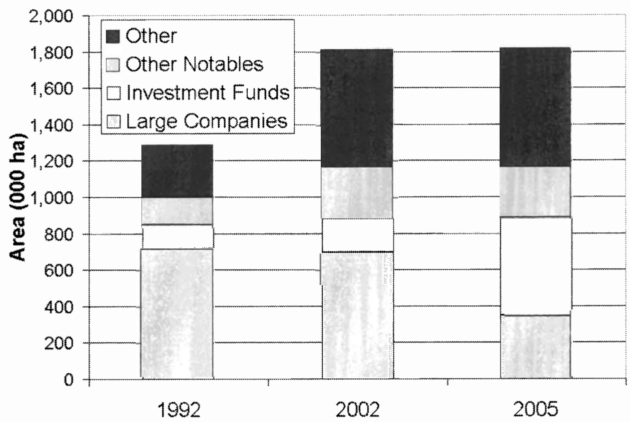
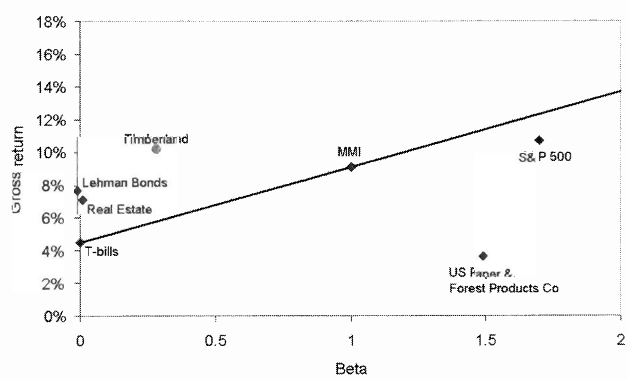


Fig. 3: Returns per annum and volatility (beta) by asset class, 31/3/87 to 31/3/05



Source: Bloomberg, NCREIF, Global Forest Partners, and UBS Global Asset Management. Data from 31/3/87 through 31/3/05. MMI is a Multiple Market Index - a benchmark created and maintained by UBS to track the global investable market (all stocks, bonds, private equity, etc.) and used as a measure of the total "market".

Timberland investment provides high historical risk-adjusted returns (Fig. 3) combined with low-to-negative correlation with traditional asset classes and this has driven interest in timberland as an asset class, especially in a constrained return environment for mainstream asset classes.

Types of investment vehicles include:

- Asset management funds managed by TIMOs.
- Real Estate Investment Trusts.
- Private equity funds.
- Publicly-traded partnerships and listed "pure play" entities (e.g. Evergreen Forests Ltd).
- Direct investments.

Of the various investment vehicles TIMOs are the most significant and manage more than US$ 15 billion worldwide. They have various fund structures for institutions and high net worth individuals. Key characteristics of TIMOs are that they:

- Focus exclusively on total return on a real IRR basis, comprising cash flow generated and value of the investment.
- Make minimal use of leverage (i.e. debt).

The contrasts between TIMOs and New Zealand forest products companies are worth noting (Table 4). Unlike the traditional forest products company with a dispersed shareholder base and a focus on reported profitability, TIMOs acquire and manage properties for small groups of limited partners with a focus on the cash-flow based internal rate of return by the fund's investments.

GFP is a "case study" of a TIMO with global timberland investment experience. GFP structures and manages timberland investments on behalf of approximately 80 institutional and private clients. Today GFP manages US$ 1.5 billion and more than 450,000 hectares through closed-end commingled funds and individually managed accounts tailored to meet the needs of investors. Investments are evenly split between Oceania (New Zealand, Australia), South America (Argentina, Brazil, Chile, Uruguay) and North America (U.S. South).

3. What are the driving factors of their purchases?

TIMOs emphasize diversification of risk and superior returns. They strongly compete with one another for investment mandates from investor clients. Only the best investment management firms succeed. Performance results are closely monitored by TIMOs and clients. The focus on investment results is unrelenting.

Sophisticated research and thorough due diligence surrounds each acquisition by a TIMO. They focus on timberlands with very limited vertical integration.

Factors that drive an acquisition are:

- The unique, articulated strategy that each TIMO has

Table 4: Comparison of the TIMO model with the traditional New Zealand forest products company model.

Traditional New Zealand Forest Products Company Model	Investment Fund Model
Dispersed shareholder base who management meet only occasionally.	Small shareholder base with which regular one-on-one meetings are the norm.
Focus on internal performance measures and reported accounting profit.	Timberland portfolio based on investment allocation models (not "strategic growth initiatives").
Quarterly sales & pricing initiatives.	Focus on macro investment return and value fundamentals.
Measured by supply-driven harvest and reported profits.	Each fund is a stand-alone entity, not a subsidiary sheltered within the corporate group.
Long asset holding periods with regional integration.	Limited integration and/or processing assets.

about the industry.
- Key investment parameters of an investment, not strategic growth justifications.
- A multitude of risk factors.

In evaluating a possible acquisition, TIMOs have the ability to globally benchmark in detail based on the spread of investments their funds own. Some seek forests with certification under internationally-recognized standards.

4. What are their strategies for the next ten years?

Investment funds will continue to focus on delivering superior risk-adjusted returns. They will:
- Facilitate the further release of capital tied up in forests.
  - o Forests are "balance sheet" businesses, while processing is driven by the "income statement".
- Enable "best of breed" manufacturers to expand by supporting these superior processing customers.
- Continue to develop markets so as to add value to the timberland investment.
- Relentlessly focus on executing investment strategies to maximize return and reduce risk.
- Improve forest quality consistent with forest value.
- Capitalize on the continued globalization of the industry.

5. What has changed to make them want to purchase NZ forest assets?

New Zealand represents an important component to a diversified timber portfolio. Although TIMO interest in New Zealand is not a new phenomenon, with more than 13 years of investment experience in this geography, investment capital targeted at the asset class has increased significantly in recent years.

By constructing a globally diversified portfolio, risk-adjusted returns from timberland are enhanced. New Zealand offers a useful component within such a timberland portfolio. New Zealand risk may be on the rise given the global nature of the business. That is, New Zealand's forestry industry is not as regionally isolated today as in the past. However, the competitive market for logs in New Zealand means that risk is still relatively low.

Conclusion

Investment funds will remain a permanent part of the New Zealand forest industry. However, they will continually assess on a relative basis both industry and country risk (including political) in their appraisal of the value and development opportunities NZ represents.

Investment funds have a vested interest in a successful and profitable processing industry. Consequently, they will be a facilitator of capital for industry expansion and will facilitate the development of new markets. Importantly, they will assist in generating new opportunities for New Zealand products in global markets.