OLSEN NEWS

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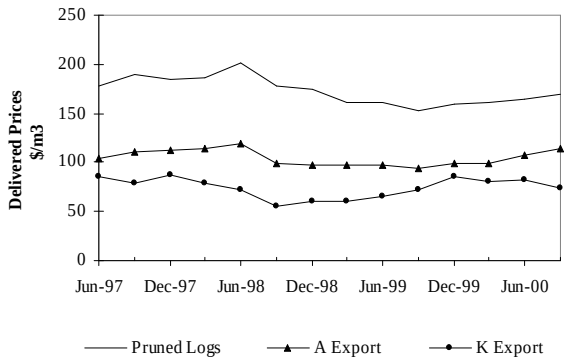
Log Prices and the Long Term Perspective

The market value of forests is subject to fluctuations in log prices, tending costs and logging costs. While it is possible that log prices will increase next year, this is by no means a certainty. Recent price rises have been mainly the result of a weakening of the NZ dollar exchange rate. In US dollar terms, prices as reported by MAF, have continued to decline until the last reported quarter ending September 2000.

If the NZ dollar exchange rate improves, then even relatively moderate increases in US dollar prices may be negated.

The following two graphs show how prices have moved in both NZ$ and US$ terms in the past 3 years.

HISTORICAL LOG PRICES TO INDEPENDENT GROWER ($NZ, inflation adjusted)



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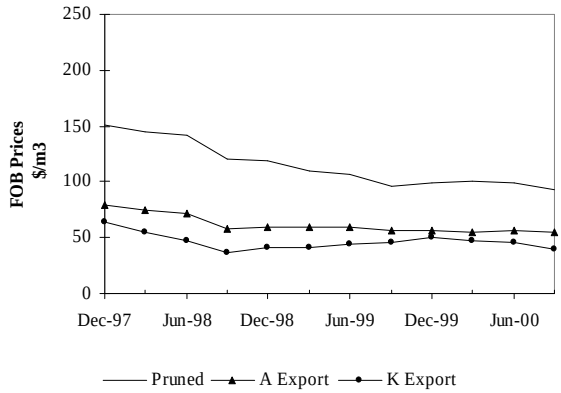
HISTORICAL LOG PRICES OVER LAST 12 QUARTERS ($US, inflation adjusted)



A confused market combined with some gloom both on the domestic and export market fronts sums up the outlook for log prices in the short term. The outlook for the domestic market is negative because of a decline in the demand for structural timber in Australia. The Olympics and the introduction of GST had increased demand early this year. Australian mills are now reportedly down to 65% of their June production levels. The New Zealand economy is also slow to come out of its recession. The US market continues to be a profitable outlet for clear grades, which continues to support the pruned log prices.

On the export front Japan is steady but the outlook for Korea is negative at present. Stocks have built up and the pressure is down for US$ prices.

Recent increases in the costs of shipping have had a significant effect on our export log prices, but in addition transport in New Zealand and logging costs have also increased by about 10% on average. This has been the direct result of high fuel costs combined with a weak New Zealand dollar and an increase in the New Zealand wide harvest levels (from 17.4 million cubic metres in the year to September 1999 to 18.6 million cubic metres in the year to September 2000). There is continuing pressure to increase these harvest levels, which provides a positive outlook for those harvest and transport companies who have seen their margins declining in recent years.

On a more positive note, a recent report by the Food and Agriculture Organisation of the United Nations (FAO) contained some good news for New Zealand forest owners. Increases in global demand for timber will continue to outstrip increases in supplies of wood available from the world's plantation forests, according to the report.

The FAO report says that overall demand for wood is expected to increase by 25 percent from 1996 levels to just under 1.9-billion cubic metres in 2010. Wood production from New Zealand's planted forests is forecast to be around 30-million cubic metres in 2010.

On a world-scale, New Zealand will continue to be a small supplier of roundwood although it will remain an important player within Asia-Pacific wood markets. New Zealand's plantation production currently contributes just over one percent of global industrial roundwood production, and just under five percent of estimated global production from forest plantations.

Another FAO report suggests that the supply of larger dimension sawlogs is undergoing serious decline:

"Overall, fibre and wood availability is abundant in Asia and the Pacific and looks likely to remain so for the near to medium-term future".

"Currently, the long-term prospects for sawlog supply are bleak. An analysis of non-coniferous sawlog supply carried out under the FAO Global Fibre Supply Study (GFSS) showed that the region's long-run sustainable yield of sawlogs will be only 59 percent of current harvest levels. This is considerably worse than in other tropical zones."

In the longer term countries such as Indonesia, India, Philippines and China are likely to import significantly more logs or processed wood products. However in the short term, demand remains quite weak at a time when supply from New Zealand is increasing quite rapidly.

Development of a Juvenile Wood Index

Olsens has recently led and managed a Technology New Zealand project in co-operation with the Radiata Pine Breeding Co-operative and ***Forest Research***.

The objective of this project was to rank top parents in the New Zealand Radiata Pine Breeding Programme in terms of grade outturn and value of the juvenile wood of their progeny. These parents are currently used in radiata pine seed orchards to produce seed for commercial forests.

Juvenile wood is considered to be of low value because of reduced strength and stiffness and has poor dimensional stability resulting in degrade from warp. The wood characteristics that cause these problems are:

- Low density
- High spiral grain
- High microfibril angle
- Increased incidence of compression wood.

These characteristics are considered to be under genetic control.

The study was in two parts:

1. Ranking of the top 85 production population parents on the basis of the four characteristics considered important in reducing the quality of juvenile wood. This data was obtained from core samples of standing trees.

2. Felling and sampling of families that are crosses among the top production population parents to establish the relationship between traits that are considered to be important for juvenile wood and grade outturn from a mill study.

The study has provided breeding value estimations for juvenile wood index traits on the top clones in the production population. The juvenile wood index will rank the production population clones with better juvenile wood for structural purposes. Results from the mill study shows clearly that there are real differences between families in terms of grade outturn.

Although further work is required on the juvenile wood index to substantiate the results, there is a good take home message from this work**: strategic selection of parents in planting stocks can result in real value gains at the mill.**

Sustainable Forest Management

Interest in SFM certification is now increasing rapidly world wide as more high value European and US markets demand Forest Stewardship Council (FSC) or other SFM certification. Here in NZ, Fletcher Challenge Forests have just achieved FSC certification as has City Forests based in Dunedin. Some other significant forest owners are well advanced towards certification.

There is increasing evidence of improved market access and even a log price premium applying for FSC certified forests. The costs of both obtaining and maintaining FSC certification can be significant to the point where smaller forest owners acting alone simply could not participate economically. To overcome this Olsens are now investigating group FSC certification on behalf of clients who wish to participate.

Carbon Credit Update

The Prime Minister has said: *"We want New Zealand to be recognised as a country which takes its environmental responsibilities seriously…Reaching our Kyoto Protocol commitments requires action across the economy and society. Our goal is to draw up a comprehensive programme to enable us to meet our international obligations"*.

The Ministry of Environment has been consulting with industry and formulating policy recommendations for the Government. Forest industry leaders remain concerned that NZ will ratify the Kyoto Protocol in mid-2002 without proper analysis of the potential impacts on NZ and the forest industry. Specific concerns are:

- Noises from Government that it may appropriate a portion of forest sink credits.
- No clear pathway for inclusion of developing countries who are not signatories to the Protocol e.g. China, Indonesia, Chile, Brazil, Malaysia, Indonesia – imposing high costs on NZ business relative to our competitors in global trade.
- Treatment of harvested logs as emissions by the forest owner in the first commitment period 2008 – 2012. (This varies from coal which is treated as an emission by the firm that burns it, not by the firm that mines it).
- Relative treatment of pre-1990 and post-1990 forests, potentially distorting the market and harvesting patterns as we approach the start of the first commitment period in 2008.
- Impact on cost structures and international competitiveness of NZ wood processing industry (that in turn impacts on forest values).

The Government is supporting the concept of both domestic and international emission trading as a mechanism to reduce overall costs of meeting the Kyoto Protocol. However at the recent meeting at the Hague the US and EU failed to agree on forest sinks as a mechanism to offset emissions. Further meetings are to be held in 2001 to try and reach a compromise agreement.

The Sydney Futures Exchange appears to have withdrawn from the carbon trading business. However, when the appropriate NZ legislation and policies are in place, and there is international agreement on some key definitions and accounting mechanisms, there will be opportunities for trading through other international exchanges or directly between pooled forest owners and domestic or international emitters.

Meanwhile, Olsens are now well equipped to act as a Carbon Pool Manager to assist forest owners with trading their carbon sequestered in 2008 to 2012. However it is our view that without Government legislation and carbon accounting procedures in place, there are considerable risks attached to early trades. Although emitters and forest owners may get together and effect a trade, unless that trade is recognised and accounted for by the NZ Government, the credits may not be able to be utilised to help offset the purchaser's emissions.

The most useful thing forest owners should be doing now is to ensure their forest descriptions will allow buyers of sequestered carbon (or the forest itself) to have confidence in what they are buying. Without this confidence there must be discounting for risk. This means good area and inventory information.

CP Seed and Wood Quality

This year we have witnessed a significant swing towards use of Control Pollinated (CP) seed and away from Open Pollinated (OP). There is also less availability of good genetics from stoolbed cuttings. The price of CP seed has fallen significantly as Proseed loses its market dominance to other producers (including Olsen Seed). Nurserymen are reluctant to establish new stoolbeds with good genetics so readily available at lower cost via seed.

The trend is driven by an increasing appreciation of the significance of spiral grain and density as determinants of the value of timber in end use (and therefore of logs). The GF Plus scheme allows selection of specific crosses that make up a family lot favouring these wood properties. Other forest owners (especially Northland) are able to get good density from the environmental conditions and favour the significantly superior growth that some CP seedlots give over OP.

The recent Wood Quality Workshop run by the University of Canterbury confirmed the significance of both density and micro-fibril angle as determinants of timber stiffness. (Timber stiffness is what matters most in structural applications and for Plywood and Laminated Veneer Lumber). Both characteristics are highly heritable. We expect to see breeding programmes further refined to favour high density and low micro-fibril angle.

Meanwhile the tools are already in use to measure the average stiffness in a log and segregate logs at the log-making stage. This technology is now being extended into the sawmill. Initially this will allow low-grade timber to be segregated before money is spent on drying, planing and Machine Stress Grading it. As the technology develops further it is not unreasonable to expect that forest owners will be paid according to the value of the timber within logs, rather than according to external log appearance, as is largely the case now.

The message for those planting a forest now is simple – plant the very best genetics you can get your hands on, having due consideration for your growth site and target end-use.

Two Lift Variable Pruning

An Olsen client that owns 350 hectares of young forest, recently made the decision to change their original tending regime. The original regime included three pruning lifts to achieve a pruned height of 6.5 metres over 300 stems per hectare. They have now switched to a two pruning lift regime to achieve an average pruned height of 5.5 metres over 350 stems per hectare.

Partnership Co-ordinator Peter Clark says the reasons for changing were:

- The need for higher final crop stockings to keep branch size in the logs above the pruned zone down. This results in sawlogs with less than 6cm maximum branch diameters - a higher value log grade. The requirement for higher stocking regimes has become apparent following the harvesting of the low stocking regimes, which were popular in the early 1970's, where low percentage outturns of quality sawlogs are being achieved.

- The market for pruned logs has changed. While there is still a premium for large diameter logs there is no longer any length premium. Processors of pruned logs are purchasing logs from 3.7 to 5.9 metres with the most active market between 4.0 and 5.0 metres.

- The cost of pruning has risen sharply. Under the new regime more stems per hectare are pruned but the reduction from three to two lifts has provided significant savings to the Partnership.

- The Tending Analysis the Partnership commissioned Olsens to complete showed that the estimated net revenue per hectare for the new regime was almost the same as the original regime. A reduction in pruned log volume per hectare was compensated for by a total per hectare volume increase and by the increased percentage of higher value sawlogs.

- Some major corporates forest owners are also using two lifts on some of their sites.

The Partnership, after the appropriate research, analysis and discussion believe they have made the right decision for their forest investment.

If you would like to re-examine your tending regimes please contact your forest manager.

Olsens wish all their clients and associates a Merry Christmas and successful year in 2001.

PF Olsen and Company Ltd was founded in 1971 by the late Peter Olsen. Since then we have grown with the forestry industry. We now have over fifty staff operating from nine offices throughout New Zealand. The company is owned solely by its employees. Our Board of Directors is elected by the staff shareholders. All the shareholders have a stake in providing the best possible service to you and in maintaining our reputation as a leader in forest consulting and management.

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