

OLSEN NEWS



PF Olsen and Company
Professional Forestry Services **Ltd**

Issue N° 18 – November 2002

▲ *Climate Change, Kyoto & Sink Credits*

We are not happy. The Government has released its Confirmed Climate Change Policy. Under this policy the Government proposes to retain full ownership of 100% of the carbon sequestration credits created by investors in forest plantations established on grasslands since 1st January 1990. The Government proposes to use about half of these credits to offset greenhouse gas emissions from other sectors of the economy (agriculture, power generation, manufacturing, vehicles etc). What it proposes to do with the other half, not needed during the first commitment period (2008 to 2012) remains unclear.

Our concern is not so much the retention of the credits – we understand that the Government cannot hope to meet its Kyoto commitments in any other way that would not cripple the whole NZ economy. Our real concern is the lack of specifics around how the forest owners are to benefit in exchange for the loss of the direct international tradable value of these credits. These credits are tradable now. There are buyers out there and they have value. In order to prevent a trade taking place the Government would have to legislate to strip the property right from the forest owner, and in the process clearly acknowledge that a property right exists that is identifiable and separate from trees and land.

It appears to us that the sink credits partially shield our building materials competitors (concrete, steel, plastics, aluminium) from the full impact of carbon taxes that would otherwise be needed to meet the Kyoto emissions targets. In addition, with US, Australia and most of our developing nation competitors not ratifying the Protocol, there is the real potential that NZ will become less attractive for wood processing than those nations – the opposite to what we need to make the most from our forests!

So what do we want from Government? The Climate Change Policy contains a number of positive initiatives for the forestry sector, but does not go nearly far enough. At NZ\$25/tonne, the value of the retained credits, surplus to requirements over the first commitment period, is in the order of \$700 million over 5 years. Our view is that 100% of the value of the surplus credits must be recycled back into making the forestry and wood processing sectors in NZ internationally competitive. This expenditure could be funded, in part at least, from the windfall in taxes the Government will receive by way of its proposed carbon tax from 2008, and the gains it makes on its electricity generation assets from the inevitable rise in power prices and associated GST. The outcome would be hugely positive for the whole

economy as wood processing investment expands. Forest owners would enjoy a competitive domestic demand for logs, vastly reducing the need to export such a high portion of our logs into lower value commodity markets.

The initiatives that could help achieve this vision are many and need not involve direct subsidies. Examples are:

- increased research into wood quality and forest health,
- investment in roads and energy supplies (including greenhouse neutral bio-fuels),
- increased efforts to break down tariff and non-tariff trade barriers,
- export market development initiatives, removal of investment blockages under the RMA and reduced business compliance costs,
- initiatives to coordinate wood supplies of small growers into supply packages,
- “green label” Sustainable Forest Management (e.g. FSC) certification assistance for small growers.

In order to avoid the need to “bank” sink credits from the first commitment period to cover shortfalls in subsequent periods, there needs to be initiatives that result in increased forest planting. The most powerful driver will be demonstrable improvements in the profitability of growing forests that will emerge as a result of the initiatives above. In addition the Government needs to make the purchase price of forests immediately tax deductible in the hands of the purchaser (rather than parked in a Cost of Bush account until the forest is sold or harvested as at present). The short-term impact of this change may be to make purchase of immature forest more attractive than new planting. But new planting is very low now anyway, so there is not much to lose. The current tax treatment reduces the liquidity of forest investments considerably, and that is a serious disincentive to new planting investment.

Energy Minister, and Convenor of the Ministerial Group on Climate Change, Hon. Pete Hodgson, has acknowledged the significant contribution made by the forestry sector to NZ meeting its emissions targets. He has acknowledged that “a portion” of the sink credits are to be channelled back into the forestry sector in some form. What we are struggling to achieve is a firm commitment as to what portion? Are we talking 5% or 95%? And are we talking about new investment initiatives or simply re-packaging current Government

spending commitments under the Forestry Framework banner?

Through NZ Forest Industries Council and the NZ Forest Owners Association we are in active dialogue with the Minister and his officials.

▲ *Forest Valuation*

Forest Valuation Standards and Practice

The New Zealand Institute of Forestry (NZIF) in May of 1999 published the Forest Valuation Standards. These standards were the work of the NZIF Forest Valuation Working Party. The Forest Valuation Standards must be adhered to by the members of the NZIF and provide a framework for the valuation of commercial forests in New Zealand. The Standards cover the following items:

- How to describe a forest;
- Guidelines in respect of the valuation methodology; and
- Rules on disclosure and presentation.

Olsens have been an active participant in the development and application of the NZIF Forest Valuation Standards. Peter Clark was a member of the group that developed the standards. Recent input has been from Consulting Manager, Theo Vos. The framework provided by the standards has allowed the development of an excellent link between the values assessed and the prices actually paid for forests. The two factors that facilitate this link are:

- The use of the Land Expectation Value in attributing the cost of land in a cashflow; and
- The incorporation of taxation as a cost in the cashflow.

The Land Expectation Value (LEV) is the economic value of the land for forestry use. The use of this concept allows the valuation of relatively young stands of trees with much better precision. A reconciliation with the land market value is necessary to make sure that the combined value of land and trees is in line with the price that is likely to result from an actual sale.

The incorporation of tax as a cost of doing business and taking the tax perspective of the purchaser has resulted in getting a much more consistent result from analysing actual sales. The implied discount rates, applied to post-tax cashflows and assessed using good estimates of costs and revenues, are now generally in a narrow band. Despite the fact that there are few transactions in New Zealand, we now have a better feel for the market.

Accurate forest description, market evidence, analysing actual transactions using the same set of standards as are used in the assessment of value and deriving a discount rate, is the key to obtaining a reliable estimate of a tree crop market value.

Using a discount rate derived from market transactions together with up-to-date log price forecasts allows a more up-to-date estimate of the tree crop value to be made.

For assistance with forest valuations please contact our Consulting Manager Theo Vos at our Rotorua office on (07) 357 4135 or email - theo.vos@pfolsen.co.nz.

▲ *Your Harvesting Decision*

What do forest owners need to consider when preparing for harvesting?

Independence and Conflicts of Interest

If your adviser is also either a logging contractor or a log buyer – be aware. There are many reputable operators that can and do manage potential conflicts of interest well. Others do not. Your best protection is to avoid situations that encompass the potential for conflicts of interest to arise.

SALE METHOD

Managed Log Sale means negotiated log sales with established log purchasers in the region. There is likely to be a mix of domestic and export purchasers. Our experience has shown that the prepared log sale technique is usually the best method to maximise the forest revenue, as the forest owner is able to seek the best price for each grade.

Lump Sum Stumpage Sale means a tender system with the effort going into structuring and packaging tenders to attract interest and obtain good prices. Stumpage sales are becoming more common and have been successfully used by Rayonier and Carter Holt Harvey. The forest owner's risks tend to be less with stumpage sales, but the potential to maximise forest values is also lower. This is understandable as stumpage buyers factor in both total volume and grade outturn risk (inventory based rather than actual), as well as harvesting operational risks.

Graded Log Stumpage Sale is a combination of a managed log sale and a stumpage sale. The stand is still sold on a stumpage basis, but the payment depends on the actual volume outturn, removing buyers' risk on both total volume and log grade mix. The buyer commits to a price per tonne or JAS for the identified grades to be cut. The vendor must supervise log making to ensure that the potential value from the tree stems is optimised.

A variation on this is the **Composite Price Stumpage Sale**. A single price for all grades is offered by the buyer. This removes the need to supervise log-making, but puts the log grade mix risk onto the buyer – a factor that will be reflected in the price offer.

The best method depends on size, location and tree quality within the stand. For example stumpage tenders for small blocks often do not attract interest. In this case the most appropriate method for marketing these is to supply the spot log markets in the region under a Managed Log Sale.

Olsens are in a unique position where we can offer the choice of these methods from an independent perspective.

Are You Getting Paid for Everything Produced?

Olsens have developed a log tracking system (Woodtrack) that records log docket information, contractor payments, reconciles buyer created invoices against actual production, generates reports and monitors woodflows. This is extremely important to ensure you are getting paid for what your forest produces.

*“Savings to clients through proper checking of buyer-created invoices presented by third parties have been enormous during 2001 & 2002 - far exceeding the total fee charged by Olsens for harvest management services”
(Dawn Lewis, Olsens Woodtrack Manager).*

“Green Labelling” your logs – improve marketing options
FSC certification at cost effective rates is now available through Olsens FSC Group Scheme. This may mean you can sell to a mill that is closer, when your neighbour whose logs are not certified cannot get access to that same market. FSC Certification enhances market options for our clients as demand for certified wood increases, or if there is a downturn in the market at the same time as harvest volumes in NZ are expanding.

Log-Making Audits

In addition to our own supervision, Olsens use industry specialised third party auditors to monitor contractor log-making performance. *“The difference between a good log maker and an average one can amount to thousands of dollars” – (Matt Dodd, Harvest Planner).*

If you have any questions about harvesting your forest you should contact your forest manager in the first instance. However, we also invite you to contact Morris Yeoman, Matt Dodd or Mike Hodgson at our Rotorua office (07 357 4135) for specialist assistance.

▲ **USA Fires**

In the late 1990’s senior government officials from New Zealand, Australia and the United States of America finalised an agreement promoting closer co-operation and assistance between the countries on fire related issues and activities. One development from the agreement was the dispatching of management teams from New Zealand to assist fire fighting operations in the USA in 2000 and Australia in 2001.

In July this year an extended fire season in the USA again put a strain on their manpower resources, particularly at an operation management level. US officials indicated they would appreciate assistance. Phill Wishnowsky from Olsens was asked if he would join a 9-strong NZ team.

After two days of briefing and kitting out at Boise, Idaho Phill was deployed to the Biscuit Fire in Southwest Oregon. ‘Home’ was a pup tent in a fire camp (one of six set up around the perimeter of Biscuit Fire), along with 1800 others. At the peak of the fire fighting effort, 7,800 people were assigned to the Biscuit Fire. When the kiwis arrived in the USA, Biscuit Fire was one of 31 campaign fires. Biscuit Fire was finally contained on 6th September at 200,000 hectares (500,000 acres). This is one of the largest fires in history in the USA. To get an idea of size, this is larger than Stewart Island, or larger than the combined area of Wellington, Porirua, Lower Hutt and Upper Hutt City Councils.

Daily routine was rise at 5.00 am, daily briefing at 6.00 am, travel to the fire ground (approx 1 hour away) for the day’s work finishing on the job anytime up to 9.00 pm before travelling back to camp for a meal, shower and bed.

Fire fighting was a mix of direct and indirect attack. Direct attack is where people, machines and (sometimes) water is used to put the fire out. Indirect attack is where firebreaks are constructed ahead of the fire front to form a barrier to hopefully stop the fire advance. Often the team would back burn from these firebreaks, lighting up a fire that would burn back towards the main fire. This method proved very effective in many situations.

Fire fighting in the USA is fully professional at all levels. Specialist “Hot Shot” teams of 20 travel the country going from campaign to campaign as needed by the authorities.

These Hot Shots are the elite fire fighting teams. Fighting campaign fires is conducted with a strong military theme – it is indeed war on fires. The whole environment (including camps) is drug and alcohol free. Discipline is strict and hard.

Daytime temperatures sometimes exceeded 40°C, usually with humidity below 30% and sometimes down as low as 5%. Night time temperatures were as low as 4°C, usually with heavy dews.

Phill’s participation was a chance in a lifetime to experience wildfires and fire suppression in the USA - experience that can be valuable when protecting our client’s forests from fire damage.

▲ **Staff**

The opportunity to return home to Whakatane, and the challenge of harvesting on some steep and difficult terrain in the Eastern Bay of Plenty for CHH Fibre Resources, was too difficult to turn down for our Harvesting and Marketing Manager Les Russell. Les has advised that he will be leaving Olsens at the end of November.

Les started with the company in 1982 and has been a loyal and extremely hard working employee throughout his time with Olsens. We wish Les the very best in his new job and look forward to working with him in the future.

We are currently interviewing candidates to replace Les and will be expecting to appoint someone within the next few weeks.

Continuing on the harvesting theme Morris Yeoman has just joined Olsens to assist in the harvesting area. Morris has 30 years experience in all aspects of harvesting and will provide considerable expertise as we expand our harvesting services.

▲ **Log Markets**

Export log markets

Export log markets were steady in the past quarter, but there is an expectation that prices will fall off slightly in the next quarter as the New Zealand dollar strengthens, demand in Korea remains flat and ocean freight charges have increased as vessels head for the undersupplied Atlantic trade.

For the year ending June 2002, Korea remains our most important log market by volume, taking more than 56% of our log exports. The ranking of other significant exporters has altered from the previous year. Japan’s imports of logs has fallen right back to 18% from 27%, while China’s imports have doubled to 17%. India’s imports have dropped to 3% from 8.4%, Philippines remains almost level at 2.8%. The total volume of log exports increased by 4% during the year.

Volumes and average log prices of exports to China continue to improve. The fall off in exports to India appears to have reversed, but annual exports are still well below the peak two years ago. The short-term outlook for export log prices is negative.

Domestic markets

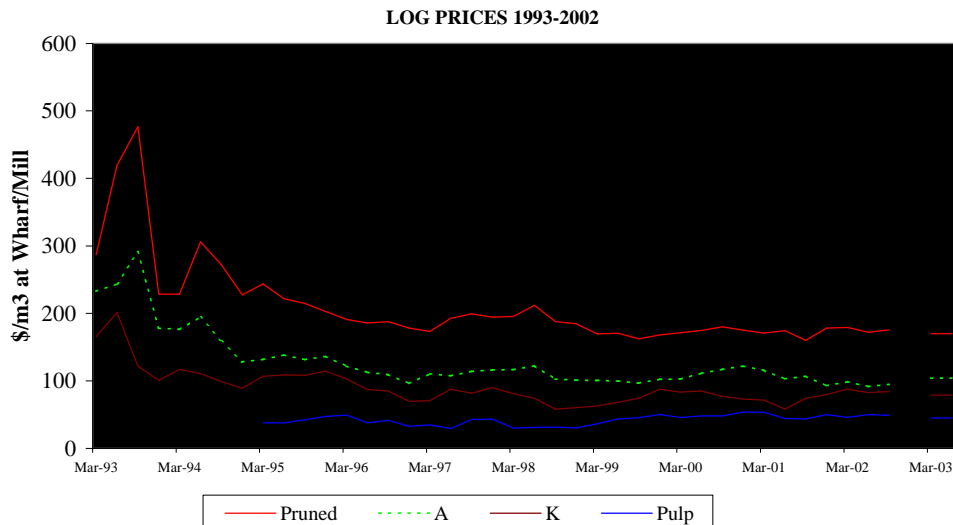
In the domestic market, pruned log prices remain firm especially for high quality pruned logs. The US prices for clear timber remain strong and the outlook there for the short term is good.

The Australian market looks steady. The government-building subsidy to first homeowners has been halved but continues to stimulate the building industry. Despite this positive outlook for sawn timber exports, the current demand for unpruned logs in the domestic market is steady and prices are weak.

Total sawn timber exports have increased, they were 15% higher in 2001/02 compared to the year before. Australia, formerly our largest market at 23%, has been overtaken by the USA at 27%. Japan increased its proportion to 19% from 18%, and Taiwan is steady at 9.0%. The increase in exports was across the board with the USA the destination for the largest increase. The smaller markets in China, Hong Kong and Thailand also expanded, but the volumes to Korea remained constant.

Longer term outlook

The decline in log production from New Zealand plantation forests in 1999 has been strongly reversed to reach a total uplift of 21.3 million cm³ for the year ending March 2002. The New Zealand domestic market is not growing and, with the recent publicity about poor quality timber frame houses, cannot be taken for granted. Expansion of both log and timber exports is essential and this year's performance has been more encouraging after the past two difficult years. Australia is an important market but Australian domestic production is increasing and the country is expected to be self sufficient in softwood by 2010. Entering new markets and expanding market share in existing markets is essential to expand the current annual harvest from 21 million cubic metres to 30 million cubic metres within the next 10 years. Our experience so far is that we have been able to find markets for our expanding supply of wood. Wood supply and demand analysts (FAO in particular) remain convinced that the demand for wood in the Asia-Pacific region in particular will exceed supply.



**HAVE A RELAXED CHRISTMAS AND HOLIDAY BREAK
AND ALL THE BEST FOR 2003 FROM THE OLSENS TEAM.**

Location	Postal Address	Office Address	Phone	Fax
Rotorua (Head Office)	Peter Clark (CEO) P O Box 1127, Rotorua	430 Ngongotaha Road	(07) 357 4135	(07) 357 5185
Far North	Bob Shirley P O Box 633, Kaitia	228 Commerce Street	(09) 408 0480	(09) 408 2974
Mid North	Peter Bullen P O Box 322, Kawakawa	62 Gillies Street	(09) 404 0032	(09) 404 0455
Gisborne	Nick Bunting P O Box 516, Gisborne	396 Childers Road	(06) 868 5426	(06) 868 4147
Hawke's Bay	Bob Pocknall P O Box 824, Napier	72 Ford Road, Onekawa	(06) 834 3871	(06) 834 3872
Wairarapa	Phill Wishnowsky P O Box 2059, Masterton	Cnr Dixon & Crayne Streets	(06) 377 3531	(03) 377 2913
Nelson	Peter Wilks P O Box 3353, Nelson	195A Queen Street	(03) 544 0066	(03) 544 0067
Marlborough	Rob Lawrence P O Box 282, Blenheim	Marlb. Research Centre, SH1	(03) 577 6675	(03) 577 6674
Otago	David Thode P O Box 975, Dunedin	Unit 12, No 4 Strathallan St	(03) 455 8995	(03) 455 0107
Olsen Seed	Wei-Young Wang P O Box 1127, Rotorua	430 Ngongotaha Road	(07) 357 4135	(07) 357 5185
E-mail:	info@pfolsen.co.nz or firstname.lastname@pfolsen.co.nz	Internet:	www.pfolsen.co.nz	

You are welcome to copy articles from this newsletter with appropriate acknowledgement of the source. However, please note that this newsletter is for information only and should not be acted upon without specific advice from us. We do not accept any liability other than to our clients and only then in relation to specific requests for advice.