

OLSEN NEWS

▲ *Forest Industries Framework Agreement (FIFA)*

The executives of NZ Forest Owners' Association (NZFOA), Farm Forestry Association (FFA) and Forest Industries Council (FIC) have been considering their response to the Government's package offered in recognition of the fact that post-1989 forests have generated the CO₂ surpluses that enable New Zealand to meet its Kyoto Protocol (KP)

commitments during the first Commitment Period (CP1).

In summary, the Government offer comprises policy matters, funding over the next 5 years (some of which is subject to industry co-funding), and funding contingent on both Russia ratifying the KP and on other Government spending priorities:

A. Policies

Item	Policy	Comment
Deforestation liabilities – Non-Kyoto forest owners.	Government retains liabilities up to the equivalent of 10% of area deforested.	No clarity on how the 10% cap will be allocated across owners, or between landowner and forest owner where these are not the same.
Deforestation liabilities – Kyoto forest owners.	Government accepts all liabilities for deforestation for CP1. For future periods the liability would not exceed the proportion of sink credits devolved (if any).	
Government procurement policies to encourage substitution of greenhouse gas intensive materials with wood.	No firm commitment from Government on this. It is under further study by Government.	

B. Funding Commitment

Item	Quantum (excl. GST)	Comment
Regional development transport funding.	\$20.44 million/annum from 2004/2005 to 2007/2008 at least.	Lack of clarity around extension beyond Northland and Tairāwhiti. Amount reduced from earlier discussions of \$23 million plus GST.
Bio Energy projects.	\$2.44 million over 5 years commencing 2004/2005.	Support for feasibility studies, knowledge, demonstrations, machinery development etc.
Market Access – Foreign Affairs and Trade.	\$1.24 million over 5 years.	Industry co-funding at least 25% required.
Generic market development.	\$10.67 million over 5 years.	Industry co-funding at least 25% required.
Education, labour & skills.	\$4.44 million over 5 years.	For purchase of equipment for wood processing training.
Total over 5 years	\$121.02 million	Approximately 84% of this total is roading that is of wider benefit to rural communities and the economy.

C. Contingent Funding (Amounts indicative only and exclude GST)

Forest Health monitoring	\$4.16 million over 5 years.	Design and trialling of forest condition monitoring (necessary for credibility of KP carbon accounting).
Alternative Species	\$7.78 million over 5 years.	Additional funding for research.
Labour & Skills	\$18.55 million over 5 years.	Wood processing training, Forest Ranger training, wood products design, capital for equipment & facilities.
Total over 5 years	\$30.5 million	All subject to review and conditions.

The Executive Council of NZFOA has met to consider our response to the FIFA package. In considering our response we have looked at the role of the forestry sector in enabling the Government to ratify the KP; carbon ownership and property rights, the distinction between pre- and post-1990 forest ownership; economics of plantation forestry and land-use change; distinction between landowner and forest owner where the two are not the same entity; our options (is this the best we can expect given the Government's position?); and the member mandate we need before either committing, rejecting or seeking amendment to the FIFA. In summary our response to Government ministers so far is:

- Disappointment with some aspects of FIFA.
- Insufficient member support to endorse FIFA in its present form.
- Further time required to consult membership on what changes may be required to achieve member support to sign a FIFA package.

As a paid-up member of Kyoto Forest Owners Association on behalf of post-1989 clients, Olsens is well aware of the concerns of this group. To best represent our client interests on the NZFOA Council, what we now need is clarity on what changes both Kyoto (post-1989) and non-Kyoto forest owners would be seeking to enable them to support a modified FIFA.

Please send your views to Peter Clark at P O Box 1127, Rotorua or email peter.clark@pfolsen.co.nz.

▲ *FIEA Conference Nelson*

The recent FIEA Conference in Nelson focussed on prospects for New Zealand clear pine.

Supply Of Clear Pine

New Zealand supply is increasing from 2 million now to 5 million m³/year in 2010, while the total market for clearwood pine worldwide is not expected to be much more than that. We need to create new products/markets or beat all our competitors on cost. (Probably need to do both to make sure!) The supply in the CNI is expected to increase from 1.1 million m³ currently to 1.4 million m³ by 2010.

Our main competitors in clear pine are as follows:

Chile: Pruned log production is forecast to increase from 1.6 million m³ currently to 3.6 million m³ by 2012. 60-65% of Chile forests are pruned. There is very focused marketing by two large competing companies, Arauco & CMPC, with the former also

making appearance grade plywood. Chile is by far the biggest competitor, especially in the US.

Brazil: Limited clearwood pine supply, but Brazil is strong in finger joint *P.taeda* & *P.elliottii* exports to the US.

South Africa: Strong domestic market and strong currency at present, low cost pruning is profitable, but no potential for expansion because of water rights/issues.

US South: Much of the pruned is going into treated lumber #2 Prime for Home Centre sales, but could go into clearwood or appearance ply production.

Russia Far East: Naturally pruned logs in old growth forests. When, (not if) the Chinese get their hands on it they will use it for clear pine products.

Relatively little increase in clearwood production is expected from sources other than Chile but MDF, finger joint and edge-glued products continue to make significant inroads into solid wood market share. Also, primed MDF is taking market share from finger joint mouldings.

When developing new uses for pine we can expect strong competition from Eucalyptus clearwood produced in Brazil, Uruguay and Argentina, grown on 15-20 year rotations. These substitutes for tropical hardwoods and supply/demand appears balanced unlike that for clear pine.

Pruning pine in NZ is generally more profitable than not pruning, and the advantage of pruning increases when prices decline (and margins for unpruned logs are affected more than those of pruned logs). The margin for pruned over unpruned logs of similar size has been about \$70/m³ from 1996 to 2002, while \$50/m³ is enough to make pruning pay on most sites.

▲ *Markets*

China

China is now the world's largest furniture manufacturer and is increasing its uptake of mainly knotty pine and clear veneer (peeled and sliced). Wood imports (lumber and logs) are soaring, estimated at 31 million m³ of logs in 2004 - two-thirds softwood predominantly from Russia (these are only the official figures and probably don't include the illegal logging imports from South East Asia).

NZ pine logs suffer from sapstain, which restricts their use in furniture to parts where the stain can be hidden. NZ lumber to China is significant but competes with a burgeoning and very low-cost China

sawmilling sector. Potential is seen to increase NZ sales of competitive Radiata lumber; (but very price sensitive); pruned logs (if sapstain can be controlled); solid lineal mouldings (although hardwoods dominate at present); and flooring (possibly needing surface hardening). The ability to stain radiata has not yet been fully exploited and there has been little marketing of the "clear pine look" or clear pine made to look like whatever happens to be in fashion.

Korea

There is potential use of Radiata clears in the rapidly increasing apartment and resort construction market but low cost lumber from China (from Russian logs) is very cost competitive. Good potential exists for Radiata clearwood in interior use incorporating doors, trim, flooring and furniture units. There is already some penetration of Radiata clears from short pruned log exports from NZ but Koreans are very cost conscious (short pruned export logs to Korea sell for about \$110/JAS m³).

United States

US is the most significant market for NZ Radiata clears at present. Demand from the US is very high at present because of a booming new construction and remodeling market.

New Zealand (Tenon in particular) has very successfully penetrated the US mouldings market (US Midwest & Northeast) but this is a mature market. Solid lineal mouldings are losing market share to MDF and finger joint material (especially exports from Chile and Brazil). Shipping costs have risen from 10% to 20% of product value giving exporters an advantage over US producers once those costs decline. The price trend for radiata solid and finger joint pine in the US has been flat for the 1994-2004 period although there is considerable price volatility month by month.

Some potential is seen for NZ Radiata in doors and windows although Brazil is very competitive in this market segment.

Japan

Juken Nissho very successfully supplies interior doors, mouldings, closet systems and housing interior components using clear NZ pine. This success has not (yet) been copied by anyone else. Clear face veneer radiata plywood has been superseded by lower cost industrial face veneer treatments.

Other Markets

Vietnam, Indonesia, Philippines, Malaysia and others are using some clear pine and those markets have the potential to grow, but the US will remain the main market for clear pine for some time yet.

Competitor Supply

Russian stumpages range between US\$0.50 to US\$5/m³ although concessionaires margins are estimated at US\$20-US\$40/m³.

At these current margins volumes are likely to continue to grow rapidly even if their prices were to decline or their costs to increase. For those who cannot access concession wood there is illegal logging supplies and margins are big enough to keep everyone involved happy for a little while longer.

Australia to become "technically" self-sufficient in wood in the next 3 years. This has implications for the structural segment.

Other Positive News

Energy prices are high at present affecting the costs of concrete, steel and aluminum substitutes. Now is the time to win back market share, especially in the construction industry (good for NZ LVL and laminated beams).

▲ Compulsory Levies

The Executive Councils of NZFOA, FIC and FFA have been considering the introduction of a compulsory levy under the Compulsory Levies Act 1990. An initial survey of forestry firms confirmed widespread support for the levy concept. Some larger forest owners had objections primarily based on increased cost of business and concerns as to the uses the money would be put.

Olsens has been supporting a compulsory levy as the only sensible option for funding industry-good expenditure. (Every other major primary industry in New Zealand uses this mechanism). At present safety, education, biosecurity, fire protection, forest health and forest growing research is all funded on a voluntary basis. In nearly all cases there is neither the ability nor the desire to protect the information or knowledge arising – meaning that non-funders get a free ride. With increasing frequency of changes in forest ownership taking place and larger numbers of small owners, voluntary funding is probably not a sustainable model.

The NZFOA Executive has endorsed the next step in the process, with the rider that any compulsory levy be at the lower end (suggested 15 to 20 cents/tonne harvested) and be applied only to programmes that are clearly needed and of benefit to all forest owners. This will most likely exclude generic market promotion initiatives. A task group will now formulate the value proposition, prior to the major expenditure items of setting up a governance structure, consulting affected parties and plebiscite.

▲ Log Markets - Export

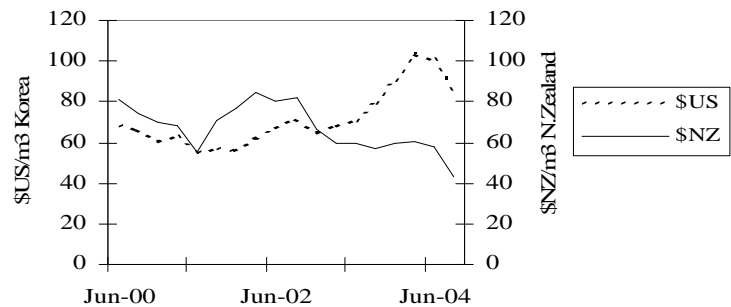
The export log market is going through a bad patch. Forest owners have reacted to falling wharf gate prices by reducing the output of export logs, either by switching harvesting to blocks with a low export log content or by reducing harvesting activity altogether.

The reasons for falling prices are straightforward. Export logs are traded in \$US. When the \$NZ to \$US exchange rate increases, either the customer pays more \$US/m³ or the grower gets less in \$NZ. In December 2001 \$US1.00 bought \$NZ2.43. In August 2004 \$US1.00 only buys \$NZ1.53.

The second factor is sharply increased freight costs. The ship owner's break-even cost to deliver logs to North Asia is around \$US25/m³. In December 2001 freight costs were \$US18/m³, due to an over-supply of ships. In 2004 an under-supply of shipping lifted freight rates to \$US52/m³, before dropping back to about \$US42/m³ in August. Neither of these costs at the extreme end of the range are sustainable in the longer term.

The graph below compares the \$NZ returns for K grade logs in New Zealand with the \$US price paid by the customer in Korea. New Zealand's price trough is a price spike in Asia. Both parties lose.

In mid-year China damped down its overheating economy by squeezing bank credit. Korea is also going through a period of low business confidence due to political and economic conditions. Chinese and Korean buyers are thus paying attention to imported log costs. If Russian logs are cheaper they will buy those in preference to Radiata pine.



Because Russian forests are harvested in winter, when the ground is hard, and are transported in spring and summer when the rivers unfreeze, New Zealand logs become more competitive during the northern winter.

Domestic log prices have held up much better than export prices. Due to improved markets in the USA the demand for pruned logs is strong and prices have increased.

Prices for structural grade log prices have remained steady, thanks to buoyant construction activity in New Zealand and Australia. Structural grade logs have a more demanding specification than export logs. Branches must be smaller and wood density higher than that required for export logs. The market for the lower quality log grades is soft, due to a lack of competition from export markets.

Summary

Low log inventories in China and Korea and upcoming seasonal restrictions in Russian log supply are expected to result in solid NZ\$ price increases this summer. If the domestic log market remains buoyant we may see a period where all log market segments are strong – an ideal time to harvest. People with mature woodlots are encouraged to prepare woodlots for harvest now, in readiness for favourable market conditions.

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