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THE SAD STORY OF FORESTRY AS AN INVESTMENT ASSET IN NEW ZEALAND – Part 1: Exporting Logs & Jobs

Back in 1983 I was working as a strategic planning analyst in the Economics Department of Tasman Pulp and Paper. It was exciting times with most of my days spent running a computer model investigating the economics of a fourth paper machine to be located at Tasman's Kawerau mill. In our spare time Neil Craig and I speculated on the NZ stock market. We were part of Fletcher Challenge, New Zealand's largest company, and all the indications were that the forestry industry was poised for huge growth. A highlight of that year, besides seeing a bunch of locals chasing a pig through the main street of Tolaga Bay whilst on a surfing trip, was the publication of the Central North Island Forestry and Transport Planning Study (CNIPS). The study was highly anticipated as it would incorporate up to date estimations of the future long term output of central North Island's forest resource and outline the implications as regards the processing of that output in terms of the pulp and paper, sawmilling and infrastructure sectors. CNIPS quoted Forest Research Institute projections which estimated that the amount of wood harvested from NZ's exotic forests would rise four-fold from around 8-9 million cubic metres a year in 1983 to 36.4 million cubic metres in 2013. The authors' estimations were about right – actual production in 2013 was 33.5 million cubic metres. What the report got wrong however was the extent to which NZ's burgeoning log production would be processed – known as the "value added" content. Despite the huge increase in log output that growth has not been matched by an increase in processing capacity. Instead, much of the extra wood output has been exported. According to a report by the FAO in 1978 NZ log exports accounted for around 5% of total roundwood production. Roll forward to today and log exports now apparently account for almost 65% of our exotic forest output.

Some will view that as a lost opportunity – for jobs, export dollars and, maybe, a competitive return on capital employed. We can speculate why the processing hasn't occurred locally – the newsprint market has all but disappeared and what remains of the pulp and paper industry requires huge and ongoing capital investment to stay competitive. One particular dark cloud was Treasury's comment on the CNIPS report where the authors made the point that the stumpage rates for government owned forests were low relative to international markets which represented a subsidy to the pulp and paper sector and urged the government to take a more market-oriented approach in respect of managing its forests. In addition, labour relations weren't conducive to big investment commitments back in the '80s and pollution regulations were probably more stringent in New Zealand than Asia so quite possibly, despite the forest resource, the returns didn't justify the investment. Whatever the reasons, none of the major pulp and paper players of the 80s like NZ Forest Products, Carter Holt and Fletcher Challenge were willing to commit the substantial capital required to materially increase processing capacity. Similarly, the expansion in sawn timber capacity didn't happen either which is interesting given that side of things is probably a lot less capital intensive than pulp and paper. In a submission on the report for Tasman Pulp & Paper, my boss at the time, John McDonald, wrote: "*It is probable that the export log trade will be more profitable and have better market growth prospects than the solid wood industry without the support of incentives for processing within New Zealand.*" The table adjacent details movement in volume and dollar value of log exports and sawn timber exports from New Zealand in 1983 and 2024 illustrating the extent to which the processing of our exotic forest resource has disappointed. Over that time the volume of sawn timber exported has increased about five-fold but the volume of logs exported has increased by about 48 times. The big changes in ownership of New Zealand's forest resource – from government and integrated pulp and paper manufacturers to overseas owned specialist forestry investors - was also probably a major factor in the decision to export unprocessed logs.

What really is extraordinary and quite sad from an investing perspective, is that more than 40 years after the excitement around the forecast strong growth in forest output, not only did the projected value-add operations via pulp and paper and sawn timber sectors not happen, but today we don't even have a large scale listed New Zealand company owning our forest resource. This is a shame because, putting aside the environmental issues, which would have occurred anyway, large scale optimally located timberland has much to commend itself as an investment asset, irrespective of the silly carbon credits regime. We will investigate that issue in a future story.

The last large scale listed forest owning company was Fletcher Forests (NZX ticker FFS). Prior to selling its forestry assets it had been a shareholder, together with the Chinese Government, in the Central North Island Forestry Partnership (CNIFP). The latter entity owned the Kaingaroa Forest which it had bought from the New Zealand Government for around $2.2 billion in 1996.

LOG AND SAWN TIMBER EXPORTS VOLUME AND $ VALUE

	1983	2024
Log volume (millions m³)	0.44	21.10
Log exports ($ million)	$28	$3,225
Sawn timber volume (millions m³)	0.28	1.40
Sawn timber exports ($ million)	$68	$854

Source: MPI and ChatGPT

CNIFP had started life with a high level of gearing and had been caught out by a strong NZ dollar and weak log prices and was put into receivership in February of 2001. Given all that bad news it is not hard to understand why local investors weren't enamored with the prospect of owning trees back then – returns in the 10 years ended May 2005 for the two pure play forestry stocks, Fletcher Forests and Evergreen Forests, were pretty dismal. Over that 10 year period $1,000 originally invested in May 1995 had fallen to just $220 and $350 respectively.

The sale of the FFS forestry assets began in 2003 when the company revalued its 106,000 hectares of forests sharply downward ahead of putting them up for sale. FFS chairman Sir Dryden Spring explained at the time that the sale decision was made because "*Over the last decade, with the exception of a brief period in the early 1990s, the forests have never earned the opportunity cost of the capital invested in them.*" As at June 2002 the forestry assets were valued at $1,176 million but after adjusting for lower log prices in NZD terms, and higher discount rates, the valuation in June 2023 was revised down to $582 million. The actual transaction occurred in 2004 for about $725 million. That transaction, which involved selling most of the forests to a consortium which comprised local Richlisters: Trevor Farmer, Ross Green, Mark Wyborn and Adrian Burr together with Prudential Timber Investments and the Ontario Teachers' Pension Plan, unfortunately coincided with a low point in the valuation of NZ forests. The nadir was a function of three important variables: log prices in US$, the exchange rate against the US$, and the discount rate used to calculate the value in 2003 $ terms of the future cashflows. While softwood lumber prices had been weak probably the biggest factors behind that lower valuation came from NZ$ appreciation – the Kiwi had strengthened from 42 cents against the US $ in January 2002 to 67 cents by January 2004 - and an increase in the real, after tax discount rate from 7.5% as at June 2002 to 10.5% as at June 2003.

That is enough for this week. In the next column we will take a closer look at that 10.5% discount rate and, with the benefit of hindsight, speculate that Fletcher Forestry assets were sold at a bargain price.