

# **Tropical Timber Plantations An Alternative Asset Class?**

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*Ethically They Make Sense  
Long Term Do They Make Profits?*

## Introduction



If you could produce a new multi-purpose material that grew itself and whilst doing so, absorbed carbon dioxide and produced oxygen. One that needed only sunlight and water and that came with a large range of capabilities. You would indeed be on to a healthy money-making-machine.

Technology has yet to produce such a product, and whether it will in the future remains highly unlikely. But let's not fret, because what we currently have is more than a match for any technological substitute. It has worked exceptionally well for thousands of years, and save for a major global climatic catastrophe, it will invariably continue to do so for thousands more .

It seems almost un-believable, yet we are all familiar with wood that we forget how incredible it is as a living material. We also tend to under estimate its value as a profitable article of trade. Simply put, timber does not actually need to rise in price to make it more intrinsically valuable, as trees naturally increase in size and thus become more valuable over the course time.

So in these times of economic turmoil, let us cast a critical eye over the global market in timber and its variety of end –user products, so that you can decide whether it should be part of your over all long term investment strategy .

Let us look at whether it is possible to turn a piece of land into a thriving forestry plantation, and from there into valuable timber and paper- thick- low -risk – profits.

**“Simply put, timber does not need to rise in price in order to become more valuable”**

## The Timber Market- Today -Tomorrow – Beyond



Because of the lengthy duration involved in most timber plantation investments detailed knowledge about the current state of the market is of relatively limited value to investors. Rather, the most successful investors will be those that accurately predict long-term economic trends and may, therefore have some idea about what the market will look like when they come to harvest the final crop. In particular, trends in end-use are likely to be very strong indicators of what the future might look like.

**“The most successful investors will be those that most accurately predict long term trends”**

### End –User Trends

Two broad views about general trends in end-use should be considered. One is that solid wood products (Sawn Wood and Plywood) will continue to dominate these markets. While the other is that fibre-based and engineered wood products will gradually increase market share.



The first view suggests that forest plantations should be planted with high quality timber species, on long rotations and with high levels of investment in silvi culture (Thinning and Pruning). The second view, a technology based future, would suggest utilising fast growing high yield species to maximise fibre production whilst minimising maintenance costs. Due consideration should also be given to processing technology.

## Other Variables

There are also a number of economic and political variables that affect the timber plantation sector. Analysis by the United Nations Food and Agriculture Organisation reveals that tropical timber plantation development is often the result of a mixture of complex economic, environmental, political and occasionally philosophical decisions.

**“Will solid wood products continue to dominate the markets?”**

## The Market Today

The main economic power houses in today’s timber market are the USA and China. These two countries alone account for 34% and 35% of **Round Wood** and **Sawn Wood** demand. (Source-FAOSTAT)

For **Wood-based Panels** the USA and China collectively account for 44% of global demand, and slightly lower for **Pulp For Paper** at 40% .Finally the USA and China again lead global consumption when it comes to **Paper and Paperboard** at 44%. (Source –FAOSTAT)

In terms of supply, again the Chinese and Americans lead the pack with **Industrial Round wood** at 29%, **Sawnwood** at 27%, **Wood Based Panels** at 42%, **Pulp For Paper** at 36% and finally **Paper and Paperboard** at 42%. (Source-FAOSTAT)

## The Global Economic Crisis



There is no doubt the global economic crisis which started with the sub-prime mortgage debacle that led to derivative- based –mortgage- backed- securities wiping out en-masse, has had a significant impact on world timber prices. Particularly markets in those economies that are heavily reliant upon financial services, like for example the UK and the USA.

It goes without saying, the construction sector, residential and commercial in both countries has fallen off sharply during this recession leading to a timber market supply / demand price scenario favourable towards buyers. However, for the reasons stated herein this situation is sure to swing favourably towards investor/growers over the long term and beyond

## China and India



Manufacturing based economies such as China and India, have fared far better during this recession. Also, given their efficient business models and cost competitive operating costs, coupled with sustained high level of growth, they will over the next decade invariably shift from being mainly producer based economies to more consumer based economies.

This all bodes well for the long term outlook for the global timber market, because like the middle classes in the Western developed countries, the middle classes of China and India will also want the variety of timber based products currently available to their western counter parts.

**Chinese demand for construction products continues  
it's relentless pace ....**

## The USA



The American economy is massive. It dwarfs into insignificance most of the worlds other leading economies, save for the collective value of the European and Chinese economies .After eighteen months of negative growth the American industrial machine is starting to see light at the end of the tunnel, and we strongly

suspect that during the third and fourth quarter of this year its growth momentum will gather pace .

The Chinese and various Sovereign Wealth Funds are not buying US Treasury Notes in abundance, because they are feeling patriotic towards their American cousins. No, they are doing so, because they have faith in a recovery of the American economy to its former glorious self.

When the American industrial / economic machine is eventually back in full flow and Wall street again starts to lend high volume development / seed capital industry and commerce as a whole will invariably reap the financial benefits.

This in turn will lead to significant growth across the board with the obvious sectors like construction leading the way .Again, this is another positive indicator vis-à-vis future long term trends for the global timber market .

**“The American industrial machine is starting to see light at the end of the tunnel”**

## Demographics-Population Growth



World population growth and demographic trends are dominant factors when assessing the long term prospects for the global timber market. If population growth currently continues at today’s mean average rate, by 2030 we will be in need of copious amounts of new properties, both residential and commercial .

The United Nations Food and Agriculture Organisation estimates that because of projected population growth, the world consumption of wood products will rise by sixty percent over the next twenty five years.

China alone will have to build fifty new cities the size of London in the next twenty years in order to house its rising population. Its urban population is forecasted to rise from 530 to 875 million by 2030. Again, this will have a significant and favourable affect on timber supplies and prices.

**“China Alone Will Have To Build 50 Cities The Size Of London”**

## Deforestation



Deforestation of our natural forests will severely affect future timber supply levels. Each year approximately thirteen million hectares of the world’s forests disappear due to deforestation. Most recently, the rate of net forest loss is slowing down, thanks in part to new planting and natural expansion of existing forests. However, the existing decline rate will have to reverse substantially in order to have a significant impact on future prices.

**“The existing decline rate will have to reverse substantially in order to have a significant impact on future prices”**

## Summary

Although the global economic crisis has severely affected the majority of the world’s residential and commercial construction sectors, in addition to the luxury yacht and boating markets to name but a few, the long term outlook for the world timber market, plus its catalogue of wood based products looks extremely healthy .

Deforestation rates, projected population and demographic trends coupled with positive American, Chinese and Indian economic factors all point to a bright future for timber and its vast array of products .

## A Serious Long Term Investment?



### Popular Investment Species

The three species grabbing investor's attention historically and currently are Teak, Acacia and Paulownia:



**TEAK** genus of tropical hardwood trees in the mint family, Lamiaceae. native to the south and southeast of Asia, and is commonly found as a component of monsoon forest vegetation. They are large trees, growing to 30–40 m tall, deciduous in the dry season.

The name teak comes from the Malayalam word Thekku.

The yellowish brown timber with good grains and texture from teak trunk is used in the manufacture of outdoor furniture, boat decks, and other articles where weather resistance is desired. It is also used for indoor flooring and as a veneer for indoor furnishings.

Teak's natural oils make it ideal for use in exposed locations and termite and pest proof, where it is durable even when not treated with oil or varnish.



**Acacia** is a genus of shrubs and trees belonging to the subfamily Mimosoideae. The plants tend to be thorny and pod-bearing, with sap and leaves typically bearing large amounts of tannins. The name derives from ακίς (*akis*) which is Greek for a sharp point, due to the thorns in the former type-species *Acacia nilotica* ("Nile Acacia") from Egypt.

Acacias are also known as **Thorn Trees**, **Whistling Thorns** or **Wattles**, including the **Yellow-Fever Acacia** and **Umbrella Acacias**.

There are approximately 1300 species of acacia worldwide, about 960 of them native to Australia, with the remainder spread around the tropical to warm-temperate regions of both hemispheres, including Europe, Africa, southern Asia, and the Americas.



**Paulownia** is famous for being the fastest growing hardwood in the world. If grown under correct conditions, it can reach the amazing height of four Metres in six months, and at just five years old the tree is harvestable for the production of sawn lumber.

Paulownia is native to China and the Far East and has been used in Japan for centuries as a furniture wood. One of the most versatile timbers in existence.

Paulownia's popularity in the West is booming, particularly in the high quality plywood industry.

**“In the timber industry Paulownia is looked upon as the Aluminum of timber”**

### **Return Components**

Returns on capital employed from a timber based investment are driven by three essential factors :- Biological Tree Growth, Timber Price Activity and finally Land Value Changes. Additionally, but non-fundamentally, there are easements. For example, a conservationist easement can often result in cash or tax benefits for the timber plantation investor / grower

**“It's value consistently increases irrespective of market trends”**

## Duration



Unlike most investments a tropical timber plantation requires a considerable period of time to reach fruition. There are however, several timber investment companies offering growth investment programs where initial returns can be obtained within three to five years. Nevertheless, for the highest returns, rule of thumb dictates a period of ten to fifteen years depending upon species and silviculture practices.

**“Returns can be delivered after a minimum period of three years”**

## Profits

A recent analysis of timber market performance during the last twenty two years by **J P Morgan Investment Analytics and Consulting**, showed that timber / timberland has provided an annualised return of **14.60%** in addition also to an array of other beneficial and diversification factors.



## Portfolio Efficiency

The study further reported timber/timberland helps to create a more efficient portfolio while providing a better platform for long term pension liabilities. It added:

***“Similar to private equity and real estate, it provides strength to the traditional asset classes of equity and fixed income. From a portfolio management perspective, it provides reduced volatility, superior risk-adjusted returns and finally low to negative correlation with other asset classes. Also, it correlates highly with inflation and because of this, it is an effective investment for preserving capital. Over the long term it has always outperformed other traditional commodities, both hard and soft , in low and high inflationary environments”***

**“By investing in timber plantation programs you are helping our planet live longer”**

## Ethical Sense

World timber plantations, both from a production- supply- facilitator view point and indeed, from an ethical perspective as well, has topped the apex of importance in today’s environmentally friendly world, more so than in any other period in history .

If we, as a planet, do not take drastic action now to reduce CO2 emissions, irreversible damage will occur to our planets well-being .By investing in timber plantation programme, you are helping our planet live longer .This in itself should be a serious enough issue, if nothing else .

## Low Volatility

Volatility is low for timber’s historic rate of return. This is attributable to biological tree growth. When timber is combined into a diversified portfolio (Equities, Property , High Deposit Accounts etc ) , returns will invariably balance over time and thus reduce your portfolios risk level.

## Diversification Benefits

Tropical timber plantation investments enjoy low correlation with other asset classes. There is however a minor negative correlation between returns on capital employed and inflation. Nevertheless, over the long term there is clearly a positive correlation to inflation, and as such the commodity itself provides a hedge against inflation.

## Risk

Economic risk is the biggest factor because pulp and lumber prices are impacted by the laws of supply and demand, in addition to cyclical and seasonal fluctuations. However, this risk can be mitigated by storing the timber on stump (Whilst the tree is still growing) and harvesting when prices trend upwards.

The other main risk factor is physical, effectively fire risk, weather, insects and disease. These risks however, vary across geographic locations and vary in severity in different climatic conditions. However, bespoke insurance cover can adversely mitigate these natural risk factors and therefore should warrant serious consideration.

## Investment Exit Options

There are a number of ways an investor can liquidate and take profits with the two most commons being:- 1. A Private Sale To Another Investor, or 2. A direct Sale on to the Secondary Market .

## Costa Rica-Economy



Costa Rica's major economic resources are its fertile land and frequent rainfall, its well-educated population, and its location in the Central American isthmus, which provides easy access to North and South American markets and direct ocean access to the European and Asian Continents.

The economy of Costa Rica heavily depends on tourism, agriculture, and electronics exports and is generally considered one of Latin America's more successful and stable economies. During the recent global economic downturn Costa Rica survived relatively un-scathed .

Locally, there is a high demand for its tropical timber plantation products, as a consequence of long term and stable economic growth, which has giving rise to increased population / consumer demand across the entire spectrum of consumer products.

### **Investment Company –Important Factors**

**A bona-fide tropical timber investment company should offer:-**

- **Flexibility.**
- **Security of Tenure**
- **Realistic Calculations**
- **Profit Projections and Returns**
- **Transparency**
- **Independently Audited Accounts & Annual Growth Reports**
- **Tree Ownership**
- **Risk Management**
- **Defined Exit Strategies**

### **Summary**

Tropical Timber plantation investments are attractive to both private retail and institutional investors alike, simply because they add to capital diversification and have attributes similar to infra-structure, such as low correlation to other asset classes, inflation adjusted cash flow and healthy long term and renewable investment. Another attraction is when timber prices fall, like they have during the period 2008-2009 and most likely during 2010 as well, there is still a steady offset of the physical growth of the tree.

Experts agree tree growth averages are about eight percent pa and when the market prices increase this is an added bonus. Conversely, when the market prices fall this also provides a stable safety net .

In conclusion, if you are looking for a long term and high return low risk alternative asset class, then a tropical timber plantation investment programme should most definitely warrant consideration. After all, a buy hold and wait approach to investing over the long term, is relatively hassle free and does not require significant input on the investors part.

If you are however, one of those investors who enjoys the participation, with its frequent ups and downs, of regular investment market activity, this safe, yet high return alternative may well not accord with your particular investment appetite. Indeed, compared to equities, leveraged or not, it is not particularly exciting.

At the end of the day, any investment vehicle whether short, medium or long term, high or low risk, high or low return is only viable if it caters to the investors specific investment risk –reward objectives. However, this long term alternative with its array of benefits has few serious competitors in terms of consistency, low risk and superior returns.

## **CONCLUSION**

In reply to the final question in the introduction part of this report “ Is it possible to turn a piece of land into a thriving forestry plantation, and from there into valuable timber and paper-thick-low-risk-profits”

The answer is a definite **YES**. Nevertheless, don't expect excitement and you will also have to be extremely patient.

Spread your investment roots today into this fast expanding sector many before you have and many after you will continue to do so.

Why? Quite simply because ethically it makes sense and long term it produces low risk significant profits.

For more information and independent advice on this rapidly expanding investment sector, please go to [www.internationalcorporateservices.com](http://www.internationalcorporateservices.com)

They are an independent ethical investment advisory company with a wealth of experience in this particular investment arena. Significantly they are not connected to any one particular tropical timber investment supply company and as such they provide completely independent and un-biased advice.

