

Timber Plantations

A Flexible Alternative?

An Overview by?

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Technology has yet to produce such a product!

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. That combined with any market increase is surly worth a look at!

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.

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.

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End User Trends

Most of the timber industry investments are unregulated! Why? Because Lumber or Timber is used in such a wide range uses and of industries from the obvious – building to the not so obvious cellulosic ethanol.

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



Timber's end products are among the most basic yet widely used goods in the world which include:-

- Lumber construction, furniture manufacture, flooring, cladding ext.
- Paper cardboard, and various containers and packaging materials.
- Woodchip chipboard, marine ply, various animal bedding and insulation.
- Timber has recently been used in the production of cellulosic ethanol and other promising source of renewable energy.
- Conversions Charcoal, animal feed, adhesives, carbon credits and even medicine.

The timber industry is unique in several important ways. First, different end uses require different types of trees. Geographic location largely determines the types of trees timber companies produce, which can limit the industries to which a company can sell its timber. For example, a timber company that operates in just one region where only paper-grade trees grow would be unable to do business with lumber companies. A second notable feature of the timber industry is that its products continue to grow until they're harvested. Unlike other goods from living sources, trees have an extremely long shelf life, allowing the timber industry to weather periods of poor market conditions with relative ease.

Due to its role as a supplier to many different industries, the timber industry itself is subject to a number of external market forces. Conditions in the markets for paper, lumber, or other timber products largely determine the demand, and therefore pricing, in the timber industry as a whole. However timber has the ability to “sell to the highest bidder!” If one particular area like paper has a bad year the same trees can be sold to charcoal producers, builder’s merchants, bio fuels and the list goes on.

Take a look at the demand for timber. ‘The United Nations forecasts that world demand for wood will nearly double by the middle of the century’.

Not surprisingly, that's in large part to China, which ranks second only to the U.S. in wood consumption. It's also the #1 importer of timber products in the world. In fact, more than half of the timber shipped anywhere in the world is destined for China,

Over the past two decades, some of the world's most prominent investors and institutions – pension funds, endowments and insurance companies – have invested \$40 billion into this asset class... up from just \$1 billion in 1989.

Timber has been one of the consistent favourite investments of legendary investor Jeremy Grantham. He points to how it's risen 3% more than inflation for more than 90 years. During the next several years, he expects timber to have an inflation-adjusted return of 6%.

The fact is that timberland has actually beaten the stock market over the long run and with less risk. It has outperformed the S&P 500 over the last 100 years since 1910. And since 1987, the NCREIF Timberland Index climbed by an average of 15% per year, compared to about 11% for the S&P 500.

China used to import large amounts from Russia, but it now derives the majority of its supplies from New Zealand and western areas of North America. To show just how important the latter area has become to China, look at shipments from just the Canadian province of British Columbia, Annual shipments from British Columbia have tripled since 2007 to \$365 million and have increased 4 fold from January 2009 to January 2010

For Canada as a whole, wood exports to China and the rest of Asia accounted for 23% of all exports in last year's fourth quarter versus only 13% in 2008, and 7% five years ago.

The commodity makes for big business. So if you've never considered investing in timber as an investment strategy, perhaps you should.

The returns on timber are especially good in bear markets...

During the Great Depression, for example, timber gained 233% while the price of stocks fell more than 70%. In fact, during the three worst market downturns of the 20th century (1911-20, 1929-41 and 1966-81), timber outperformed the S&P 500 by a wide margin.

More recently, when the S&P tanked by 38% in 2008, timberland rose by 9.5% based on the NCREIF Timberland Index.

You see, trees grow come rain or shine/ And so does their value... by an average of 2% – 8% per year. It might not be a glamorous business, but it definitely is a profitable one... in more ways than one.

Timber is also a natural inflation hedge. Real prices for timberland have risen steadily for over 100 years. And during the last bout of high inflation in the U.S. (1973-1981), it was a fabulous hedge, increasing by an average of 22% per year.

Timber is also a fabulous portfolio diversification tool. It sports a very low correlation with most asset classes of less than 0.1. So adding it to your portfolio enhances the potential for return while reducing your risk at the same time.

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 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.

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.

Popular Investment Species

The three species grabbing investor's attention and currently are Teak, Melina & Millettia:



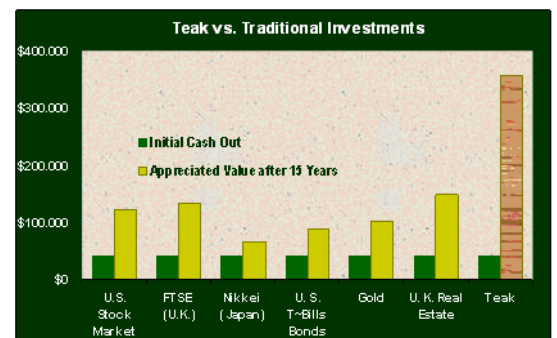
Teak genus of tropical hardwood trees. Native to the South America and southeast of Asia, and is commonly found as a component of rainforest vegetation. They are large trees, growing to 30-40 m tall, deciduous in the dry season.

The 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.

Teak has been the subject of comprehensive research programmes in India, Indonesia, Thailand and Myanmar for at least 50 years. Some of the key outcomes from those programmes with respect to plantations have been the identification of elite genetic material for wide-scale planting and the development of silvicultural practices that optimize the production of high-grade timber.

Teak trees are highly fire resistant due to high silicate content; it is also resistant to humidity, acids, fungus and insects. Teak is extremely resistant to inclement weather due to its oil content.

After the first year, Teak plantations have no fire risk because by then the trees are fire resistant. Furthermore, the tree tops pack tightly and the shade from these trees creates a ground cover that prevents the growth of grass and any other plants that could be a source of fire.





Melina *Gmelina arborea*, (In English Beachwood, Gmelina, Goomar teak, Kashmir tree, Malay Beachwood, White teak, Vemane), locally known as Gamhar, is a fast growing deciduous tree, occurring naturally throughout greater part of India at altitudes up to 1500 meters. It also occurs naturally in Myanmar, Thailand, Laos, Cambodia, Vietnam, and in southern provinces of China, and has been planted extensively in Sierra Leone, Nigeria, Malaysia, and on experimental basis in other countries as well. It is also planted in gardens and avenues.

In 2004, a joint effort between the Centre for the Investigation and Integration of the Forestry Industry in Costa Rica & the School of Forestry Engineering at the Costa Rican Institute of Technology produced a 160 Page 'Manual for Melina Producers' for the Costa Rican National Forestry Financing Fund. This study concluded that Melina has become the predominant non-native wood in Costa Rica – with a 35% market share, followed by 19% for Laurel, 16% for Pine, and 16% for teak. With recent Costa Rican legislation prohibiting the harvest of native tree species, the increase in demand for non-native species, primarily Melina, to supply national and international lumber markets has been established and is growing.

Melina is a strong, light-coloured, even-grained wood that is naturally insect resistant, easy to work, and which accepts stains and finishes well. It is a fast growing tree which can be harvested at different stages of its 14 year mature growth cycle, for varied markets. For this reason, and its economy compared to other lumber offered on the Costa Rican market, the construction, furniture and packing industries have begun, over the last ten years, using Melina extensively.

The widest parts are used for plywood, veneers, and furniture. The lower-middle to upper-middle parts are used for dimensional lumber for the construction industry. The upper parts are used for making palettes, other packing products, and pressure-treated posts.

Current market shares for Melina in Costa Rica are 55% Construction, 20% Furniture, 20% Packaging, 5% varied. Together they account for approximately 50,000,000 board feet purchased each year in Costa Rica. Melina can be utilized for both high and low end uses; from fine furniture for exportation to frame construction and raw material for palettes. The trend in sales, however, has been shifting more towards utilizing Melina wood for higher end use. For example, one of the first uses for Melina was as form boards for concrete construction. Over the years, however, the use of Melina in construction has shifted to flooring, moulding, structural beams, and tongue-in-groove panelling. Melina lumber was practically unknown 10-15 years ago in Costa Rica. Today, it is the most widely used by many industries and businesses, and represents 20% of all milled lumber in Costa Rica.



Millettia *pinnata* is a deciduous tree that grows to about 15-25 metres in height with a large canopy that spreads equally wide. The leaves are a soft, shiny burgundy in early summer and mature to a glossy deep green as the season progresses. Flowers, borne on racemes, are pink light purple or white.

Pods are elliptical 3-6 cm long and 2-3 cm wide, thick walled and usually contains a single seed. Seeds are 10-20 cm long, fig oblong and light brown in colour.

The tree is well suited to intense heat and sunlight and its dense network of lateral roots and its thick long taproot make it extremely drought resistant and wind tolerant.

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

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.

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

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 timbers 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 most common being:-

1. A private sale to another Investor.
2. A direct sale through a Secondary Market.
3. Simply harvest the remaining trees.

Investment Company Important Factors

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

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

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. 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 investor's part. If you are however, one of those investors who enjoy 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. The answer is a definite **YES**. Nevertheless, don't expect excitement and you will also have to be 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.

It is important whilst thinking of timber investments to gather as much independent advice as possible, try to steer clear of companies selling only 1 product as whatever product they are selling is bound to be the best on the market. If possible try to deal with a broker that deal with different companies and deals with different timber projects thereby finding the best project for you (diversity is the best policy).

Information and independent advice on this rapidly expanding investment sector can be found quite readily on the internet but the only broker type company that we have found in our searches that tick all the boxes are a company called Forestry Trading, 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 and as a free service they walk you through the mine fields of any purchase and deal with the companies on your behalf. They work as an introductory company and like an some Independent Financial Advisers they get paid by the seller company. Interested parties are advised to have a look at their web site and have a talk and request information and due diligence on any company that looks promising. www.forestry-trading.com

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