Great Northern Nekoosa and 'The Sale of the Century'

One of the most confusing and vexing things about the great NZ State Forest sell-off concerns the question of just how much these forests are really worth. Estimates can be found that range from as little as under $1 billion to as much as $9 billion - and all from supposedly reputable sources.

Back in 1987 when the Forestry Corporation was a potential buyer of the forests its Chairman went on record as saying that the forests weren't worth much more than their book value ($1.2 billion). (Now Corporation material gives figures of $4 billion or more.) In July 1984 Treasury-commissioned BERL report of 1988 and, has been used to, justify a (1987) value of $7 billion - approximately $8.3 billion in 1990 terms. Even the politicians, who ultimately will be responsible for accepting or rejecting the bids for the forests, have been in on the act. Lately, though, their expectations of what would be a fair price seem to have fallen somewhat with statements/predictions that the Government could make some $2 to $3 billion from the sale to pay off debt.

Given all the confusion these figures must induce one could be tempted to forget about valuing the forest estate and just wait until whenever the sale is finally concluded, or abandoned, and see what eventuates. The problem with this, however, is how will we know whether a bid should be accepted or rejected? No, we need an acceptable and defensible valuation. One approach to producing this, and one that should find support in these days when everything is market, is to see what is being paid internationally for forests and forest companies and then to relate this to the New Zealand estate. Enter Great Northern Nekoosa.

Great Northern Nekoosa is, or perhaps more accurately was, a "smallish" US forestry company which in March of this year was taken over by Georgia Pacific. It owned installed annual pulp capacity of some 3.3 million short tons and pulp, paper and containerboard capacity of 4.4 million short tons per year - about three times the capacity of the total NZ industry. As well, its assets included 26 corrugated box plants, 16 envelope manufacturing plants, a soft-wood ply plant producing 137,000 m³ of plywood and 46,000 m³ of veneer per annum (about three times the production of the total NZ production from five plants) and 1.38 million hectares of forestland. In 1988 Great Northern Nekoosa had an after-tax income of some $US341.7 million on sales of $US3.6 billion. Its balance sheet asset value as of October 1989 was some $US3.8 billion.

So what's a company like this worth? The initial offer by Georgia Pacific was $US558 per share, or about $US3.18 billion (NZ $5.48 billion). This was rejected as being too low. However Georgia Pacific persisted and finally reached an agreement that $US65.75 per share was a fair price, and so acquired the company for some $US3.6 billion, ($NZ6.2 billion). What is interesting is that, provided one is prepared to combine this information with that from other sources, it allows one to put a value on the forestland.

Hugh Fletcher is on record as claiming that at present it is cheaper to acquire existing pulp and paper capacity rather than to build a greenfield plant. His claim is that you can buy 500,000 tonnes of existing capacity for the cost of 300,000 tonnes brand new. A new 300,000 tonne plant is going to cost some $NZ600 million. On this basis the existing pulp and paper capacity of GNN has to be worth at least $NZ4.01 billion, and perhaps as much as $NZ5.28 billion. Sticking with the lower figure however, the numbers imply that 26 corrugated box plants, 16 envelope plants, a ply mill, 1.38 million hectares of forestland, and a few other assets like the odd building and the right to take a half share in Kenaf of North America's planned 265,000 tpy recycled linerboard plant, are worth some $NZ2.19 billion.

A studious researcher would no doubt be able to come up with an appropriate value for the non-forestland assets. For simplicity though let's just assume that they're worth no more than $NZ2.20 billion - which has to be a very conservative figure. This makes the forestland worth around $NZ2.19 billion.

Now it must be conceded that GNN's forestland isn't like that managed by the NZ Forestry Corporation. For a start 850,000 hectares of it are in Maine where growth rates average 2.5 m³ a year while the remaining 530,000 hectares are in the US south where growth rates are more like 5 to 6 m³ a year. Still there is a lot of land and the sustainable harvest from it is some 5 million m³ per year or about the same as the Corporation's current harvest level. Long-term, the Corporation's forests may be capable of supplying around 10 to 12 million m³ per annum (24 m³ per ha per annum) but in the longer term GNN's forests are also capable of supplying much more than they currently do. Estimates of how much more range from as little as an extra 3 million m³ to more than 8 million m³. The crude overall conclusion may well be that in terms of production capability the two forest estates have broadly similar capabilities.

Estates with similar capabilities should be worth similar amounts of money - the law of one price. This means the Forestry Corporation managed NZ estate of some $50,000 ha would have a forest value (land plus trees) of some $2000 million. However in the case of the "Sale of the Century", unlike the sale of GNN, the land is not going to be sold along with the trees. Buyers of the trees purchase instead the right to rent the land for periods of up to 70 years. Rent, it is estimated, will bring in to the Government some $18 million per annum. At a 15% discount rate this rental has a present value of some $120 million. For the NZ estate this amount should be deducted from the forest value of $2000 million to give a likely sales value of the trees.

A market value of some $NZ1900 million may not be to everyone's taste, and is certainly quite a bit less than some of the figures one hears being bandied about. Some might well have some reservations about the way in which it was derived, and possibly even question the relevancy of GNN and its forests to New Zealand's plantation Pinus radiata estate. Can any other market evidence be found to support this figure? The answer has to be yes.

London Pacific Limited are buying 4000 ha of forests and a sawmill on Matakania Island from Elders Resources NZFP for some $20 million. Just scaling this figure up to an estate the size of that managed by the Corporation, (i.e. multiply by 137.5) and ignoring any value for the sawmill or other assets, would give a value of some $250 million. Knock $4 million, or thereabouts, off the Matakania...
Island price to account for the sawmill and other assets, and one ends up with a value for the State forests of about $2200 million. As before the rental value of the land should be deducted from this, one might also wish to make some adjustments for age structure of the two forests - more normal for Matakana Island than that of the Corporation's forests - and for location. All in all, it would not be hard to envisage an estate value derived from Matakana Island being within 10 per cent of that derived from the sale of Great Northern Nekoosa.

It may be that this is still not sufficient to satisfy the sceptic. Well, there still remains the failed attempt by Fletcher Challenge to purchase Central North Island forests. Claims in the media would lead one to believe that the government turned down slightly less than $500 million for the cutting rights to about one-fifth of the total state forests. Just on a straight area basis this would suggest that cutting rights for the total estate might be worth some $2500 million. Again this figure could well be adjusted to take account of forest age, infrastructure, silviculture, topography, etc, etc, and of course the fact that the bid failed was rejected. As prices in the Tasman sale are supposedly market prices it shouldn't be necessary to adjust the offer for the State's commitment to continue to supply wood to the Kawerau mill until 2030.

No doubt each of the above examples of using the market to value the "sale of the century" forests could be justifiably criticised for both assumptions made and the way in which the available data have been presented and used. In their defence, however, these examples were not meant to be definitive. Rather the purpose in presenting them was illustrative - to point out that by turning to "the market" it should be possible to get much better handle on what the NZ public exotic forest assets are worth than an examination of the media would suggest is currently the case.

What is perhaps of interest is that all three suggest that a value in the $2 to $2.5 billion range might well be in order. This is certainly a much narrower range than that mentioned at the start of this note, and one that if generally accepted raises some rather interesting questions about the quality of government advice and its impact on subsequent actions. Did, for example, the sales process start as a result of Treasury's $4.5 billion valuation and the Forestry Corporation's failure to offer anything near this amount? No doubt this and similar questions will prove of interest to some future student of history. In the meantime, however, it is far more important that we stop trying to value the estate by, it would appear, drawing numbers between 1 and 10 out of a hat, and start to use the market. The market should give us both realistic and defensible valuations and, moreover, a sound basis for either accepting or rejecting bids for the forests when they are finally presented.

R. Boer

State Forest Asset Sales: Myths and Realities

Why is Government selling the cutting rights to the Crown plantation forests? Much of the "news" from Government concerning the sale is really a repeat of old information. There is a theory that if something is repeated often enough, people will believe it. What I have attempted to do is isolate the often-repeated statements and critically examine them. References are given for all Government's statements. This does not mean that this is where they first appeared. Nor does it mean that it is the only place they have appeared. Unfortunately, where they have appeared, they have not generally been questioned.

MYTH: The billions of dollars that will be needed to finance the colossal development of wood processing from State forests is too heavy and too risky a burden to lump onto taxpayers.

Mr J. Sutton, Minister of Forestry, in: Choy, Harris. 1990
REALITY: This is not actually a myth, it is a red herring. It is a not a valid argument. In using this argument, Mr Sutton is assuming that the alternative to selling the forest cutting rights means that the State will have to invest billions in financing processing developments. There are other alternatives which Mr Sutton ignores. One is log exports. If the State exported the logs it could not sell to the domestic processing industry, no investment would be required. This may not be the most desirable alternative with regard to the wealth of New Zealand. However, investment in domestic processing could occur with no State investment. All that is needed is a stable economic environment (something Government claims they are achieving), and some sort of guarantee to forest processing industry that they will have a guaranteed wood supply, or at least the first opportunity to purchase the wood at a market price. Due to the fact that they were negotiating with Government over the value of the forest assets, the Forestry Corporation has not been willing or able to guarantee any sort of wood supply during its brief history. As a result, there has been little new investment in the processing sector of New Zealand's forest industry over the past three years, except by companies with a captive wood supply. An outright sale of the State assets is not needed. Long-term contracts, or joint ventures are other equally suitable possibilities which will encourage processing investment without additional State investment. In a commercial environment, the Forestry Corporation should be able to make such contracts and provide continued market returns. Is that not one of the reasons they were established?

MYTH: The sale is necessary in order for Government to pay off debt.

Mr R. Douglas, (former) Minister of Finance, 1988
REALITY: While some of the proceeds of the sale may be used to pay off foreign debt, the sale will result in a large reduction in future income which could also be used to pay off that debt. In the case of the forests, the reduction in future income may very well be larger than the value received for the forests. According to conservative estimates based on Andy Kirkland, the Forestry Corporation was earning over 10 percent real interest on the Crown's forest lands. Government is

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1 Andy Kirkland, Managing Director of the Forestry Corporation, recently reported: "With good forest management, the value of the present forest area can be doubled by the end of the century and net revenues of $2 billion in real terms earned between now and then" (Aonon. Herald, 13 May 1989. "For Sale' Signs Out on State Forests.").

While Mr Kirkland did not state what value could be doubled, using some conservative assumptions (beginning asset valuation of $3 billion implying an ending asset valuation of $6 billion, and the entire $2 billion earned at the end of the century), this equates to an expected real rate of return of 10.3 per cent. Reducing the beginning value or assuming the returns were earned before the end of the century would increase this rate of return.

2 Real interest is interest over and above inflation.