Forest investment in New Zealand: an attractive opportunity

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Abstract
Timberland investment opportunities in New Zealand offer a uniquely attractive combination of well-established, high-yield plantations, mature forest management techniques, well-trained forestry professionals, sophisticated decision support systems and valuation methods, an adequate to well-developed infrastructure, and a conducive business climate. The increasing number of large timberland properties being transacted at attractive risk-adjusted investment returns further enhances the interest in timberland investment management in New Zealand.

Introduction
Over the last decade, The Campbell Group, headquartered in Portland, Oregon, has been actively investigating the investment attributes of properties we believe to be some of the best timberland investment opportunities that New Zealand has to offer. Our firm has been drawn to the country due to a combination of advantages that it offers relative to other opportunities. New Zealand is culturally, aesthetically, recreationally and geographically inviting. However, these are not the driving force considerations leading investors to pursue opportunities there. The following reflects our impressions of forestry and timberland investment. The openness and generous sharing of information by numerous New Zealand forestry professionals have shaped our impressions.

International Investment Considerations
Investors seeking international diversification with limited risk are drawn to New Zealand for a number of reasons. Investment opportunities are viewed from a risk and return perspective, taking into account risks in New Zealand relative to elsewhere in the world. Risks considered include liquidity, valuation risk, political and currency risk, log and stumpage price risk, growth and yield risk, land tenure risk, regulatory risk, and physical or biological risk. On balance, the relatively low level of risk in New Zealand should be viewed as an attractive opportunity for investment at appropriate levels of investment return.

Liquidity Considerations
Timberland markets in New Zealand are rapidly evolving, a transition initially fueled by the sale of New Zealand Government forest licences in the early 1990s and the sale of its Central North Island timberlands in 1996. Ongoing transactions since that time have furthered this transition.

Species and product diversification as well as access to Australian and Asian markets with reasonable transportation expense provides investors the opportunity to invest in property at attractive rates of return relative to the more mature timberland markets in North America.

The relative maturity of timberland markets and the current level of transactions encourage greater interest and investment from a liquidity perspective, particularly in the more concentrated forest regions of the central North Island, Northland and the northern and southern regions of the South Island. Timberland investors take into account long-term exit strategies, irrespective of their investment horizon. Relative liquidity is an important consideration. While New Zealand does not provide investors the level of liquidity available in the United States, we anticipate increased liquidity in the future as timberland markets mature in the region.

Valuation Techniques
New Zealand’s forestland owners rely upon timberland valuation techniques including forest optimization and discounted cash flow analysis similar to those techniques utilized by most timberland investment managers. Highly skilled, local professionals are readily available to provide country-specific tools and expertise for analysis and due diligence. Increasingly, tools and techniques are crossing international boundaries and do not create barriers to entry.

Alternative land use and conversion from forest to grazing or development are increasing considerations in New Zealand timberland valuation. These considerations are important relative to many locations in the world, but are still minor compared to the heavily populated regions of North America.

Timberland pricing has evolved over the last ten years. This has led to increased interest in New Zealand timberland investment. Valuation adjustments made by large industrial owners suggest realistic expectations of timberland value.

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Key drivers of valuations are current and projected log prices. Prices have been relatively stable in recent years, after having adjusted from prices in the early 1990s. Current pricing is more sustainable, providing reduced risk.

**Economic and Business Considerations**

The general business climate in New Zealand is favourable compared to many other regions of the world, including some regions of North America. The forest industry is a significant sector of the country's economy. In 2002, forestry and wood processing contributed 4% to GDP, but provided only 1.1% of world forestry output. Business practices have encouraged forestry investment. Broadly, business practices are more similar than different relative to those in North America. Tax laws are complicated and need to be understood and reflected in investment decisions; however, once understood, tax laws provide a favourable environment for forestry investment. The business environment is more readily understood due to the common language we share.

Environmental protection is a very significant consideration for forestry operations. The New Zealand forest industry has been successful in helping shape environmental considerations. The value of well-defined protection requirements and explicit area designations for the native forest adjacent to radiata pine plantation management can not be overemphasised, allowing for a greater focus on intensive forest management. This consideration has caused some forestland managers to invest in New Zealand instead of other opportunities, including some in North America.

New Zealand and Australian currencies are fairly stable compared to currencies in Chile, Argentina and Brazil. International investment must consider currency risk and, where possible, needs to incorporate hedge strategies as part of that investment. The stability of the New Zealand dollar and the opportunity to hedge this risk makes timberland investment more attractive.

**Market Considerations**

A significant percentage of forest products produced in New Zealand are not consumed domestically. About one third of exports are pulp and paper, a fifth are logs and wood chips, 22 percent sawn timber and 14 percent panel products. Four markets - Australia, Japan, Korea and the United States - take three quarters of forest exports by value.

This dependency on export markets makes New Zealand investors somewhat dependent upon factors outside of their control, adding an element of risk. Trade restrictions and transportation costs to offshore markets are just a couple of examples. Development and access to cost-competitive ports and domestic value-added processing infrastructure are important considerations. Investment and management strategies must address these considerations. Managing these opportunities effectively and developing strategies that leverage the greatest value-added opportunities provides a unique challenge to offshore investors considering acquisitions in New Zealand.

**Management Practices**

The focus placed on radiata pine plantation forestry in New Zealand, as well as elsewhere in the world, has advanced the knowledge of and has led to a widespread acceptance of radiata pine. Plantation forestry practices are very well established and supported by a wealth of readily

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**Guide to Forestry Investment in Australia and New Zealand**

Our Guide to the expanding plantation sector provides a valuable resource for managers, investors, industry advisors, analysts and researchers.

Contents include:

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available research data. In addition, a well-established community of forestry consultants is available to provide potential investors access to data and analysis critical to investment decisions.

The intensity and sophistication of management practices in New Zealand is impressive. The investment in research and development of radiata pine plantation management provides a high level of confidence in the growth and yield projections that are critical to investment decisions, up to a point. The growth and yield tools that are available provide a vast array of options to choose from with respect to taper functions, growth rate functions, merchandising functions, and silvicultural response functions. When these tools are used appropriately, they provide powerful decision support; however, these tools are just as readily misused and could potentially erode confidence in the outcomes.

Genetic improvement, clonal research and implementation of these techniques are highly advanced. These advances combined with other silvicultural practices have led to significant improvements in productivity. The challenge they create is in gaining confidence in the yield predictions that result from the interaction between management activities. This has implications for wood quality, wood utilisation, and continued market acceptance of the timber and finished products that result. New Zealand research in these areas is as advanced as anywhere we have seen, and in some cases well ahead of research for other species. This is a tremendous accomplishment for the New Zealand forest products industry.

Timberland managers and investors in New Zealand are challenged to consider the question "At what point in the evolution of silvicultural and management practices will I reach the point of diminishing return in a globally competitive marketplace?". Timberland managers will need to remain cost-competitive and critically revisit intensity of management considerations. This is not unique to New Zealand forestry; however, given the level of advance in forest practices in New Zealand, foresters will increasingly need to confront this challenge.

Conclusions
New Zealand offers very attractive forestry investment opportunities given the biological growth potential of radiata pine, sophistication of management practices and access to markets. Domestic demand relative to growing timber supply and the country's dependency on offshore markets are significant considerations with respect to these opportunities. Investment returns will be dependent upon the industry's ability to address the growing imbalance between timber supply and value-added processing. Returns will also depend upon New Zealand's ability to remain globally cost competitive in the growing and processing of radiata pine. Forestry practices are impressive and clearly defined, providing limited risk to investment returns.