Financial capital continues to flow into timberland – entering via a whole host of investment options – each at varying degrees of exposure to the asset class and each with differing levels of risk and return inherent in the type of ownership and the level of investor control.

Traditional timberland investing – buying relatively large tracts of timberland and holding for relatively long time periods – has typically been an investment option for very large investors. It has been pension funds and university endowments who have been able to accommodate the upfront costs and commit capital for the long time horizon.

Today, an array of indices and public funds are available to investors looking to gain access to timber and timberland markets, yet performance of these public vehicles deviate from traditional timberland investment performance.

Timberland investment options, with their many differences, seem to be most easily categorized by ownership type and level of control. As such, timberland can be owned either publically or privately and control can be either direct or indirect.

A timberland investment held in private ownership under direct control is a separate account purchased with private equity. This is the traditional method of timberland investing – typically equated with timberland investments held with TIMOs (timberland investment management organizations). Private investment in timberland held under indirect control, is again purchased with private equity but held by many investors typically within a commingled fund or REIT (Real Estate Investment Trust). These too are the more traditional methods of timberland investing.

Timberland held in public ownership, under indirect control occurs through traded equity, for example, individual holdings of stock in a public timber or forest product company. This method of investing is not new, yet is often confused with direct, private investment in timberland.

A newer group of vehicles in the public ownership/indirect control category are public timber funds and public timber or forest indices. These types of investments provide easy access for an investor – and theoretically provide the diversification benefits inherent in holding timber and timberland assets. Yet, do they in practice?

And, lastly, public timberland ownership under direct control, as we know, is not possible.

It is the public, indirectly controlled vehicles we focus on here. It is true that this type of ownership and control combination avoids the barriers to entry which make traditional private, direct and indirect timberland ownership more tricky. More specifically, the need for relatively large amounts of capital to invest; long time horizons to capture the full investment benefits; and liquidity to exit easily. Yet, historical performance of publically held, indirectly controlled timberland shows a weak link to private timberland and hence a theoretical stretch to suggest the same diversification benefits.

Performance of Publically Owned, Indirectly Controlled Timber and Timberland Vehicles

Several publically available vehicles exist, each exposed in some way or another to timber and timberland. These include public REITs in the U.S., global common stocks, funds and timber or forest products indices. Plotted on the next page is the annualized return and standard deviation over the past 28 months, a common-period snap-shot of performance during the global economic crisis. Private timberland performance, by way of the NCREIF Timberland Index, is presented along side (Performance since 1990, or inception if newer, through 1Q 2010 is provided in Endnotes, page 6).

Investment performance has been varied across the sample. In general, the publically held vehicles followed the downturn in financial markets – varying

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Three of the vehicles sampled here are REITs: Potlatch (PCH), Rayonier (RYN) and Plum Creek (PCL). Historical rates of change in share prices of these public companies have been strongly correlated to broader commercial REIT values, such as the MSCI REIT Index (See Endnote, page 6). Total returns since December 2007 for PCH, PCL and the MSCI REIT Index show similar performance, ranging from -5.5 to -7.5.

Performance for many of the public timber vehicles is driven by the success of real estate development, timber management consulting, commodities trading, and wood products manufacturing. For example, RYN, a publically traded REIT, performed differently than other REITs (PCL and PCH) due to the company’s high percentage of sales in manufacturing pulp and packaging materials.

In an effort to find the degree of exposure to timber and timberland, financial summaries for both year-end periods over the last three years and quarterly reports as at March 31, 2010 were reviewed and an average percentage of sales categorized from selling timber (Sales) along with the percentage of timber and timberland value comprised in plant, property, and equipment (PPE). Sorting the table above by the percentage of asset value comprised of timber and timberland, Cambium Funds rises to the top, with all but a small piece of its assets held in timberland. Cambium Funds, publically listed on the Alternative Investment Market (AIM), a sub-market of the London Stock Exchange, is a closed-end fund investing in plantation timber in both developed and developing markets. Cambium’s income from right-of-ways and leases supplement the 60 percent income from timber and timberland sales.

Sino-forest and Timberwest, both Canadian corporations and listed on the Toronto Stock Exchange, are comprised of mostly timber and timberland assets and both have over three-quarters of revenue from timber or timberland sales. Timberwest sold off its sawmills in the early 1990s. Sino-Forest owns and manages timber plantations in China and sells wood products – both logs and fiber – sourced from other producers in China, and processes logs into engineered-wood products.

Potlatch sold the majority of its pulp manufacturing plants, helping increase its percentage of timberland to PPE but still has numerous wood products facilities. Likewise, Plum Creek, the largest timberland owner in the U.S., continues to operate ten manufacturing facilities.

Pope Resources L.P. has moderate sales from timber and timberland, yet also has substantial real estate and consulting revenues.

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Figure 1. Softwood Sawtimber Stumpage Prices
Prices for timber in major markets across the globe hit a low point starting in the second quarter of 2009 and have steadily climbed upward since that time. Domestic markets in the U.S. have been the drag on demand, with Asian-led demand driving wood flows. Log exports out of New Zealand to Pacific Rim markets, China and India in particular, has rocketed prices up close to 60 percent from lows in 2009. Pacific Rim markets have also buoyed U.S. Pacific Northwest log prices up by similar amounts. With domestic demand in both New Zealand and the U.S. meager by comparison to offshore demand, domestic sorts have been pulled into export markets where possible. In the U.S. South, cold and wet weather this past winter added to reduced inventories at mills while a period of small but real increases in demand for building materials combined to push prices for southern pine sawtimber up 5 percent in the first quarter.

Figure 2. Lumber and Sawlog Prices in the U.S. South
After falling 25 percent from September of 2008 to September of 2009, southern pine lumber prices took a sharp turn upward as a combination of weather, low mill inventories and the earthquake in Chile combined to lift solid wood product prices up dramatically first quarter of this year. The price of Random Lengths Southern Pine 2x4 lumber jumped over 30 percent during the first quarter of 2010, reaching $335 per MBF, up from $250 per MBF last quarter. Delivered southern pine log prices, which lag movements in lumber markets, moved up 6 percent during the first quarter.

Figure 3. Lumber and Sawlog Prices in the U.S. Pacific Northwest
With log inventories at U.S. sawmills kept to a minimum during the prolonged slowdown in domestic wood demand, a shock to either demand or supply can cause volatile swings in prices. The first quarter earthquake in Chile removed a substantial share of their supply of lumber and panels in world markets. Prices around the globe responded to the change. Lumber prices in the U.S. Pacific Northwest rose 30 percent during the first quarter, an increase on the heels of a 15 percent cumulative rise over the prior 4 quarters. By April, log markets in the Pacific Northwest have nearly reached the levels of those seen before the economic crisis – although on much reduced volumes.
Many sections of the U.S. South experienced colder and wet weather this past winter, which led to reduced inventories at mills. All sizes of logs were affected, but price pressure was most pronounced for pine pulpwood as wood on “wet weather sites” sold for a premium. The specifications for size and quality of pulpwood logs were often expanded, allowing smaller wood to become acceptable and some chip-n-saw sized material was converted to chips, at chip-n-saw prices or better.

First quarter market pulp prices were driven higher, mostly by supply-side issues, which limited production in several key regions. The earthquake in Chile caused the immediate closure of eight pulp mills representing about 11 percent of the world’s BSKP (bleached softwood kraft pulp) production. Wet or cold weather, logistical bottlenecks, and shipping delays were widespread. In North America, first quarter prices for NBSK (northern bleached softwood kraft pulp) hit $US 880 per metric ton, close to an historical record high price.

Rising discount rates and weakening timber markets have pulled down U.S. woodland property values since fourth quarter of 2008. Persistently wide bid-ask spreads, however, are hindering transactions and constraining price discovery. Therefore, reductions in third-party appraised values are lagging actual declines in market prices due to a lack of comparable sales evidence to show values declining. NCREIF property values, as charted here, are based on third party appraisals.
Quarterly EBITDDA Multiples for Privately Traded Timberland (trailing 4-quarter EBITDDA)

Figure 7. U.S. Timberland Valuation Multiples in Private Property Markets
Timberland pricing multiples fell first quarter as EBITDDA levels spiked as timberland managers increased harvests to capture rising timber prices. In the Pacific Northwest, several years of harvest deferrals in anticipation of a rebound in timber prices has dropped EBITDDA levels leading to dramatic increases in the multiple.

Monthly Securitized Timberland Share Value (Indexed to 100 at start date)

Figure 8. Hancock Securitized Timberland Index
Share prices for public timber-focused companies were flat to trending upward first quarter, with the overall Index in March up 5 percent from December. The current Hancock Securitized Timberland Index includes Plum Creek, Rayonier, Deltic Timber, Potlatch, and Timberwest.

Quarterly U.S. South Timberland Values ($ per acre)

Figure 9. U.S. South Timberland Values in Public Equity and Private Property Markets
Public market timberland values have begun to recover from the crash they experienced along side overall financial markets in the fourth quarter of 2008. Since then, public timberland market values have been rising 7 percent per quarter, on average. Private timberland, in contrast, has been trending downward beginning second quarter of 2009. The wide gap between private and public timberland markets continues to be at historic levels.
Phaunos, a closed-end fund publically listed on the main market of the London Stock Exchange, has numerous projects ranging from biofuels and wood pellets to sawmills and greenfield plantations. Examining the holdings of the public Funds and Indices show small levels of exposure to pure timberland. iShares’ WOOD ETF located in the UK has holdings which include REITs such as PCL and PCH and securities of major wood products and pulp producing companies including Gunns Limited in Australia, West Fraser Timber in Canada, Aracruz Celulose SA in Brazil, and Weyerhaeuser in the U.S.

The S&P Global Timber & Forestry Index is comprised of 25 of the largest publically traded companies engaged in the ownership, management or upstream supply chain of forests and timberlands. PCL and RYN in the U.S. are about 20 percent of the Index, Oji Paper in Japan and UPM-Kymmene Oyj in Finland each make up close to 10 percent.

Claymore’s CUT ETF trades in the U.S. and top holdings include paper and pulp producing and packaging companies including Smurfit Kappa Group, International Paper Co, and Votorantim Celulose Papel.

Summary and Conclusions

All of these Funds and Indices are investing in a range of publically traded timber-related and non-timber-related sectors – which in some cases is far removed from the timberland asset itself.

Exposure to timberland investing via vehicles held in public ownership under indirect control does provide liquidity. Yet, these types of investments dilute the traditional benefits of holding timberland, with performance looking much more similar to financial assets – something investors intentionally set out to avoid with an allocation to timberland.

Figure 1. The composite price for southern sawlumber is based on quarterly average Timber Mart-South published prices for pine sawlumber and chip-n-see stumpage. Pacific Northwest prices are derived from quarterly average Log Lines published prices for whitewoods and Douglas-fir with internal analysis of logging costs for stumpage calculations. New Zealand export prices are based on New Zealand Ministry of Forestry quarterly average published prices for radiata unpruned A, J, and K sort export logs with internal analysis of logging costs for stumpage calculations. Northeast sawlumber prices are calculated from internal analysis.

Figure 2. Quarterly southern pine (Westside), klm dried, 2x4 #2 lumber price published by Random Lengths. Timber Mart-South published southern pine sawlumber and chip-n-see log prices converted to lumber scale using RISI historical lumber recovery rates as published in their North American Lumber Forecast.

Figure 3. Quarterly Douglas-fir, green 2x4 lumber (Portland rate) and Hem-Fir (coast), klm dried, 2x4 lumber prices published by Random Lengths. Douglas-fir and whitewood sawing prices derived from Log Lines published prices for #2 and #3 sawlogs in various regions in the Pacific Northwest converted to lumber scale using RISI historical lumber recovery rates as published in their North American Lumber Forecast.

Figure 4. Pulpwood composite prices are derived from quarterly average Timber Mart-South published prices for southern pine pulpwood stumpage. Log Lines published whitewood and Douglas-fir pulp log prices with internal analysis of logging costs for the Pacific Northwest, and HTRG analysis of spruce/fir pulpwood in the North-East.

Figure 5. Quarterly NSBK pulp priced derived from daily list prices reported by FOEX industries Ltd. Southern pine pulp log prices published by Timber Mart-South. Pacific Northwest Douglas-fir pulp log prices published by Log Lines. Pulp log prices expressed in multiples of 10 to accommodate market pulp pricing scale.

Figure 6. Regional NCREIF timberland market value per acre is derived by dividing the total regional market value at quarter end by the number of acres reported in that region.

Figure 7. EBITDDA multiples are calculated using NCREIF timberland value per acre at quarter end divided by trailing four-quarter average NCREIF net income per acre.

Figure 8. The Hancock Securitised Timberland Index (HSTI) uses a base-weighted aggregate methodology (similar to that used to construct the S&P 600) to calculate a market capitalization-weighted value for seven publicly traded timber-intensive forest products companies. Base weights were adjusted for the emergence of new companies or at the beginning of each year. Dividends are not reinvested. The companies included in the HSTI have no investment relationship with Hancock Timber Resource Group.

Figure 9. Public equity values are derived from our Timberland Enterprise Value per Southern Equivalent Acre (TEV/SEA) calculation for seven timber-intensive publicly traded companies as compared to southern timberland values per acre calculated from the NCREIF database. TEV is a quarterly estimate based on local enterprise value (total market equity + book value debt) less estimated value of processing facilities, other non-timber assets and non-enterprise working capital. SEA uses regional NCREIF $/acre values to translate a company’s timberland holdings in various regions to the area of southern timberland that would have an equivalent market value. Rayonier has been added to the index as of Q1 2004 when they changed their status to a REIT. Potlatch recently changed its status to a REIT.

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