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Feature Grade Timber Markets

Tropical hardwoods are prized for their durability and appearance, but natural sources are collapsing.

• Feature grade timber markets are dominated by valuable species like teak and mahogany that have attractive colour and grain.
• The natural durability of most hardwoods also makes them ideal for external applications, such as decking and outdoor furniture.
• A significant proportion of international tropical hardwood comes from Southeast Asia - e.g. Malaysia and Indonesia.
• Southeast Asia’s forests are very rich in commercial species and contain a large proportion of light hardwood trees, which are most in demand in the international market. As natural forest supply of these timbers declines, plantation sources are needed to sustain the resource.
Tropical Hardwood Timber – Supply

Tropical hardwood supply is tightening as natural forest resources become more difficult to access and plantation resources struggle to keep pace with Asian demand growth.

- Asia has lagged behind other regions in the development of commercial plantations for higher value end uses.
- Traditionally, Southeast Asia’s natural forests supplied domestic and regional timber markets. However, regional log production has declined steadily over the past three decades due to unsustainable logging and legislation limiting logging of natural forests.
- Sustainable natural forest harvesting is not a realistic option for supporting timber demand growth in Asian markets. Natural forests are complex ecosystems, and their growth is slow relative to timber plantations.
- While oil palm plantations have proven highly lucrative, timber plantations have been less attractive to investors because positive cash yield can take over 15 years.

Rising Demand and Declining Supply

The combination of rising demand and declining supply will lead to a growing tropical timber supply deficit across Asia.

- The aging but wealthier populations of China, South Korea, Japan, and Europe, along with a growing middle class in Indonesia and India, will drive demand for higher value consumer goods like hardwood furniture, kitchen cabinets and flooring.
- The Chinese government says it will move 250 million people from rural to urban areas by 2025, with the aim of equalising the standard of living for all. The proportion of urban dwellers reached 52% in 2012, overtaking the number in rural areas for the first time.*
- Timber demand is highly correlated with new housing starts and GDP.
- Higher-value end use hardwood timber plantations have not been established at the scale needed to replace this supply or meet growing demand.
- This could lead to shortage of timber supply and translate into rising real prices.

*Source: McKinsey Global Institute: 'Preparing for China’s Urban Billion'
Asia and Pacific Wood Demand Is Growing

Timber demand is highly correlated with new housing starts and GDP.

Sources: ITTO, International Wood Markets 2014 and McKinsey
Regional Economy and Production Are Strong

China’s furniture exports to North America and Europe remain strong but the domestic market has provided most demand growth over the past five years.

42% of all the lumber and panels consumed in China’s domestic and export markets went into the production of furniture.

Other rapidly growing economies in the region have contributed to timber demand growth:

- India is the world’s main market for teak.
- Malaysia and Vietnam have substantial export-oriented hardwood furniture manufacturing industries.
- Indonesia has burgeoning domestic consumption as well as its own export-oriented furniture industry.

Source: RISI furniture production index, China Timber Outlook 2013
Regional Timber Demand Is Increasing

Asian Economic Outlook: Forecast GDP Growth

GDP Per Capita Change (2000-2013)

- China: 542%
- East Asia &...: 445%
- Indonesia: 350%
- Laos: 335%
- Vietnam: 297%
- India: 215%
- Thailand: 178%
- Malaysia: 159%
- Philippines: 148%
- Euro Zone: 84%
- USA: 22%

Sources: RISI 2014; World Bank (2014); FAO (2013)
Investing in an Increasingly Important Region

• Southeast Asia needs timber supply for both export and local/domestic use.
• Southeast Asian industry is developing around supplying hardwood products in US and Europe.
• Example: Since 1997, Vietnam has risen to become one of the world’s largest exporters of secondary wood products, principally furniture. With a rapidly growing capacity and a competitive, skilled workforce, Vietnam is likely to continue its rising status as a wood products exporter.
• Regional forest industry growth is focused on supplying higher-value end products, e.g. sawlogs, veneer logs, and product certification.

Southeast Asia has significant potential for tropical plantation development due to competitive growing costs and growth rates, large areas of land zoned for forestry, considerable experience in plantation management and processing, and low shipping costs to Asian markets.
Regional Manufacturing Increase

Shift in global timber products manufacturing to Asia is supported by lower operating costs and increasing urbanisation, with growing middle class in key countries.

Export of Secondary Wood Products
(USD Billions)

Source: ITTO.
Keeping up with US Demand

• Traditionally, the US has imported furniture from Canada, Italy, and Taiwan. In recent years, furniture from Southeast Asia has begun to dominate the import market.

• US is one of Malaysia’s largest export destinations for furniture, mouldings, builders’ joinery, and carpentry.

• In 2013 Indonesia became the leading supplier to the US of hardwood flooring, while China’s market share of hardwood furniture in the US has also grown.

• The US Lacey Act (2008), EU Forest Law Enforcement, Governance and Trade (FLEGT), and Australian Illegal Logging Prohibition Act have also strengthened demand for certified imported products.

• Value of US imports for wood furniture in 2012 was $US800 million. Total domestic demand for the industry in 2012 was $US3.5 billion

Keeping Up With European Demand

Europe is a major importer for rubberwood timber and furniture.

- In Europe, rubberwood is the main source for wooden furniture, accounting for 70% of EU furniture imports. Because of its even texture and light colour, rubberwood can be stained and finished to suit specific tastes.*
- In 2012, the total value of EU wood furniture imports (from outside the EU) increased by 3.8% to Euro 5.39 billion.
- Rubber plantations now supply both latex and timber.

*Sources: http://www.tradeforum.org/tradeforumhome/
Market Opportunity – Investment Gap

Regional supply is decreasing yet there is limited high-quality plantation investment.

- **Malaysia** – State of Sarawak is the second largest tropical log exporter in Asia (behind Papua New Guinea) and is major source of plywood; extraction volumes are declining and have been above calculated sustainable yield for more than a decade. In Peninsula Malaysia, resource scarcity and adoption of new logging regulations will require 100% third-party certification by 2014.

- **Indonesia** – Legal supply from natural forests has declined dramatically as areas are logged out; plantation production has been ramped up, but the plantation crop is almost wholly dedicated to the large pulp mills in Sumatra.

- **Vietnam** – Reduction in available volumes leaves the export-oriented wood products industries vulnerable as they have to import 80% of required volume; large potential for substitution of imported volume from domestic supply; current forestry plantations have focus on small log production for export chip industry.*

*Source: Sustainable Forestry in a Changing Climate conference, Hanoi, Sept. 2010*
# Risks and Risk Management

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<td>Financial</td>
<td>• Financial and exchange rate fluctuations</td>
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<td></td>
<td>• Impacts of government incentives and subsidies</td>
<td>• Strong government support in these countries for timber plantation development</td>
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<td></td>
<td>• Taxation changes</td>
<td>• Corruption/bribery most likely to encounter is petty facilitation payment</td>
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<td></td>
<td>• Corruption, strength of contract law, and judicial independence</td>
<td>requests to process paperwork—manage with patience</td>
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<td></td>
<td>• Pests and diseases</td>
<td>• Long record of plantation management in the region so operational experience</td>
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<td>• Site nutrition and sustainability</td>
<td>available</td>
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<td></td>
<td>• Escalating production costs</td>
<td>• Focus on use of experienced staff in all processes with balance of forestry</td>
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<td></td>
<td>• Natural disasters</td>
<td>and finance expertise</td>
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<td></td>
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<td>• Full due diligence covering technical forestry and social and environmental</td>
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<td></td>
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<td>criteria</td>
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<td></td>
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<td>• Implementation of forest monitoring procedures and use in auditing and</td>
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<td>reporting</td>
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<td></td>
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<td>• Regular site visits and third-party auditors for certification and valuation</td>
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<tr>
<td><strong>Markets</strong></td>
<td>• Commodity cycles</td>
<td>• Certification secures preferential export market access</td>
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<td></td>
<td>• Changes in tariffs and export regulations</td>
<td>• Significant wood supply deficit in Asia</td>
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<td></td>
<td>• Some species hard to market</td>
<td>• Assets will have diversified exposure across US/EU export markets and rapidly</td>
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<td></td>
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<td>• Reputational/association</td>
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<tr>
<td></td>
<td></td>
<td>• Document governance arrangements and management control</td>
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Want to Learn More?

To learn more about New Forests’ investment programs in plantation tropical hardwoods in Southeast Asia contact Radha Kuppalli at rkuppalli@newforests.com.au.