

# Log Market Analysis

As at 14 August 2019



Photo 1: Aerial spraying prior to replanting in Pinedale Forest, Wairarapa

The content of this Log Market Analysis is produced monthly as part of a suite of documents that comprise the regular reporting to forest owners during harvest. This standalone document is made available to other forest owners approaching harvest to keep them informed on market conditions.

We have included log price series separately for Wairarapa and Gisborne forests, as the price series differ for reasons including different customers, log specifications and locations.

Forest Enterprises (FE) is currently harvesting approximately 600,000 tonnes of logs per annum for Wairarapa and Gisborne forest owners. Most of these owners are Investors in forestry investments our company markets and manages, however some harvesting is undertaken for other forest owners.

Overall, harvest volume is increasing materially year on year.

## IMPORTANT

Every effort has been made to provide current accurate information in this document, which is for information purposes only. Any opinions and views expressed are those currently held by Forest Enterprises, however the reader accepts that where they are opinions and views in respect of future prices, they may subsequently be proven incorrect. The nature of the international log market is that of price fluctuations, and these fluctuations can be material, and material changes can arise due to factors not previously able to be foreseen.

## Overview

Come August, more data is available on the poor market conditions and log price following the passage of time. Often additional information can give heat but not bring light to our deliberations on what is the best way forward.

Price has stopped getting worse and may be improving. Improvement is not assured though, as there remains some imbalance in supply and demand with China port inventories rising and offtake falling. In any event, we have enjoyed a stable August so far and have adjusted production targets downwards in response to lower returns. There is more optimism now than we saw last month.

I have answered a number of questions from our Investors about the market changes, clarifying that Forest Enterprises reacts to lower stumpage returns to Investors by minimising costs and reducing production levels. On the face of it, these measures protect harvesting contractors and our customers, but I'm asked, how do they benefit Investors?

My answer is to reiterate that Forest Enterprises' investment forests are of good quality; this quality means that they remain in positive cashflow territory longer than forests with more difficult logistics or terrain. Keeping the forests producing steadily means that the harvest period does not lengthen and become uncertain. There is no reason to believe that quitting logging now will reduce the risk of lower average log sales over the several years duration of the planned harvest. Turning logging into a seasonal or sporadic business will add cost, and so continuing harvest in today's conditions is in the best interest of Investors over the expected harvest periods.

We are not "helping" contractors - we are maintaining the productive capacity that drives forest investment performance in the long term. That is the most prudent measure we can take.

More on this topic is available on our website:

<https://www.forestenterprises.co.nz/forestry-is-a-long-term-investment/>



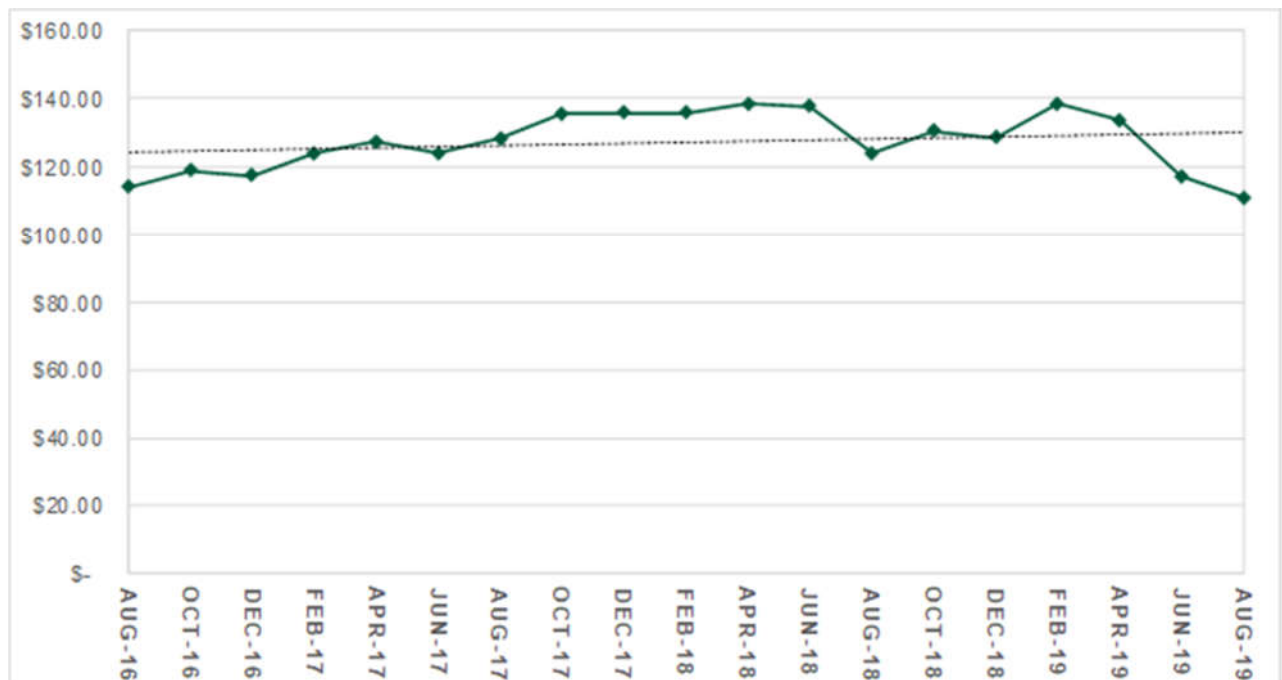
Photo 2: Great views from a landing in Te Karaka Forest, Gisborne



## Wairarapa Log Prices Per Tonne

Grade	Forest Enterprises Jul-19	Forest Enterprises 36 Month Average	Current vs 36 Month Average	Percentage of the 36m Average
Export P40	\$153.90	\$182.75	(\$28.85)	84%
Export P30	\$118.30	\$144.85	(\$26.55)	82%
Export A	\$103.70	\$135.75	(\$32.05)	76%
Export K	\$89.45	\$120.00	(\$30.55)	75%
Export KI	\$83.70	\$113.15	(\$29.45)	74%
Export Pulp	\$71.45	\$97.40	(\$25.95)	73%
Domestic P35	\$168.00	\$176.55	(\$8.55)	95%
Domestic S30	\$117.00	\$120.10	(\$3.10)	97%
Domestic S20	\$102.00	\$105.10	(\$3.10)	97%
Domestic Pulp	\$31.00	\$31.00	\$0.00	100%
Export sales units are volumetric (JAS) while domestic sales units are paid per tonne. The Export JAS prices have been converted to tonnes. Refer to page 4 for more detail on the JAS to tonne conversions.				
<b>Index Log Price</b>	<b>\$109.39</b>	<b>\$128.44</b>	<b>(\$19.05)</b>	<b>85%</b>
Index Log Price is calculated using inventory measurements from our Wairarapa forest crops and establishing an average log grade recovery for our typical Wairarapa Forest. Applying these estimates to our long run prices per grade has derived an Index Log Price. This index price helps to estimate the average logs sales predicted for a typical forest.				

## Index Log Price for our typical Wairarapa Forests



## Gisborne Log Prices Per Tonne

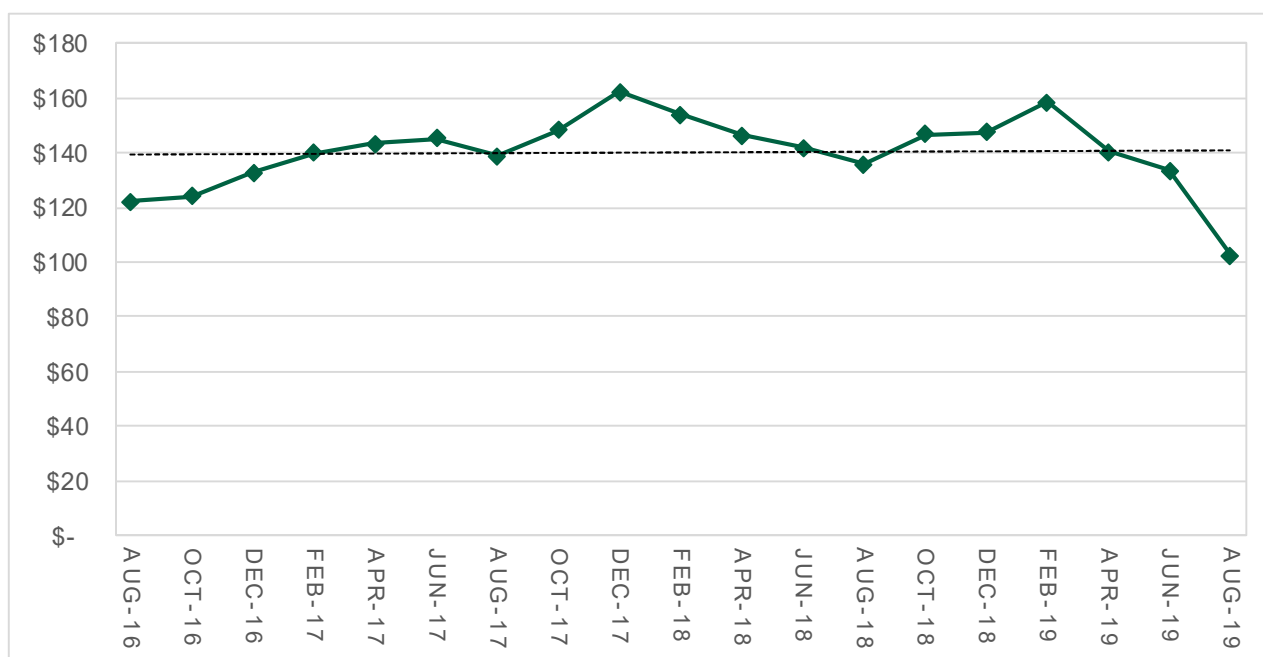
Grade	Forest Enterprises Jul-19	Forest Enterprises 36 Month Average	Current vs 36 Month Average	Percentage of the 36m Average
Export P40	\$140.95	\$180.75	(\$39.80)	78%
Export P30	\$108.00	\$148.75	(\$40.75)	73%
Export A	\$100.70	\$140.25	(\$39.55)	72%
Export K	\$87.35	\$125.30	(\$37.95)	70%
Export KI	\$75.90	\$114.70	(\$38.80)	66%
Export Pulp	\$69.85	\$102.15	(\$32.30)	68%
Domestic P35	\$180.00	\$180.00	\$0.00	100%

Export sales units are volumetric (JAS) while domestic sales units are paid per tonne. The Export JAS prices have been converted to tonnes. Refer to page 4 for more detail on the JAS to tonne conversions.

Index Log Price	\$102.89	\$141.77	(\$38.88)	73%
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Index Log Price is calculated using inventory measurements from our Wairarapa forest crops and establishing an average log grade recovery for our typical Wairarapa Forest. Applying these estimates to our long run prices per grade has derived an Index Log Price. This index price helps to estimate the average logs sales predicted for a typical forest.

## Index Log Price for our typical Gisborne Forests



Investors will notice that the Gisborne price series only includes domestic price for Pruned 35 due to log customers. This is because there has been only East Coast Lumber sawmill in Wairoa purchasing a limited number of logs in the Gisborne region. We have expanded our customer base to 2 additional pruned mills in July.



# Factors Influencing Current Log Price

Key:

↑ More Benefit to the Investor

↓ Less Benefit to the Investor

↔ Neutral

## Price, Costs and Logistics

### ↑ Foreign Exchange (Forex)

Export logs are priced in USD. FE's August rate is forecast at 0.6672. Our long run average rate is 0.665 but we saw a large correction this week and shipped at a favourable 0.6467.

FE takes no forward position or hedge in currency trading. Hedging imposes transaction costs without giving certainty of improved outcomes.

### ↓ Shipping

Shipping rates are firming; largely the bigger bulk sizes but handysize loggers are rising as well. Oil price has been volatile and we are getting closer to the low sulphur fuel deadline which is forecast to add to fuel costs. The trade war rhetoric between US and China is making shipping markets uncertain.

### ↑ JAS to Tonne Conversion

JAS-to-tonne conversion rates strengthened by 0.6% to an average of 97.4% for July across all export grades.

Export logs are sold in Japanese Agricultural Standard cubic metres (JAS). JAS is a measure of useable log volume rather than weight. Payments to most contractors are made based on weight, which is appropriate for handling heavy material. This means the return to the forest owner is affected strongly by the conversion of weight to volume in the logs.

Conversion has seasonal trends and varies between log grades, length and log quality. Accounting for conversion is necessary to report comparable values from different sales options. Our convention is to report all prices converted to the 'per tonne basis', which would appear different if compared with a per cubic metre (JAS) series. Hence why our harvest reports show monthly JAS/tonne conversion per forest.

### ↓ Log Price, Export CFR

CFR (Cost and Freight) is the price in USD paid by the end user/buyer.

China Price low and may have settled at the bottom.

South Korea Follows China, down; domestic mills becoming more competitive with imported lumber and panels.

India Down, but settled.

## Log Demand

### ↓ Export Log Inventory in Market

China Inventory of logs in China is a leading supply/price indicator. Inventory levels in China have grown and is high at about 4.7 million JAS. Daily sales have fallen to about 65,000 JAS per day leading to higher 'days of stock'. Days of stock is inventory divided by usage so is currently about 72; higher than in July. The speed that logs turn to lumber and lumber turns to cash drives market sentiment.

South Korea Mills are taking time out to reduce inventory of lumber. The economy suffering from US-China and Korea-Japan issues. Lots of PNW hemlock logs in the market.

India Housing demand in India expected to rise as the Government lowers corporate taxes and increases spending on infrastructure. Log imports slower in 2019 than 2018.

Japan Industrial output and growth from exports is falling, which reduces log demand in the packaging sector. Chinese Tsugi (cedar) log exports to China dropped off as the cedar was intended for Chinese merchandise exports to US which have dried up.

### ↔ NZ Domestic

Domestic price and demand steady, with long term customers continuing to take our forecast production levels at good pricing levels. Exports to Australia under increasing pressure from cheaper Russian lumber.



## ↔ Housing and Business

Housing drives panel, lumber and furniture sales and therefore log demand. Housing timber use has two primary markets: new house starts, or remodel and renovate. These two uses have different cycles based on relative consumer optimism. Australia has rising household indebtedness which weighs down investment.

## ↔ Pruned Log Grades

We have successfully supplied new pruned log customers in Napier and Tokoroa from our Gisborne forests and prices were favourable to export options. This has helped to lower our stock levels following a period of slow uplift onto Port which restricted cartage.

## ↔ Domestic Construction

The coalition government is putting Fletcher's proposed 272 new houses at Ihumatao out of business which places the KiwiBuild promise into negative territory for new build numbers. Housing consents and planned construction is a leading indicator of demand for wood products.

## Log Supply

NZ Woodlots and high-cost forests are stopping activity; talk of productions rates at 70-80% of previous level.

Australia Unharvested annual timber growth in Russia is 22 times the total Australian annual harvest.

Russia Sawn lumber from Russia into China growing and is about 63% of China's imported lumber. Russian log market has generally transitioned to sawn lumber supply rather than logs.

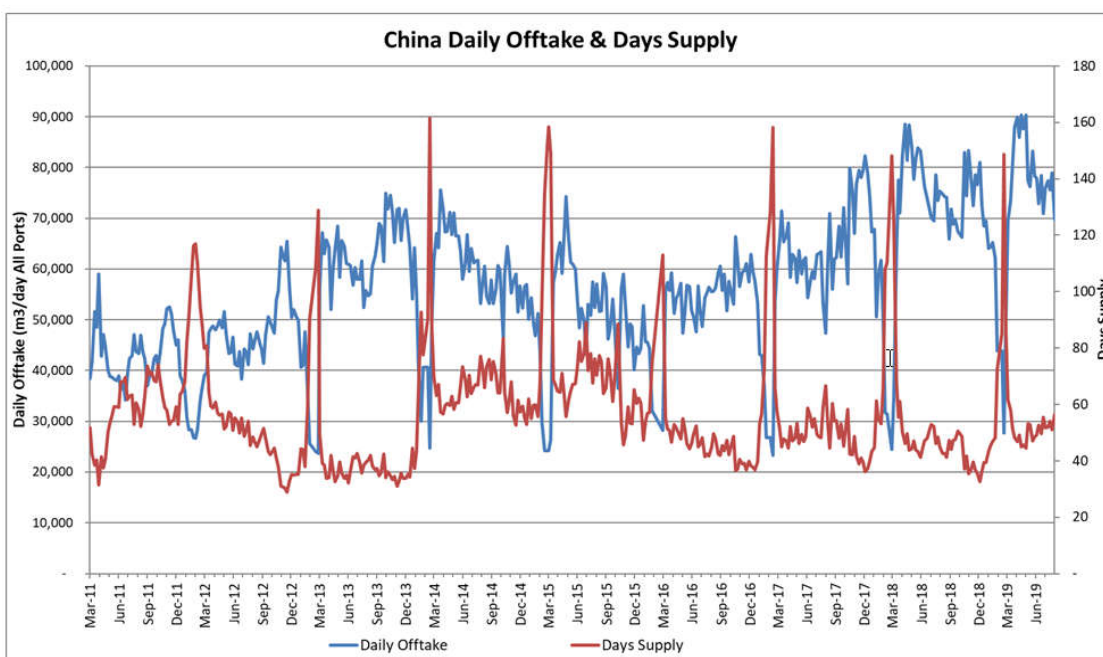
Pacific Northwest (PNW) Large slug of hemlock exported to Korea, proving hard to sell on.

US South High rains reducing building activity as well as harvesting. Listed timberland and wood products company Weyerhaeuser having a loss-making year.

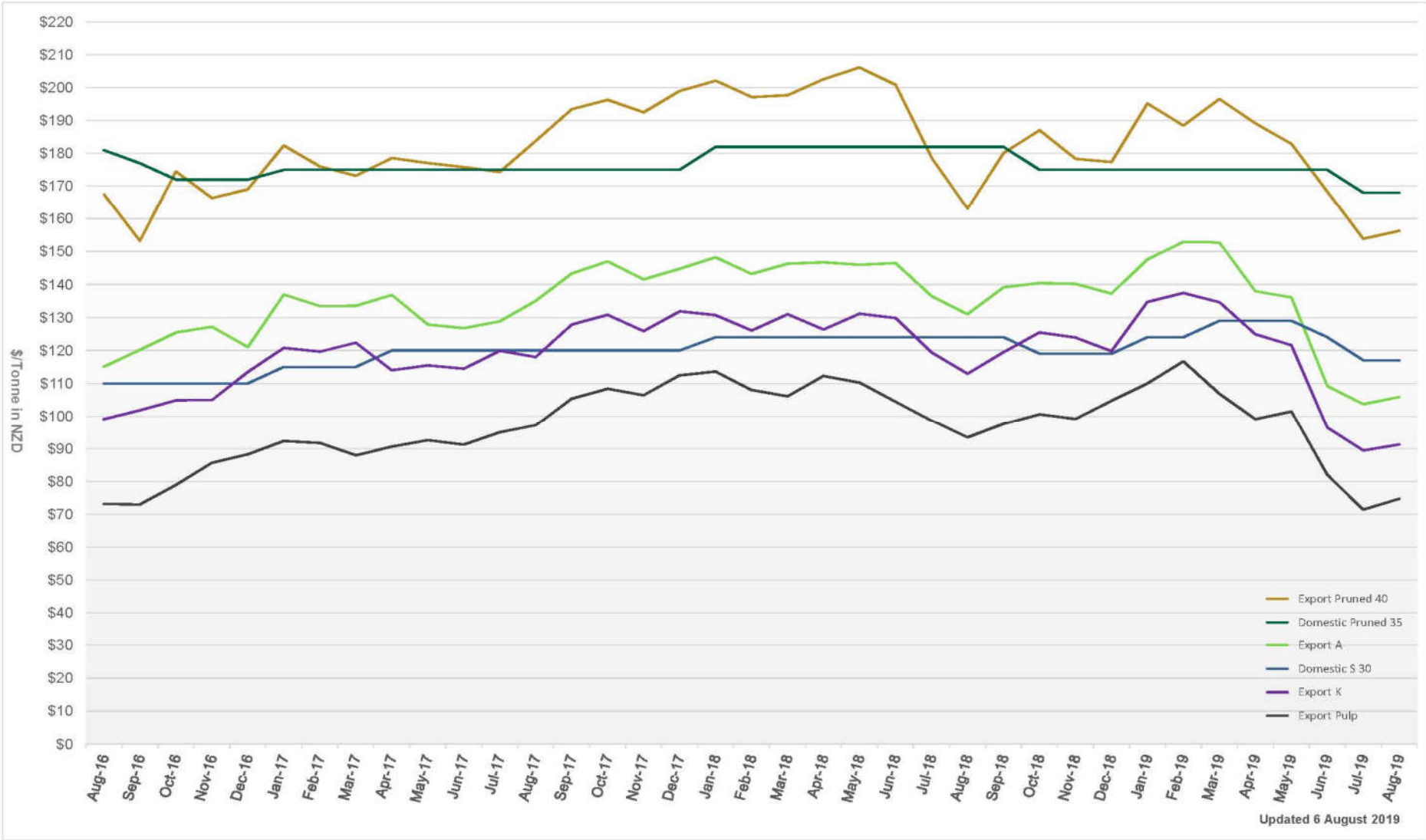
Other Eastern Europe's areas of storm damage and pine bark beetle mortality continue to hold up; supply displacing higher transport cost sawn lumber from the Americas.

## Point of Interest

Offtake falling, and days' supply of logs rising. Graph of log inventory trend sourced from PFP.



# Lower North Island Log Price Graph per Tonne



**Log Price Graph:** Tracks the key log prices for a 37-month period. The first 36 months are the months which comprise the average referred to under Log Prices per Tonne above. The 37<sup>th</sup> month shows the indicative prices scheduled for the current month. Export sales units are volumetric (JAS) while domestic sales units are paid per tonne. The Export JAS prices have been converted to tonnes.



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Contact **Nikki Coulmann**

+64 27 55 44 325

[ncoulmann@forestenterprises.co.nz](mailto:ncoulmann@forestenterprises.co.nz)

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