

Log Market Analysis

As at 26 June 2020



Photo 1: Emerald Hills Forest near Gisborne. Leaving the poplars in place to protect the soil.

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 650,000 tonnes of logs per annum for Wairarapa and Gisborne forest owners. We now harvest and deliver a further 350,000 tonnes for a private fund manager client in the same regions.

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.

Corrections to the last report

Some observant readers of the last edition of the Log Market Analysis (for May, published 5 June 2020) provided feedback to me that it reported log prices which seemed anomalous. I have determined that the report had been updated with June pricing rather than the considerably higher May pricing, and that the May label should therefore have changed to June at that point.

The good news is the revenues reported are not affected by this error, and once we understood the timing issue, we corrected it. Our aim to have the report out before the next month's prices are published, however on this occasion the May report was prepared after June prices were received.

May log prices were exceptionally high as revealed in the graphs and price series below, and June prices reverted to trend levels.

Overview

As I write this report late in June, we are coming out of great results from May log sales and June looks ok. Looking forward however, I'm less optimistic.

China and USA seem to increasingly clash, and there is no sign of a Covid-19 vaccine. The level of borrowing which governments, including our own, are currently undertaking seems unsustainable, and the spending of that borrowed money often feels superfluous. I hope I'm wrong. Being a pessimist means I'm more likely to be happy about the news I read rather than surprised.

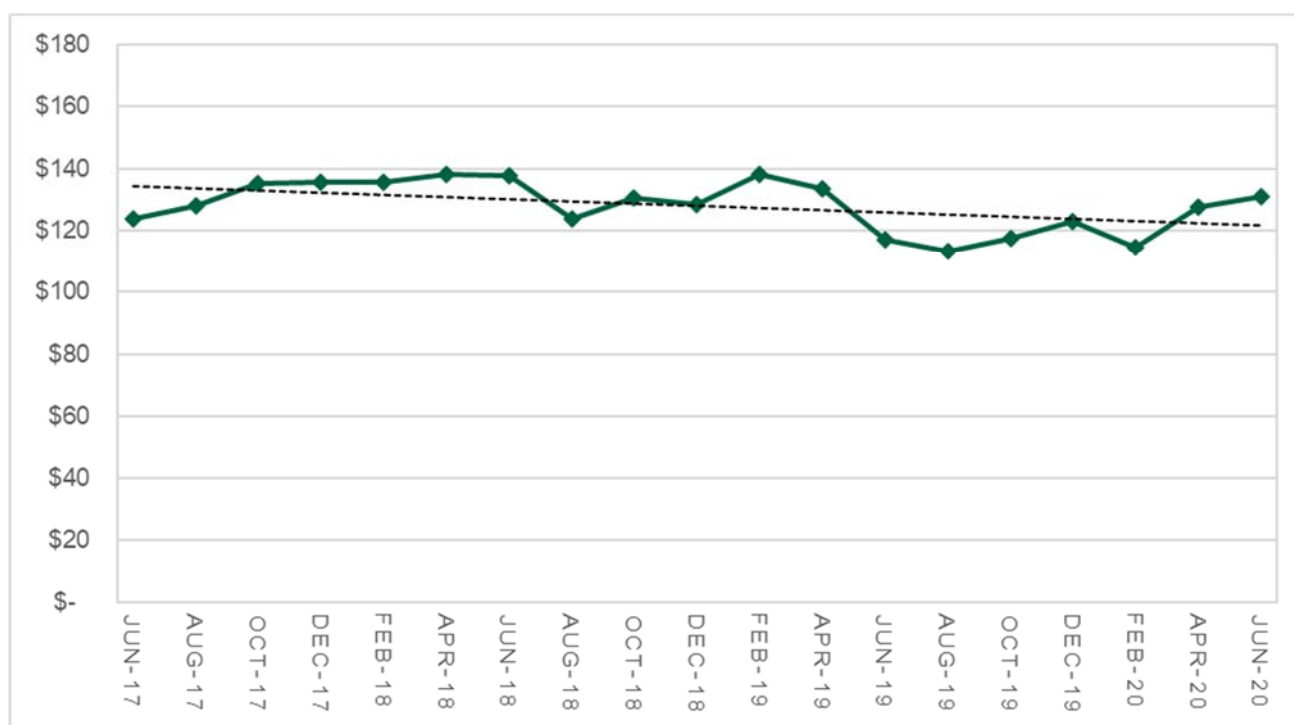
Investment in infrastructure construction during a recession is a good use of surplus economic capacity, but it's important that Government spend is on investment grade activities, not on vanity projects.



Wairarapa Log Prices Per Tonne

Grade	Forest Enterprises Jun-20	Forest Enterprises 36 Month Average	Current vs 36 Month Average	Percentage of 36 Month Average
Export P40	\$181.10	\$184.00	(\$2.90)	98%
Export P30	\$168.35	\$147.50	\$20.85	114%
Export A	\$144.55	\$135.00	\$9.55	107%
Export K	\$128.00	\$119.70	\$8.30	107%
Export KI	\$125.20	\$113.00	\$12.20	111%
Export Pulp	\$106.85	\$97.50	\$9.35	110%
Domestic P35	\$178.00	\$175.35	\$2.65	102%
Domestic S30	\$117.00	\$121.00	(\$4.00)	97%
Domestic S20	\$102.00	\$106.00	(\$4.00)	96%
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 5 for more detail on the JAS to Tonne Conversion.				
Index Log Price	\$131.00	\$128.70	\$2.30	102%
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.				

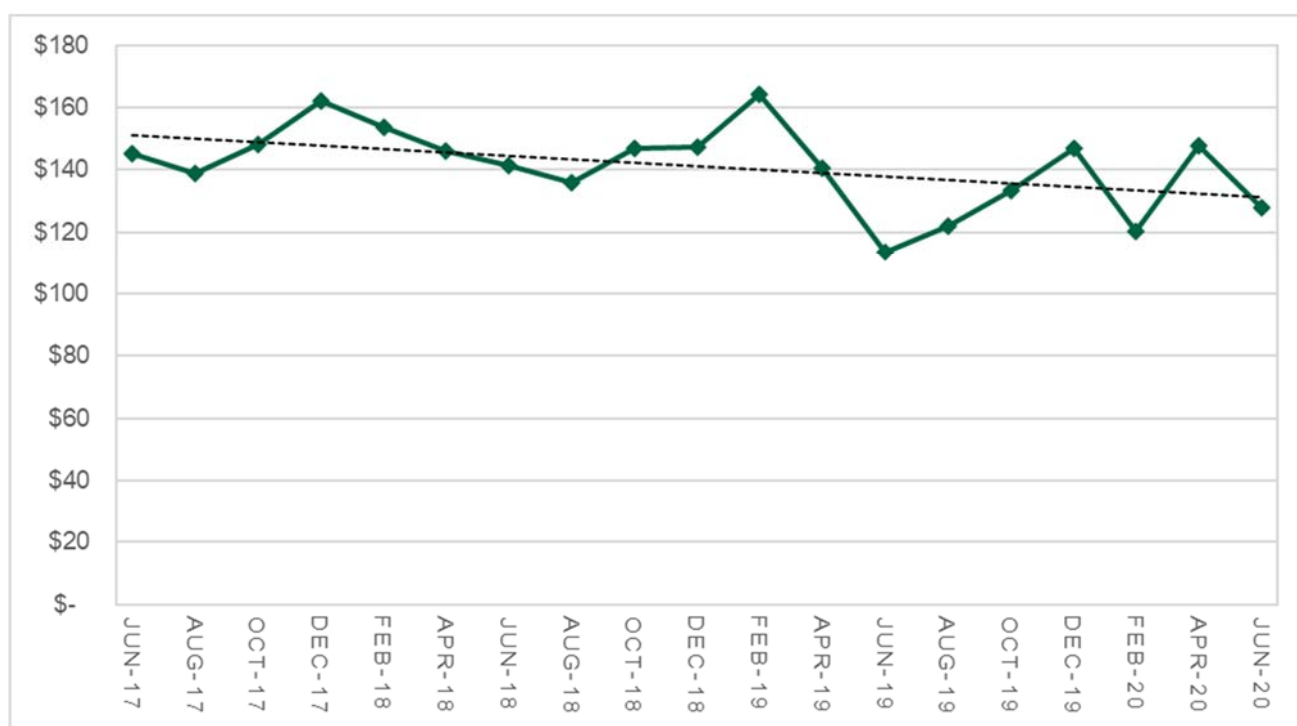
Index Log Price for our typical Wairarapa Forests



Gisborne Log Prices Per Tonne

Grade	Forest Enterprises Jun-20	Forest Enterprises 36 Month Average	Current vs 36 Month Average	Percentage of 36 Month Average
Export P40	\$169.05	\$181.40	(\$12.70)	93%
Export P30	\$128.00	\$147.80	(\$20.30)	86%
Export A	\$126.00	\$139.50	(\$14.00)	90%
Export K	\$112.00	\$124.90	(\$13.40)	89%
Export KI	\$102.00	\$115.55	(\$13.95)	88%
Export Pulp	\$85.50	\$102.50	(\$17.50)	83%
Domestic P35	\$175.00	\$178.45	(\$3.75)	98%
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 5 for more detail on the JAS to Tonne Conversion.				
Index Log Price	\$127.74	\$141.55	(\$13.81)	90%
Index Log Price is calculated using inventory measurements from our Gisborne forest crops and establishing an average log grade recovery for our typical Gisborne 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



NOTE: The trend shown on the charts is that Gisborne returns are more volatile than in the Wairarapa due to fewer sawmill supply options. Domestic sawmill price is more stable than export, but often at lower prices.



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. June saw some movement in rate but less than in May.

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



Shipping

Shipping rates are still quite low as there has been little activity but are rising noticeably. Both fuel cost and charter rates are moving upwards.



JAS to Tonne Conversion

JAS-to-tonne conversion rates are reducing as we go further into winter. Rates dropped from 100% (May) to average 97.9% in June, which reduces revenues vs fixed cost.

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.

<u>China</u>	Falling.
<u>South Korea</u>	Low price and demand.
<u>India</u>	Price limited by low demand for lumber.
<u>Japan</u>	Falling demand restricts price.

Log Demand



Export Log Inventory in Market

<u>China</u>	Inventory of logs in China is a leading supply/price indicator. Inventory levels in China declined as they came out of Covid-19 lockdown but the falling trend in log inventory levels has flattened. Current stocks are estimated to be down from about 4.2M JASm ³ in May to something like 3.9M in late June; daily usage is flat at around 60,000 per day. Days of stock is inventory divided by usage and has declined to about 65 days, which is still high. The speed that logs turn to lumber and lumber turns to cash drives market sentiment. European spruce lumber has increased rapidly; volume is hard to measure as it arrives by containers which are delivered to a wide variety of destinations, rather than bulk ships discharging into main ports.
<u>South Korea</u>	Sawmills losing money.
<u>India</u>	Tough times; low demand.
<u>Japan</u>	Log and lumber consumption flat, large increase in local timber supply and processing.



Pruned Log Grades

Demand is holding up. We have started supplying a sawmill in Gisborne, owned by Kiwi Sawmills who have a lot of history with us, with a steady demand for pruned logs. This certainly reduces cartage distance, and reliance on the port and log exports for those 10 loads per week.



↔ NZ Domestic

Demand remains good but not growing. As JAS-to-tonne conversion declines, domestic saw logs (sold in \$/tonne) become more competitive than export log sales (sold in \$/JAS).

↓ Housing and Business

Still waiting for the new houses. There is a lot of visible building to be seen in the Wairarapa if you drive around, but building rates reflect decisions made some months before the current date.

↓ Domestic Construction

We are expecting a pickup in construction activity as Government projects start, but the 'year of delivery' has yet to ramp up.

Log Supply

NZ

Production levels fall in winter, and as log prices fall the woodlot supply declines.

Australia

Clearing burnt logs and conventional logging continues.

Europe and Russia

Rapidly cutting dying spruce forests for export in containers to China.

Pacific Northwest (PNW)

Still harvesting.

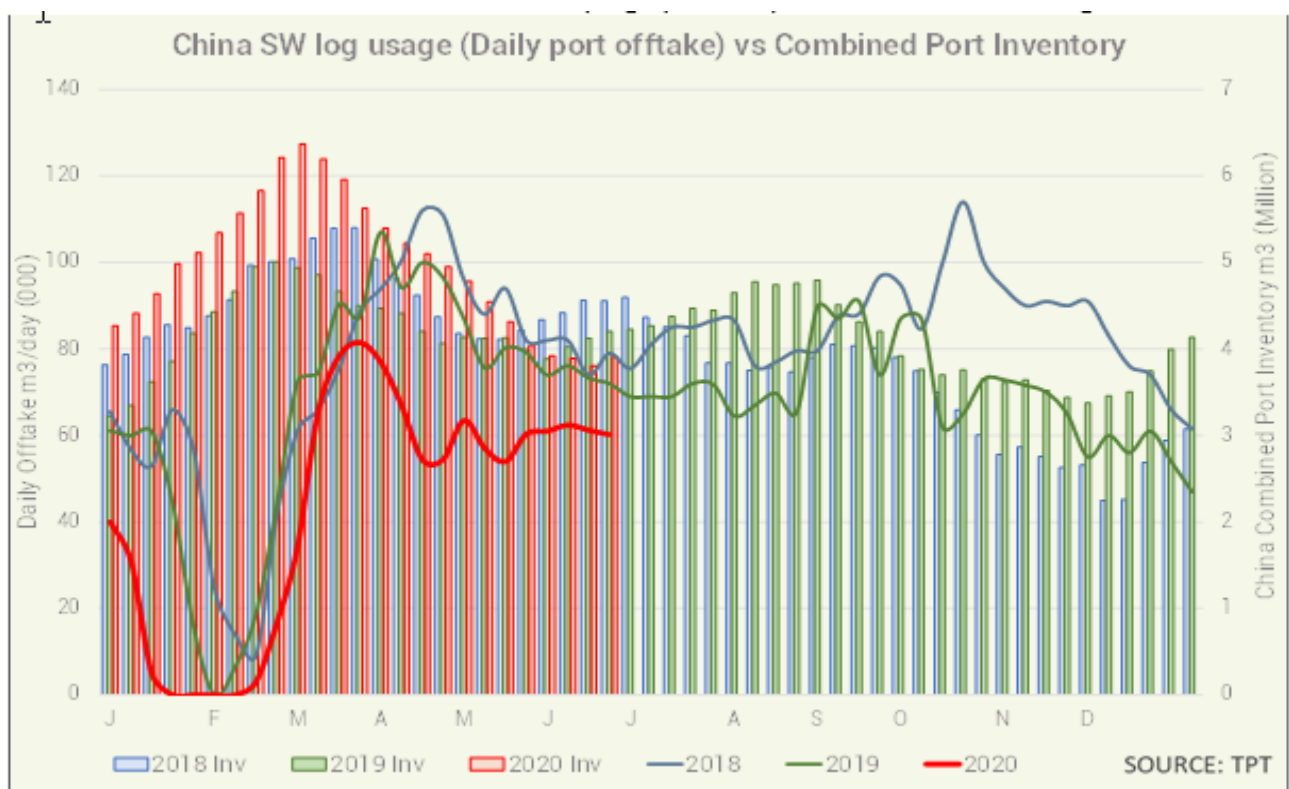
Other

A bumpy ride in Uruguay where margins on log sales are tight due to relatively high freight costs.

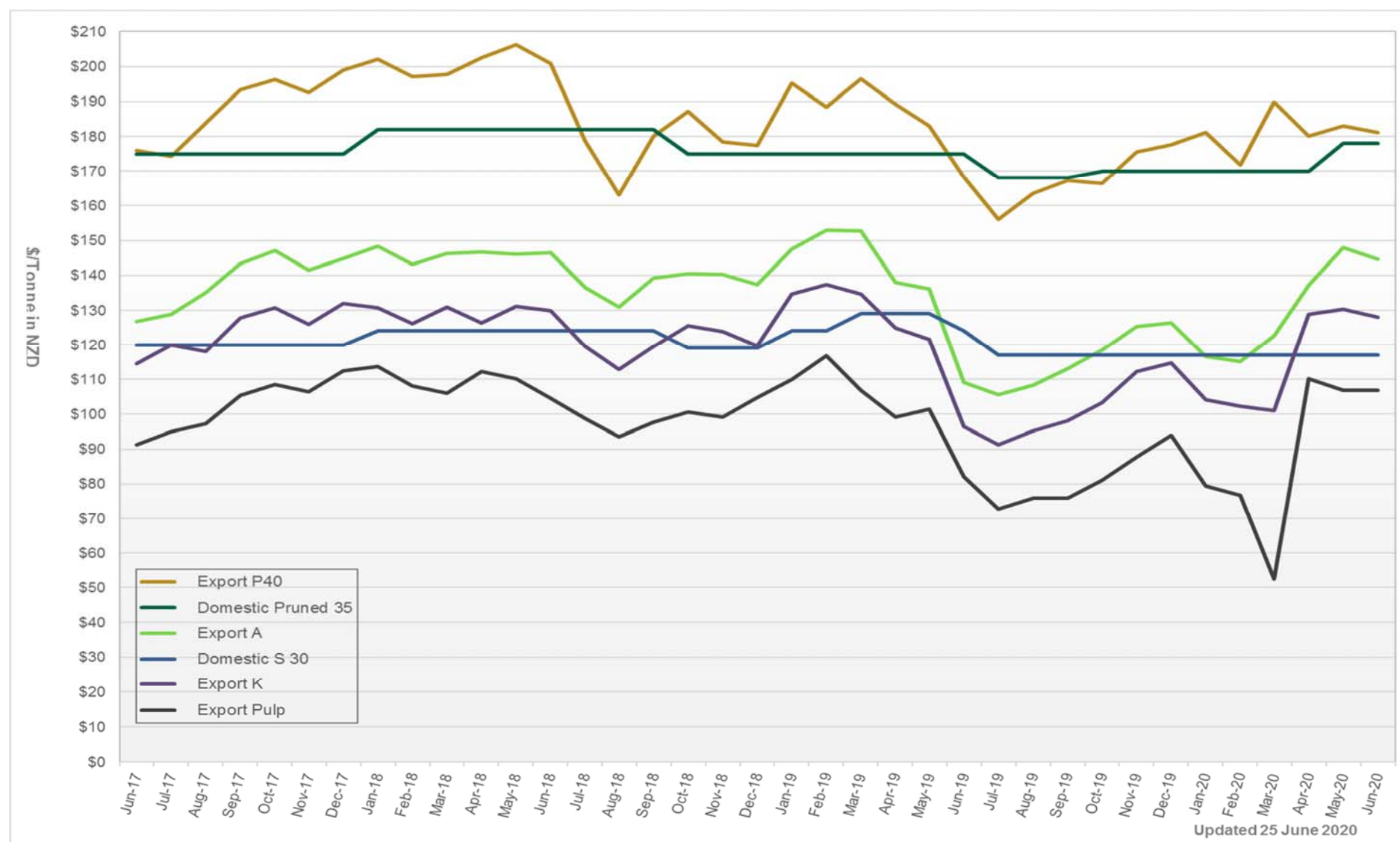
Point of Interest

Graph courtesy of TPT Forests who are doing their best to bring light to these dark and troubled times.

The graph below highlights the use of bright colours and wobbly lines by the forecasting fraternity. Make of that what you will, but its more downward than up in my interpretation. Inventory remains high and off-take (representing usage of logs) is low.



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 37th 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.



NGATAWHAI GROUP FOREST INVESTMENT

We are proud to provide this opportunity to invest in a sustainable, productive future for New Zealand.

The Ngatawhai Group Forest in Wairarapa is 627 stocked hectares of outstanding pine forestry, as well as 200+ hectares of permanent native bush and wetland.

This is existing forest land Forest Enterprises managed over three decades, through to the productive harvest of the first rotation crop.

Ready planted for its second crop rotation, this forest is now available for the next generation of investors.

Investment Overview:

- Initial Investment: Minimum initial application cost \$10,651 for 200 shares, plus affordable annual contributions
- Additional shares may be purchased at \$53.26 per share
- Projected annual contributions: Calls are projected to average around \$1,011* per year for 8 years, then drop to an average of around \$291* per year until harvest commences in 2038. The next call is 30 June 2021.
- Projected total investment: \$20,797*
- Projected gross return: \$129,060*
- Projected gross IRR: 9.33%*
- Harvest period (income): 2038-2046
- Production forest 627 net stocked hectares - 2.09 hectares per 200 shares

* Per 200 shares, based on 2% per annum inflation and Forest Enterprises' 36-month log price series to 30 June 2019. Refer Cashflow on pages 28-29 and other financial information in section 6 of the Product Disclosure Statement from page 25.

To learn more and for a copy of the product disclosure statement, contact Nikki Coulmann:

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forestenterprises.co.nz/new-investments

Ngatawhai Group Forest Investment is a managed investment scheme structured as a limited partnership, offered by Forest Enterprises Growth Limited, issued and managed by Forest Enterprises Limited.

Forest Enterprises is the business name of Forest Enterprises Growth Limited and its subsidiary Forest Enterprises Limited. Forest Enterprises Limited is licensed to manage Managed Investment Schemes (excluding managed funds) which are primarily invested in forestry assets.