Sustainable Timberland Investment.

Timberland Investment in Southeast Asia
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Who Will Own the Forest 5
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Why Southeast Asia?

Overview of the region, current players

"Benchmarking" investment environment and SEA timberland (TL) investment potential

Opportunities and challenges

Can one transfer US timberland model to SE Asia?
Dasos Capital Oy: Sustainable Timberland Investment for Profit

- Timberland investment adviser/fund manager for institutional investors and private equity clients

- We manage a Luxembourg-based TL fund
  - only fund with focus solely on **Europe** and **emerging markets**
  - strong sustainability focus

- In Asia, main focus is on **South East Asia** and China where Dasos team has worked since 1990
Presentation focus on forest plantations and TL investment in
- Indonesia
- Laos
- Malaysia
- Thailand
- Vietnam

In addition, references made to China and India
Historical Perspective: Weyerhauser in Indonesia in 1970s

- Weyerhauser was the pioneer in international timberland investment in Asia
- Developed pine plantations in East Kalimantan in Indonesia already in 1970 (left in late 1970s)
Timberland Investment Players in SE Asia

- Most of the foreign TL investment in Asia by large-scale vertically integrated forest industry companies especially to China, less to SE Asia
  - e.g. Stora Enso in Guanxi China and Oji Paper in Laos, Vietnam and China
  - Indonesian APP and April in China

- Investments in forestry development in China by listed companies
  - Canadian Cathay Forest and Sino Forest; US-based Greenwood Resources; German-Chinese UFC

- As of mid 2009, only limited investments by TIMOs in SE Asian forestry but interest growing rapidly
  - GEF/IFIA in Sabah; NewForests in Sabah
  - other timberland funds active in the region incl. e.g. Dasos Capital and IWC
Why SEA Asia: Push Factors

- ICT/electronic media and demographics reducing demand for paper in developed markets combined with uncompetitive old small mills → mill closures in Europe and USA → downward price pressure

- New investments in paper production shifting closer to end-use markets; pulp expansion close to fibre sources and low-cost production → LA and Asia

- US TL market is efficient with a large number of players competing for a limited number of deals → downward pressure on returns

- Investors looking for new markets such as SEA to achieve higher risk-adjusted returns

Source: Dasos, based on FA and UN data 2009

Source: Pöyry 2009
Sustainable Timberland Investment.

Why SE Asia: Pull Factors

- Long-term paper demand increase 4.1%/a in emerging markets

- Most of the demand growth for forest products in Asia
  - in China, India and Vietnam demand increases 7%-11%/a for both solid wood paper products
  - soon China will surpass USA and become world’s largest paper consumer

- Asia lead by China and India will face increasing fibre deficits
  - land scarcity in India and China constrain plantation development → increasing demand for imported fibre and forest products

Source: Pöyry 2009
Indonesia

- 1.3 – 1.5 mill. ha of fast growing pulpwood plantations most of them private
- Land owned by the State
- Industry well-developed with largest P&P industry in SE Asia; mechanical forest industry also significant
- Good domestic market potential; strategically located for the Asian market
- Acquisition of timberland through long-term concessions; both existing and greenfield projects
  - a lot of land available for development
Malaysia

- Total productive plantation area some 1.6 mill. ha
  - industrial plantations centered in Sabah and Sarawak amounting to 220-240 000 ha

- Land owned by the State; plantations developed in past by State Organisations

- No large-scale P&P industry; mechanical forest industry reasonably well-developed

- Strategically located for the Asian market

- Long-term leases of existing areas and (limited) development of new areas possible
  - a State Organisation often as partner
Laos

- No major industrial forest plantations
  - 120-150,000 ha of fast-growing plantations owned by state, smallholders, and private companies
- Land owned by the State
- Mainly small and medium size sawmills
- Good access to the Thai and Vietnamese market (and then to China, Korea)
- Quite a lot of land available for leasehold plantation development
  - Several foreign companies initiated projects but experiences are still limited
Thailand

- Some 400,000 ha of industrial plantations
  - owned primarily by small holders; some by companies and State
- Land owned by the State
- Domestic P&P and mechanical forest industry reasonably well-developed
- Good access to the Asian market
- Limited land available for plantation development due to population pressure
Vietnam

- Total plantation area 2.3 mill ha; productive plantation area 1.4 mill. ha
  - owned primarily by the State, JVs, army, farmers and co-operatives in scattered plots; low productivity

- Land owned by the State

- Domestic P&P and mechanical forest industry small-scale and inefficient

- Rapidly growing large domestic market; good access to China

- Limited land available for large-scale plantation development; medium and small-scale operations based on leases and JVs with State organisations
# Benchmarking Plantation and TL Investment Potential

<table>
<thead>
<tr>
<th>Region/Country</th>
<th>Estimated Forest Plantation Area</th>
<th>Potential for...</th>
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<tbody>
<tr>
<td></td>
<td>Production Area, M ha</td>
<td>Productivity m³/ha/yr</td>
</tr>
<tr>
<td><strong>South East Asia:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>1.3-1.5</td>
<td>25-37</td>
</tr>
<tr>
<td>Laos</td>
<td>0.15</td>
<td>15-27</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1.6</td>
<td>20-30</td>
</tr>
<tr>
<td>Thailand</td>
<td>2.0; industrial some 400 000 ha</td>
<td>20-30</td>
</tr>
<tr>
<td>Vietnam</td>
<td>2.3</td>
<td>10-24</td>
</tr>
</tbody>
</table>

Source: Indufor Oy, Dasos Capital Oy
I thought we have a valid land lease contract for 50 years!

Yes, but now we will have another contract as long as we agree on new fees and lease period.

“\In Laos, contract signing is commonly regarded as a starting point for negotiations”\”

Source: UNDP Doing Business in Lao PDR
Doing Business in SE Asia: Int’l Rankings

How Many Days Does It Take to Establish a Company

Transparency International Corruption Ranking 2009

Sources: IFC Doing Business Reports 2009
Transparency International 2009
Benchmarking Country Risks in SE Asia and China

- Based on **general** investment climate indicators
  - Malaysia and Thailand are most attractive SE Asian countries
  - together with China fare well e.g. compared with Brazil

- In countries such as Indonesia, Vietnam and Laos
  - lengthy processes, likely delays in acquisitions and running operations
  - higher returns needed to adjust for risks

Source: Damodaran Jan 2009
Some Due Diligence (DD) Issues

- DDs are more comprehensive and time consuming
- Information base often weak
- Environmental and social issues can be complex and their mgmt. costly

- Important to access
  - int’l consultants with strong DD and forestry (not only technical but social and environmental) experience in concerned countries and the region at broad
  - local resource persons and organisations knowledgeable of local conditions
Critical Issues in Securing Land Rights

- Most common way of gaining secure land rights is through a concession/long-term lease agreement

- In-depth legal reviews needed:
  - what land uses/conversions are allowed in the lease area
  - length of lease and related fees and payments
  - recognition of the rights of indigenous people and possible compensations

- DD should shed light on issues such as:
  - that authorities have not granted concessions over land where land titles are not clear, or there are indigenous people that enjoy traditional land use rights
  - central and local authorities and communities share the same understanding regarding the lease area
Main Opportunities

- Excellent market prospects in the (SE) Asian region
  - fastest growing market for most forest products
  - most of the forest industry expansion, especially P&P will take place in Asia
    → more wood fibre needed

- Excellent growing conditions and proximity to the growing market:
  - MAIs >40 m3/a feasible e.g. in Indonesia and Malaysia
  - existing assets and land areas that are not yet under efficient management
  - potential to add value to the existing resource

- Improving investment climates in the region → declining country risks

- Not (yet) a crowded market

- Provides an opportunity for investors to diversify their timberland portfolio

- Return expectations: 13% - 17%
Main Challenges

- Unstable and/or unclear policy environment → higher country risk → higher target IRRs

- Corporate governance issues: influence on IRRs and reputational risk

- Social/environmental issues: influence on mgmt costs and reputational risks

- Exit issues: no functioning timberland markets

- Higher transaction and governance/execution costs
  - good information and forest mgmt service providers scarce → adds to forest mgmt. costs

- Security of land tenure
  - no freehold land but land owned by the State; cooperation with State often difficult
  - lease/concession regulations often unclear or may not exist at all

- Forest industry sector in individual countries often not deep enough
What about Investing in Natural Forests in SE Asia

- Some of the most important natural forests in the world can be found in SEA, e.g. in Indonesia, Sabah and Sarawak

- Foreign and national investment in natural forests in SEA has too often meant exploitative logging and not SFM

- These forest can be managed sustainably only through monetising the values and creating supportive incentive frameworks for key stakeholders, e.g. communities

- **Due to reputational risks most institutional investors want to stay away from natural forests in the tropics**

However:

- Avoided deforestation REDD and payments for environmental services offer new ways of promoting sustainable forest mgmt. while generating profits to investors
Can One Transfer the US Timberland Model to SE Asia?

A simplified answer is NO – in most cases

- Most available projects are greenfield with associated risk profile
  - i.e. there is no divestment of already existing mature assets by industry
  - in addition, quite often a need to invest in processing to add value to forest asset contrary to the “classic” timberland divestment/investment logic

- Land is not purchased but leased

- Joint ventures (often with state authorities) are common
  - even without having a state organisation as a partner, one must continuously deal with state authorities and even politicians

- A model involving a DFI (e.g. IFC, development banks and funds) as a partner could help in reducing country/political risks
  - in any case, a strong local partner is always needed
THANK YOU

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