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TCA National Conference, 27-29 April 2007

Hardwood plantations and their markets

INTRODUCTION

The Australian plantation timber industry continues to amaze. Despite opposition from many quarters on many different issues, it is expanding and making acceptable returns for its owners.

The subject of my paper is the hardwood sector and its performance in the international wood fibre market.

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About 2.5 million green tonnes of plantation-grown eucalypt woodchip will be exported to Japanese pulp and paper manufacturers this year[1]. At current prices, that's worth about $250 million to Australia – good revenue for a commodity that critics insist is in oversupply. It's also worth over $100 million to the ATO in direct tax – again, not a bad result for a tax dodge!

I intend to focus on the market for Australian eucalypt woodchip – its current state, its prospects and the factors growers have to address as we take our product to market. In conclusion I shall deliver a report card on key issues in the Australian hardwood plantation industry.

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[1] URS Forestry, presentation to ABARE Outlook Conference, March 2007

CURRENT MARKET

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In the 2005-06 financial year, Australia exported over 8 million green tonnes of hardwood chips from both natural forest and plantations[2].

The total hardwood chip export volume was down slightly on the previous year because of a reduction in the contribution from natural forests. But higher prices from plantation woodchip cushioned the impact and the value of exports slipped only marginally.

More than 85% of Australian hardwood chips went to Japanese manufacturers – about a third of their requirements. Japan is still the market driver for wood fibre.

In April this year, hardwood plantation companies announced they had negotiated an $8.40 a bone dry tonne rise in the price of their woodchips exported to Japan[3]. This has lifted the FOB price to $100 per green tonne for the first time – a milestone.

It should be obvious that supply is tight at present and demand at the very least unchanged. There is no oversupply. In fact, the technical characteristics of the Australian plantation-grown eucalypt fibre make it highly sought-after for quality paper making. Demand for our product is rising.

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[2] *Australian Forest and Wood Product Statistics, March and June Quarters 2006*, ABARE, November 2006

[3] News release, Timbercorp Limited, 10 April 2007.

MARKET PROSPECTS

The good conditions in the current market should not blind us to a central fact – one to which the critics keep returning to – and that is:

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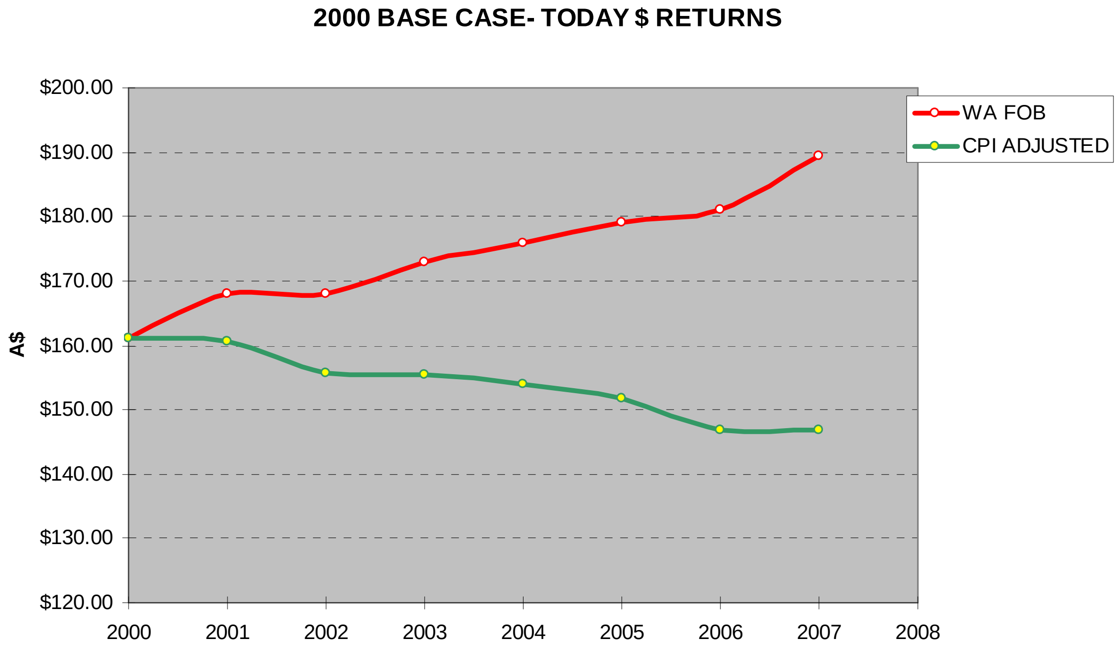
- The long term price trend for Australian hardwood is downwards in real terms.



Plantation chips realise a premium over natural forest chips but the long term price trend is still down.

In one respect, this is not surprising – all traded commodities show a similar price trend as supply increases and demand declines over a long period. But this amounts to no more than the constant background.

What's important is how we operate within that context.

The key factors for Australia in assessing market directions are:

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- China's continuing demand for wood pulp to feed its rapidly expanding paper manufacturing industry
- Reducing competition in wood chips from South America and South Africa, but increasing market influence from Russia (albeit mainly into China and a likely reversal of this as Russia introduces a significant log tax to halt illegal logging)
- Stable pulp and paper manufacture in Japan and increasing manufacture in South America, South Africa and Indonesia
- The continued drive against logging native forests, both legal and illegal, and international certification of wood products
- Non expansion of plantations world-wide (Australia is one of the very few countries still increasing its plantings), and importantly
- Continuing gains being made in production and handling costs, which are sustaining the all-important stumpage prices being returned to growers.

On balance, I believe the outlook is very positive. China wants feedstock and its home plantations are both inadequate and uncompetitive. The non-growth in Japan is being addressed by the major companies integrating their operations into China – meaning that for their suppliers to serve the Japanese market is also to serve the Chinese market. Competition for wood from Indonesian and South American pulp and paper manufacturers is increasing fibre demand, especially as the manufacturers are forced more and more to source feedstock from plantations, rather than natural forest.

WOODCHIP SUPPLY

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The supply of Australian plantation-grown hardwood chip was forecast at this year's ABARE conference to expand nearly four times by 2015 – to 8 million green tonnes a year[4]. This will double Australia's present total hardwood production and is the basis for assertions by the likes of ANU economist Dr Judith Ajani (formerly Clark) that Australian production is unsustainable, although given her view that an international oversupply already exists[5] this is hardly surprising or new. But for those of us at the pointy end of the industry, it is also considered necessary simply to meet existing customer-needs. In fact my own assessment is that we need more like 8 million dry tonnes to meet demand, not green tonnes.

Dr Adjani and other critics of the rapid growth in the Australian hardwood plantation industry take the global supply numbers, weight them according to factors like Japan's integration into China and Indonesia's rise, place them against the background long term price trend and come to the conclusion that our business is being expanded without regard to the markets. She wants trees planted only on the basis of having a firm market for the product. Tying up a market 10 years before the quantity and quality of product are known might be more difficult than Dr Ajani imagines.

On the other hand, it is simply not true that plantations are established more or less on speculation. The industry does make detailed market projections and plant accordingly. But with 10-12 years between planting and sale, we have to make a judgement, a calculated risk. We can't wait for academic certainty. That's the nature of business. If the opportunity and funding exists, for an industry like forestry, we simply must take advantage of it, because as we see

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[4] URS Forestry, presentation to ABARE Outlook Conference, March 2007
[5] Interview transcript, *Treechange,* Four Corners, 9 April 2007.

all too often, the rules change and suddenly we can't fund new plantings or even re-plantings. But fortunately, trees don't have to be harvested by the season, so if infrastructure, harvesting capacity or markets are in short supply, then the trees can stay growing for another year – or two.

The real challenge is to identify the competitive advantage of Australian plantation hardwood fibre.

Evan Shield is an internationally recognised expert in forest product industries – albeit not one given to over-optimistic forecasts. In fact, two years ago in reviewing the Japanese pulpwood market, he came to the conclusion that prospects were poor for woodchip suppliers not owned by the Japanese mills[6].

While it is easy to disagree with Evan on this point, he did make an important observation. Suppliers could operate in this poor market, he said, by providing the Japanese with the fibre they have demonstrated they prefer – plantation-grown *Eucalyptus globulus* fibre, and preferably with certification that it is grown according to proper environmental principles.

This is precisely what the Australian plantation industry is doing. We marry our quantitative market projections to what our Japanese customers want, on both cost and quality. We are certified by the likes of the Forest Stewardship Council and the Australian Forestry Standard. The business requirements are tough but we are succeeding – as the current market demonstrates. I'm afraid Dr Ajani still can't see the wood for the trees.

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[6] *An Analysis of the Japanese Pulpwood Market,* Evan D. Shield, International Pulpwood Resource and Trade Conference, Uruguay, April 2005.

PULP MILLS

One matter I can agree with Dr Ajani on is the need for development of more pulp mills in Australia. Whether pulp mills or other kinds of wood processing should drive forest industry policy, as she advocates, I am not going to debate in this paper. My focus is on what impact a couple of new pulp mills might have on the global market for woodchips from operators like Timbercorp not tied to mills anywhere.

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With a domestic market for our fibre, we would have a choice – supplying a pulp mill close to our plantations at the world price or supplying export markets at the same price. We would naturally seek the best margin. Given that the Australian industry is on the verge of tipping a huge new volume of chip into the market, as Dr Ajani says, the question then becomes what the competition from new Australian mills does for the market price of hardwood fibre.

It is disappointing, therefore, that Gunns is encountering such strong opposition to its pulp mill project in Tasmania and that Protavia, which Timbercorp has been supporting, has been unable to go ahead with its proposal for two mills in the Green Triangle. Still, one mill is better than none.

REPORT CARD

Two years ago, when I last addressed this conference, I identified four broad and interconnected groups of public policy issues that the plantation industry needed to address if it were to realise its potential.

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1. The survival and adaptation of the MIS structure for funding plantation investment.
2. Industry regulation and land access.
3. Water use and regulation.
4. Reform of our industry bodies

It seems public policy moves as slowly as growing trees. Only the MIS issue has been dealt with – and not very satisfactorily but it has established some investment certainty. The critics remain loud, however, and I can only hope future governments hold fast against their unfounded assertions.

Water remains the most critical issue, and as the drought has closed in ever more tightly on the users of our most precious resource the accusations have grown more intense and bizzare, if that were possible.

One interesting spin-off, however, has been a coming-together of the various forest industry representative groups. In my paper to this conference two years ago I asked for a rationalisation of the alphabet soup our industry representation has become. That hasn't happened – we still have a multiplicity of organisations representing various parts of the industry – but in facing the water issue we have achieved a broad commonality of purpose, and across the hardwood/softwood divide.

First and foremost it is agreed that South Australia is the test case. In the South East of SA, the perceived competition between trees and irrigated crops is most direct – all the water used is groundwater. Therefore the Government, under the Natural Resource Management Act, is seeking to regulate dryland farming – vis tree plantations – along the same lines as irrigation farming. The authority claimed for this is the National Water Initiative. So if the regime proposed in the Water Allocation Plan for the South East region comes into force it will quickly spread to all other states.

Timbercorp, initially alone, but now with the broad alliance of forest industry groups have managed to hold up the imposition of the proposed regime but it is a struggle, especially while drought drives water policy everywhere.

SUMMARY

In this paper I have sought to show that the hardwood plantation industry is thriving, despite the forces ranged against it.

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We are achieving prices rises in the market for our woodchip, although various authorities say it is in oversupply and the prospects are for that to worsen. These authorities – and they are reputable – take an academic view of the world. They do not see that the Australian hardwood sector has gained a place in the market that is competitive not only on price but on its ability to provide pulp and paper manufacturers with the feedstock they want – *Eucalyptus globulus* – and at top quality.

If we can maintain our competitive advantage in this sector, market prospects are bright – especially if we can develop more pulp mills in Australia to compete for our product.

What might hold us back are the key public policy issues associated with plantation development – government regulation and access to land and water.

Water is the most critical. Tree plantations are dryland agricultural crops, but government is seeking to allocate water to the industry as if it were irrigated. Somehow it is believed that we can get by on inferior land with inferior water supply.

The fact is we are succeeding in the international market place only because we grow and sell a superior product – and, like other superior Australian agricultural products, that requires the best land and climatic conditions.

That said, it is ultimately a business judgment whether our product will have a market when the trees reach maturity. If we don’t accept the risk that such a judgment entails, the trees will never be planted. Then, no doubt, the critics will say we missed the boat.

For me, that would be a massive failure of nerve on our part. We’re better than that and, I believe, the results to date show it:

[Slide 10]

- Virtually 100% of the success of the 2020 Vision is due to the MIS hardwood sector

- There now exists a thriving timber industry centred around Albany in WA’s south which will continue to grow and will rival SA’s Mt Gambier

- Every rural community in Australia that plantations have penetrated have grown and prospered, in direct contrast to what was previously happening to those communities

- Trees continue to be the lifeline to environmental salvation and rural prosperity: to water quality, to soil health, acidity, salinity, air quality and carbon sequestration, jobs, good health.

Frankly, if Australian in fact world governments, academics, scientists and ENGO’s were serious about conservation and climate change, they would gather up all the money being spent pontificating about climate change and spend it instead on growing timber trees, and the great majority of the so-called environmental ills of the world would fast disappear. That they don’t is simply proof that they don’t believe their own lies.

[Slide 11]

Carn timber!