



# MADISON'S TIMBER PREVIEW

PO Box 2486, Vancouver, BC V6B 3W7 ✦ Tel: 604-984-6838 ✦ Email: [madrep@shawcable.com](mailto:madrep@shawcable.com) ✦ Web: [www.madisonsreport.com](http://www.madisonsreport.com)

February 03, 2012

At the IQPC 10th Timberland Investment Summit this week in New York City, *Madison's* was privy to developments as they unfolded, and is now in a position to provide Timber Preview subscribers with the kind of scoop that does not come around often.

By way of overview, these conferences are attended mainly by those with timber assets or timberland to sell, analysts and economists from various sectors, those interested in natural resources as an investment strategy, US land groups and agencies, and representatives from some lumber producers, especially those with timber holdings. Conifex CEO Ken Shields has shown up the past couple of times, which always gets *Madison's* excited at the prospect of gaining access to some inside information. Alas, no such luck, Shields knows better than to say anything sensitive within earshot of Canada's biggest forest industry blabbermouth.

In essence, this conference, and others related to timberland investment, are attended by a lot of peddlers and only a few funds or endowments. Those with big cheque books looking to invest in this asset class. There are, however, enough players from the financing side to get post-presentation discussions really cooking.

It was fascinating for *Madison's* to witness the unfolding of events about to be laid out below. A good cross-section of the US, and global, timber investment community came up with a solution to a problem that has been looming over the past year or two.

This problem boils down to the TIMOs. Over the past several years, too many TIMOs in the US have become too small to allow for proper financial maneuvering and their timber appraisals have become increasingly more questionable. Meaning: inaccurate. Meanwhile, the REITs are at the point of having been bought up, and of late there is a lot of money from around the world looking for stable, consistent, long term returns, but less and less forested land available for sale, especially in the US, with which to do this.

By way of explanation, fundamentally a TIMO, or Timberland Investment Management Organization, aids institutional investors in managing their timberland investments. A TIMO acts as a broker for institutional clients. While a REIT, or Real Estate Investment Trust, is a security that sells like a stock on the major exchanges and invests in real estate directly. Put differently, a REIT is a corporation or trust that uses the pooled capital of many investors to purchase and manage income property. It is, in essence, a real estate mutual fund, and is allowed by income tax laws to avoid corporate income tax.

REITs offer several benefits over actually owning properties, because they are highly liquid, unlike traditional real estate. They also pay yields in the form of dividends no matter how the shares perform. REITs have been formed by a number of large financial institutions such as banks and insurance companies. The stocks of many of them are traded on security exchanges, thereby providing investors with a marketable interest in a real estate investment portfolio.

Clearly REITs are an attractive investment for a variety of investment players with a lot of money to manage, plenty of other holdings, and a long term view.

TIMO's, on the other hand, do not own land; they buy land, manage it and sell it for their clients. The job of a TIMO is to find, analyze and acquire investment properties that would best suit their clients. Once an investment property is chosen, the TIMO is given the responsibility of actively managing the timberland to achieve adequate returns for the investors. In order to do this, thereby to protect and to increase the value of their asset base, they need information like: forestland asset attributes, for example, number of trees per acre; tree health; forest biomass, tree species location; environmental impact assessment of management efforts; and in some ways most importantly, when and where to thin and to harvest.

The 17 largest TIMOs plus the smaller ones together manage approximately 25 million acres worth more than US\$30 billion. The four REITs; Plum Creek, Potlatch, Rayonier, and now Weyerhaeuser, own about 17 million acres worth about US\$28 billion.

The only TIMO to make the top 13 US timberland transactions last year to October was the Molpus Woodlands Group, which bought approximately 26,500 acres of timberland located in Georgia and Virginia. The price was not disclosed but per acre timberland prices for those regions are not hard to find.

By contrast, Potlatch's full year 2011 financial results, released January 31, 2012, show that company sold approximately 46,400 acres total in Wisconsin and in Arkansas. Insiders say the Wisconsin sale shouldn't be counted because it was for a conservation easement rather than a fee simple transaction. That land transaction occurred, however, regardless of details.

As a foreshadowing of things to come, Tim Corriero of FIA Partners announced during his presentation that Plum Creek had completed a 50,000 acre timber acquisition from a TIMO for US\$100 million the previous day. The deal included an eight year timber deed of fully mature southern acreage.

"Plum Creek is buying cash flow," said Corriero as the entire room launched itself on notepaper, laptops, and iPads to take note of the news.

Apart from this purchase, Corriero described Plum Creek as, "in terms of EBITDA, this company is cannabilizing itself in order to pay a dividend."

"There is US\$40 billion in US privately held timberlands, with the main investors being pensions funds, foundations and the like," said Corriero. "These timberlands consistently undervalue their merchantable timber, there are consistent errors in the appraisal valuations.

"As for the publicly owned companies, there is way too much information reported and way too little land area to bother trying to sort out the real value. Therefore, investors are much more confident in private valuations than in public."

"The TIMOs will go public because public markets will value these assets more highly," explained Corriero to a rising crescendo of murmurs among this normally very subdued crowd.

One of the final speakers, Chong-Hong Fu of Timberland Investment Resources, concluded his presentation by suggesting, "Generally speaking investors have either an active or a passive role in their investment strategy. There is a trade-off between diversification and return, and the benefit is in the economy of scale. A small timberland holding has higher fixed costs and higher variable costs. So an investor might want to lower the risk but the subsequent income will also be lower."

By the end of the conference the floor was opened up to discussion, and the ideas were flying freely from one corner to the next.

One attendee asked the room, "In the case of multiple small tracts, how much is an investor sacrificing versus a large tract? By what per cent is the reduction of return?"

"Where there is a very strong forestry infrastructure [meaning a lot of sawmills - ed], the investor is more cushioned," came the answer.

After some lively conversation, the general conclusion was that the TIMOs are going to be bought up and bundled into REITs. It's all about exit strategy.

Time to buy: now. Time frame to be bought out: less than one year.

Keta Kosman

Publisher

Madison's Lumber Reporter

Madison's Timber Preview

Madison's Investment Rx

[www.madisonsreport.com](http://www.madisonsreport.com)

604 984-6838