



WARNELL

The Changing Landscape of Private Timberland Ownership

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Background

- Following the Southern Forest Resource Assessment, a perception that things had changed with respect to timberland
- Southern Group of State Foresters arranged through Dave Wear and John Greis to fund this study
- Brought together an advisory group of interested parties including Forest Industry, TIMOs, environmental groups and others to lay out the scope of the question



Commercial Timberland Transactions

Over 39 million acres of industrial timberland has changed ownership in the past ten years (in large transactions)

- The traditional vertically integrated forest products companies have been the sellers and institutional investors and REITs have been the purchasers
 - Trends are evident by region (NE, South, Lake States, PNW)
- Trends appear to be continuing with additional asset sales by integrated forest products companies. If any are left ??



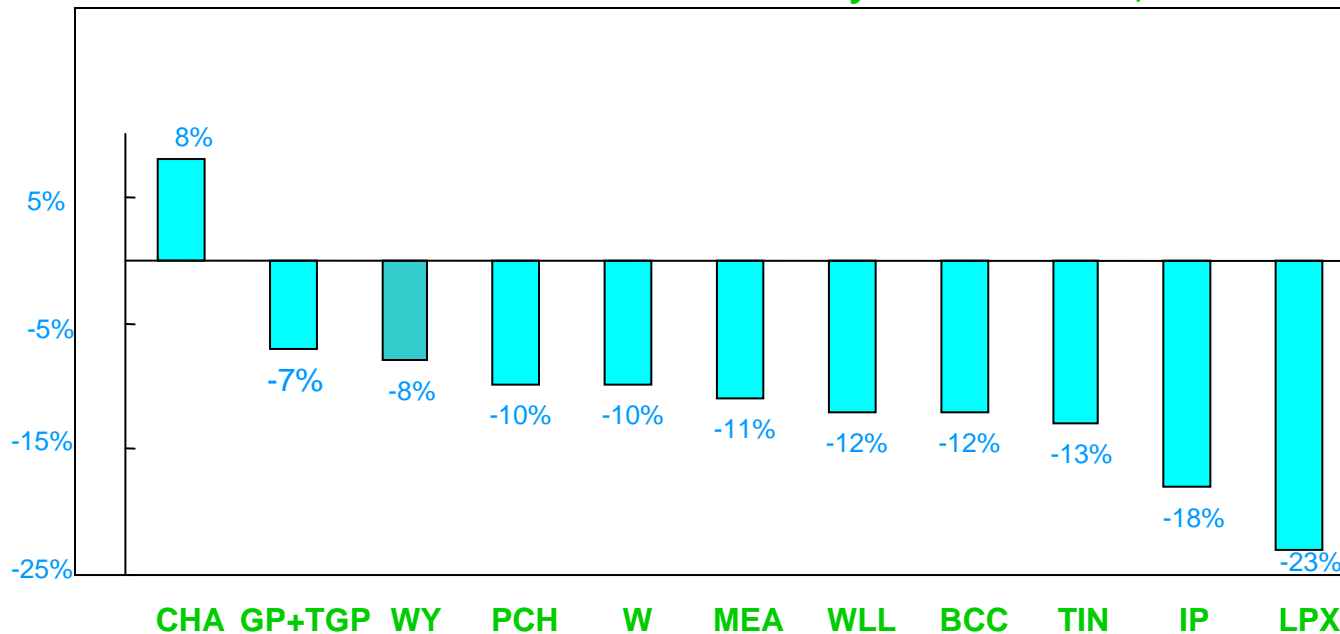
Why ?

- Performance issues in the forest products industry
 - Abysmal shareholder returns. Private placement returns on timberlands have been far better
 - Consolidation among companies in the industry has left substantial debt on their balance sheets
- Recognition that timberland ownership may not be required to be in the forest products manufacturing business (a change in strategic thinking)
- Deep and mature markets for most raw materials in most regions of the country
- More efficient tax structures for owning timberland have evolved (not C-corporations)
- Tax efficient strategies to mitigate capital gains taxes

Strategic Context...

S&P500 Return for same period: 18%

Total Shareholder Return: January 1998 - June 30, 2001





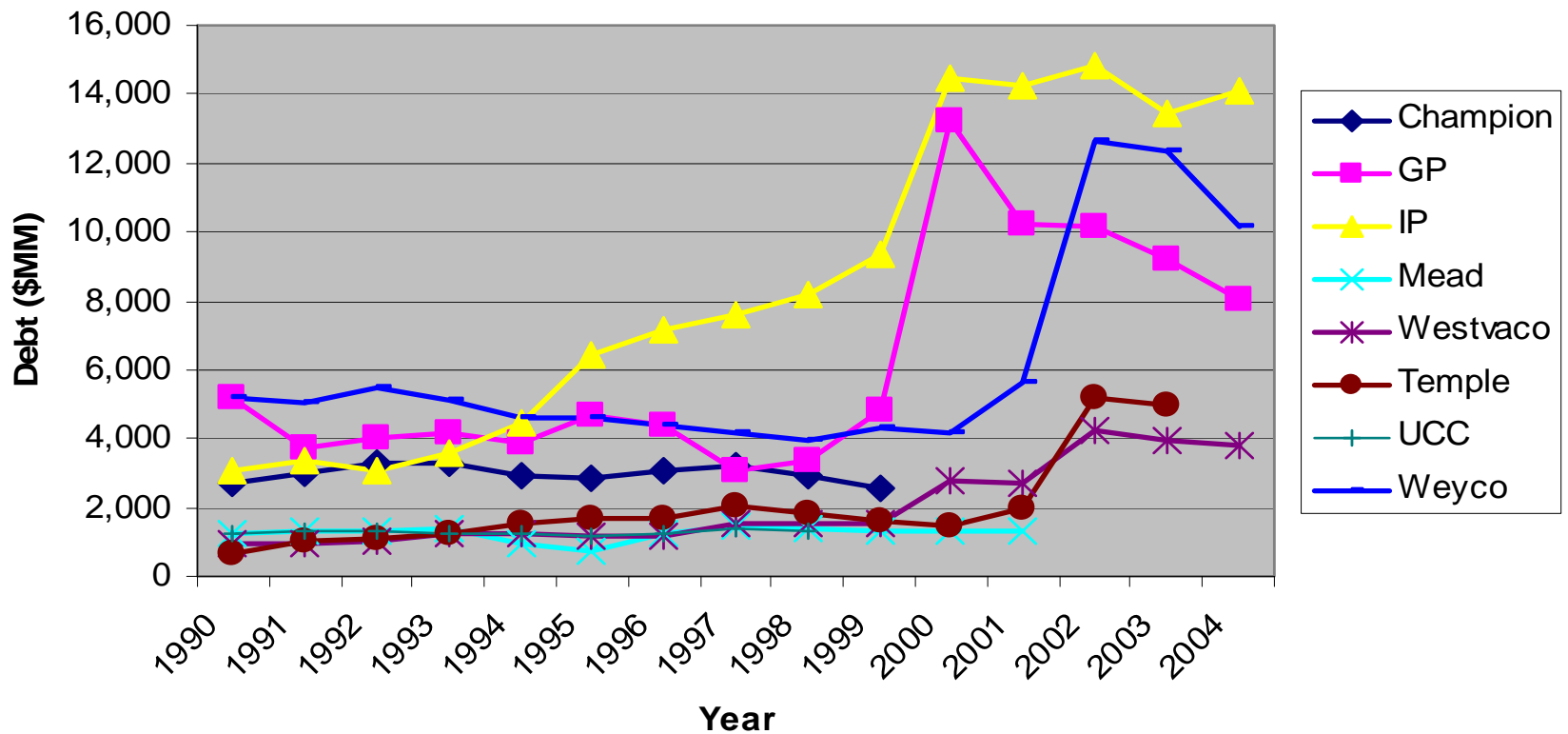
Forest Product industry performance relative to key benchmarks

	2004 returns	Five-year return	Ten-year return
Dow Jones Industrial	+5.3%	+0.7%	+13.1%
S&P 500	+10.9%	-2.3%	+12.1%
Forestry & Paper Group	+5.1%	-0.9%	+6.2%

Source: Wall Street Journal, 2/28/05

Strategic Context...

Long-term Debt (\$MM) by Company



Leading Owners or Managers of Timberland in the U.S. (as of 1/1/2008)

	Company	Type	M acres
1	Plum Creek	T-REIT	8,336
2	Weyerhaeuser	FP-Company	6,800
3	Hancock	TIMO	3,764
4	Forest Investment Assoc	TIMO	2,903
5	Wagner Forest Mgmt.	TIMO	2,500
6	Resource Mgt Services	TIMO	2,479
7	Forestland Group	TIMO	2,123
8	Forest Capital Partners	TIMO	2,100
9	Rayonier	T-REIT	2,036
10	Sierra Pacific	Family	1,700
11	Potlatch	T-REIT	1,525
12	Global Forest Partners	TIMO	1,400

- Of the top 12 land owners, only 1 is a forest products company, 7 are TIMOs, 3 are REITs.

- Remember TIMOs do not own land – they manage it for other investors



Impacts on Timberland

- There are substantial concerns about the impact of these timberlands changing ownership including:
 - Will this trend increase / accelerate fragmentation across forested landscapes?
 - Will management objectives and silvicultural practices change dramatically?
 - How will the changes impact fire suppression / management activities?
 - Will closed end fixed length funds change the investment in silviculture?



Methodology

- Interview-based methodology utilizing a common set of questions with a broad range of timberland investors, firms and consultants.
- Objective:
 - Determine how these entities manage timberlands and how they perceive others are managing timberlands.
 - Question is “How are pine types managed by various entities?”



Types of questions related to timberland ownership

- Strategy and objectives
 - For owning & for selling
- Approach of managing while owning
 - Operational philosophy & intensity
 - Community presence
 - Metrics used to measure performance
- Expenditures
 - Research, soil mapping, fire suppression
- Transaction-specific questions
- Perspectives on fragmentation, community involvement, issues related to the public good



Study group includes 39 interviews from four industry sectors.

- Timberland Investment Management Organizations (TIMOs)
 - e.g. FIA, RMK, Hancock, GMO, Campbell Group
- Forest industry firms
 - e.g. Weyerhaeuser, GP, IP, Temple-Inland
- Real Estate Investment Trusts
 - e.g. Potlatch, Plum Creek, Rayonier
- Forestry consultants
 - e.g. F&W, Larson & McGowan, MBG, etc.



Results highlight the roles of taxes, debt levels, and shareholder returns.

- For most C-corps, timberland ownership does not make sense.
 - Double-taxation issues.
 - In some cases timberlands were suboptimized to support mills
- Timberlands are easily sold relative to manufacturing assets.
 - Proceeds can be used to reduce debt levels.
 - Return proceeds to shareholders
- Shareholders, analysts, and executives of public firms believed returns on industry-owned timberlands lagged alternative investments.
 - Selling timberlands freed up capital and generated shareholder value.



Strategy for Owning Timberland

- The reasons for owning timberland varied widely
 - Integrated forest products companies – raw materials support for mills, insurance, etc.
 - Consultants – Depends on the client
 - TIMOs – Focused on return on investment for their clients
 - REITs – focused on financial metrics, dividend yield, capital appreciation, total returns
- Institutional investors, as represented by the TIMOs were the most consistently focused on returns



Strategy for Owning Timberland

- Forest management differs by ownership
 - Integrated firms, on average, more intensive over long-run
 - TIMOs take both intensive and passive approaches depending on timeframe and investor
 - Increased emphasis on cost control – shrinking silviculture budgets and increased emphasis on costs among new owners



Silviculture and Forest Management

- A variety of perspectives from the vertically integrated forest products companies, TIMOs, and large private landowners
 - Silviculture practices probably are impacted
 - More harvest flexibility for TIMOs and REITs – maybe
 - Less long term silviculture investment – maybe
 - Little investment in activities like soil mapping, etc.
 - Fund length (investment horizon) appears have an impact on investment decisions



Research Expenditures

- Widely differing views on the role of applied research and the funding of technology development
 - Forest products companies see traditional forestry research dwindling as they move away from timberland ownership
 - TIMOs have a poor record of supporting such activities
- Substantial questions about the future of traditional forestry research



Fragmentation

- In several of our case studies, these divestitures and acquisitions have accelerated fragmentation in a variety of ways
- Many have voiced concerns about this increased fragmentation and its impact on wildlife habitat, recreation opportunities, future growth rates and timber supply, etc.
- Viewed as a “two-edged sword”.
 - All recognized the value creation from HBU sales
 - Also mentioned the environmental and resources management issues



Use of Debt in A&D activity

- Some of the deals have used debt extensively and have a higher probability of greatly increased harvest and minimal silviculture investment. These deals can be identified.
- Generally purchased by entities that do not have a long-term interest in timber and timberland investment



Capital Gains Taxes

- All of the large transactions have involved some strategy to mitigate or eliminate the large capital gains taxes due from the sellers of the timberland
 - Installment notes
 - Reverse Morris Trust Transactions



Some New Legislation

- The new Farm Bill contains some substantial changes for both C-Corp and REITS
 - The C-Corp tax rate goes from about 40% to 15% making this structure far more attractive than in the recent past
 - Gaining REIT status is easier now with relaxed tests on income
 - Some other changes on REIT rules
- However, the changes are only for one year!



Predictions

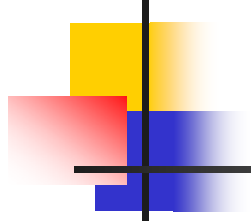
- TIMOs (actually their clients) and REITs will continue to gain substantial timberland ownership.
- Timberland will continue to be an attractive asset class for institutional investors.
- In two years no publicly traded vertically integrated forest product company will own more than one million acres of timberland in the United States



Thanks



A Southern Baptism



Questions ??

