New Forests

Insight

Region profile:

Investing in sustainable forestry in Southeast Asia

Responsibly managed Southeast Asian plantation forestry has the potential to offer attractive returns due to strong regional and international demand for timber products, competitive cost structures and carbon market opportunities. Integrating plantations into sustainably managed landscapes can also lead to climate change mitigation through forest protection, restoration, and biodiversity enhancement. Further, focusing on sustainable development outcomes creates economic opportunities for local communities.

Investment opportunity – rising Asian timber demand

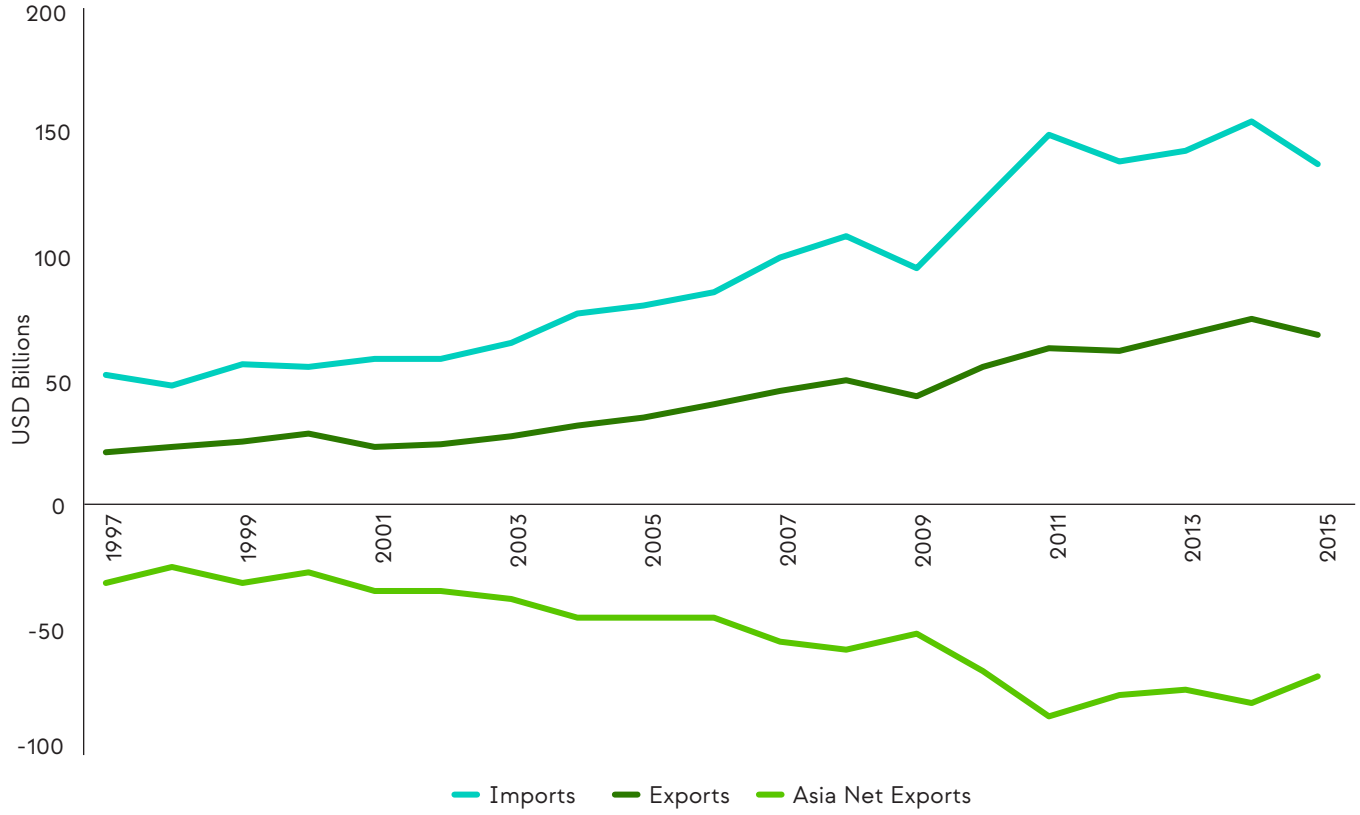
The Asian region has both the world's fastest growing demand for wood products and an increasing timber deficit.

China has grown in importance as both a consumer and producer of forest products, overtaking traditional timber production regions such as Canada and the United States. Chinese demand continues to grow for hardwood and softwood logs, woodchips, plywood, lumber, wooden furniture, pulp, paper and wood pellets for fuel.

Other rapidly growing economies in Asia also contribute to timber demand growth:

- India is the world's largest market for teak;
- Malaysia and Vietnam have substantial export-oriented furniture manufacturing industries; and
- Indonesia has burgeoning domestic consumption as well as its own export-oriented furniture industry.

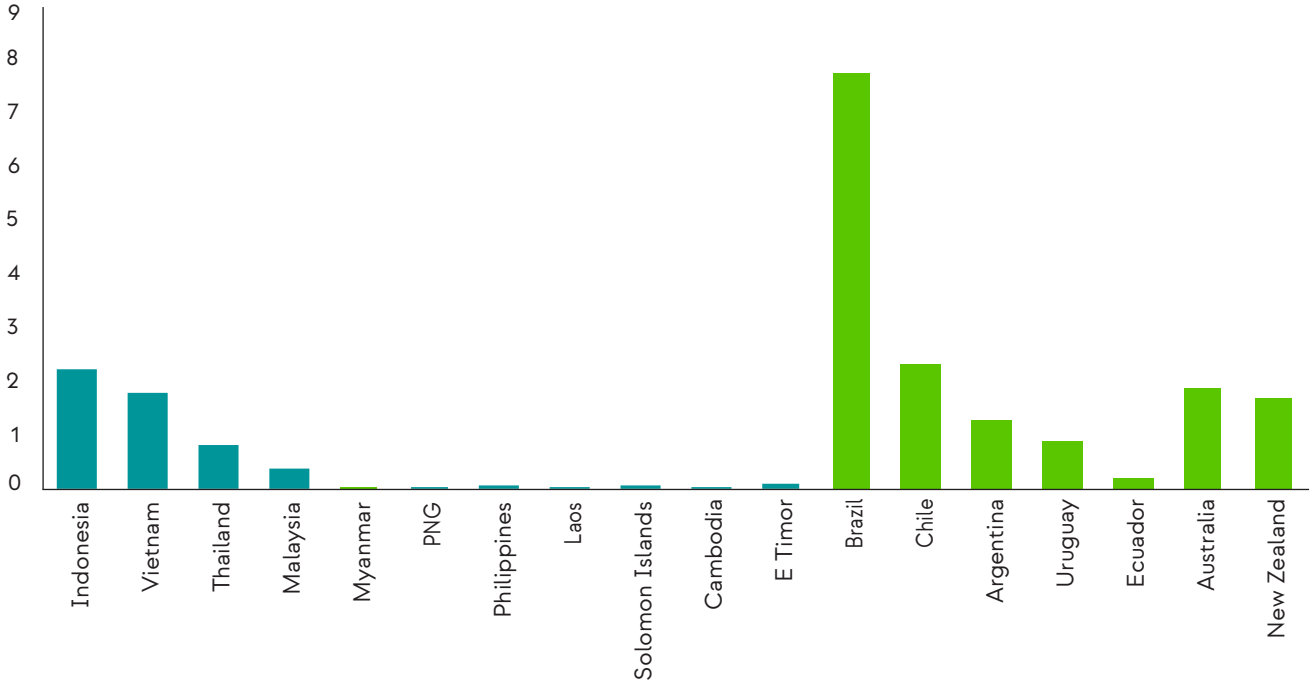
Figure 1 – Asian Trade in Forest and Wood Products[1]



Despite growing demand for timber, the development of commercial plantations for high value uses has lagged in Southeast Asia versus other regions such as South America (see Figure 2). Total plantation area in key forestry countries – Malaysia, Indonesia, Vietnam, Cambodia, Laos and Thailand – is estimated at only five to six million hectares. To date, plantation development has focused on short rotation, low value crops for the pulp and paper industry. New Forests believes these plantations can transition to higher value species over time. Southeast Asia's share of timber production is expected to rise from 39% in 2013 to 62% of world plantation production by 2050.[2]

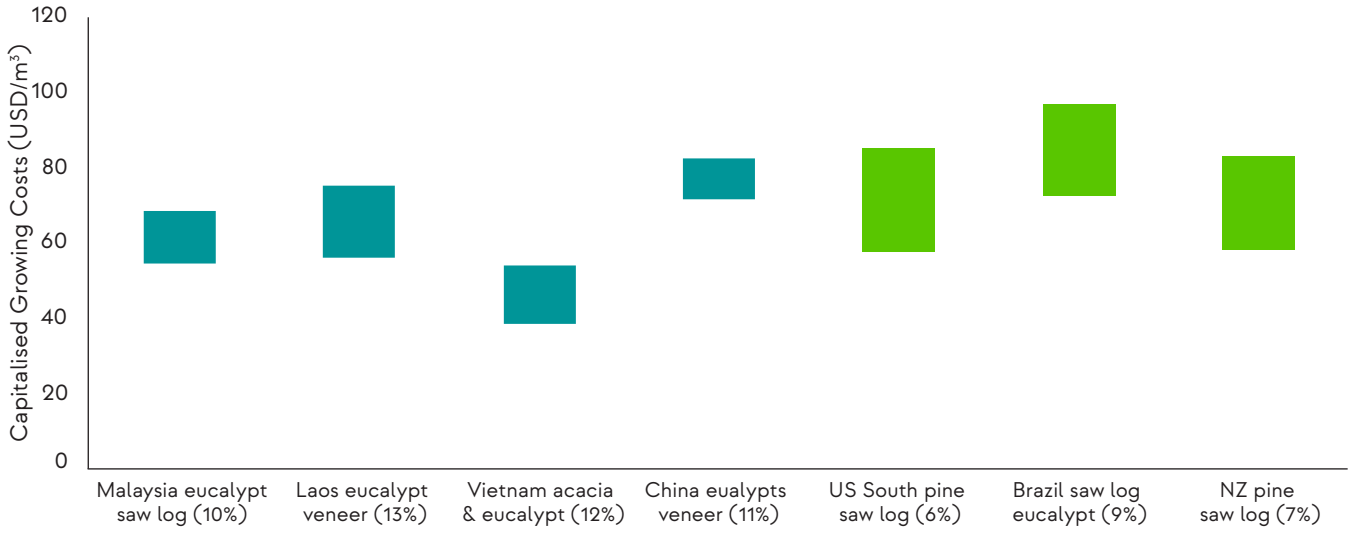
1 Source: FAO and RISI 2015 Southeast Asia Regional Timber Supply and Market Outlook. Includes primary forest products and valued-added wood products (2016).

Figure 2 – Plantation Investment by Country, Southern Hemisphere[3]



Southeast Asia has significant potential for sustainable plantation development due to competitive growing costs and fast biological growth rates. In addition, large areas of land have been zoned for forestry, the region has considerable experience in plantation management, processing and shipping costs to Asian markets are low.

Figure 3 – Capitalised Plantation Growing Cost Estimates by Region[4]



Parentheses indicate cost of capital in real pre-tax terms.

2 Food and Agricultural Organisation (FAO).

3 RISI 2016 International Pulpwood Trade review, RISI 2017 Global Tree Farm Study, ITTO, Government datasets and New Forests Asia estimates. Data does not include rubber estates and is based on private/government commercial scale plantations, not small holders (except for Vietnam where small scale private growers are fundamental to the industry).

4 New Forests' analysis. The above chart provides New Forests' estimates of the growing costs for plantation timber including allowances for site productivity, growth rates, the time value of money invested, and the opportunity cost or cost of capital. Relevant costs (direct, indirect, and land) are compounded forward to an assumed time of harvest using an appropriately adjusted cost of capital. At the assumed time of harvest, this compounded growing cost is then divided by New Forests' projections about a range of likely harvest timber yields to give a range of growing costs expressed in USD per cubic metre.

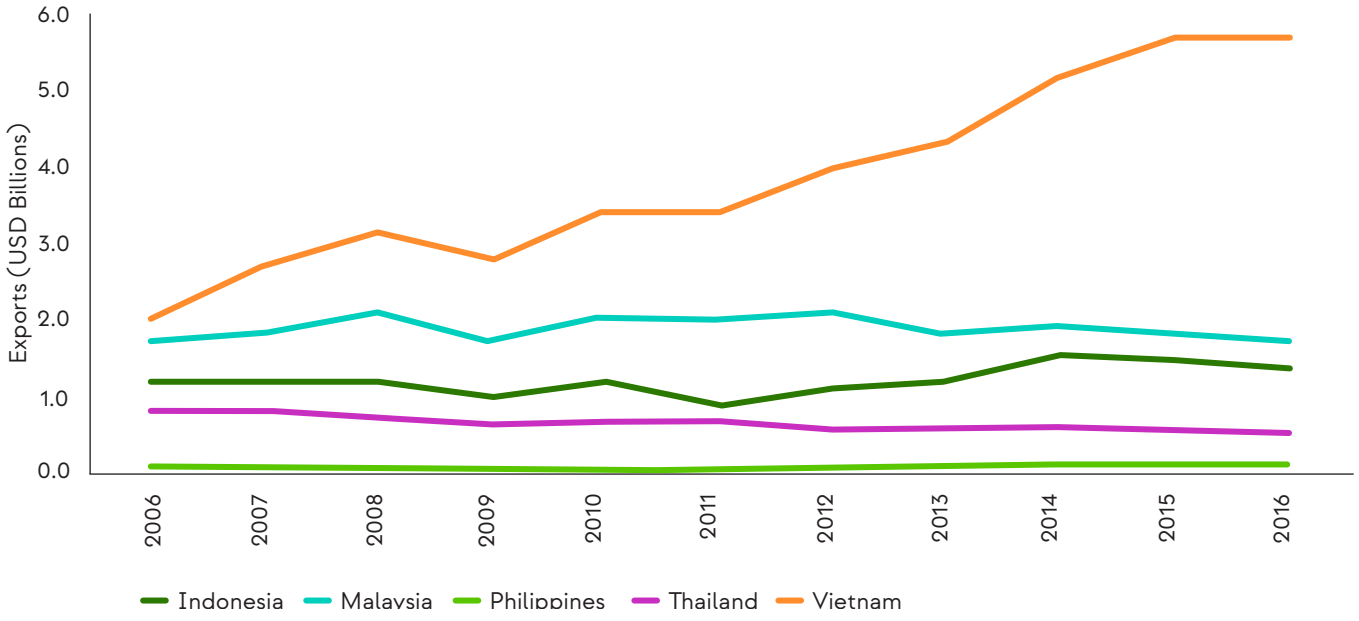
Diversification across geography, asset type and species

Investors can access a diverse Southeast Asian forestry portfolio across geography, asset types and tree species. Furthermore, Southeast Asian forestry assets also include opportunities to invest in timber processing and carbon projects that enhance cash flows and support climate change mitigation.

Key timber market exposures

Investing into Southeast Asian plantation forestry assets will give investors exposure to a variety of end markets. These include the European, UK, and US furniture markets and the Asian veneer, plywood, woodchip and pulp markets. Timber manufacturing across southeast Asian countries has been growing. Part of the reason is that the European, UK and US furniture markets source both raw materials and manufactured goods from Southeast Asia. Vietnam in particular is a leader in terms of wood products exports, including furniture (see Figure 4, below), due to competitive labour rates and foreign investment.

Figure 4 – Timber Exports across Southeast Asia



Vietnam also has a thriving veneer and plywood industry, 95% of which is exported to China and India.

As well as timber manufacturing and plywood production, Southeast Asian plantations primarily produce hardwood logs specifically for wood chipping. Hardwood chips are used for wood pulp, which in turn is used for paper, carton boards, tissue and sanitary products, and are used to make textiles such as rayon. Pulp mills tend to be located in and around their plantations.

The rise of the voluntary carbon market

Sustainable forestry investment in Southeast Asia creates opportunities to develop carbon projects for the voluntary carbon market, including:

- Afforestation, reforestation and revegetation of plantation forests with the intent to harvest and repeat planting cycles.
- Afforestation, reforestation and revegetation of natural forest with no intent to harvest.
- Improved forest management by extending the rotation age of the plantation crop. This means converting a short rotation crop to a long rotation crop, such as swapping pulp for sawlog.
- Improved forest management by converting logged areas of natural forest to protected forest.
- Protecting from unplanned and planned drivers of deforestation and degradation, also known as REDD.

Carbon credit project development can be integrated into New Forests' origination, acquisition and asset management processes and add incremental value to forestry assets.

The investible universe includes:

Southeast Asia offers investors diverse forestry assets that provide multiple income streams and opportunities for high impact investing. Key species include acacia, eucalyptus, teak and rubberwood. The investible universe of asset types includes:

Existing, mature forestry assets
Existing fully or near fully established plantations that are currently operating and expected to generate positive cash flow in the short term.

Brownfield plantations
Previously developed plantations that require harvest and replanting to reach full commercial potential. There may be additional areas available to plant.

Greenfield plantations
Plantation sites where plantation development is in its early stages or has yet to commence. Income from carbon credits could generate income in the near-term; opportunity to generate capital appreciation through biological growth.

Timber processing and infrastructure
Create supply chain efficiencies and access new markets.

Creating impact through forestry investment

Responsibly managed investment in sustainable forest plantations will play a crucial role in transitioning the Southeast Asian forestry sector away from unsustainable logging of natural forests. Investment must be channelled into landscapes that integrate third-party certified sustainable plantations with natural forest conservation, ecosystem restoration and biodiversity enhancement, in addition to fostering rural economic development and community livelihoods. Opportunities to generate significant positive environmental, social and governance (ESG) outcomes include:

- Biodiversity conservation such as habitat restoration, conservation corridors, revegetation and restoration activities;
- Support for communities and rural livelihoods through community joint ventures, out-grower schemes and community-based monitoring; and
- Introduction of globally leading, third-party standards and certification schemes, such as Forest Stewardship Council (FSC) and International Finance Corporation Performance Standards (IFC PS). These schemes help protect environmental values along with Indigenous, community and worker's rights, and support the improvement of governance and risk management.

Maximising the value of Southeast Asian forestry assets

Creating value in Southeast Asia's forestry landscape can be achieved through:

- **Disciplined management and resourcing approach** to create operational improvement, and build harvesting capacity and infrastructure, and the use of technology to reduce overheads.
- **Careful, strategic management of assets** throughout each step in the value chain. This includes improving systems and operations, containing costs and creating value for communities.
- **Strengthening timber product distribution and marketing** by rationalising market arrangements by geographies and products to increase brand loyalty and reduce prices. Value can also be generated through third-party forest certification schemes, streamlining marketing to reduce logistic costs and collaborating to build new distribution channels.
- **Ensuring projects are guided by responsible investment principles** to create positive outcomes for communities in the region, sustainable management of forest species and silvicultural regimes.

Contact us

To find out more about how you can benefit from New Forests' investment opportunities in Southeast Asia, please contact:

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