Important Distinctions between Forest Managers, Investors and Investment Managers

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TOPICS

- Investment Model
- Investors
- Investment Managers
- Forest Managers
- Trends, Friction Points & the Future
About TimberLink LLC

- Advising timberland investors since 2002
- Clients from 10 countries, over US$10 billion invested in 9 countries
- Do not work for investment managers
- Do not promote deals or accept commissions
- Do not promote funds or manage money
- Independent
Investment Model for Private Timberland

INSTITUTIONAL INVESTOR

INVESTMENT MANAGER

FOREST MANAGER
How big is the asset class?
About US$45-50 billion
What Makes the Model Work?

- Belief in diversification attributes
- Attractive historical performance
- Long investment horizons
- Appraisals – interim to exit
- Mark-to-market accounting practices
- Tax policies – *many tax-free investors*
- Capital inflows from Investors
- *Investment Managers* & *Forest Managers* success
INVESTORS – Who are they?

_Institutional investors of scale_

_Typically US$5 billion to over US$200 billion assets under management_

- Public and private pension funds
- Sovereign wealth funds
- Foundations and endowments
- Family offices
INVESTORS – What’s the mix?

- Public pension funds
- Corporate pension funds
- Foundations, endowments
- High net worth, family offices
- Funds of funds
- Other
INVESTORS –
Increasing mix of global players

Non-U.S. investors

U.S. investors

2007  2008  2009  2010  2011  2012  2013
INVESTORS – The Driving Force

- Investment allocation strategies
- Acceptable “risk adjusted” returns
- Manager selection & fiduciary service
- Timely capital placement
- Forestry & management expertise
INVESTORS - Non-Timber Issues

- Managing Staff
- Performance Measures
- External Reporting
- Incentive Compensation
- Achieving Target Asset Allocations
- Managing Managers
- Board Politics
- Managing Consultants
- Funding Obligations
- Rates of Return vs. Risk
- The Public Image
- Reviewing/Changing Asset Allocations
- Managing Staff
- Performance Measures
- External Reporting
- Incentive Compensation
- Achieving Target Asset Allocations
- Managing Managers
- Board Politics
- Managing Consultants
- Funding Obligations
- Rates of Return vs. Risk
- The Public Image
- Reviewing/Changing Asset Allocations
INVESTMENT MANAGERS – Who are they?

![Bar chart showing the number of investment managers by asset size]

- < $500 million: 8
- $500 million - 2 billion: 7
- $2-4 billion: 4
- > $4 billion: 4

TimberLink
INVESTMENT MANAGERS – The Driving Force

- Raising capital
- Placing capital
- Investor satisfaction
- Continuity
- Profit
INVESTMENT MANAGERS – Differentiation

- Investment strategies
- Investment structures
- Regional expertise
- Scale
- Fees & incentives
- Personality
- Vertical integration
INVESTMENT MANAGERS – Degrees of Vertical Integration

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<th>OUT-source ALL Forest Management Services</th>
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Forest Management Differentiation

-----------------------------Vertical Integration-----------------------------
INVESTMENT MANAGERS – Degrees of Vertical Integration

[Graph showing the relationship between Vertical Integration Score and Hectares per Forester, with data points plotted on a scatter plot.]
FOREST MANAGERS –
The “Cornerstone” of the asset class

- Silviculture
- Marketing
- Engineering
- Environmental
- Safety
- Compliance
- Protection
- Reporting
FOREST MANAGERS – Driving Forces

- Science
- Markets
- Environment / Nature
- Clients
- Continuity
- Profit
Forest Management Approaches
Pros & Cons

- **Vertically integrated**
  - In-house forestry & field staff
  - Separate forest management fee
  - Economies of scale
  - Integrated systems

- **Outsourced**
  - Third-party forest management via contract
  - Costs passed through to investor
  - No conflict of interest in disposition decisions

Both approaches include pass-through expenses such as legal, audit, insurance, property taxes, reforestation, roads.
Trends, Friction Points & the Future
A History of Invested Capital
(at market value)

Assets Under Management (USD billions)

2005 2006 2007 2008 2009 2010 2011 2012 2013
INVESTORS – Trends

- Growing recognition of timber illiquidity
- Growing recognition of performance risk
- Increasing aversion to “option” values
- Desire for greater influence, governance
- Declining “blind” commitments
- Challenging underwriting assumptions
- Questioning fees over the longer term
- Support stronger alignment of interest
INVESTORS – Issues & Concerns

- Placing capital expediently
- Placing capital judiciously
- Appraisals, external reporting
- Cash yield vs. capital appreciation
- Investment oversight & staff limitations
- Exit strategies
INVESTMENT MANAGERS – Trends

Funds

Separate Accounts
INVESTMENT MANAGERS –
A history of invested forest hectares
INVESTMENT MANAGERS – A Global Tally

- 1991
- 1995-2002
- 2004-2008
- 2014
INVESTMENT MANAGERS – Trends

- New players, no track record
- Continuing emphasis on funds
- Fee compression, competition
- Want to “go global,” skill challenges
- Significant liquidations pending
- More firm-to-firm transactions
- Fewer market inefficiencies to exploit
INVESTMENT MANAGERS – Issues & Concerns

- New capital raising challenges
- Placing capital
- Mega-deals virtually gone
- Market inefficiencies compressed
- Perpetuating ownership
- Growth plateau
FOREST MANAGERS – Trends

- Mergers & consolidations, but difficult
- Seeking closer connections with investors
- Benefitting from technology advances
- Conflicts with investment managers for growth
- Desire diversified client base
Potential Threats to the Model

- Capital inflows
- Leverage
- Poor performance
- Illiquidity
- Direct investments, bypass Investment Managers
- Tax policies
- Maturing funds, secondary market efficiency
Friction Points of the Model

- Assumed long-term real price appreciation of a commodity
- “If you grow it they will come” mentality
- Land values, terminal values
- Discount rates – before or after fees?
- Conflicting incentives to do deals
- Long investment horizons concomitant with poorly understood or anticipated public policy
## Public Policy – Unintended Consequences

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<th>Policy Shift</th>
<th>Consequence</th>
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<td>Timberland taxed at corporate rates</td>
<td>Transfer of +20 million hectares to private ownership</td>
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<td>Russia</td>
<td>Log export tax</td>
<td>Windfall benefit to New Zealand, PNW</td>
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<td>United States</td>
<td>Timber qualifies for REIT status</td>
<td>A few C-Corps converted to REITS</td>
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<td>Europe</td>
<td>Mandate for use of renewable fuels</td>
<td>Explosion of U.S. pellet mills</td>
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<td>United States</td>
<td>Effective closure of public lands to logging</td>
<td>Price run up for southern timber</td>
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<td>Brazil</td>
<td>Foreign landownership restrictions</td>
<td>Reduced foreign investor interest, price declines</td>
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<td>United States</td>
<td>Everyone should own a house</td>
<td>Mortgage Crisis</td>
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<td>Australia</td>
<td>MIS Scheme, Privatization</td>
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<td>New Zealand</td>
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QUESTIONS