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Month year Market Update

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Opinion Piece

It's amazing how a spell of fine weather and some increased temperatures improves the general fettle, especially those that haven't really seen a decent summer for a few years. Unfortunately, the impending dry spell is about the only good news as most China-exposed primary markets are looking down the barrel of a medium-term period of queasiness thanks to reduced demand and hence pricing. Our meat and milk cousins are suffering from the same issues of lacklustre global demand and increased costs resulting in red ink on most balance sheets that would make even the most steeled bank manager wince. If we thought the 2022 balance of payments was ugly, 2023 will probably knock it out of the park.

It doesn't matter which news feed you look at, there's generally a story about China's economic woes somewhere near the top. Country Garden is the latest Chinese property developer to get the wobbles and has only just managed to pay a $US22.5 million interest bill. There have so far been over 50 large Chinese development companies that have gone to the wall in recent years, and around 70% of the remaining large developers have missed debt payments over the same period. The worry is that if more of these bizarrely named developers tip over, China could be in for their very own Lehman moment which would mean anyone relying on China as a primary market would likely be in for a good dose of the trots.

The Chinese government will most likely be chewing through herculean volumes of Quick-Eze as they try to figure a way out of the debt crisis in the property sector which accounts for around 25% of the economy. Beijing has started releasing some stimulus measures including a lowering of existing mortgage rates, reducing deposit ratios and providing preferential loans for first home buyers in larger cities. This easing has seen shares in property developers jump somewhat but it's very unlikely to quell the fiscal indigestion.

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September at wharf gate (AWG) prices have been published with a reasonable range between exporters and an average of around $NZ116/JAS for A grade for SNI ports. Actual sales prices in China (CFR) reached $US119/JAS on a rally during August but quickly dropped back below the $US113 level as Chinese wholesalers struggled to pass increases on to customers. Shipping costs increased over the same period due to reductions in inbound cargos putting further pressure on AWG numbers. The general consensus for the rest of the year is that trying to lever any CFR price increase will be like eating miso soup with chopsticks – long and arduous. We are starting to see reductions in log inventory volumes on Chinese ports as a result of supply reductions rather than demand increases. We are already below the magic 3 million m^3 inventory number that historically creates buyer panic, and this will keep dropping for the rest of the year. NZ supply will be reduced further as the Taupo windthrow salvage becomes unmerchantable and the Pan Pac mill in Napier restarts later this year.

Domestic sawmills are seeing very average lumber demand as NZ construction bumbles along, however salesmen peddling exported lumber products are having to take pointers from the politicians on one-upmanship as competition gets tighter. Domestic demand for outdoor products should increase over the spring and summer as we all start building decks and fences with our newfound tax relief. Pruned sawmills in the central region are starting to get tight for supply as the windthrow in Taupo has taken out a number of years' future supply. This, combined with the general price related reductions in harvest volume, will see significant shortages of pruned logs going forward, and, unlike the China conundrum, we will see some price increases with reduced supply.

Carbon has been the favourite child lately as the price of NZU's has steadily climbed following the high court ruling against the government's fiddling which saw prices crash to a low of $35 in July. Current spot prices are in the mid $60's, still short of the peak of $88 in late 2022 but, like the poll results, heading in the right direction.

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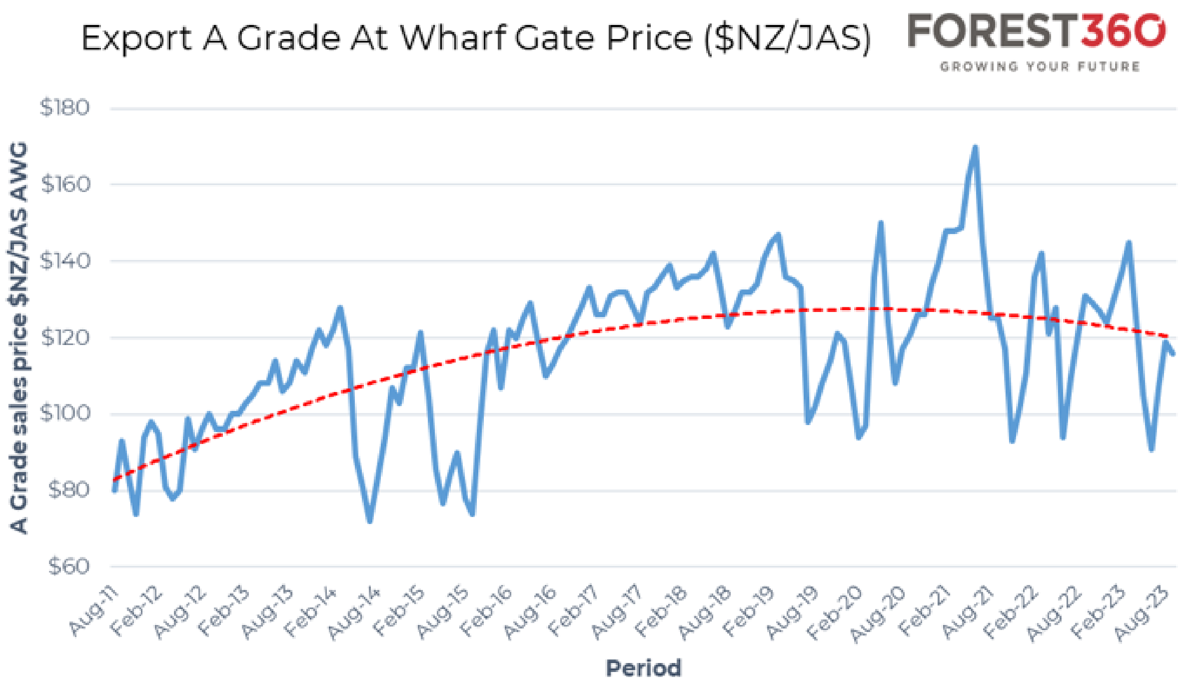
The latest NZU auction failed yet again (for the third successive time) as bids didn't meet the reserve price. Bids were received for only 7.7 million of the 13 million on offer and as a result the government is now short around $900 million in revenue which one would suspect would be reasonably handy. The interesting thing here is that if the fourth auction were to fail in December this year, the expected 18 million credits would be taken away from the market and the government would effectively lose out on over a billion in revenue. This will be seen as a positive for the carbon market which is currently viewed as being in an oversupply situation and expectations are that a fourth failure will give NZU values a Redbull rush.

So, all in all its bloody hard to be positive at the moment. We had hoped that the All Blacks would clean up in the opening world cup game and that we would see wins for the Warriors, Black Caps and Israel Adesanya but none of them obviously got the memo. Having said that, we've got a fantastic product in our radiata resource and even though there's a few potholes in the road and plenty of road cones, the future looks bright. Greater use of natural fibres domestically is the key to a strong primary industry so please build with wood, print your emails in triplicate, be generous with the purex and use wool carpet.



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Thinking about planting?

We are coming to the end of another successful planting season, which means we are now preparing our 2024 Forest Establishment Programme.
If you are considering carrying out forest replanting or afforestation programs in 2024 now is the time to contact us. Forest360 is currently negotiating seedling supply for next year's planting season. To ensure we know how many seedlings to purchase we would like to have an idea of area requiring establishment. We currently have around 30% planting capacity left. If you are interested in planting next year, please get in touch with the Head of Forestry Operations, Blake Jones on 027 253 2537 or blake@forest360.nz to indicate interest and avoid missing out.

Alternatively, if you have planted this winter and would like to start the process of registering in the ETS or adding to your current registration, please get in touch with out ETS Administrator Alice Cantwell on 0800 366 700 or alice@forest360.nz.

ETS Cost Recovery Announcement – Pay to Play

In a topsy turvy ETS world where confidence has been waning and the politicians can't seem to help themselves but keep tinkering with our primary tool to fight climate change, MPI have now announced that costs to forest owners for ETS participation are increasing while letting the entities that actually emit CO^2 off Scot-free. These changes were lobbied against very hard from industry participants, but this seems to have fallen on deaf ears.
A new annual charge of $30.25 per hectare (regardless of forest type) and **twenty-two** new fees related to existing services will come into effect on 19 October 2023. This annual charge invoice will be sent by MPI **directly to each ETS participant** for the part financial year (19 October to 30 June) in November and will be calculated based on the land registered in the ETS at the beginning of this period.

In subsequent years, invoices will be sent at the beginning of the financial year and cover the year ahead (1 July to 30 June).

The twenty-two new fees will be detailed on the MPI website on 19 October when they become available. A list of the upcoming changes can be found in the most recent Forestry ETS Alert #38.

This is a major disappointment to us and the wider industry, who we are working with to challenge. We believe that this cost recovery scheme is fundamentally unfair as the cost is placed solely on forest owners who have entered the scheme in good faith. These forests provide enormous benefit to New Zealand in terms of assisting in meeting our NDC under the Paris Accord, as well as a host of other positive outcomes. The fact that they are now effectively being penalised for providing a public good is a bitter pill to swallow.

This is emblematic of the continuously changing legislative and regulatory environment of the last two years that have resulted in forest owners having to read, digest and react to a series of policy changes that have enormous implications for their forests and the businesses that operate around them.

When coupled with a period of high interest rates and low commodity prices, many forest-owning farming businesses have been forced to generate cashflow through the sale of NZUs in a period where poorly considered cabinet decisions have artificially depressed the NZU price.

Please clearly read the following information, including the attached detail of the regulations to drive your actions going forward.

Implications:

These cost increases carry implications for all ETS registered forest owners, but the annual fee is of greater significance for forests in the following categories:

Native forests

Native forests are slow growing by nature and therefore generate fewer NZUs each year. This is particularly pronounced in the first 6 years of growth (which MPI have recognised and provided an exemption option for) but is also the case in forest areas older than 35 years. It is also important to note that native forest registrations over

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100ha with Participant-Specific Tables will in many cases have even lower allocations.

Second rotation forests

Owners of second rotation forests will understand that carbon accrual essentially pauses for 8-10 years following harvest and replanting as the sequestration of the second rotation trees are more than offset by the residual decay from harvest residues over this period.

Effectively this means that no carbon income can be derived from forests in this category over this time, but the annual per hectare fee will still be charged by MPI.

Older forests in Averaging

Forests registered under averaging accounting will not be allocated any further NZUs once the average age is reached so cannot generate any additional income until they are harvested at maturity. These forests will not earn any NZUs during any subsequent rotation.

MPI are still undecided about how to treat the registration fee for these forests after they have reached the average age. Officials have verbally suggested that it wouldn't appear fair to charge the full amount when there is essentially no demand on their services. Of course, expecting a government department to give up revenue might be like expecting a politician to tell the truth but let's hope sanity prevails here.

Considerations for ETS registered forest owners:

Participation in the ETS is fundamentally a commercial investment decision for forest owners. This decision is made by assessing the investment costs against the projected financial returns ultimately driven by an expectation around future carbon prices.

The ability for a forest to produce NZUs at a value that provides an acceptable risk adjusted return is fundamental to a decision regarding ongoing participation in the scheme.

The difficulty here is forecasting NZU price – if this is high then costs are manageable and participation may make sense on a risk adjusted return basis. The other consideration is one of cashflow as costs and revenues generally are not matched so

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facing significant participation costs and accumulating NZU's has all of a sudden become more challenging.

Some participants may find that these changes mean that part or all of their registration will be rendered financially unviable for a short period, or potentially in perpetuity. In these cases, they may wish to de-register part or all of their registration from the ETS.

A decision to exit the ETS prior to these charges coming into effect will remove the obligation to pay the annual fee.

MPI have left a very small window to complete partial removals or deregistration's. It is important to note that deregistration of forest areas will result in the following:

Mandated surrender of all NZUs allocated to the forest areas in question.

Removal of option to use sawtooth carbon accounting should a forest re-enter the ETS in future.

Forest owners who have harvested in the 2018-2022 Compliance Period will have met their surrender obligations either through the surrender of NZUs or as cash with the Fixed Price Option (FPO).

If you believe that these newly enforced costs from MPI render ongoing ETS registration untenable, please reach out to us immediately to discuss your specific involvement with the ETS and new cost recovery regulations.

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