

Benefits of Forest Certification

The International Woodland Company has recently decided on a policy stating that "IWC will work towards attaining the most appropriate, recognized third-party forest certification for all forest investments and forestry activities under advice or management by IWC." This article describes some of the major reasons why IWC has decided on this policy.

Forest certification is particularly important in high value natural forests where low impact logging can maintain forest quality and there is a high demand for certified wood.

Based on IWC's due diligence and ongoing evaluation, including the application of IWC's SRI Guidelines (available on the website, www.iwc.dk), IWC expects that all its forest investments under advice and management are managed according to high ethical standards and good stewardship practices. In most cases, the management practices are at least equivalent to the requirements of generally recognized forest certification schemes such as FSC, SFI, or PEFC.



One could therefore ask: Why do we recommend that investors spend money for extra administration costs and certification fees when the required forest management standards are already applied?

There are several reasons why IWC believes it is beneficial to certify the forests:

Higher timber prices

In some cases, wood harvested from a certified forest can be sold at a price premium compared to uncertified wood from equivalent forests.

Market advantage

In other cases, there may not be an expected price premium for certified wood from a certain property. There may, however, be a market advantage in terms of the volumes which can be harvested and sold because the wood is certified. In some regions, certified wood is necessary for access to major wood buyers. This is particularly the case if the trend continues in the end markets toward certification requirements on wood products.

Higher liquidation value

Increased timberland value of certified forests at liquidation is often not recognized as a reason for certification. IWC believes this could very well be, in many cases, the most important financial benefit from forest certification.

Most of IWC's clients' forest investments have a holding period of 10 to 15 years, after which the forests will to be sold. The certification process provides impartial documentation of how the forests have been managed and IWC believes that this documentation has great potential value.

Through comprehensive third-party documentation of the forest management history of a property, potential buyers will have much more confidence in the forest's condition and value. Furthermore, some future buyers may appreciate that they do not have to go through the certification process which they otherwise might.

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IWC continues to strengthen its team

As indicated in our previous newsletter, in order to ensure the best quality service to our clients and their expanding global timberland portfolios, The International Woodland Company continues its recruiting process.



Lars Holm Simonsen

In January 2008, IWC welcomed Lars Holm Simonsen who joined IWC as an Investment Forester. In this capacity Lars is handling forestry-related aspects of IWC's clients' investments. This includes the yearly evaluation of appraisals, as well as conducting forest property visits and assisting in investment due diligence. Lars is also responsible for the enhanced utilization of property data in order to support the assessment of both present and future investments.

Lars holds an MSc in Forestry from the Royal Veterinary and Agricultural University of Copenhagen. Prior to joining IWC, Lars worked six years with forest economics and timber price statistics as a Senior Academic Assistant at the Danish Forest Association.

In the spring of 2008, IWC expects to welcome an additional Investment Forester as well as an Executive Assistant.

IWC's Portfolio Management team develops, monitors, and manages international forest portfolios, while the Investment Development and Analysis team researches, develops and promotes new markets for forest investment.

IWC's organization spring 2008



In our last publication, we presented a biographical sketch of Mogens Pedersen, IWC's SRI Coordinator. As his picture was unavailable at the time, we are including it here.



FACTS

- Timberland asset under advice or management as of September 30, 2007
- Value of assets plus uninvested binding commitments: 1.9 billion USD
- Amount invested: 950.3 million USD (ca 500,000 hectares)
- Market value of investments: 1,131.6 million USD
- Uninvested binding commitments: 790.5 million USD
- Remaining allocations / future commitments according to clients' strategies: ca 1 billion USD
- Total strategic allocation to forest investments by IWC's clients: ca 3 billion USD

IWC's Appraisal Evaluation

There are various circumstances when a forest valuation is required, such as sale and purchase, taxation, insurance and compensation among others. IWC's clients' investments are most often valued annually by independent third-party appraisers to be able to:

- Assess and ensure the investments' market value
- Derive a book value to be disclosed in the investor's financial statements
- Track the investment's performance through time

As one of the services to its clients, IWC carries out a thorough evaluation on each individual valuation of each respective property. The evaluation procedure involves the use of a detailed checklist and a database supplying benchmarks and forecasts for various drivers of the asset's market value. The team responsible for these evaluations have been scaled up in 2008 and consists of three professional foresters, each one specializing in certain regions for forest investments all over the world. The desktop based evaluation is further supported by IWC's ongoing dialogue with forest managers as well as on-the-ground evaluation of client investments through property visits.

One finds several guidelines on how to appraise the market value of forest lands, each associated with certain countries or regions. Common to most standards is the use of three basically different approaches for valuing forest lands:

- Cost
- Comparable Sales
- Income Approaches

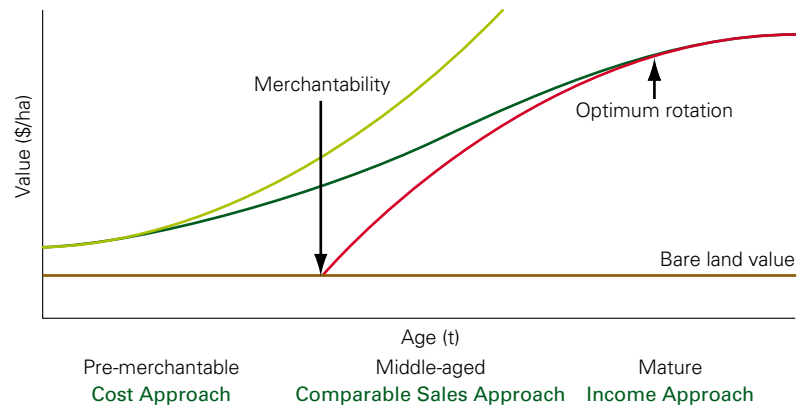
Which approach is the most suitable under which circumstances depends mainly on three criteria:

- Size (area)
- Age structure of stands (age-class-distribution)
- Availability and extent of market data

Size matters in consideration of the Economies of Scale theory, since the price per hectare generally declines as the total size of the property increases. Age structure matters in regard

Simplifying when to use which approach
Depending on a forest's maturity, different valuation approaches properly reflect its market value.

- Liquidation Value
- Forest Market Value
- Replacement Costs



to certainty about the market value, which can be benchmarked towards replacement costs for young forests and the liquidation value for mature forests. Market data matters for the Cost and the Comparable Sales methods. Both approaches depend on market evidence at different scales, but the number and detail of market transactions is most important for the Comparable Sales method.

The Cost Approach splits the forest land theoretically into its components, e.g. bare land, merchantable and pre-merchantable timber as well as infrastructure. The market value is derived by summing the single values needed to provide a complete asset with the same utility as the subject property. The Cost Approach is most suitable for small properties, as it doesn't take into account economies of scale, and it is also very

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Therefore, a property premium may be obtained for certified forest properties.

Sending the right message

These days, the media and non-governmental organizations (NGOs) have significantly increased focus on how forests are being utilized and managed around the world and institutional investors are not immune to criticism in this regard. If there is no proper documentation or third-party auditing of forest management, there is a risk that the forest owners will receive negative attention.

Media pressure and NGO activity can also have an impact on support from local communities and authorities close to the forest investments.

If this happens, the total return could potentially be harmed due to legislative changes, bureaucratic impediments, or loss of cutting rights. IWC and its managers practice state-of-the-art forestry and sound forest stewardship. Certification is a proven path to validate this level of management.

Always certify?

It may not seem, in all cases, financially beneficial to have every forest certified. However, IWC believes that this is still the best path to follow. At portfolio level, the costs of certification of all the forests in the portfolio will, in IWC's belief, be more than offset by identified values and potential values over the life of the investment.



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applicable to young forests with replacement costs mainly determining the market value.

The Comparable Sales Approach is based on prices paid for similar properties in the open market. Such direct comparison of sales is highly dependent on the similarity of the properties' unique characteristics and in most cases adjustments for various attributes must be made since no two forests are totally alike. Provided that comparable market data is available, this approach can be applied to forests with various size and age structures. However, when the physical characteristics of comparable forests differ significantly, the relative values can sometimes be identified more accurately with the Cost Approach.

The Income Approach determines the present capital value (Net Present Value) by discounting the cash-flow that the property will produce in

future years. This involves projecting the anticipated future wood-flow, computing it into a net income stream and then discounting it, at a suitable Cost of Capital, in order to acknowledge the lower economic value of delayed receipts. Since forest investments are generally of long range, their net present value is rather sensitive to the discount rate, silvicultural regime (tending and rotation) as well as forecasts on timber prices and the cost of goods sold. The less time that remains until a stand reaches its rotation age, the less influential are price and cost predictions as well as the discount rate. Hence, certainty about the market value is high for mature forests valued under the Income Approach, while their total size is less important.

Finally, all of the approaches' advantages and disadvantages shall be weighted to derive a final judgment of market value.



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