Current Russian Industry Issues and Outlook

New Zealand as a Competitor to Russian Logs and Lumber

By: Gerry Van Leeuwen, Vice President, International WOOD MARKETS Group

International WOOD MARKETS Group Inc.

WOOD MARKETS' Speakers

Gerry Van Leeuwen

- 15 trips to Russia
- 20 trips to China

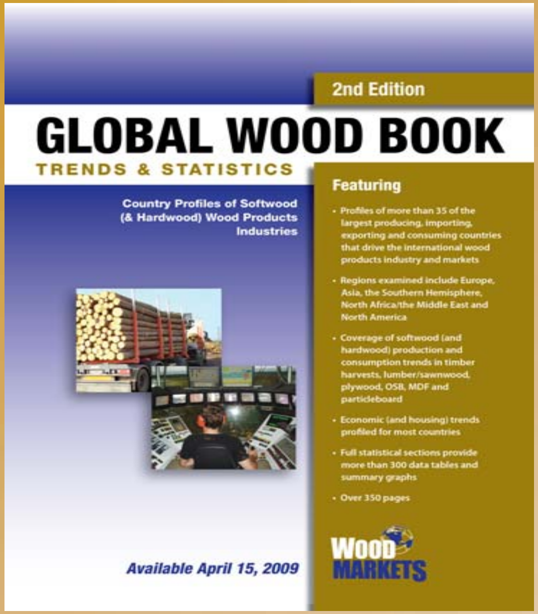
Russ Taylor

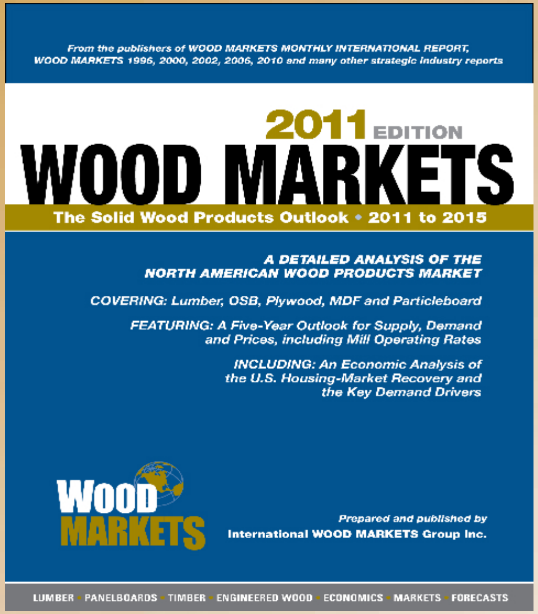
- 8 trips to Russia
- 10 trips to China

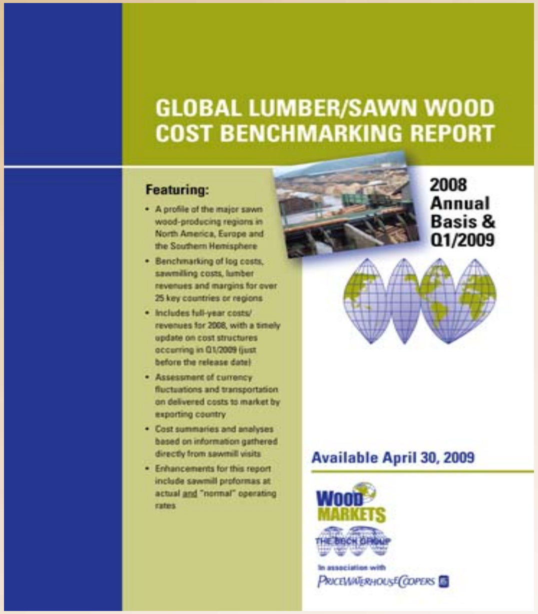
Introduction to: International WOOD MARKETS Group

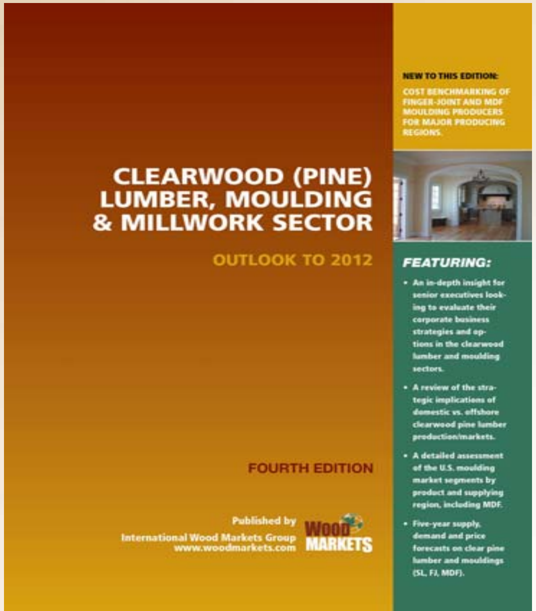
- **We are <u>wood products industry consultants</u> and we assist companies around the world to develop operational, marketing & business strategies.**
- **We are known as <u>global market & industry experts/analysts</u> on timber, lumber, panels & many millwork products sold in the U.S. market & key export markets.**
- **We produce <u>Multi-Client Reports:</u> Europe & Russia; Clearwood Pine; Global Lumber Benchmarking; The China Book; WOOD Markets 2000, 2002, 2006, 2010; & the WOOD Markets Monthly Report**

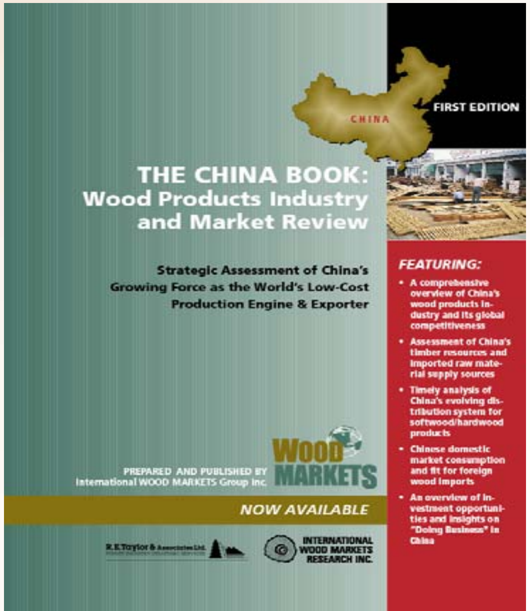
WOOD Markets' Multi-Client Reports











Presentation Outline

1. Russia - Industry Overview
2. Russia - Log Export Tax Implications
3. Russia – Issues Impacting the Industry
4. Summary

Note: all data in this presentation are extracts from WOOD MARKETS' publications: *The China Book: Outlook to 2015*; the monthly *China Bulletin; & WOOD Markets Monthly*.

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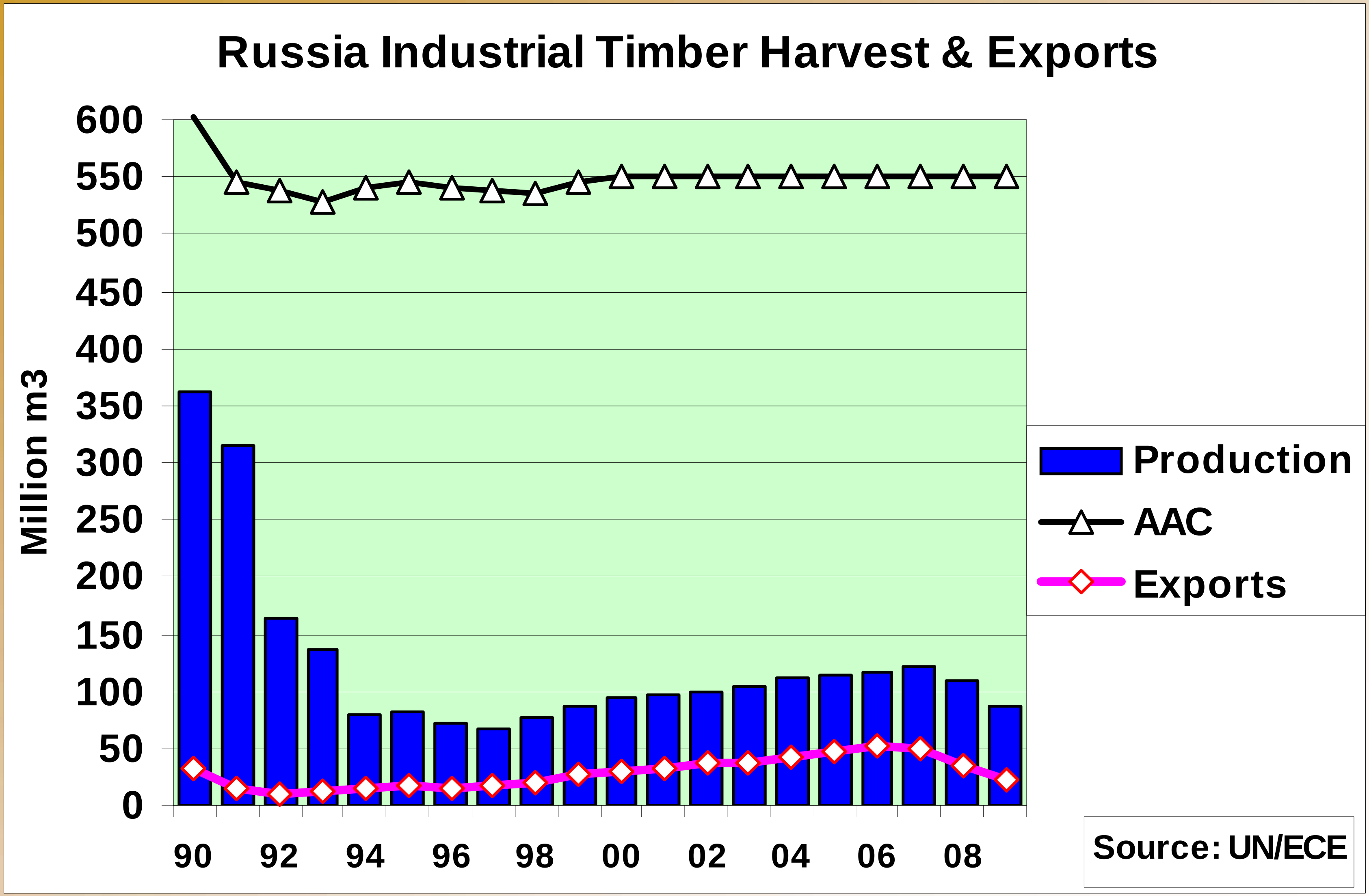
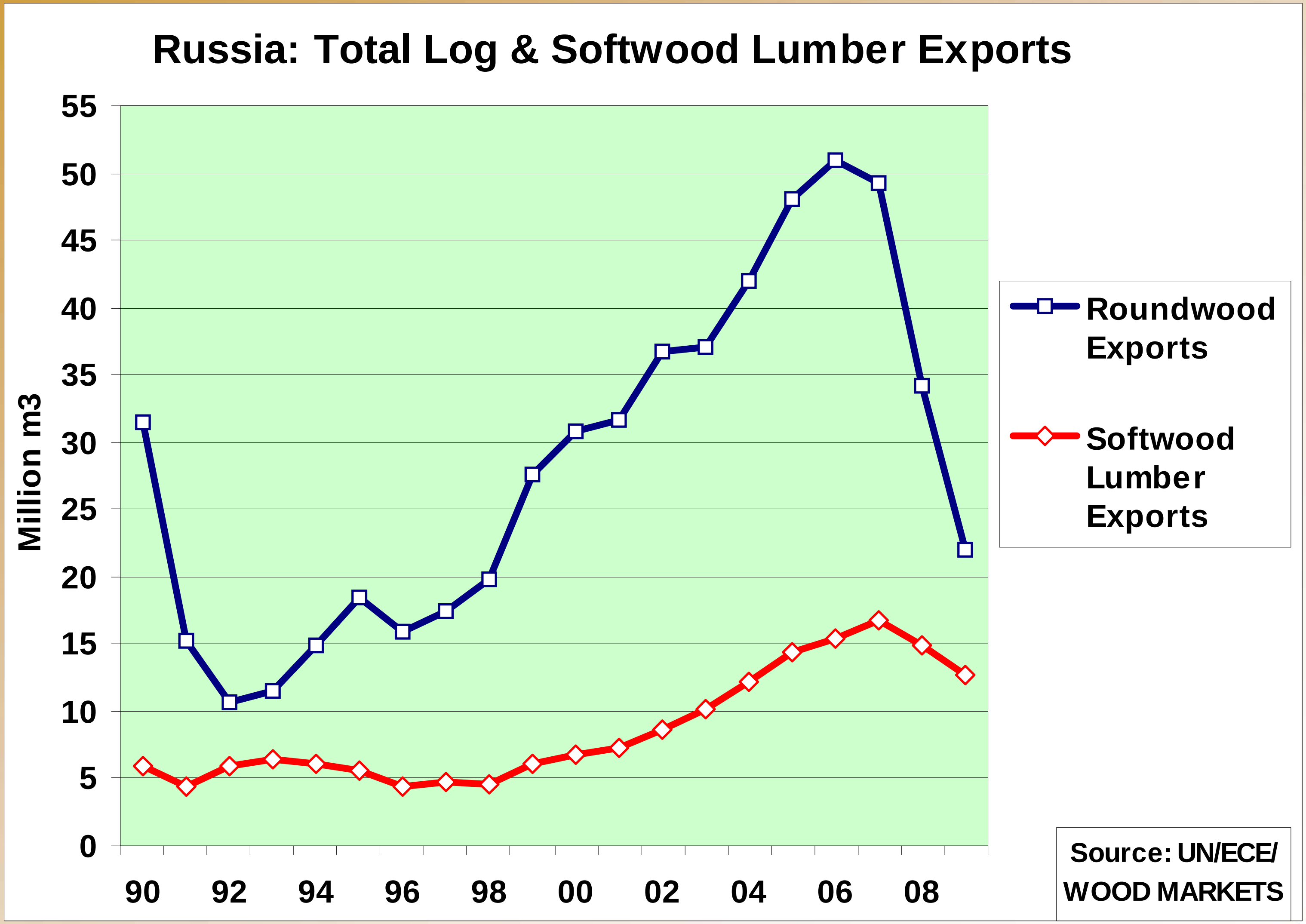
Russian Harvest: Lots of Upside



Realistically, Russia's harvest can probably only Increase by 75 to 100 million m3 in the next few decades

Russia Exports Now Plunging from Global Economic Crisis & Log Tax

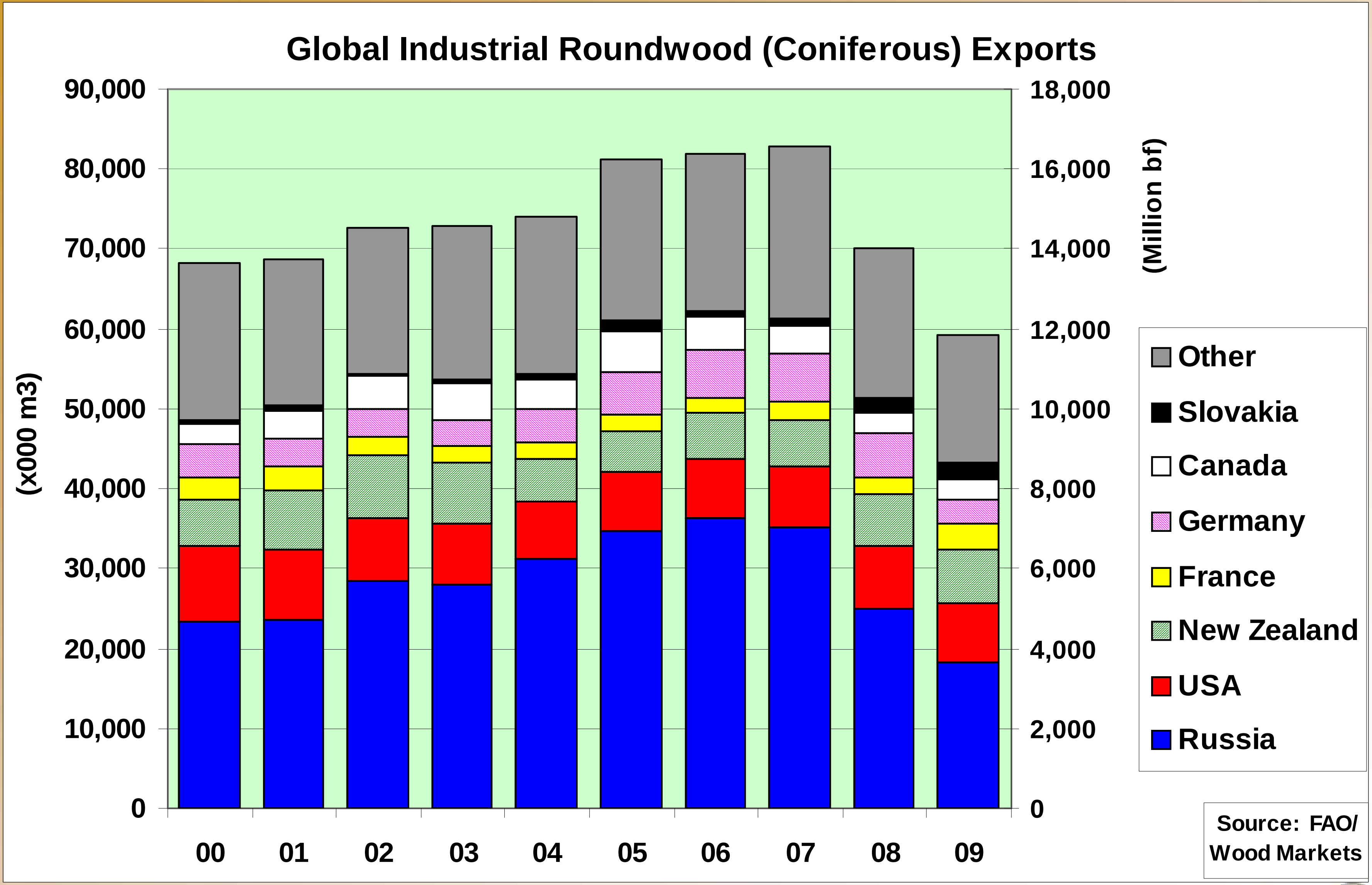


Russian exports have collapsed, soared & now collapsed

RUSSIA: Timber Export Tax

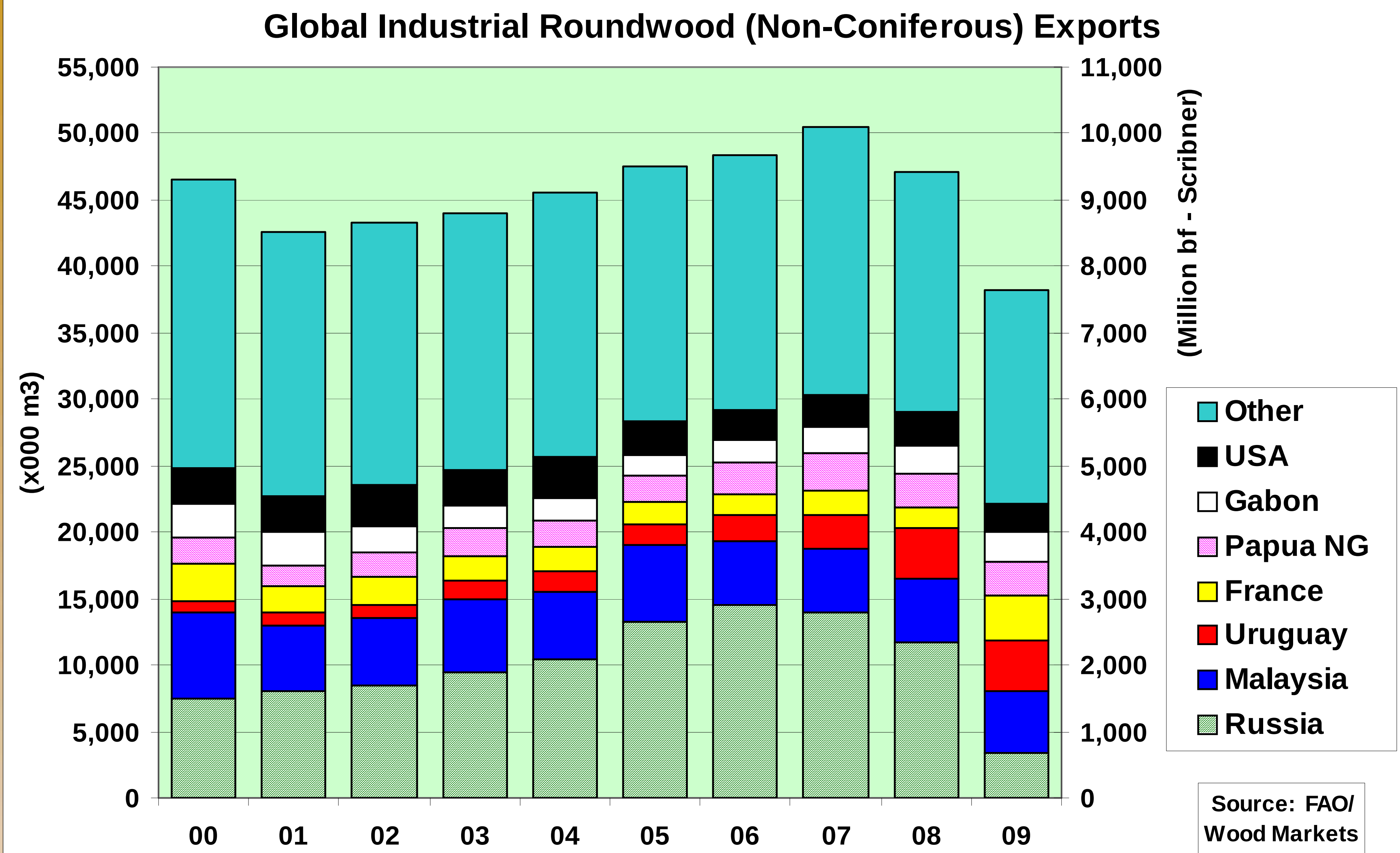
- **For softwood logs, the tax has risen:**
  - **from 6.5% to 20% (euro 10/m3) in July 2007.**
  - **to 25% (euro 15/m3) in April 2008.**
  - **to 80% (euro 50/m3) in Jan. 2011 (not likely)**
- **For hardwood saw/veneer logs, the export tax is already at euro 100/m3.** ☑
- **For birch pulpwood, the tax has been delayed.**
- **Many uncertainties on whether the tax will go ahead as scheduled or what role investments will play…**
- **Russia is 40% of world's softwood log export supply & 30% of hardwood log exports, so this export tax is dramatic for its customers!**

Russia was 45% of SW Log Exports



Russian SW log exports soared then plummeted from export tax

Russia was 30% of HW Log Exports



Russian HW log exports soared then plummeted from export tax

Russian Log Export Tax - Implications

There will be a new supply realignment of replacement log and wood products to rebalance supply in the most affected countries.

- **Russian logs will be replaced: Domestic + imported log sources + lumber and perhaps OSB or plywood.**
- **Which countries or companies are most likely to offer supply solutions to the importing countries?**
- **Due to logistics, the Pacific Rim countries (including NZ) will be major benefiters in selected products, grades and species to Asia (and also may see less growth in imports from Asia).**

Issues Impacting Russian Industry

- **25% Russian log export tax + global recession = very negative impact on Russian log production and exports. Annual harvest down by about 35% and log exports down by 60%.**

- **Log export tax is expected to remain at 25% for next two to three years. Don't expect tax to increase to 80%, but it could possibly increase by another 10% or 15% in the next five years.**

- **Many small logging companies have disappeared or purchased by larger companies.**

Issues Impacting Russian Industry

- **Domestic Russian log prices have increased by $10-$15/m3 in the last year (2010) due to:**
  - **Lack of profit derived from high priced log export business.**
  - **Reduced log availability as a result of decreased annual harvest.**
  - **Rising lumber prices in Europe, Japan, North Africa and CIS countries.**
- **Many sawmills in Eastern Russia are operating on less than one shift due to lack of saw logs and constrained bank lending.**

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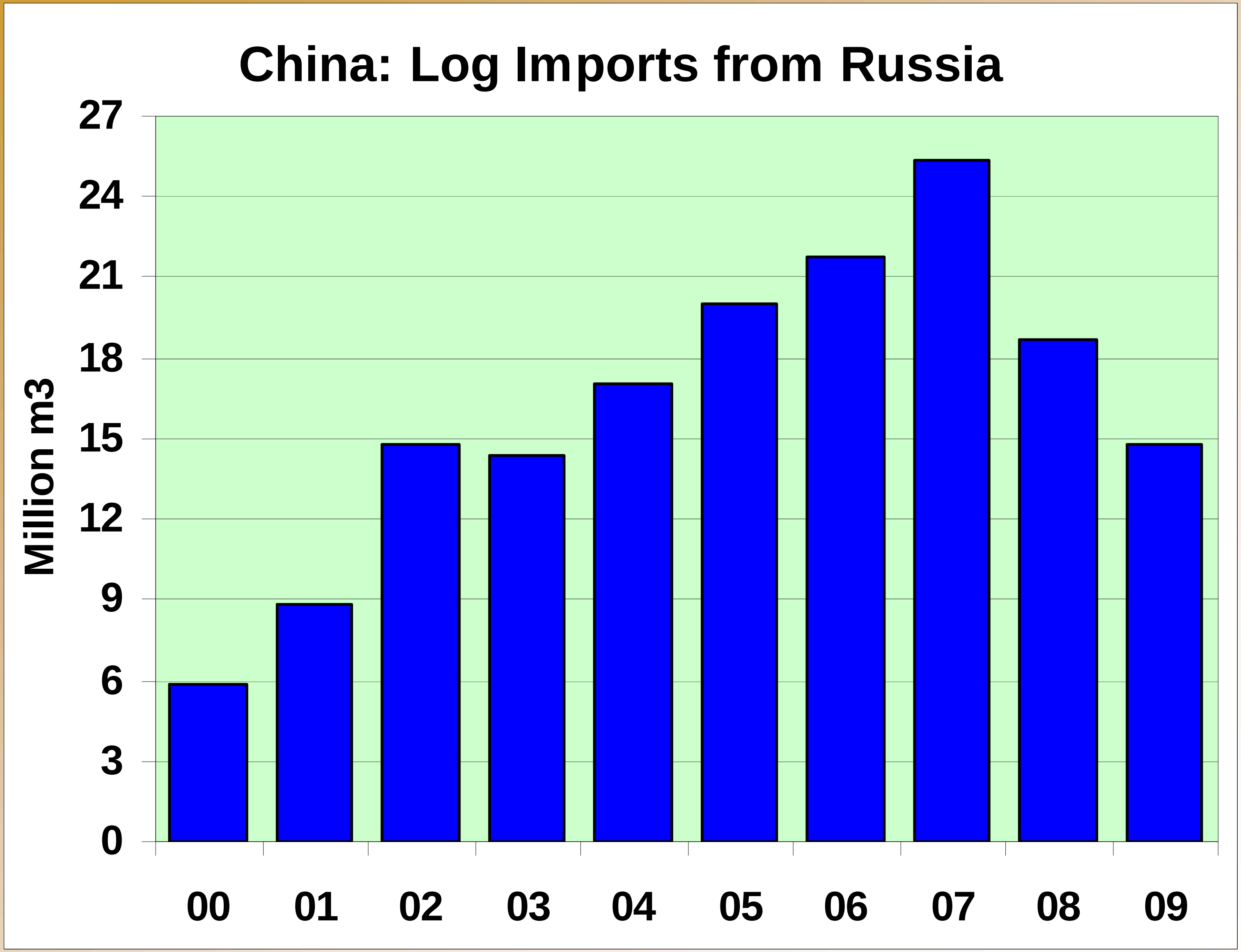
Russia's Log Exports to China = Down



China's total log imports = was ~ 2/3 from Russia!

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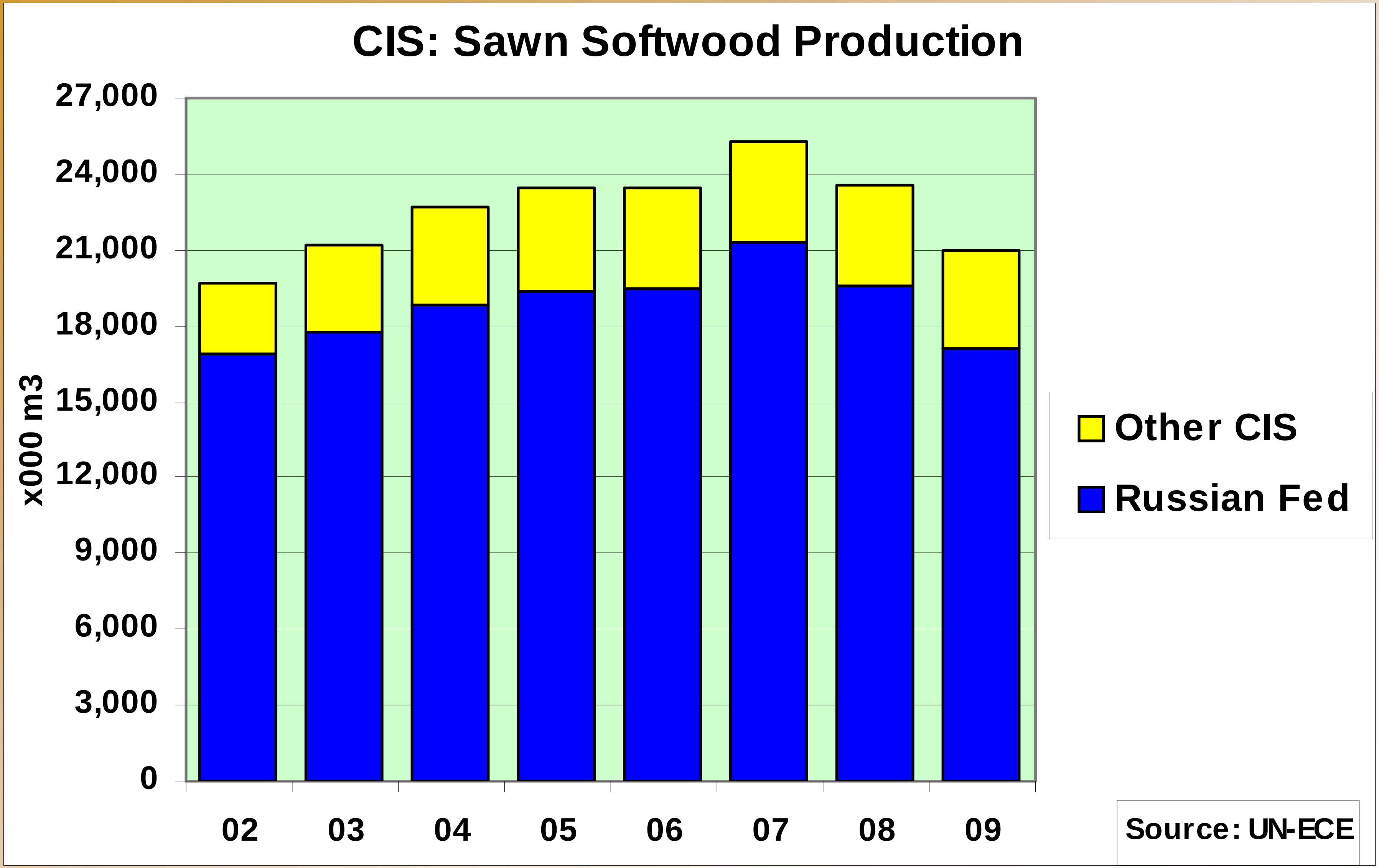
Issues Impacting Russian Industry

- **Most Russian owned sawmills produce lumber for high priced markets in Japan, Europe, N. Africa and CIS countries.**
- **Number of Chinese owned sawmills in Eastern Russia is steadily increasing. Current estimate is 150-200 Chinese sawmills cutting an average of 10,000-15,000 m3 of lumber each per year.**
- **Chinese sawmills produce rough sawn, green lumber that is further processed in China.**
- **As a result, about 2/3 of Russian lumber exports to China is produced by Chinese owned sawmills.**

CIS (incl. Russia) – Production Trends

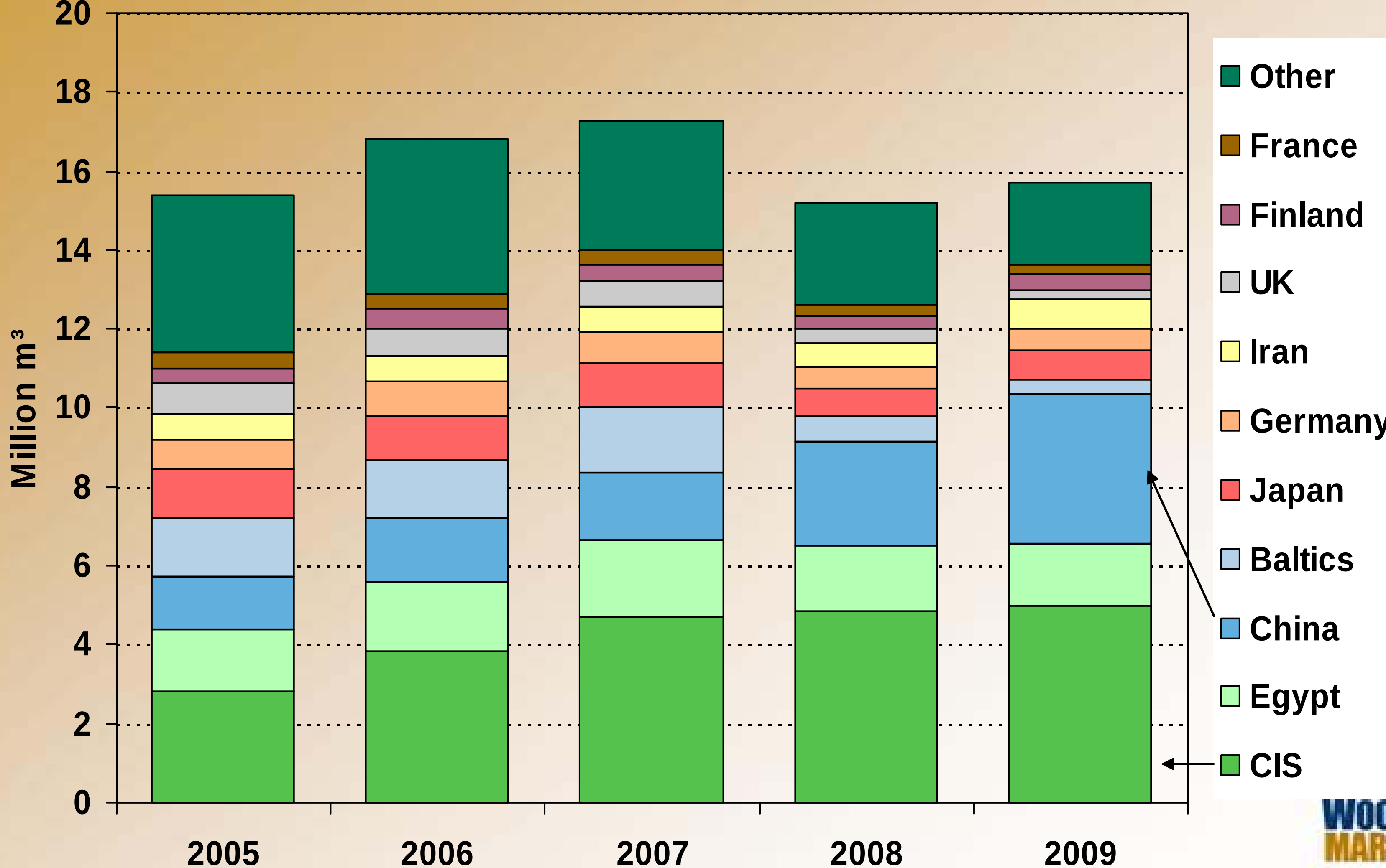


Reductions were also the rule in Russia and the CIS in 2009

Source: UNECE/FAO Timber database 2010

Russia – Lumber Export Markets

Russia exports grew in 2009 - the share of CIS countries & China was over 55% of total exports and is expected to increase further as sawn softwood exports replace log exports.



Source: OAO

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Issues Impacting Russian Industry

- Chinese owned sawmills have lower production costs than Russian sawmills. As result, can sell rough green lumber at a lower price. Profit is realized in processing operations in China.
- The number of Chinese owned sawmills in Russia is expected to continue to grow steadily as the advantages of importing lumber in place of logs (with 25% export duty) provides incentive.
- A number of new, modern sawmills and plywood/veneer mills have been built or are being built but mainly with Russian money (i.e., 3 new Linck mills, 2 new veneer/plywood mills, new MDF plant). (Pictures)

Issues Impacting Russian Industry

- Questions remain about how efficiently Russians can operate these modern sawmills & veneer mills.
- Foreign investment in Eastern Russia log processing is still minimal (except for Chinese).
- Proformas indicate strong business case for investment in Russia, but execution and dealing with Russian politics, corruption, transparency, etc., are still real issues.
- Significant new investment in mechanized logging equipment throughout Russia. Due mainly to the lack of skilled labor and the low productivity of manual logging methods.

Expected Impact on Russian Log and Lumber Exports to China

- **A few Russian forestry companies are importing foreign labor (Ukraine, CIS countries) due to the lack of a skilled and efficient Russian labor force.**
- **Russian log exports to China are expected to grow slowly with the 25% log export tax. If the export tax moves higher, exports will decrease substantially!**
- **Russian lumber exports to China are expected to continue to increase but will come from mainly Chinese-owned or operated sawmills as long as Russian-owned mills have higher priced markets available.**
- **China-Russia border infrastructure is excellent.**

Expected Impact on New Zealand Log Exports to China:

- **A slow growth of Russian log exports to China is forecast – this means a "log shortage" in China (as forecast in WOOD MARKETS' *China Book – Outlook to 2015*).**
- **The current 25% log export tax provides a <u>growing opportunity for New Zealand</u> (and other softwood log exporters) to fill a growing Chinese demand.**
- **New Zealand log exports to China must be <u>priced competitively</u> compared to higher quality North American and Russian softwood logs.**
- **Chinese log importers have a clear price structure and price relationship between these three major suppliers and domestic softwood logs.**

Thank You!

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