



# U.S. Timber Ownership Trends Tax Efficiency Drives Transition

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## The times they are a changin’

- A few years ago discussion of timberland ownership trends were “academic”
- Theory suggested ownership would migrate from...
- Fully taxed industrial land owners...
- To tax efficient ownership structures...
- Is it happening in the U.S.?
  
- **YOU BET!**



# Tax Considerations Drive Timber Ownership

- How does tax structure drive ownership trends?
- Consider the following...
- A taxable “C-Corp” pays Fed/State tax at a combined rate approaching 40%, eventual dividends are taxed at 15% in shareholder’s hands
- But slow growing trees are eligible for capital gains treatment
- Holding timber in a REIT, TIMO, S-Corp or other tax efficient entity can relieve tax burden – this is evident with Canadian Income Trusts...



## Why Does Tax Drive Timber Ownership? Behold a real but vastly oversimplified example

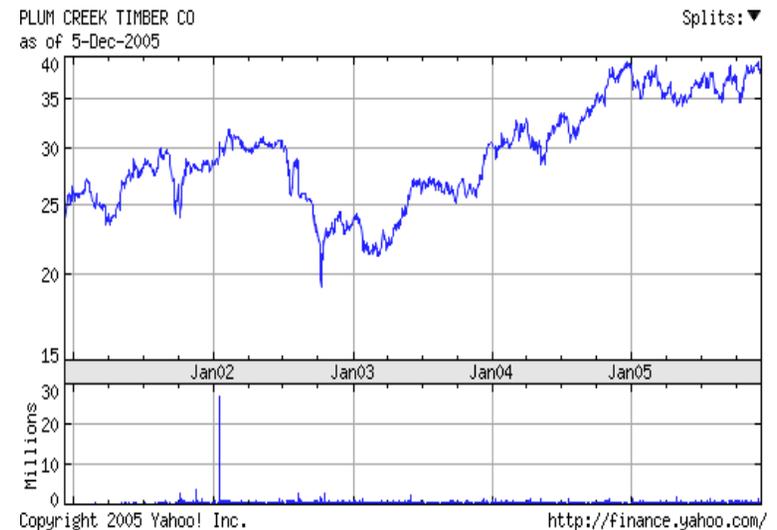
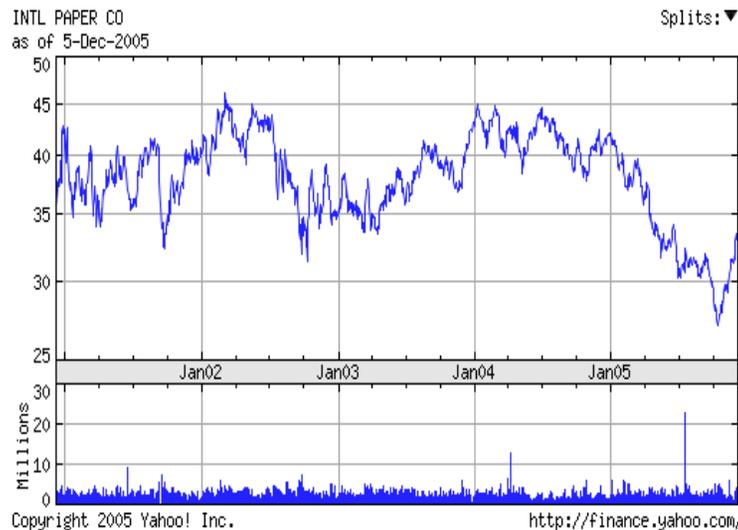
- International Paper (C-Corp)
  - Cuts \$1.00 of Timber
  - Pays 40% Corporate Tax
  - Pays \$0.60 dividend
  - Shareholder Taxed at 15%
  - Shareholder keeps \$0.51
  - Assume 5% discount rate
  - This stream of cash is worth \$10.20 to shareholder
- Plum Creek (REIT)
  - Cuts \$1.00 of Timber
  - Tax Efficient Structure allows “Pass Through” to Shareholders
  - Pays \$1.00 dividend
  - Shareholder Taxed at 15%
  - Shareholder keeps \$0.85
  - Assume 5% discount rate
  - This stream of cash is worth \$17.00 to shareholder



# Why Does Tax Drive Timber Ownership?

## Investment Characteristics

- International Paper (C-Corp)
- Volatile, Cyclical earnings
- Declining industry
- High risk
- P/E = 31.3 (But E is Low)
- EV/EBITDA = 9.5
- Plum Creek (REIT)
- Relatively stable earnings
- Growing industry (no pun)
- Low Risk
- P/E = 21.1
- EV/EBITDA = 13.1



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## Implications of the valuation disparity

- Companies without “tax advantage” become uncompetitive for timberland acquisitions – due to multiple differential.
- If market values timberland earnings differently, either management must address it or Wall Street will.
- This has become a very visible issue as Timber/Real Estate have thrived and paper making has struggled
- Failure to address issue makes company vulnerable to takeover or Mgmt liable for ‘breach of fiduciary duty’
- Options for maximizing shareholder value – sell land to higher multiple bidder, change tax structure, or tax code
  - GP created Timber Co and sold it to capture higher multiple
  - RYN converted to REIT to “Pass through” timber earnings
  - WY is lobbying for change in tax code for its timber cash flows



## Other Benefits of Pure Timber Ownership

- Portfolio diversification – negative correlation to stocks, bonds, inflation hedge, leverage tolerant
- Lower cost of capital due to diminished risk
- Avoid capital intensive and/or declining industry
- Timber Focus enables management to concentrate on maximizing value of land and log merchandise
- Able to refine portfolio via Like Kind Exchanges
- Logistical excellence, mineral rights, leases
- Overall economic value enhancement



## Is sale of Timberland bad for Operators?

- Not necessarily so...
- Can prompt much more efficient use of assets as “subsidized” logs are eliminated– Contribute or die
- Better financial disclosure for investors
- Spurs innovation to reduce fibre use, enhance logistics, ensure right log goes to right mill
- Georgia Pacific is thriving despite owning no trees
- Louisiana Pacific also thriving sans trees – their internal supply was only about 10% pre-sale
- Each business unit must be economically viable



# Is Timberland Ownership Changing?

- Absolutely...consider events of past 18 months
- Boise Cascade sold – ForestCap now controls trees
- MeadWestvaco sells 900K acres – PCL buys most
- Longview Fibre converting to REIT Jan. 1, 2006
- Potlatch converting to REIT Jan. 1, 2006
- International Paper considers selling all timberlands as part of massive restructuring
- Weyerhaeuser lobbies for tax change and conducts internal strategic review
- Key theme- timber landing in tax efficient vehicles

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## Role of Government in Forest Management

- Job #1 is to create a climate that is good for business
- U.S. Forest Service is in trouble, outsourcing service
- However managing land for public good is important
- Providing access to and through forest for other parties
- Suppression of infestations, fire management, reasonable regulations... riparian zone/species mgmt
- Determine societal objectives and ensure policy does no harm – ie. if tax policy is driving land ownership patterns – assess if this is desirable outcome

# Thank You

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