Investing In Timber

The Only Money That Grows On Trees... And How to Invest in the Two "Redwoods" of Wall Street

An Investment U White Paper Report
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If you've never considered investing in timber as an investment strategy, you should...

The fact is, managed timber (as the professional investors call it) has actually beaten the stock market – with less risk – over the long run. From 1973-2002, the sector returned roughly 15% annually. Stocks returned 11%.

Even better, the returns on timber are less volatile than those of the stock market. And they are especially good in bear markets...

During the Great Depression, for example, timber was up 233%, while the price of stocks fell more than 70%. In fact, during the three worst market downturns of the 20th century (1911-20,1929-41 and 1966-81), timber outperformed the S&P 500 by a wide margin.

Glamorous? Not really.

Profitable? You bet.

China and oil may take up all the headlines, but timberland can make you rich.

Timber's "Double-Compounding" Growth Rate

Every American "consumes" a 100-foot tree every year.

Look around. Chances are you're sitting at a desk or conference table made of wood, in a wooden chair, in a room with wood trim all around, in a house that was framed in (what else?) wood. Perhaps you're taking notes on paper right now (from a tree).

Consider these facts:

- The Food and Agricultural Organization of the United Nations forecasts that world demand for wood will nearly double by the middle of this century.
- The USDA-Forest Service projects that demand for U.S. forest products will reach 25 billion cubic feet annually by 2050, up from nearly 18 billion in the1990s.
- Based on rising consumption, and slowing growth in timber inventories, most experts believe prices for timber should rise considerably over the next two to three years.
- Another advantage of investing in timber: unlike other commodities like oil or steel, timber literally grows by anywhere from 4%-10% a year.

But the value of the wood compounds, too. In fact, according to legendary investor Jeremy Grantham, it's risen 3% more than inflation for the last 90 years.

And the cost of doing business for timber companies remains steady: timberlands function as factories and warehouses simultaneously, while costs remain constant.

So while the stock market gyrates, timber keeps growing on the stump – and increasing in value – year after year... and so can your timber investments.

Who Owns These Timberlands?

Contrary to popular thought, most timber is no longer harvested from public lands…

Remember the controversy over protecting the spotted owl habitat under the Endangered Species Act in the early 1990s? Well, the results are in, and the owls won.

Under intense public pressure, timber harvests from the U.S. National Forest System have been reduced dramatically.

The U.S. has about 500 million acres of potentially productive timberland, more than two-thirds of which is now private. Environmental restrictions and loss of land to development pressures have greatly reduced global availability of timberland.

Reduced cutting on public lands has increased the value of private forests, and has also increased imports from international sources. In 2004, the U.S. became a net importer of wood for the first time.

Meanwhile, the Bush administration's recent Forest Health Initiative, designed to reduce fuel loads and fire danger, is also aimed at reducing costly lawsuits from activist environmental groups. That just means more timberlands will end up in private hands.

Up until the 90s, most private timber was owned by integrated lumber companies involved in all aspects of the timber processing business. Companies like Weyerhauser and Georgia Pacific produce construction lumber, bulk paper, cardboard and even pencils.

But then they began looking for ways to "monetize" their timber assets in order to increase the value of their stock. The most practical way to do this was to sell the land outright.

Enter TIMOs – Timber Investment Management Organizations. TIMOs raise pools of money mostly from pension funds, university endowment funds, and other institutional investors. They use the funds they raise to buy and manage the land.

Worldwide, TIMOs have attracted more than $20 billion of investment from institutional investors. For instance, Harvard Management, which invests $27 billion of the university's endowment and pension money, has 10% of its assets in timber.

For these institutional investors, their timber portfolios have been growing like redwoods: slow and steady. But there's another advantage to investing in timber we haven't talked about…

Tax Breaks Galore on Timber Investments

The federal government likes timber, too.

Tax laws dictate that timber be carried on the books at cost. Essentially, land purchased many years ago is valued at the purchase price as opposed to what it will fetch on the open market. So the timber assets of publicly traded corporations tend to be undervalued on their books.

Also, profits on the sale of timberland (or harvested timber) held for more than one year, are taxed as a capital gain instead of the higher earned income rate.

On top of that, as timber is cut, another tax break called a depletion allowance kicks in.

All you need to know is that current law reduces taxes, which increases cash flows to investors. But how do individuals profit?

But How Do Individuals Profit? By Investing In Timber

Until recently, the advantages to investing in timber have been limited to large investors with deep pockets. For the "saplings" of the investor forest, investing in timber has been prohibitively expensive.

But not any longer…

Several public companies are profitably harvesting their own timberlands. And the financial press has virtually missed their stories, which means this rising market is still "invisible" to most investors.

But when Wall Street realizes these stocks have been outperforming other investments, these companies are going to light up the radar.

Two Top-Tier Timber Companies

The *Investment U* research staff has identified two businesses we think deserve your attention…

Rayonier (NYSE: RYN) and Plum Creek Timber (NYSE: PCL) are, by far, the largest direct timber investment plays you can buy.

Plum Creek is larger and more diversified, but Rayonier is still an excellent timber investment, with over 2 million acres of quality lands.

Together, they own more than 10 million acres of timberland, which, at $1,000 an acre, would be valued at over $10 billion dollars.

Both traditionally pay dividends in the 4% range. And they're both relatively cheap, with timber assets valued at only $800 to $1,500 per acre (depending on how you crunch the numbers).

Think about it. You get paid high dividends. And you own millions of acres of exceptional real estate in the U.S. for around $1,000 an acre.

Just imagine if you owned that... and you just saw lumber prices double. Your trees are just sitting there... and your cost of production doesn't really change. So your potential investment earnings have gone through the roof.

If history is any guide, timber may turn out to be a safer place to invest than the stock market or the real estate market over the next five years.

Timber companies offer steady capital appreciation over the long run. Their cash flow is high and reliable. And management tends to funnel excess cash back to shareholders in the form of dividends.

Good Investing,

Stewart Miller and The *Investment U* Research Team

P.S. Here are eight more investments with superior cash flows. They're all built for long-term capital appreciation and above-average income.

Return to the complete Investing in Timber white paper in .html format

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