



**IRISH TIMBER COUNCIL**

*Established 1918*

**The impacts on the sawmill sector arising from the  
proposed sale of Coillte's harvesting rights**

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**A Report by EPS Consulting for the Irish Timber Council**

**February 2013**

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## Foreword

### Pat Glennon, Chairman of the Irish Timber Council

*The proposed sale of Coillte's harvesting rights makes no sense from a commercial, economic or financial point of view.*

*The evidence set out in this report assesses the impacts from the perspective of Ireland's sawmill industry and the 2,500 jobs that depend on this indigenous and rural based sector maintaining its competitive position.*

*Our key message to Government is not to sell the harvesting rights but to secure monies from the privatisation of other State assets.*

*A risk based assessment of the proposed sale of harvesting rights suggests the net residual value to the Exchequer is minimal and indeed damaging to Coillte's financial capacity to continue as a viable entity; that essential and enforceable conditions would have to be attached to such a sale (and this will depress the sale price); and that there is a serious risk to the commercial viability of this critical part of the forestry chain as prices will almost inevitably increase to the sole benefit of the purchaser.*

*There are alternatives. Coillte could re-focus on its mandate as a commercial State company to contribute consistent and worthwhile dividends to the benefit of the taxpayer. The Government might better serve the entire forestry and forest products sector by publishing the outcome of the long overview forest sector strategy. What sawmills, like everyone else in the sector needs, is policy certainty and a clear Government commitment to make the sector competitive.*

*We are very encouraged that the Minister for Agriculture, Food and the Marine, has given a categorical assurance that no sale will take place if there is a risk that this could jeopardise the commercial viability of the sawmill sector.*

*We want to add value to the Irish economy and to grow employment in rural communities. The surest way to prevent this happening is for the Government to progress with the proposed sale of harvesting rights.*

*I would like to thank EPS Consulting for working with the Irish Timber Council in the preparation of this report.*

*The ITC hopes this report stimulates a debate about the arguments, evidence and the facts that should inform the Government's decision.*

## Executive Summary

### The sawmill sector opposes the proposed sale of harvesting rights

The ten companies that comprise the Irish sawmill sector have major misgivings about the proposed sale of Coillte's harvesting rights. These sawmills buy all available Coillte sawlog. There are significant commercial issues that need to be addressed and enforceable safeguards put in place before any decision in principle is taken by the Government to advance this unwise sale process.

### The core arguments

The principal issues insofar as the ITC is concerned are as follows:

1. The net realisable value from the proposed sale of harvesting rights will be so small and disproportionate to the negative impacts on the sawmill sector that have been identified in this report.
2. The purchaser could export some or all of forecast production thereby depriving the sector of a critical raw material. Allowing a purchaser to export significant volumes of unprocessed sawlog would force the closure of every sawmill in the country with consequent job losses in rural communities, deprive the Exchequer of revenue and force the building materials sector to import higher cost materials.
3. The purchaser would have no commercial imperative to supply sawlog at regular intervals to meet the demands of the sawmill sector. On foot of its commitments, Coillte tries its best to meet the sector's supply requirements.
4. The purchaser may decide not to allow the sawmills to harvest available sawlog. Sawmills need the flexibility to harvest what they purchase to meet their customer's requirements.
5. The purchaser could also withhold supply and thereby increase prices to an unsustainable level. A basic assumption is that the purchaser will want to make a significant rate of return on the investment. So securing a high price for sawlog will no doubt be a commercial imperative.
6. A disruption of supply to the sawmills will result in a shortfall of residue product used by the board mills.
7. The Government's focus should instead be on encouraging Irish sawmills to add value, grow employment and to export more processed product.

Should the proposed sale progress and assuming that legally binding conditions could be imposed, the commercial viability of the sector would be jeopardised. Pushing up the price of sawlog will render exports uncompetitive and if sawmills cannot export, they will close given the collapse of the construction sector in Ireland, which until recently was the largest purchaser of timber products.

### Does selling harvesting rights make commercial sense?

Attaching conditions to the sale of the harvesting rights will depress the sale price. As a consequence, the ITC believes that the value of the timber will fall well short of the mooted valuation of €400m to €600m.

Despite the fact that some countries have sold some or all of their harvesting rights there is no proven and successful model for the privatisation of this State asset in a comparable country.

The EU/IMF conditions require that 50 percent of the proceeds must be used to repay the national debt; this could leave a net residual value of just €300m. If this balance was used to reduce Coillte's bank debt, to fund the company's pensions deficit and to finance the €85m investment in one of its board mills, nothing would be left. So what then is the economic rationale of the proposed sale?

Another major unknown is whether the remainder of Coillte can continue as a commercial State company without recourse to ongoing Exchequer support. It would not make any sense if the company had to receive an annual subvention because its primary revenue stream had been auctioned off.

### Have the wider implications of the proposed sale been assessed?

Given Ireland's binding greenhouse gas emissions reduction and renewable energy targets, the sale could also have negative impacts as regards the carbon value of the timber (that should not be included as a potential windfall benefit of a purchaser); on the supply of biomass where forecast demand is growing; and on Coillte's ambitions in relation to wind farms (which require capital investment from the company's own resources).

### Sawmills will close and jobs will be lost

It needs to be recalled that the sector invested some €174m since 2000 (but very little in recent years) in anticipation of an increased and guaranteed supply of sawlog, a buoyant economy, a growing construction sector and export prospects. The majority of sawmills have as a consequence significant over-capacity. The prospect of reduced indigenous supply of sawlog together with higher prices is creating unnecessary uncertainty across the sector and its 2,500 employees.

Selling the timber harvesting rights by way of a fire sale will not result in a positive rate of return for the forestry sector. On the contrary, even if conditions of sale were legally enforceable, and given the tight margins within which the sawmill sector operates, such a sale would inevitably force many sawmills, which are all located in rural areas, to close.

### Minister's commitment

The Minister for Agriculture, Food and the Marine told the Dail (September 2012) that it will be necessary to protect the supply arrangements which sawmills have with Coillte in the event of a sale of harvesting rights. The Minister said ***I am not in the business of supporting any process that would put the timber sector out of business***. The ITC welcomes this statement.

## 1. Introduction

The Irish forestry sector is an important industry.<sup>1</sup>

Ireland's sawmills, which play a critical part in the wood processing supply chain, are among the most modern in the world.<sup>2</sup> The sawmill sector, one of the principal sub-sectors within the industry and like most other sectors operating in the domestic economy, is facing a series of challenges.

While production output has stabilised following a sharp downturn that coincided with the demise of the Irish construction sector, sawmills' margins are under severe pressure due to high sawlog costs, a collapsed domestic economy and the rising transport costs that must be taken into account to get product into the UK and other export markets.

An added uncertainty is the impact of the proposed sale of Coillte on the sawmill sector, in particular the future arrangements for the sale of sawlog to the country's sawmills at a fair market price and a reliable guaranteed supply.

This report starts (**Section 2**) with an overview of the Irish forestry and forest products sector.

**Section 3** then sets out an economic profile of the sector and assesses the contribution of the sector, which provides employment to some 2,500 people in rural communities in Ireland, to the national economy.

Building on this evidence, gathered by way of a sector-wide survey, the implications of proposed sale of Coillte's harvesting rights are assessed and the views of the Irish Timber Council's members are presented (**Section 4**). The key and over-arching concern is a requirement for a guaranteed supply of some 1.5 million cubic metres of sawlog per annum and that conditions be added to the proposed sale of harvesting rights to protect the supply of sawlog to sawmills and at a price which is commercially viable.

Coillte's views on the proposed privatisation are reviewed (**Section 5**).

Finally, the report concludes (**Section 6**) with the ITC's considered views about the sale of Coillte. The Council has serious misgivings about the sale of Coillte's harvesting rights. It is noted that the Competition Authority will have to determine if this disposal and the conditions of sale, comply with national and/or EU competition legislation. However, the Council's firm view is that in the event of a sale of harvesting rights enforceable guarantees will need to be inserted into both primary legislation and the sale agreement about matters such as log supply, log prices, the auctioning system (an independent operator is recommended), forecasting demand, allowing sawmills to harvest and haul the bulk of their requirements and ensuring there is better transparency about the operation of the Coillte's board mills.

The report's conclusions are set out in **Section 7**.

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<sup>1</sup> Department of Agriculture, Fisheries and Food, background paper for review of Irish forestry, 2010.

<sup>2</sup> Statement by David Gunning, Chief Executive, Coillte, to the Oireachtas Joint Committee on Agriculture, Food and Marine, 2 October 2012.

## 2. Overview of the Irish Forestry and Forest Products Sector

### Introduction

The Government's strategy for forestry is based on the 1996 strategic plan for the sector.<sup>3</sup> A review of this strategy has been completed but has not been published.

The industry sub-sectors involved are the forest services sector, the sawmill sector and the board mill sector respectively. These sectors are interrelated and operate at different levels of the supply chain.<sup>4</sup>

Sawlog comprises some 65 per cent of the end product price and hence the price (and supply) of sawlog is a critical issue for the ten sawmills that are members of the Irish Timber Council.

Sawmills produce sawn timber (processed timber used in construction, pallets, fencing and leisure products) and residues (woodchips, sawdust, bark) from sawlog. Residues account for about half of total output by volume. Woodchips are sold to the downstream board mills sector, which are predominantly owned by Coillte.

The vibrant forest products sector, with state-of-the-art sawmills and board mills, exported some €308m in 2011. The sector has been successful in developing and growing export markets to combat the sharp fall in domestic demand due to the demise of the construction industry. However, that success has not been mirrored in resource expansion which is at a critically low level.<sup>5</sup>

Unfortunately, afforestation levels at under 7,000 hectares is well below the target of 15,000 hectares which the sawmill sector believes is the required level to maintain the sustainability of the industry.<sup>6</sup> To achieve a 17% forest cover target by 2030, an afforestation programme of 25,000 hectares per annum would be needed. More realistic afforestation targets and timeframes are proposed in the *Review of Forest Policy*.

The sector's job potential has been clearly articulated to Government in previous submissions. Every 15,000 hectares planted will generate 490 direct jobs. Furthermore, for every 100 jobs in the sawmill sector generates an extra 70 full-time equivalent jobs elsewhere in the economy. A steady supply of raw material from Irish forests could generate some additional 7,000 jobs by 2025.<sup>7</sup>

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<sup>3</sup> Department of Agriculture, Food and Forestry (1996), *Growing for the Future: a Strategic Plan for the Development of the Forestry Sector in Ireland*.

<sup>4</sup> Competition Authority, *Determination of the Merger Notification M/06/057 – Coillte/Weyerhaeuser*, November 2006. The Authority found in favour of the acquisition on the grounds that it would not substantially lessen competition.

<sup>5</sup> Irish Forestry and Forest Products Association (2012), *An Overview of the Irish Forestry and Forest Products Sector 2012*.

<sup>6</sup> The target of 10,000 hectares set in the National Development Plan (2007-2010) is not being met. Annual planting was 6,947, 6,181 and 6,648 hectares in 2007, 2008 and 2009 respectively. The 2012 budget provision allows for 7,000 ha of new planting.

<sup>7</sup> Ni Dhubháin, Á., and Richard Moloney, R., COFORD FORECON Project (2010).

Food Harvest 2020 set out a strong growth agenda for both the timber processing and wood energy sectors.<sup>8</sup> However, a key recommendation, *a significant increase in the annual afforestation level per annum to 2020*, is not being implemented.

The Government’s delay in publishing the long-overdue review of the forest sector is adding to uncertainty as indeed is the lack of clarity about the proposed sale of Coillte’s harvesting rights and the introduction of measures to protect the future of the sawmill industry in Ireland. Investment decisions have been postponed as a consequence.

**Table 1 Forestry – Key Statistics**

- Value of forests and forest products: €2.2 billion (1.4 per cent of GDP)
- Numbers employed: 11,939
- Total direct output of €380m (2010)
- National forest estate 744,000 hectares
- Land afforested: 10.6 per cent of total land
- Ownership of the forest estate: 53 per cent public and 47 per cent private
- Current afforestation rate: 6,653 hectares
- Volume of roundwood harvested: 2.7m cubic metres
- Expenditure multiplier: 0.78
- Sawmill production: 1,058,000 cubic metres (2011)
- Value of exports: €308m
- Government expenditure on the forestry programme (2013): €116m.

*Source:* FORECON Report (2010) and IFFPA (2012)

### The Irish Sawmill Sector

The Irish sawmill sector, which comprises ten companies most of which are certified to Forest Stewardship Council or to PEFC (Programme for the Endorsement of Forest Certification) standards, is modern, efficient, export focused and customer focused.

**Table 2 Ireland’s Sawmills**

Name	Location
Balcas	Enniskillen, Co. Fermanagh
ECC Timber Products Ltd/ Earrai Coillte Chonnacht Teoranta	Corr na Mona, Co. Galway
Glennon Brothers Ltd.	Longford, Co. Longford Fermoy, Co. Cork
Grainger Sawmills Ltd.	Enniskeane, Co. Cork
Murray Timber Group Ltd. (MTG)	Ballygar, Co. Galway

<sup>8</sup> Department of Agriculture, Fisheries and Food, *Food Harvest 2020*, July 2010.



	Ballon, Co. Carlow
Coolrain Sawmills Ltd.	Coolrain, Co. Laois
Laois Sawmills Ltd.	Portlaois, Co. Laois
Palfab, Ltd.	Lissarda, Macroom Co. Cork
Woodfab Timber Ltd.	Aughrim, Co Wicklow
Drenagh Sawmills	Limavady, Northern Ireland

Source: EPS Consulting (2012) from industry survey data

Several companies (Glennon Brothers and Balcas) also have operations in Great Britain.

Sawmills provides the primary outlet for the sawlog and stakewood which is harvested in Ireland. The sector also supplies large volumes of sawmill residues (including bark, sawdust shavings and wood chip) to the panel products and bio-energy sectors.

The total value to the economy of the forest and forest products sector is €2.2 billion.<sup>9</sup>

### Timber Volumes and Demand

All of the sawlog available from Coillte is purchased by the Irish sawmilling sector.

The sector requires accurate and reliable forecast volumes at an all-island basis to underpin investment decisions and capacity utilisation.

These forecasts rely on a range of assumptions, yield models, forest management regimes and forecast rules that may or may not be applicable at individual plantation level.

In 2011, COFORD published the *All Ireland Roundwood Production Forecast 2011-2028*, in which they attempted to provide as accurate an available supply as possible by presenting figures as Net Realisable Volumes (NRV) that take into account harvesting losses, accessibility and crops unlikely to be harvested. These forecasts are being reviewed against actual returns for 2010 and 2011 to identify issues with the forecasts as regards mobilisation.

It is a matter of serious and ongoing concern to the sawmilling sector that there are significant differences between forecast volumes and actual timber volumes processed by the timber industry in a given year. Specifically, the sector is unhappy with the accuracy of the forecast supply of sawlogs as recent experience has demonstrated that shortages of supply in comparison to projected harvesting levels has become a common feature. As a consequence, the price of sawlogs continues to be at unsustainably high levels by comparison to sawlogs offered for sale in the UK.

Coillte represents the single largest source of sawlog supply, with over 61 per cent of the volume available for the forecast period to 2028. Given the dominance of Coillte as the supplier of an essential raw material for sawmills in the short to medium term, it is a matter of grave concern that Coillte's supply in 2010 was some 388,000 m<sup>3</sup> below the NRV forecast and a staggering 578,000m<sup>3</sup> below the NRV in 2011; this is some 19 per cent of total forecast supply.

COFORD explains that factors such as volume losses arising during harvesting, planned volumes not being harvested and individual owner's circumstances and preferences are all factors influence the

<sup>9</sup> Ní Dhubháin, Á, Bullock, C., Moloney, R., and Upton, V. (2012). Final report of the FORECON project. In press. COFORD.

supply balance. Against this background, COFORD estimates that total roundwood harvest in 2011 was some 2.7 million cubic metres and net realisable roundwood volume production for the island of Ireland will increase to 4.6 million cubic metres by 2020, of which 1.4 million (some 30 per cent) will come from private sector forests.<sup>10</sup>

If it is not possible to forecast production accurately in the short terms it is almost impossible to predict production levels 40 or even 80 years hence; a key issue for assessing the valuation of the harvesting rights.

Coillte will sell some 2.3 million m<sup>3</sup> of roundwood in 2012. Of this some 1.5 million m<sup>3</sup> (64 per cent) will be sold to sawmills. Most of the balance (36 per cent), some 800,000 m<sup>3</sup>, was sold to Coillte's panel board mills, SmartPly and Medite Europe Ltd. Coillte is forecasting that its gross productive capacity for the period 2011-2020 will be stable at between 3,016 to 3,102 ('000 cubic metres).<sup>11</sup> In addition, forecast demand for forest-based biomass and firewood (unsawn timber logs) is expected to be very strong over the period to 2020 and this will have an impact on prices.<sup>12</sup> The following table shows the trend in roundwood processed in Irish sawmills.

**Table 3 Roundwood Processed in Ireland (000m<sup>3</sup>)**

	<b>2007</b>	<b>2009</b>	<b>2011</b>
<b>Log imports less exports</b>	57	-63	55
<b>Coillte harvest</b>	2,556	2,354	2,299
<b>Private forest harvest</b>	390	130	386
<b>Roundwood available for processing</b>	3,003	2,421	2,740
<i>of which</i>			
<b>Sawlog</b>	1,934	1,602	1,580
<b>Stakewood</b>	180	88	116
<b>Total use of roundwood by sawmills</b>	2,114	1,690	1,696

Source: IFFPA Overview of the Irish Forestry and Forest Products Sector (2012)

<sup>10</sup> COFORD, Department of Agriculture, Fisheries and Food, *All-Island Roundwood Production Forecast 2011-2028* (author: Henry Phillips), 2011.

<sup>11</sup> Coillte, [Roundwood Supply Forecast](#) 2011-2015. While there is an obvious relationship between a roundwood forecast and actual production from the forest, predicted future volume that will actually be harvested from the forest are unlikely to be the same as, firstly, the forecast estimates the gross volume for all forest crops, including those which may not be harvested because of infrastructure constraints or costs and marketing conditions pertaining at the time the crop is ready for sale.

<sup>12</sup> COFORD, Roundwood Demand Group, 2011.

Due to Ireland's disease free status sawmills can only source sawlog from a very limited area in Scotland. Sawlog imported from anywhere else has to be debarked prior to landing in Ireland. This is not a commercially viable option.

### Timber Prices

The main price driver is the over-capacity of the sawmill sector which was geared up on the basis of Coillte's forecasts about sawlog supply which consistently have not materialised at the projected level.

In 1997, Coillte introduced an electronic auction system for selling roundwood coming from its forests as part of a new timber sales system (**TSS**). Auctions take place every fortnight and alternates between standing and harvested sales; in the period up to 2010 the split was standing 50% and harvested 50%. Coillte subsequently changed this and the split is now standing 37% and harvested 63%.

Lots are sold to the highest bidder subject to the reserve price (set by Coillte) being exceeded. The reserve price, which is not disclosed, is calculated using a methodology devised by McKinsey & Co that combines two estimates: willingness to pay and historic prices. The components that make up this pricing methodology are not disclosed.

However, there is no transparency in price as regards pulpwood provided to the board mills.

Imported sawlog or private sawlog does not go through the TSS. Under the TSS there is only a spot market. There are no long-term contracts as might be expected for a long-lived natural resource, nor any forward market.<sup>13</sup> The TSS works in such a way that sawmills are discouraged from building up inventories of sawlog.

The current (average) price of €50.58 per m<sup>3</sup> is significantly above the timber price over the past five years, which varied from a high of €54.57 per m<sup>3</sup> (2007) to as low as €27.77 per m<sup>3</sup> (2009); or an average of around €43 per m<sup>3</sup>.<sup>14</sup> The 2007 prices, especially for large trees, was reflective of the increase in demand for construction timber at the height of the construction boom. Demand fell sharply in 2009 as many sawmills reduced their working week. Prices spiked in the summer of 2010 reflecting strong timber product prices in the UK. Prices in Ireland are much higher than corresponding prices in the UK with the average difference in price being €13.50/m<sup>3</sup>.<sup>15</sup>

While timber sales from private forestry are small compared to Coillte's sales, there will be much higher volumes available in the long term. Strong demand from sawmills for private sector timber has helped maintain a high price for most categories. It is important that Ireland has a viable sawmill sector capable of processing the future Coillte and private harvests.

High sawlog prices in Ireland have led to very tight profit margins for sawmills who rely heavily on exports. Fluctuations in the euro/sterling exchange rate have also affected margins.<sup>16</sup> As a

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<sup>13</sup> op cit. The Competition Authority. The Authority concluded the market for softwood roundwood is a properly defined intermediate market which is no wider than the island of Ireland.

<sup>14</sup> COFORD, Forestry and Timber Yearbook Statistics 2010.

<sup>15</sup> Forestry Commission, *Timber Price Indices, Data to September 2012*, November 2012.

<sup>16</sup> op cit. Casey and Ryan.

consequence of high log prices and fluctuations in currency exchange rates some sawmills are operating at a loss.

The ITC's view about the TSS has been consistent over the years; it is designed to allow Coillte to engage in a form of first degree price discrimination so as to obtain the highest possible prices from the sawmills without regard to the wider interests of the forestry sector.<sup>17</sup>

### Capacity

There is substantial over-capacity in sawmills given current market conditions. Sawmills have invested heavily in anticipation of Coillte's estimates of sawlog production. In fact, since 2000, some €174m has been invested. Significant rationalisation has taken place. In 1991, 70 per cent of sawlogs were processed by ten sawmills; now (2012) over 80 per cent of sawlogs are processed by five sawmills in Ireland and ten sawmills on the island process 97 per cent of sawlogs.

### Enterprise Interlinkages

While the sawmills process roundwood into finished products, the sector contributes to other enterprises' efforts by virtue of the fact that there is such a vibrant market for roundwood.

For example, forests thinned and harvested provide biomass, which is needed as a feedstock for primary energy and as a supply for the board mills. Ireland has a binding EU target to achieve a 16% share of renewable energy in final energy consumption by 2020. Current production (122 kilo-tonnes of oil equivalent) of biomass from forestry is well below the generation requirement of 258 ktoe needed by 2020.<sup>18</sup> One reason for this shortfall is the low level of afforestation. On the other hand, in 2010 a third of roundwood harvested was used for the production of biomass energy.<sup>19</sup>

Furthermore, high levels of afforestation contribute to Ireland's climate change targets. Forests (absorb) sequester carbon.<sup>20</sup> Ireland's forest sink contains some 4 Million tonnes (Mt) of carbon per annum. At current (February 2013) carbon prices (€5/tonne) the monetised value of this carbon is some €20m. Therefore, and provided EU rules on Land Use, Land Use Change and Forestry so provide, the value of Ireland's forest carbon is a major asset to Coillte and to private owners. However, Coillte has warned that at current levels of afforestation, instead of forest carbon making a net contribution there could be a loss of 45 Mt between 2035 and 2055; a major potential loss to the Exchequer.<sup>21</sup>

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<sup>17</sup> op cit. The Competition Authority (page 27). Also in its submission, the ITC argued that the proposed acquisition of Coillte and Weyerhaeuser would significantly increase buyer power in the upstream market enabling Coillte to drive down pulpwood and residue prices to the detriment of both sawmills and private forests.

<sup>18</sup> Department of Communications, Marine and Natural Resources (2010), *National Renewable Energy Action Plan (draft)*, June 2019, pages 113-120.

<sup>19</sup> Statement by Shane McEntee, Minister of State at the Department of Agriculture, Food and the Marine to the Joint Committee on Communications, Natural Resources and Agriculture, 14 February 2012.

<sup>20</sup> A forest sink is the dynamic removal of atmospheric carbon dioxide through photosynthesis measured as the net increase in terrestrial carbon over time. Forests represent some 40 per cent of the world's terrestrial store of carbon.

<sup>21</sup> Oireachtas, *Report on the European Commission's Green Paper on Protecting Europe's Forests Against Climate Change*, Report by the Joint Committees on Climate Change and Energy Security and Agriculture,

### 3. Economic Profile of the Sawmill Sector

#### Overview

The following table sets out the key statistics for the sawmilling sector.

**Table 4 Sawmill Key Statistics**

- Employs 2,500: 1,600 directly and a further 900 indirectly in Ireland (2012)
- Invested €174m since 2000
- Used 2.2m cubic metres of roundwood (2012)
- Uses 100 per cent of available Coillte logs
- Produced 1,058,000 cubic metres of sawn timber (2012)
- Market share (2010) in UK for sawn softwood timber now 6.3 per cent (up from 4.2 per cent in 2007)<sup>22</sup>
- Volume of sawn timber exports (€83m) have grown by 227 per cent over the decade to 2010.

*Source:* EPS Consulting (2012), FORECON Report (2012) and IFFPA (2012)

#### Economic Contribution

The following key statistics suggest the contribution of the sawmill sector (in Ireland) is some €370m.

**Table 5 Sawmill Direct Expenditure (2010)**

	Expenditure (€m)
<b>Total domestic intermediate inputs</b>	201.7
<b>Wages and salaries</b>	40.7
<b>Net other domestic inputs</b>	5.2
<b>Total domestic inputs</b>	263.5
<b>Imports</b>	106.7
<b>Total inputs</b>	370.2
<b>Employment</b>	2,500

*Source:* FORECON Report (2012) and IFFPA (2012)

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Fisheries and Food, July 2010, submission by Coillte. At an assumed price of €45/tonne this represents some €2 billion.

<sup>22</sup> EUROSTAT (2010).

## Employment

The sawmill sector as an employer of 1,600 people in many rural communities sustains a further 900 jobs in the economy as sawmills buy a wide variety of goods and services from local suppliers thereby providing and sustaining employment in other businesses within their region.<sup>23</sup>

## Exports

The sawmilling sector has had to invest in new product development to secure export marketing opportunities.

Marketing efforts targeting the UK have resulted in certified sawn timber exports rising from 387,000 m<sup>3</sup> (2008) to 621,000 m<sup>3</sup> (2010); a 60 per cent increase. The UK imports some 4.9 m<sup>3</sup> (2011) so Irish exports have grown their market share in what is a declining market.<sup>24</sup> Ireland has a 5 per cent share of the overall UK timber market.<sup>25</sup>

In 2011, sawn softwood to a value of €83m was exported to the UK and France primarily

This is a positive performance as the European sawnwood market has not yet recovered from the 25 per cent fall in demand from the peak in 2007 to 2009. The current market volume (2012) is close to that of 15 years ago. In addition to low volume, the industry is challenged by reducing margins.<sup>26</sup>

Given that the volume of exports has grown by almost 230 per cent in the past decade the prospects for the future would appear to be good provided, critically, that roundwood can be sourced at sufficient volumes and at a competitive price.

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<sup>23</sup> Ní Dhubháin, Á, Fléchar, M-C., Moloney, R., O'Connor, D., and Crowley, T., (2008). *The Economic Impact of the Forestry and Wood Products Sectors in Ireland*, COFORD. An input-output analysis was used to assess the economic impacts of the forestry and wood products sectors. All members of the ITC were surveyed as part of this assessment. Using current benchmarks, the employment multiplier in the sawmill sector is 1.74; thus for every 100 jobs in sawmilling an extra 71 full-time jobs are provided in other sectors of the economy. The wider output multiplier is 1.71.

<sup>24</sup> Casey, J., and Ryan, M, TEAGASC, *Situation and Outlook for Forestry 2011/2012* (2012).

<sup>25</sup> Enterprise Ireland, 2011.

<sup>26</sup> Pöyry Management Consultancy, *Forest Sector Trends*, October 2012. Some 7% goes to bioenergy; 19% to wood-based panels; and 33% to pulp and paper.

## 4. The Proposed Sale of Harvest Rights

### Introduction

A condition of the EU/IMF Memorandum of Understanding is that Ireland must generate €3 billion from the sale of State-owned assets and companies.

The review group on the sale of State assets recommended that Coillte's forests and non-forest assets (but not its forest land) should be sold, possibly using a suitably modified version of the New Zealand Crown Forest Licence template and that unforested surplus land be disposed of.<sup>27</sup> The report stated that concerns over Coillte's power in relation to the sale of logs could be addressed by suitable provisions in the sale agreement(s).

These recommendations were made without sight of the findings and recommendations of the as yet unpublished report of the National Forestry Review Group that assessed forestry policy goals and the Coillte Review Group that examined the future development of Coillte. It would have been prudent to await the publication of these reviews before recommendations about the sale of part or all of Coillte were made.

It would also have been helpful if the sawmilling sector had been consulted at the outset about the significant impacts arising from the proposed sale of harvesting rights.

The Government announced its response to the troika on 22<sup>nd</sup> February 2012 and listed Coillte as one of the State bodies that may be disposed of, along with Bord Na Mona, the energy business of Bord Gais Eireann, some of ESB's non-strategic power generation capacity and the State's remaining shareholding in Aer Lingus.

The Minister for Public Expenditure and Reform told the Dáil on 8 March 2012 that *we have agreed (with the EU/IMF) to give consideration to the sale of some of Coillte's assets, which is likely to focus primarily on the harvesting rights of Coillte's forests, but the land on which the forests are situated is not for sale*. The Minister then cited some legitimate concerns that had been raised, public access to forests for example, but did not reference the impact of the sale of harvesting rights on the sawmill sector.

Subsequently, the Minister for Public Expenditure and Reform gave the following assurance to the Dáil: ***the Government will ensure that all of the implications of each asset disposal will be carefully considered, with a view to mitigating any potential negative impacts associated with the disposals.***

More recently (May 2012), the Minister for Agriculture, Food and the Marine told the Dáil that no decision on the possible sale of Coillte's assets will be taken until a valuation of Coillte's assets is completed. The Government appointed Macquarie, an Australian investment bank, to evaluate proposals for the privatisation of Coillte. It also decided (26 June) in principle to sell the harvesting

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<sup>27</sup> *Report of the Review Group on State Assets and Liabilities*, April 2011, Government Publication Sales Office.

rights to Coillte's forests by way of a concession for a period of between 50 to 80 years as part of the overall target of €3 billion of asset disposals.

In the past months a working group, comprising the Departments of Public Expenditure and Reform (D/PER) and Agriculture, Food and the Marine and NewERA has assessed the wider policy, regulatory, legislative, corporate governance and financial issues that need to be addressed in order to facilitate the disposal of Coillte or some of its assets.

In the November 2012 review of the EU/IMF Programme, the Government was required during Q4/2012 i.e. before end-year to 'complete the regulatory, legislative, corporate governance reforms required to bring to the point of sale the assets it has identified for disposal'. In Q2/2013 the quantum of the proceeds to be realised has to be reported to the EU/IMF. The D/PER has indicated to the EU/IMF that having undertaken detailed examinations, they do not foresee any legislative or regulatory obstacles towards the commencement of the sale process in 2013.<sup>28</sup>

Coillte, on the instruction of the Government, has evaluated the implications of the sale of harvesting rights for 50 to 80 years. Coillte has identified all the possible risks and implications arising out of the sale of harvesting rights to the Government, including impacts on employment and transport companies. In addition, Coillte was asked to assess the feasibility of the remaining businesses (including Smartply and Medite, non-commercial forests, wind energy and telecommunications) and their ability to remain viable and profitable without recourse to State intervention. This work has been signed off at board level.

The process by which the actual harvesting rights would be put for sale has not been determined yet, nor has the price as this is a matter for Government, NewERA and the steering committee with their respective advisors. The steering group will be consulting with international advisors on the value of forests.

Coillte's findings (as yet unpublished) have been given to the steering group set up by Government to supervise the sale of Coillte.

Case studies of the sale of State owned forestry in other countries, including New Zealand, has formed part of the analysis to date.

A three month review period (to March 2013) is anticipated.

Considerable interest has been shown in various assets by trade players, infrastructure funds and private equity interests. This feedback will inform the Government's decisions in respect of each State entity.<sup>29</sup>

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<sup>28</sup> EU/IMF *Programme of Financial Support for Ireland*, 29 November 2012.

<sup>29</sup> There is a protocol in place between Coillte and NewERA whereby any company expressing an interest in even a discussion around the proposed transaction must first contact NewERA staff.



A final decision on how best to release value from Coillte still remains to be taken by the Government. A decision in principle is expected during early Q2 2013 with regard to whether to proceed and on the sale process around that, whatever the decision.

The Coillte's board in exercise of its statutory and fiduciary duties will ultimately determine the legality of any proposed disposal.

There is an expectation that the value of the harvesting rights will be between €400m to €600m.<sup>30</sup>

The thinking is that a clear unrestricted auction of the assets for an 80 year period, without conditions, would probably realise a higher up-front price.<sup>31</sup>

The Minister for Agriculture, Food and the Marine told the Dáil (September 2012) that it will be necessary to protect the supply arrangements which sawmills have with Coillte in the event of a sale of harvesting rights and *one can stitch it (the protection of supply contract) into any sales process*. He argued this has been done successfully in other parts of the world. The Minister added ***I am not in the business of supporting any process that would put the timber sector out of business.***

The Minister expects that the purchaser will be required to replant felled forests. He suggested that Coillte may be contracted by the new owner to manage its forest estate.

It is expected that a transaction may take place in Q4 of 2013.

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<sup>30</sup> Statement by Minister Simon Coveney to Deputy Éamon Ó Cuív, 25 September 2012.

<sup>31</sup> Statement by Andrew Doyle, T.D., chairman of the Joint Oireachtas Committee on Agriculture, Food and the Marine, 2 October 2012.

## 5. Coillte and its Views on Privatisation

Coillte,<sup>32</sup> which has 1,000 employees in Ireland the UK, owns 7 per cent of Ireland's land; some 1.2 million acres. In 2011, Coillte planted 14 million trees on 5,641 hectares.

Coillte's after-tax profit in 2011 on a turnover of €259m was €19.9m; profit was €32m in 2010 on a turnover of €250m.<sup>33</sup> This positive performance in 2011 was due to strong sawlog prices in Ireland and improved prices for panel products in the UK and other export markets. Coillte policy is to secure a much higher margin product mix within the family of Coillte products.<sup>34</sup>

Board policy is the re-invest much of its dividend back every year as capital investment in forests. However, in 2011 a dividend of €10m was paid to the shareholders.<sup>35</sup>

The maintenance of public access costs in the region of €10m a year by way of investment in roads, pathways, new cycle paths etc.

The forestry business, one of the company's three operating divisions, is a €100m business with 70 per cent derived from the sale of sawlogs to sawmills. Coillte (and the industry generally) employs 70 harvesting companies and 30 haulage contractors (that move 100,000 truckloads of logs every year).

When the Smartply plant, which employs some 350 people, was built Coillte had a minority shareholding and acquired the entire shareholding some years later. The plant was built for one purpose and for one mass-produced product. The cost structures in Ireland and the needs of export markets no longer require that type of product, which is a commodity. In the past four years Coillte has developed new products that are contributing about €12.5m. Coillte cannot compete with the Eastern Europeans in particular. The plant has metal fatigue hence the requirement (approved by the Coillte Board in July 2012) to invest €85m in capital investment to produce speciality-type products. Without investment the Smartply plant will have to close within three to four years. The Medite plant in Clonmel is also part of Coillte's Panel Products; a €150m business which exports some 90 per cent of their products to the UK, Turkey, Israel and the Middle East.

Coillte has 55 projects underway within the wind sector ranging from wind farm development through joint ventures and other activities. The company provides some 17 per cent of Ireland's telecommunications mast structures (420 in total).

The Coillte pension fund deficit is €122m and at end 2012 its debt will be in the region of €180m. Coillte has indicated that in the event of a transaction, the banks expect this debt will be repaid.

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<sup>32</sup> Coillte Teoranta was established as a private commercial company under the Forestry Act, 1988.

<sup>33</sup> The 2011 figure included a €9m provision for a pension funding issue.

<sup>34</sup> Coillte does not operate an overall gross margin as one of the company's metrics.

<sup>35</sup> The Minister for Public Expenditure and Reform owns all the shares bar one, which is held by the Minister for Agriculture, Food and the Marine. NewERA is performing the shareholder responsibility for Coillte. NewERA will also advise Government, in due course, about the sale of harvesting rights.

Coillte's chairman told the Oireachtas that there is no reason why the company cannot be one of the leading fibre technology companies in Europe within the next seven years. All the pillars that can make Coillte successful are in place; they have good strategic and innovation plans. **With regard to guaranteeing supply to its operations and to sawmills, Coillte's chairman acknowledged that the sale process (of harvesting rights) would have to include an explicit guarantee of supply to all users and 'it would be unacceptable to approve a process that did not carry that guarantee'.**<sup>36</sup> However, the nature of that guarantee has not yet been determined, nor has it been clarified if conditions to the sale would be legally enforceable, with penalties if they were breached.

Coillte has been engaged in significant dialogue and discussion with NewERA and the Departments of Agriculture, Food and the Marine and D/PER about the proposed disposal programme. Coillte has been involved in work on estate valuation, and in identifying issues associated with the sale of harvesting rights. One such issue is the potential impact of the transaction on the timber processing sector. In that context, Coillte has analysed timber supply to the sector and the central role that Coillte plays in that regard.

Another issue is who will have responsibility for replanting in the event of the sale of harvest rights as currently replanting is funded from the proceeds of sawlog sales.<sup>37</sup>

It is known that Coillte favoured a number of options, as follows, to realise value from its assets:

- Increase dividends to at least 30 per cent of profit after tax.
- Liquidate the assets of the No. 2 pension fund.
- Adjust Coillte's funding proposal for the No. 1 pension fund.
- Sell Coillte's telecommunications business.
- Sell Coillte's panel products business (Smartply and Medite)
- Expand the sales of immature forests i.e. those that are ten to 25 years from maturity.
- Sell Coillte's wind energy portfolio

**In its submission (September 2010) to the review group on the sale of State assets, the Department of Agriculture, Fisheries and Food signalled that the sawmill industry would have serious concerns about security of supply** in the event that a full privatisation was contemplated and that significant public unease could be foreseen associated with the privatisation of Coillte Forest.<sup>38</sup>

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<sup>36</sup> Statement by Brendan McKenna, Chairman Designate, to the Oireachtas Joint Committee on Agriculture, Food and Marine, 20 November 2012.

<sup>37</sup> One of the conditions of a felling licence, granted by the Forest Service under the Forestry Act 1946 is that the area felled must be replanted within a specific period, generally within 12 months of the felling being completed. The Minister has the power to give a derogation and to waive the replanting obligation by way of a limited felling licence.

<sup>38</sup> *Submission on Coillte to the Review Group on State Assets and Liabilities*, Department of Agriculture, Fisheries and Food, September 2010.

## 6. ITC's Views on the Sale of Coillte's Harvesting Rights

ITC has major misgivings about the very principle of the proposed sale of Coillte's harvesting rights.

These views about the extent to which Coillte might be privatised are informed *inter alia* by ITC's view on the privatisation programme in general. To this end, the literature on the strategic role of State assets was reviewed, in particular the TASC report *Reframing the Privatisation Debate*.<sup>39</sup>

The Bacon report, which ITC supports in broad terms, lists many arguments that affirmed the proposed sale is not based on economic rationale and cannot be justified.<sup>40</sup>

This is a crude attempt to secure cash by way of a fire sale to satisfy the EU/IMF Agreement.

The business model being used, the sale of harvesting rights in New Zealand, has failed.

The principal issues insofar as the ITC is concerned are as follows.

1. The net realisable value from the proposed sale of harvesting rights will be so small and disproportionate to the negative impacts on the sawmill sector that have been identified in this report. If 50 per cent of the proceeds are used to repay the national debt and assuming €300m net is secured from the sale of the harvest rights, from this will have to be deducted provisions for: funding the Coillte pension deficit; reducing the company's bank debt; a provision towards the estimated €85m capital cost of rebuilding one of the board mills; and working capital to guarantee that what remains of Coillte can survive as a commercial entity.
2. The purchaser could export some or all of forecast timber production thereby depriving the sawmill sector of a critical raw material. Allowing a purchaser to export significant volumes of unprocessed sawlog would force the closure of every sawmill in the country with consequent job losses in rural communities, deprive the Exchequer of revenue and force the building materials sector to import higher cost materials.
3. The purchaser would have no commercial imperative to supply sawlog at regular intervals to meet the demands of the sawmill sector. On foot of its commitments, Coillte does its best to meet the sector's supply requirements.
4. The purchaser may decide not to allow sawmills to harvest available sawlog. Sawmills need the flexibility to harvest what they purchase to meet their customer's requirements.
5. The purchaser could also withhold supply and thereby increase prices to an unsustainable level. A basic assumption is that the purchaser will want to make a significant rate of return on the investment. So securing a high price

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<sup>39</sup> *The Strategic Role of State Assets – Reframing the Privatisation Debate*, TASC, February 2012.

<sup>40</sup> Bacon, P., *Assessment of the Consequences of the Proposed Sale of Coillte's Timber Harvesting Rights*, Final Report to IMPACT, January 2013.

- for sawlog will no doubt be a commercial imperative.
6. A disruption of supply to sawmills will result in a shortfall of residue product used by the board mills.
  7. The Government's focus should be on encouraging Irish sawmills to add value, create jobs in rural Ireland and to export more processed product. The strategic review of the forestry sector should be published forthwith so as to better inform the debate about what will happen to the forest and forestry products sector in the event that the proposed sale of harvesting rights takes place.

Under these scenarios, and assuming that legally binding conditions could be imposed, the commercial viability of the sector would be jeopardised.

Pushing up the price of sawlog will render exports uncompetitive and if sawmills cannot export they will close given the collapse of the construction sector in Ireland which was until recently the largest purchaser of timber products.

A risk assessment of the proposed sale would highlight the acute sensitivity of such a sale on the sawmill sector.

The options and their possible consequences insofar as the ITC is concerned are as follows:

#### **Business-as-usual**

Even if the EU/IMF target of €3 billion can be found from the disposal of other State assets, and the sale of harvesting rights is delayed or postponed, the ITC has serious issues to raise with Coillte about a range of operational issues, including guarantees of the supply of sawlog at required standards over the next five years; the lack of transparency in relation to a reserve price at auction; a more transparent auctioning system; the implications for the sawmill sector of the proposed investment of €85m in Smartply, and the sector's commercial requirement to harvest more timber (and for Coillte to scale back its harvesting operations as a consequence).

To this end, the ITC and Coillte are in the process of agreeing a forum where these issues can be discussed in a constructive manner.

#### **The sale of assets other than harvesting rights**

This is the ITC's preferred position – should it become a political necessity to sell some Coillte assets - as it has the least detrimental impact on the future of the sawmill sector.

While the Government's decision of 23 June 2012 instructed the Coillte board to assess the sale of harvesting rights, the ITC believes other options should be considered in the first instance. For example, there is no commercial reason why Coillte's wind farm, biomass or telecommunications businesses should not be sold. Indeed, both Smartply and Medite either as single plants or together could be disposed of, not least because Smartply requires such a high level of investment to prevent its closure. As Minister Coveney has set the expected revenue from the sale of harvest rights at at least €400m and as Coillte has indicated that its banks expect to be repaid €180m in debts and

assuming the deficit (€130m) in its pension scheme will be funded, it is arguable that the net realisable value will be quite small. In such an event, there is no need to sell the harvesting rights at all while still delivering on the EU/IMF agreement to raise monies on foot of the sale of some other State assets where the net realisable value is much higher and the return for the taxpayer is more obvious.

### **The sale of harvesting rights**

It has been acknowledged by Government and Coillte that the sale of harvesting rights (by way of a concession) is problematic because of the knock-on impacts on the timber processing industry. For example, if the purchaser of the harvesting rights reduced supply for whatever reason the price of sawlogs would inevitably rise given the sector's over-capacity. A rise of just 10% would jeopardise the commercial viability of most plants as the margins they get on export sales (that are exposed to currency variations) are currently very low. If sawmills cannot sell product to their clients due to high sawlog prices, these clients (including the major client base in the UK) has the option of sourcing finished product from other countries. In this scenario (i.e. a tightening supply resulting in higher prices) most sawmills would have no option but to reduce production with resulting job losses.

Therefore at a very minimum certain conditions, as follows, must be included in the concession agreement (or whatever form of contract is proposed):

- i) The new owner (s) of the harvesting rights be required to provide sawmills with a minimum guaranteed supply of some 1.5 m<sup>3</sup> of sawlog.
- ii) A fair market price is essential to protect both parties.
- iii) That the supply of sawlogs allows sawmills sufficient commercial freedom to grow their exports.
- iv) That sawmills are allowed to harvest at least 80 per cent of the sawlogs offered for sale.
- v) That the purchaser be required to replant.
- vi) That the management of the TSS is assigned by way of competitive tender to an independent third party.
- vii) Sanctions would be imposed for breaches of the conditions of sale.
- viii) The State would retain the carbon rights to the timber.

If there were price spikes because the concessionaires sought to restrict supply (and secure higher prices) the Minister should be allowed to bring balance to the market through the TSS setting reserve prices reflecting, for example, comparable prices in the UK market place as a benchmark.

ITC would need explicit assurances from Government that such conditions would be enforced. It is acknowledged that competition issues would inevitably arise if the purchaser had conditions of sale attached and private foresters were allowed to sell to the market without any restrictions.

Attaching conditions to the sale of the harvesting rights will depress the sale price. As a consequence, the ITC believes that the sale price of the harvesting rights will fall well short of the mooted valuation of €400m to €600m.

It is assumed in the event that the sale of the harvesting rights to one buyer would be referred to the Competition Authority given the potential for the purchaser to manipulate supply and therefore

price (and profitability) to the detriment of the sawmill sector (but no doubt to the benefit of the new owners' shareholders).

This option has the highest risk for sawmills and is therefore not favoured.

The risks as perceived by the ITC are further exacerbated by the absence of a State policy on the future development of the wider forestry sector.

### **Partial and phased sale of harvesting rights**

An alternative to the full sale of harvesting rights is the option of a partial sale on a phased basis. It is important that a private monopoly is not created.

Based on what happened in New Zealand, several smaller lots, perhaps 20 to 30, based in geographical areas adjacent to sawmills, could be offered for sale by tender over a period of five years for example.<sup>41</sup> The outcome for the New Zealand sawmillers is that the dominant presence of the state in the sawlog market has been eliminated. There is now a competitive log market although some dominant suppliers do wield considerable influence on price and supply.<sup>42</sup>

This option would not have the same potentially disruptive effect on supply and price as the disposal of full harvest rights. It would also allow the sector time to adjust to what will become a new business model.

Under this scenario, only limited conditions of sale would need to be inserted in the concession agreement. As a consequence a higher price might be secured.

Under this scenario the Competition Authority may not be as exercised about potential anti-competitive behaviour.

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<sup>41</sup> The New Zealand Crown Forest Assets Act, 1989 divided the forest estate into 90 units ranging in size from 51 to 132,112 hectares. Each unit was assigned tradable property rights, called Crown Forestry Licences, and contained individual terms and conditions of sale. The advocacy of the New Zealand Timber Industry Association was the primary reason why smaller parcels were sold. Offshore Timber Investment Management Organisations now own almost 50 per cent of the harvesting rights.

<sup>42</sup> Correspondence between the President of the ITC and the New Zealand Timber Industry Federation (November 2012).

## 7. Conclusions

The ITC has major misgivings about the proposed sale of Coillte's harvesting rights as part of the wider EU/IMF privatisation programme not least because the net realisable value will be so small and disproportionate to the negative impacts on the sawmill sector that have been identified.

Furthermore this is an enforced sale with few if any net proven benefits to the Irish economy, the general taxpayers and certainly of no obvious benefit to the forestry or the sawmill sectors.

In addressing the implications of the possible sale of harvesting rights it has become clear to the ITC that regardless of what is decided, the Government needs to publish its forest sector review without any further delay and to announce the measures it intends to take (with a supporting budget and implementation plan) to secure the future of the forestry sector in general and the sawmill sector in particular.

Before any decisions are taken about Coillte's future the Government must stress test the implications of a full or partial sale of harvesting rights in relation to the future commercial viability of the sawmill sector.

In common with other stakeholders affected by the proposed sale, the ITC submits that before publishing the enabling legislation, Government should engage earnestly with those likely to be most affected. To this end, the Government should publish its economic and financial appraisal of the proposed sale, its risk assessment, a cost benefit analysis and the legal opinions to hand about the conditions that must be included should the sale proceed.

Finally, the ITC takes great comfort that Coillte's shareholders, the Ministers of Public Expenditure and Reform and Agriculture, Food and Marine, as well as the CEO of Coillte, have publicly acknowledged that the **sale process (of harvesting rights) would have to include an explicit guarantee of supply to all users and it would be unacceptable to approve a process that did not carry that guarantee.**

This report provides the arguments, evidence and the facts that should inform the Government's decision.