

## EDITORIAL

Dear Reader,

I am very pleased to introduce the first issue of Indufor's Newsletter. During the past five years Indufor's business has been increasingly driven by the emerging markets including Russia, China, Africa and South America.

The expanding consumption of wood products and bioenergy are contributing towards the demand for Indufor's services. Simultaneously, forests have become an asset and an investment area, especially for institutional investors attracted by the low-risk profile of timberland.

In view of these new challenges, our firm is committed to serving the long-term interests of our private and public sector clients.

A good example of one of our recent assignments is Russia, where Indufor has been assisting several entrepreneurs in planning and supporting their investments in wood industry projects. Our services cover feasibility studies, wood procurement plans, forest management plans, certification, marketing plans as well as management and personnel training.



*Forest Roads near Kostamus in Russian Karelia*

From the companies' point of view the learning process of investing in wood industry in Russia has been time well spent. The companies have learnt how to operate successfully in Russia and how to minimise risks when investing in bigger business in the emergence of the wood industry investments.

Another recent example of Indufor's core expertise is in assisting investors and forest companies in plantation development in China. High demand for forest

products, Government efforts to increase forest area, and the re-organization of conventional state forest management towards private management have created need for services in the forest plantation establishment and development, environmental and social impact assessments, forest asset valuations, financial engineering and risk management.

We have had an opportunity to serve our Chinese clients by supporting efficient and effective silvicultural regimes and other efforts that add value to their plantation assets. We have combined our global know-how with local practical experience. So far the results are promising.

This first issue features a brief interview with the new Head of the Forest Industry Team. Two articles discuss the fight against illegal logging and global climate change.

The first article describes how Indufor provides support in combating illegal logging in Indonesia under the EU-Indonesia Forest Law Enforcement, Governance and Trade (FLEGT) Project. Indufor takes great pride in providing technical assistance for this landmark project, which in its part helps to find effective means to combat illegal logging, the root cause of deforestation in many countries.

The second article deals with forests and the climate change. Forests have an important role in combating climate change. They have the ability to sequester carbon dioxide from the atmosphere and serve as renewable carbon storage. In total, the world's forests possess a huge capacity in this respect when sustainably managed. The Stern Review recently concluded that deforestation contributes to global carbon dioxide emissions more than the whole transport sector worldwide.

I hope you enjoy the articles in this Newsletter. Future newsletters will provide you with articles on other current topics in Indufor's other business segments.

*Olli Haltia*  
Chief Executive Officer & Chairman  
Indufor Oy



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## COMBATING ILLEGAL LOGGING IN INDONESIA

**Indufor Oy heads a landmark project turning EU's FLEGT Action Plan recommendations on reducing illegal logging into concrete action in Indonesia. The project consortium implementing the five-year project also includes COWI A/S, Denmark, WWF Indonesia, and Natural Resources Law Institute of Indonesia. The project is expected to provide significant practical experience and lessons learnt which can be adapted in similar future projects elsewhere.**

### LESSONS LEARNT SO FAR

The experience from the first year of the project implementation shows that:

- a) There is genuine interest in improving forest sector governance and reducing illegal activities in forestry. On the other hand, there are also strong forces benefiting from the illegal logging and thus fiercely opposing any change in the *status quo*. To become a success, the project must support the progressive forces.
- b) Some procedures take longer time than anticipated, particularly the establishment of different committees, and procurement arrangements.
- c) Proper introduction of the project to key stakeholders is of utmost importance for any success.
- d) Intensive informal lobbying must precede formal procedures.

### ENVIRONMENTAL AND SOCIAL DAMAGE

Illegal logging results in serious environmental and social damage, and costs the Indonesian government lost revenues every year. It is deeply rooted in the society for a number of reasons, such as widespread vested interests, profitability and slack controls.

Indonesia's forests probably possess the richest diversity and genetic resources of flora and fauna in the world. Illegal logging is a major factor contributing to deforestation and large-scale degradation of the forests.

Illegal logging may also be the cause of a permanent change of the forest microclimate from humid to dry. When the top canopy layer is removed and roads and trails are built in the forest, the combined impact of wind accessing the interior of the forest and the increased radiation of the sun onto the forest floor accelerates the evaporation.

The change in microclimate increases the incidence of forest fires. The fires in peat land forests are particularly difficult to extinguish. Increased forest fires have serious implications to the release of CO<sub>2</sub> into the



*EC-Indonesia FLEGT Support Project brought journalist to observe illegal logging activities in West Kalimantan*

atmosphere. In addition, the restoration of the forest ecosystem may be compromised, because of the delicate balance between the forest based communities' livelihood priorities and the sustainable management of the natural resources.

### EU-INDONESIA FLEGT SUPPORT PROJECT

The objective of the project is to promote the role of forests in the sustainable development of Indonesia by addressing the underlying causes of illegal logging. The Indonesian government, the civil society and the timber industry, are supported in their efforts to achieve sustainable forest management through governance reform, timber legality certification, awareness raising and capacity building.

The project aims at reaching its objectives by 2010 under five project components, which are:

- 1) Improving forest law and its enforcement
- 2) Improving forest governance
- 3) Reducing illegal trade in forest products, and promoting legal trade
- 4) Adoption of appropriate silvicultural systems by stakeholders; and
- 5) Co-ordination of FLEGT activities, liaison among the Government of Indonesia and stakeholders.

*Jozsef Micski, Liaison Manager, EU-FLEGT Project  
Jyrki Salmi, Head of Forest Policy, Indufor Oy*



*Working with local community on conflict resolution in West Kalimantan*

## WOOD PRODUCTS EXPERTISE FROM NORTH AMERICA

**Jussi Silventoinen has recently joined Indufor as Head of the Forest Industry Team. Since he has been consulting the wood product industry in North America, the newsletter team interviewed him regarding the developments there. Here are the highlights of the interview.**

*Recent news about the U.S. economy has been quite bleak. How are the wood product manufacturers faring the storm?*

**Jussi Silventoinen:** The weak housing market has reduced the demand and prices for most wood products and most sawmills and panel plants are currently either losing money or close to cash breakeven levels. Even many of the most competitive mills have taken market related downtime at their mills recently. Several additional permanent mill closures and bankruptcies are likely before the market turns.

*What is the outlook for the industry?*

**JS:** While the short-term outlook is quite uncertain, it is important to keep in mind that the long-term demand outlook in the U.S. is quite favourable due to the strong population growth. Also, wooden housing will continue to dominate the construction markets. However, there is a significant risk that some of the industry segments, such as OSB, will have overcapacity for several years.

*What are some of the things that the North American wood products industry does particularly well?*

**JS:** North American companies have been successful in developing and introducing new engineered wood products. Laminated Veneer Lumber and I-Joints have been well accepted and have been successfully marketed as parts of a structural solution, not just a bulk product. I have been involved in the market development of other new products, such as Oriented Strand Lumber, and I think that some of the new products will have a significant impact in the market within the next five years.

*Indufor has recently gained several wood industry assignments in Russia and China. How does your expertise apply in those markets?*

**JS:** I have had exposure to both countries in my prior work. For example, I am familiar with wood flooring exports from China and with solid wood products made from plantation poplar (a common species in China). In Russia, I have worked with U.S. companies planning to invest in the wood products industry there. While Indufor already has expertise in China and Russia, I can contribute by working with potential investors to these countries from North America. I can also provide expertise on the North American markets for companies in both countries. This will make Indufor's geographic reach in this industry segment truly global.

## ROLE OF FORESTS IN CLIMATE CHANGE

Since the Rio Summit in 1992, the international community has been focusing, among other things, on forests' positive influence on the Earth's climate, given that forests are important storehouses of carbon. Even though forests can be a powerful tool in combating climate change and its effects, in many parts of the world they are being cleared to convert land for agriculture, pasture and mining. They are also constantly being degraded by human ignited fires. These activities release the stored carbon back into the atmosphere, contributing to climate change.

Therefore, we must focus our efforts on promoting projects that promote carbon sinks and address the issues that lead to forest degradation and clearance.

### ACTIONS FORWARD

There are several actions we can undertake to assure that forestry has a positive impact on the world's climate. In this article, we will focus on three: avoided deforestation schemes, afforestation and reforestation initiatives and utilising forest biomass as renewable energy.

#### Avoided Deforestation

Deforestation accounts for about one fifth of annual global emissions, but there are currently no incentives or mechanisms to reward countries to bring deforestation and consequent emissions under strict control.

Sir Stern and other specialists have suggested that curbing deforestation is a highly cost-effective way to reduce emissions if the right policies and institutional structures are in place. Therefore, the global community should focus on developing pilot projects to explore effective approaches to combining national action and international support. The lessons learned will serve as guidelines to policy makers to put in place an international scheme to encourage countries to address the issue.

#### Afforestation and Reforestation

There are several initiatives to encourage countries to reforest their lands.

The 1997 Kyoto Protocol under the United Nations Framework Convention on Climate Change, which has been signed by over 170 countries, encourages the promotion of afforestation and reforestation projects in various parts of the world, including the tropics and temperate zones. The carbon sink generated in a project is then converted into credits, which can be sold on the international markets.

In addition to the Kyoto framework, voluntary carbon markets have rapidly been evolving. They allow for companies, public bodies and individuals to purchase credits from forestry based projects on a voluntary basis. Since these markets have more flexible rules, experts suggest that they currently host the majority of finance flowing into forestry-based mitigation projects.

## Forest Biomass

An alternative way to use forestry to tackle climate change is to exploit its renewable energy potential. Currently, a great number of countries have overlooked the benefits to utilise forest residues to generate heat and electricity. Instead, improper disposal of forest waste from sawmills and wood industries continue generating serious environmental problems.



In order to change this reality, countries should engage in joint projects where they share available technology and contribute to diminishing greenhouse gas emissions. These projects could be undertaken under the CDM or JI frameworks. The difference between these two Kyoto mechanisms is that under CDM projects are agreed between developed and developing countries, and in the case of JI, the project involves only industrial countries.

*Marisa Camargo*  
Social-Environment Consultant, Indufor Oy

## NEWS FROM INDUFOR

➤ This year's Indufor lecture at the Forest Science Day was delivered by *Maryanne Grieg-Gran* on the Economics of Climate Change and Deforestation in Helsinki on 23 Oct. 2007. The Forest Science Day was organised by the Finnish Society of Forest Science. Ms Grieg-Gran's message for the forest sector was that avoiding deforestation, particularly in tropical countries, could be a cost-effective means of reducing greenhouse gas emissions. By paying landowners enough to compensate them for what they would have earned from the land over time if they had deforested it, incentives can be provided for conserving forest.

➤ *Mr. Jussi Silventoinen*, M.Sc. Forest Sciences from the University of Helsinki, joined the Indufor team in September 2007 as the Head of the Forest Industry Team. Previously Mr. Silventoinen worked as a senior consultant in the United States at a wood products consulting company called The Beck Group.



➤ *Mr. Allan Flink*, M.Sc. Forest Sciences from University of Helsinki, and BA Faculty of Arts from University of Helsinki, has been promoted to Forest Industry Consultant specializing in Russia in Indufor's Forest Industry Team. Mr Flink has extensive project experience in Russia. His special fields of competence are forest resources and wood flows in Russia and CIS, investment projects in Russian forest industry and markets of forest products in Russia and Eastern Europe.



➤ *Ms. Marisa Camargo*, MEM from Yale University and LL.M. from Vermont Law School, joined Indufor team in June 2007 to strengthen Indufor's climate change strategies. Ms. Camargo specializes on corporate social responsibility and climate change.



➤ The management of Indufor Ltd, *Olli Haltia, Petri Lehtonen, Jyrki Salmi, Jussi Silventoinen, Anna-Leena Simula*, and *Jukka Tissari*, and 17 Indufor staff members acquired 100% of the shares of Indufor Ltd from Finnmezzanine Fund III A managed by CapMan in September 2007. Indufor, previously owned by the Finnish Savcor Group, was transferred to the ownership of the Fund in March 2007.

➤ Indufor Oy, together with SEK Advisory Services of Sweden and Sustainable Development Services (SDS), Ecuador, won the tendering by the Inter-American Development Bank (IADB) on project "Improving the Business Climate for Forest-Based Investments in Ecuador". The project started in November 2007.

➤ Indufor and ITSU Oy carried out the *ex-ante* evaluation of Finland's National Forest Programme 2015. The results were discussed in a national workshop on 8 November 2007, and the Government is expected to approve the programme in early 2008.

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