



SOUTH AFRICAN FORESTRY COMPANY (SOC) LIMITED

**PRESENTATION TO THE PORTFOLIO COMMITTEE
ON PUBLIC ENTERPRISES
SAFCOL'S DIVERSIFICATION STRATEGY**



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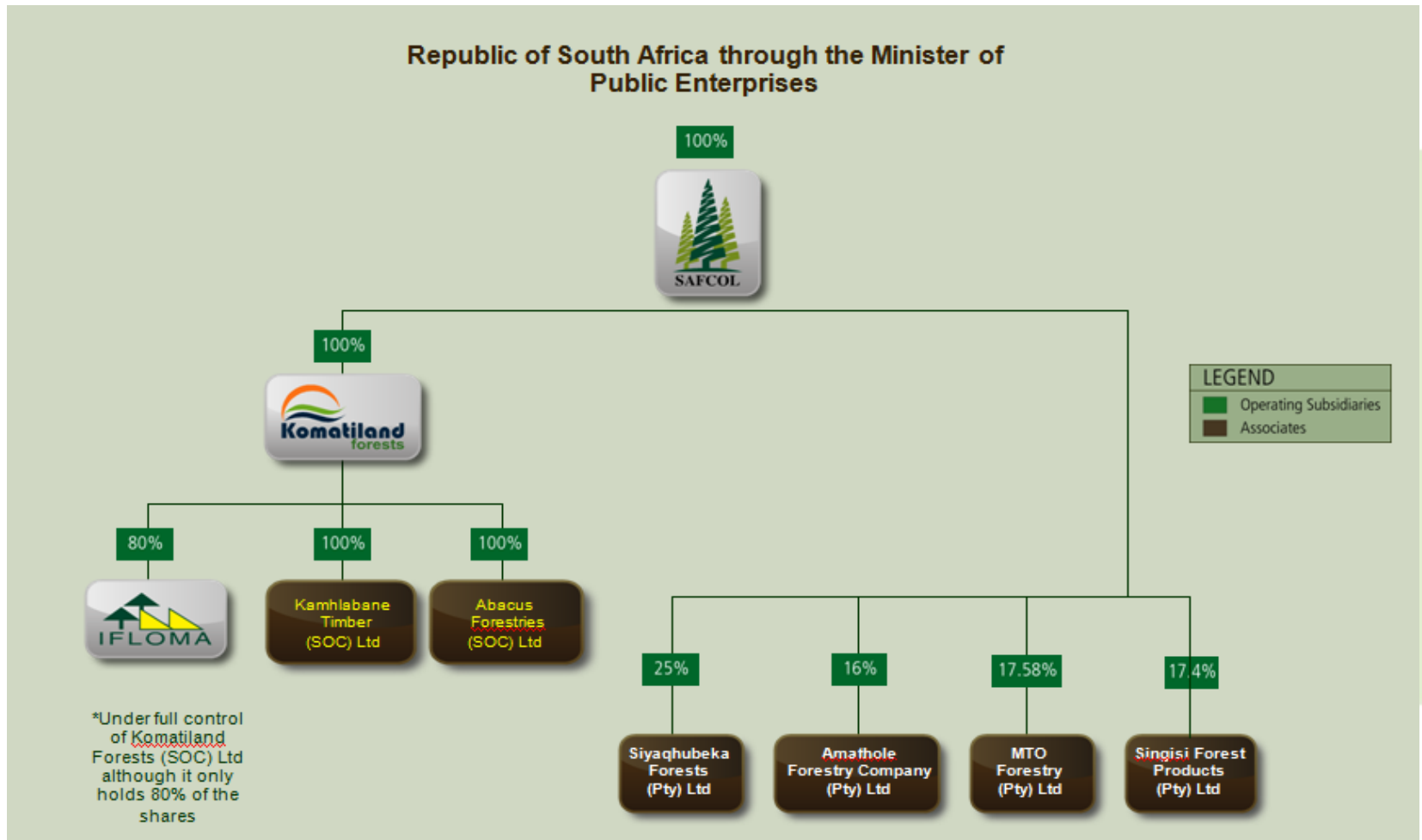
Executive Summary (1/2)

- Total log production by the SA industry is 18.5 million m³ per year, excluding imports.
- SAFCOL harvests around 1.45 million m³ of logs per year sustainably.
- SAFCOL has been over-reliant on the sale of saw logs to the domestic market.
- The domestic opportunity for the supply of logs is somewhat constrained, mainly due to the saturation of the market and depressed prices.
- On the other hand, emerging growth in the construction sector is increasing domestic demand for processed logs or lumber.
- The market in the rest of Africa is also experiencing strong demand for lumber and this market needs to be further developed.
- Furthermore, there is strong demand for high value added products in other export markets such as the EU and Middle East.
- In response to the external environment, SAFCOL's new strategy includes a number of short-term and long-term strategic initiatives to ensure SAFCOL's sustainability.
- These include organisational streamlining, revenue diversification, cost efficiencies, strategic investments to develop new products and socio-economic projects.

Executive Summary (2/2)

- SAFCOL's core competitive advantage is its FSC certified pruned logs which yield a high percentage of clear lumber.
- SAFCOL needs to extract maximum value from its logs and must develop new products through innovation, requiring strategic investments in processing.
- These investments will enable SAFCOL to supply high value clear-wood products to growing export markets over the medium term.
- In addition, SAFCOL is focusing on transformation across the entire value chain. This will bring about socio-economic development and new downstream products.
- Over the short term, new markets need to be developed to supplement the domestic market with a focus on the export of logs and specialised custom cut boards.
- SAFCOL will continue to supply the growing South African lumber market and will pursue further business in the SADC market, including the export of structural lumber.
- An action plan has been developed which is focused on growing existing product sales, new products, driving business efficiencies, transformation, branding, packaging and enhanced distribution channels.

SAFCOL owns 100% of KLF, 80% of IFLOMA and has associate companies, including minority stakes in the privatised forestry packages



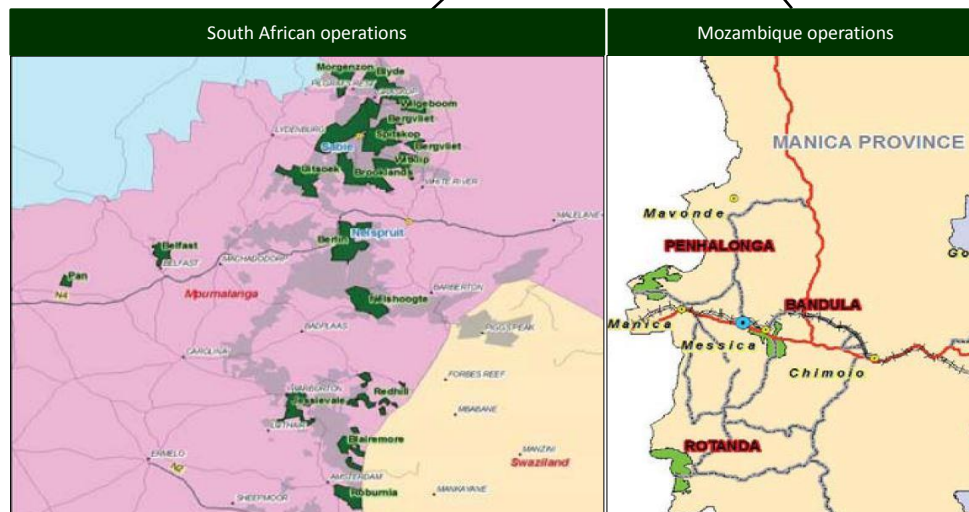
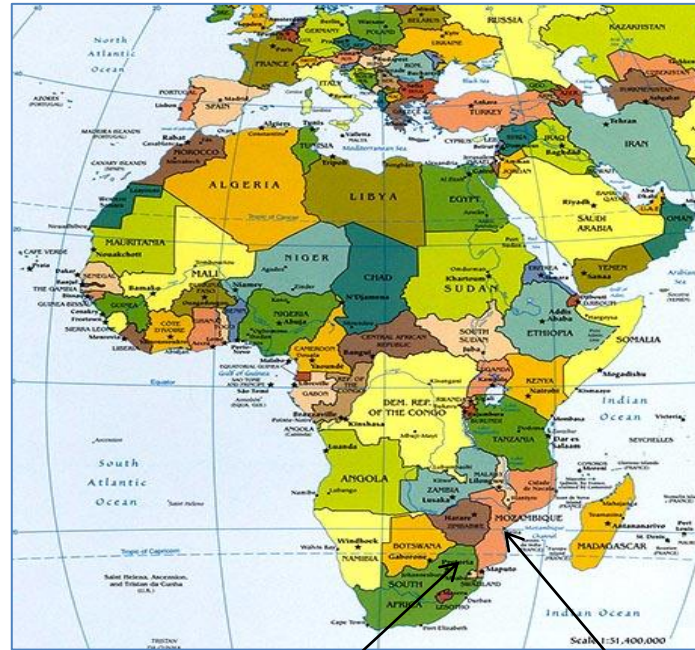
SAFCOL operates in the plantation forestry and wood processing value chain

- SAFCOL's existing operations can be distinguished as:
 - Plantation forest research, development and management.
 - Wood processing.
 - The marketing and sale of plantation forestry and lumber products.
- SAFCOL operates mainly in rural areas
 - Providing opportunities for economic development and community participation.
- KLF manages around 180 000 ha of land:
 - This extends across 18 plantations in Mpumalanga, KwaZulu-Natal and Limpopo.
- Nearly two thirds of the total land is commercially planted:
 - The remaining land is made up of conservation areas, wetlands, grasslands, thickets and indigenous forests.

SAFCOL has milling operations in South Africa and manages plantations in Mozambique through IFLOMA

- KLF's milling operations produce finished products mainly for the construction market.
- The Timbadola sawmill in Limpopo has an annual intake capacity of 120 000 m³.
 - This mill needs to be modernised.
- SAFCOL also contracts privately-owned sawmills for custom cuts.
 - Combined in-take capacity of 150 000 m³ per year.
- The IFLOMA plantations in Mozambique cover a total area of 31 754 ha:
 - 16 238 ha are plantable.
 - SAFCOL has a leasing right for a further 69 000 ha, with 45 000 ha plantable.

SAFCOL's operations are located in three Provinces in South Africa and in the Manica Province in Mozambique

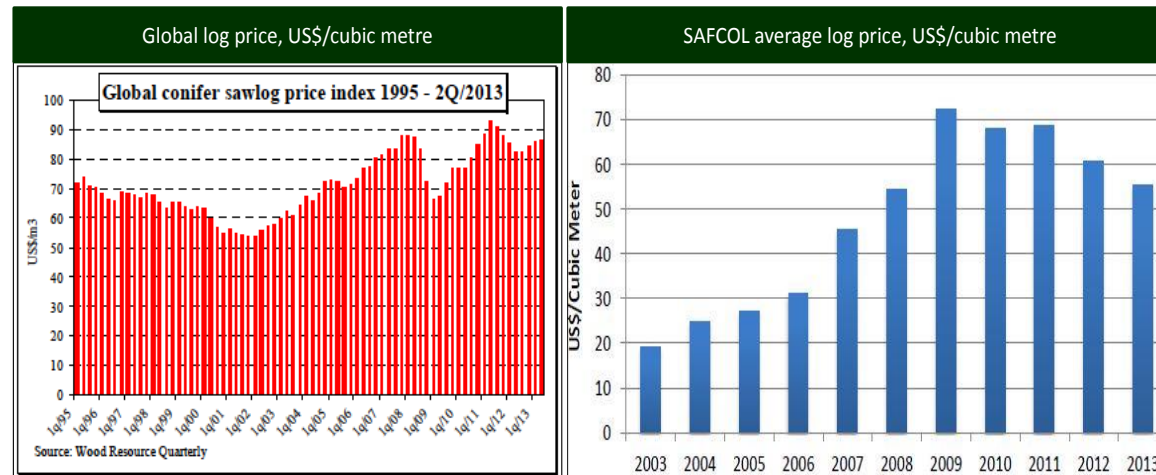


External analysis shows that key priorities need to include investment in plant, as well as enhancing the environmental and socio-economic impact of the SOC

Political	Economic	Social
<ul style="list-style-type: none">• The shareholders expectations of an SOC• Limited funds in National Treasury• Land claims	<ul style="list-style-type: none">• Weakening Rand• Rising unemployment rate• Electricity shortage• The domestic construction market	<ul style="list-style-type: none">• Negative media views of SOCs• SOCs' impact on society (job creation and rural economic development)• SAFCOL brand strength• Education and skill level in the forestry sector
Technological	Environmental	Legal and regulatory
<ul style="list-style-type: none">• Technological innovation (e.g. scanning and cutting equipment)• Competitor advancements in upgrading the technology in their operations	<ul style="list-style-type: none">• Fires• Pests and diseases• Climate change• Water scarcity	<ul style="list-style-type: none">• Industry-specific regulations and policies e.g. . The National Forests Act (1998) and Management of State Forests Act, (Act No. 128 of 1992), Forestry Sector Charter• The Competition Act• National policies e.g. National Development Plan, Industrial Policy Action Plan (IPAP and IPAP2), New Growth Path, Comprehensive Rural Development Programme

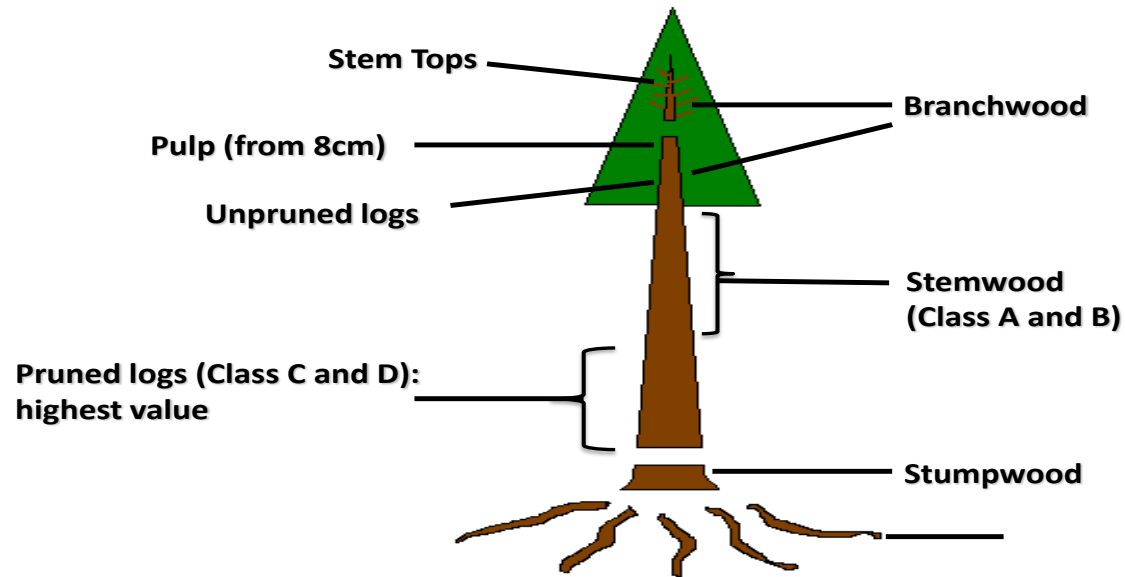
In terms of the market, locally SAFCOL's competitors are vertically integrated and log prices are depressed

- Total log production by the local industry is 18.5 million m³ p.a., excluding imports.
- SA imports 90 000m³ of softwood lumber and 74 000 m³ of plywood per year.
- SAFCOL'S competitors are vertically integrated and have invested in more modern technology.
- There is an oversupply of logs locally due to SAPPI's conversion from pine to eucalypt.
- The domestic market is experiencing depressed prices - prices are far lower than international prices:



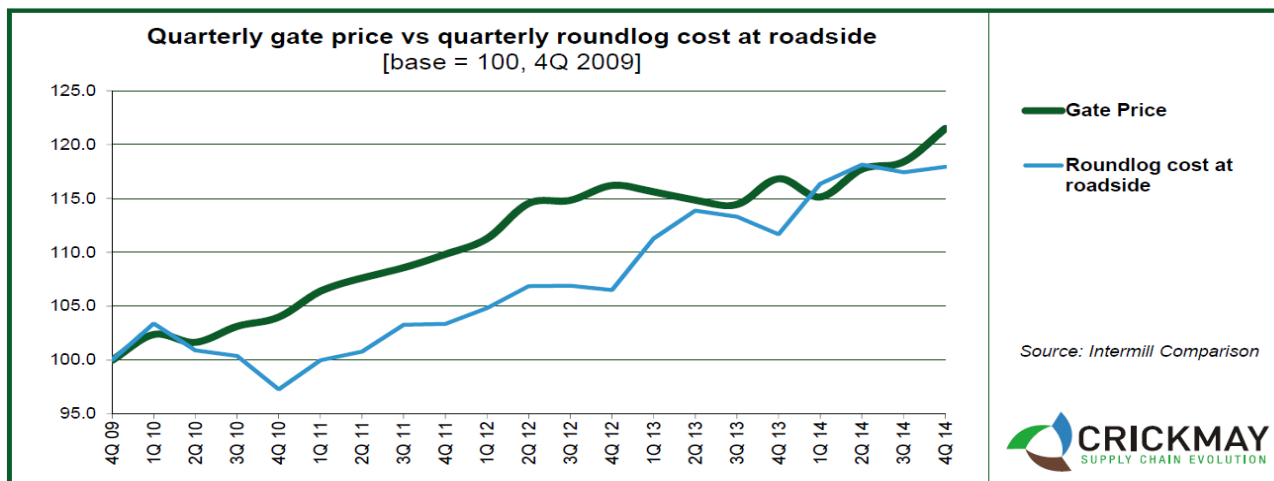
SAFCOL is limited in terms of the log classes it can sell domestically....

- Sawmillers have invested in plant and equipment that uses mainly class B and C logs.
- There is decreased demand for wide diameter pruned logs:
 - This reduces the ability of SAFCOL to sell class D sawlogs and pruned logs
 - The value that has been invested in these log classes over 30 years needs to be realised.



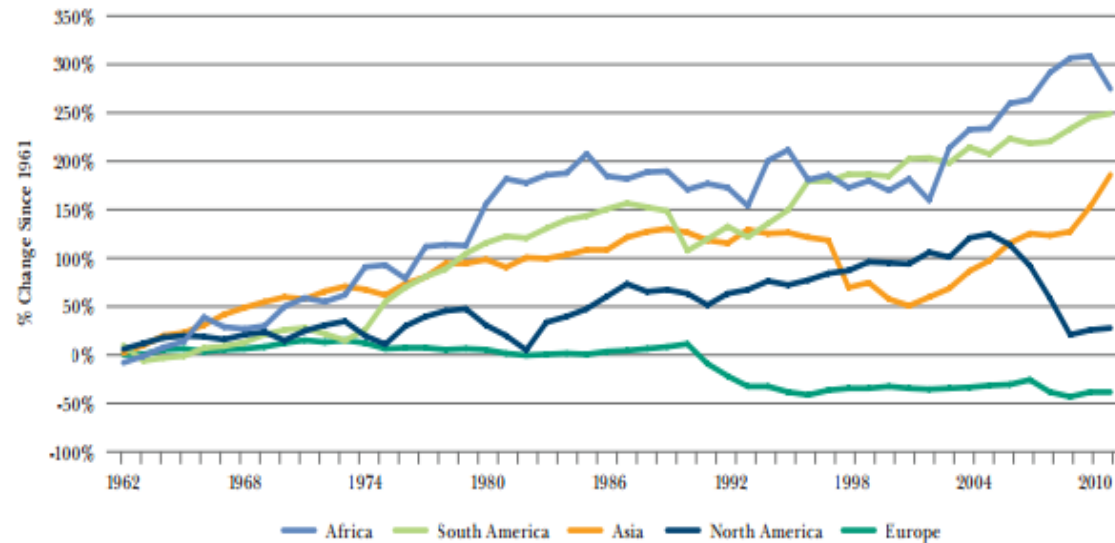
On the other hand, a re-emerging construction sector is increasing demand for lumber

- Selling prices for lumber are slowly increasing after a long period of lateral movement (refer to graph below).
- Lumber market forecasts are optimistic based on increased 'residential building plans passed' and the recent up-tick in demand.



The market in the rest of Africa also represents a solid opportunity for lumber exports

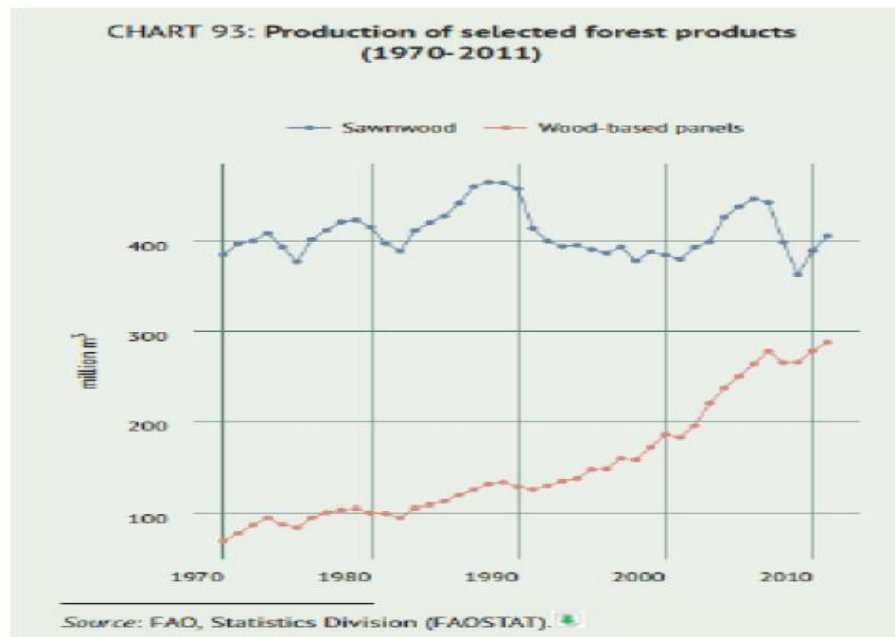
- Economic growth in Africa including infrastructure investments, a rising middle class and a growing construction sector are driving demand for structural lumber and poles (e.g. for telecommunications).
- The consumption of lumber has grown faster in Africa than in other regions of the world during the past 50 years:



Source: Data from FAO—FORESTAT

In addition to exporting logs to India and China, there are opportunities for the export of high value added products

- The data shows strong international market growth in wood based products:



- There is solid market potential for the export of processed and high value added clear wood products to the EU and Middle East - niche market.
- Clear-wood has been sourced from unsustainable plantations in a number of countries and this practice is now being curtailed - key opportunity for SAFCOL.

In summary, SAFCOL needs to modernize its technological base, extract maximum value from its high quality logs and grow exports

Over reliance on log sales

- A log seller is at the mercy of log buyers; during difficult times buyers tap into their own log reserves.
- The cost pressure is always on the raw material since price increases in electricity, fuel and capital are driven by external or mandatory influences.
- Competing against fully vertically integrated companies, when the company is a small player in the downstream market, is difficult due to economies of scale.

Pursuing maximum value extraction from logs and new markets

- Exporting large diameter sawlogs to India and China.
- Growing the sale of smaller log classes (A to C) to meet the demand in the recovering construction sector and the growing DIY market in South Africa.
- Exporting lumber and poles to growing SADC markets, other African countries and Asia (lumber only).
- Strategic investments in modernising Timbadola and establishing a high value add plant in Sabie to extract greater value from logs.
- Pursuing the export of high value clear wood products to the EU and the Middle East.

A SWOT analysis has revealed a number of opportunities available to SAFCOL, but there are areas that require attention

Strengths

- High quality timber grown over a period of 30 years
- FSC certification
- Forestry skills and expertise within the Group
- Research and development capabilities in forestry

Weaknesses

- Focus on sale of primary product with little focus on further processing
- Limited regional and global presence
- Failure to innovate and move beyond traditional markets and products
- Lack of SAFCOL brand awareness
- No model to create market differentiation

Opportunities

- Further processing and value addition
- Targeting the current product range at customers in other regions (exports)
- Implementation of modern technologies in harvesting and processing
- Leveraging NOSA compliance and FSC certification for export markets
- Strategic partnerships in project execution
- Marketing and brand positioning
- Driving innovation through research and development

Threats

- Unresolved land claims
- Land claimants choosing not to partner with SAFCOL
- Labour unrest (such as strike in 2012/13)
- Customer bargaining power
- Strong reliance on contractors in forestry and transport
- Cheap wood product imports
- Overdependence on external saw millers
- Continuous competition commission investigations

SAFCOL's new strategic objectives are based on commercial and developmental imperatives, as well as the needs of customers and stakeholders

Profitability

- Profitability of operations
- Expansion down the plantation forestry value chain e.g. from raw material into processing
- Expansion into activities across the plantation forestry value chain such as energy production and eco-tourism
- Product diversification and expansion into new markets
- Branding and aggressive marketing of products
- Cost management and reduction

Plantation forestry management

- Increasing the contribution of green energy to power operations
- Maintaining FSC certification
- Growing plantation forestry land under management
- Improving productivity in plantation forestry activities

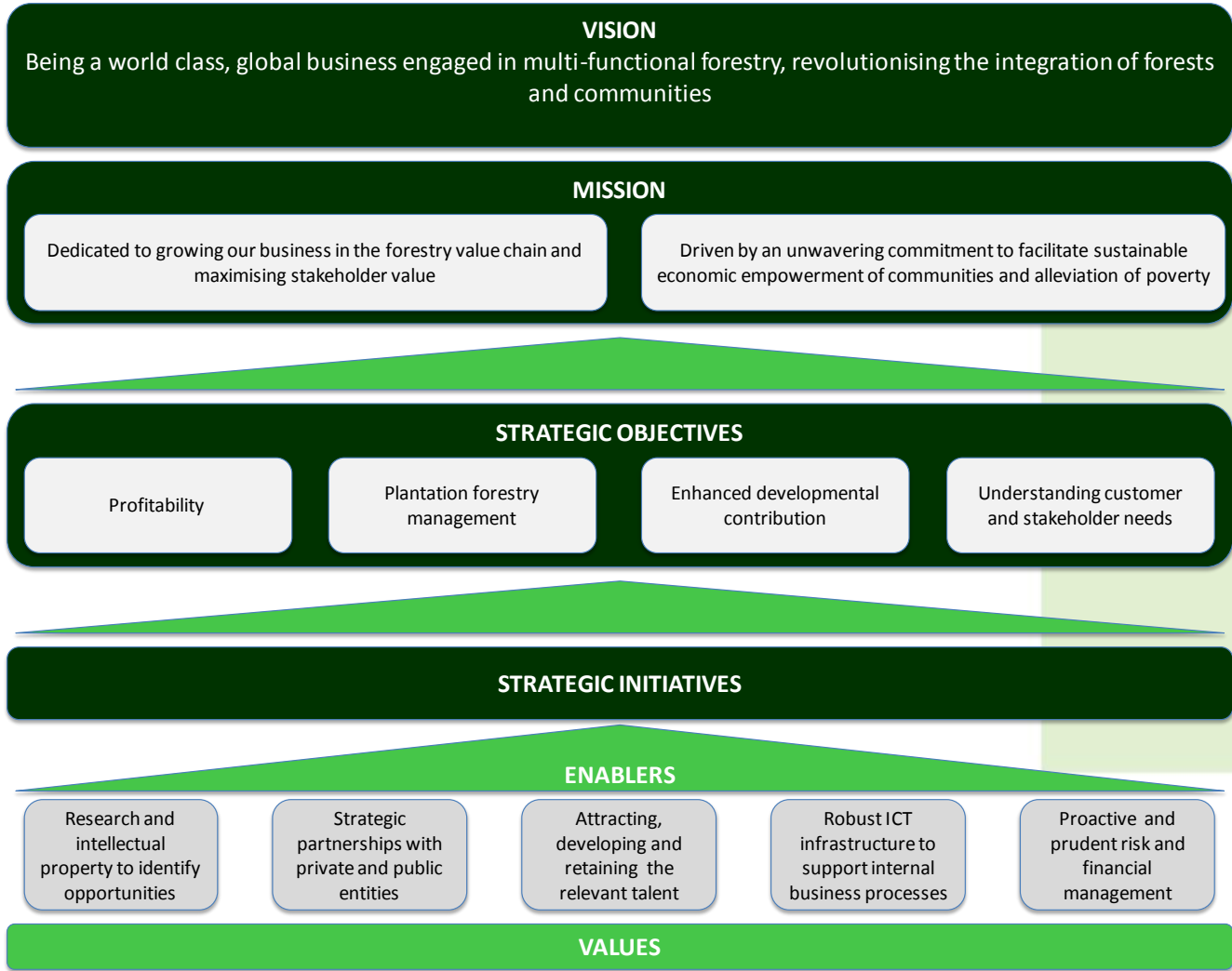
Enhanced developmental contribution

- Training and performance management
- Overseeing rural socio-economic development
- Supporting SMME development
- Actively facilitating land claims
- Adding knowledge to the plantation forestry industry

Understanding customer and stakeholder needs

- Establishing new and enhancing existing strategic partnerships with private and public sector parties for plantation forestry activities
- Proactive customer and stakeholder relationship management
- Effective after sales service

The pursuit of these objectives coupled with planned strategic initiatives will enable the SOC to fulfil its mission and achieve its vision



Planned initiatives over the short-term are aimed at organizational re-alignment, market diversification, cost reductions and optimisation

Initiative	2015/16	2016/17	2017/18	2018/19	2019/20
Short-term initiatives					
Organisational re-alignment Nelspruit office relocation* Streamlining non-core businesses (Disposals, property management and eco-tourism*)	████████████████████	████████████████████	████████████████████		
Revenue enhancement – market diversification Log exports, lumber sales to SADC markets and export of custom produced boards to international markets	████████████████████	████████████████████	████████████████████		
Cost reduction and optimisation SAFCOL cost base reduction* Timbadola upgrade Establishing log merchandising yard and warehouse* Harvesting optimisation	████████████████████	████████████████████	████████████████████		

Note: *New initiatives



SAFCOL can leverage its FSC certified pruned logs which yield a high percentage of clear lumber to create new products and access new markets

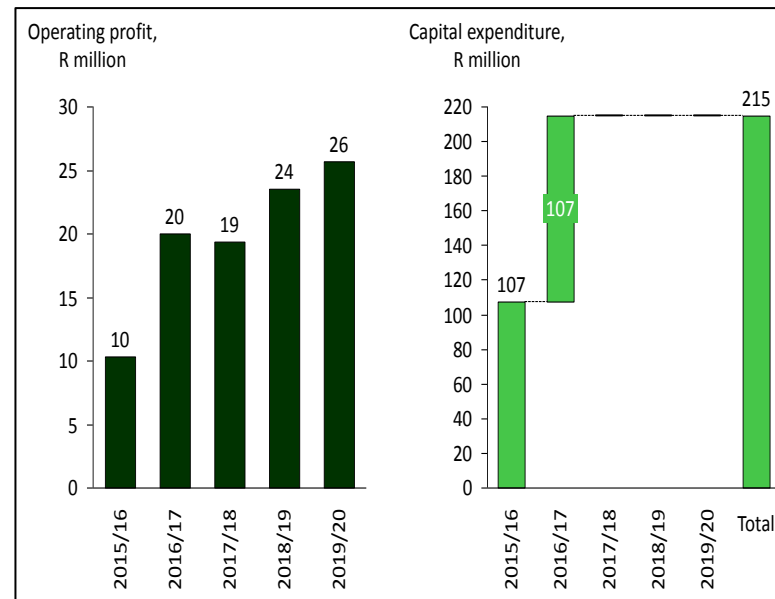
- SAFCOL's sawlogs are sourced from sustainably managed forests.
- The large diameter sawlogs are grown over a 30 year rotation cycle.
 - The company has world class pruning practices.
- This results in large diameter sawlogs that have a knotty core of only 120mm:



- These factors are considered a major competitive advantage and SAFCOL needs to extract greater value from these logs.

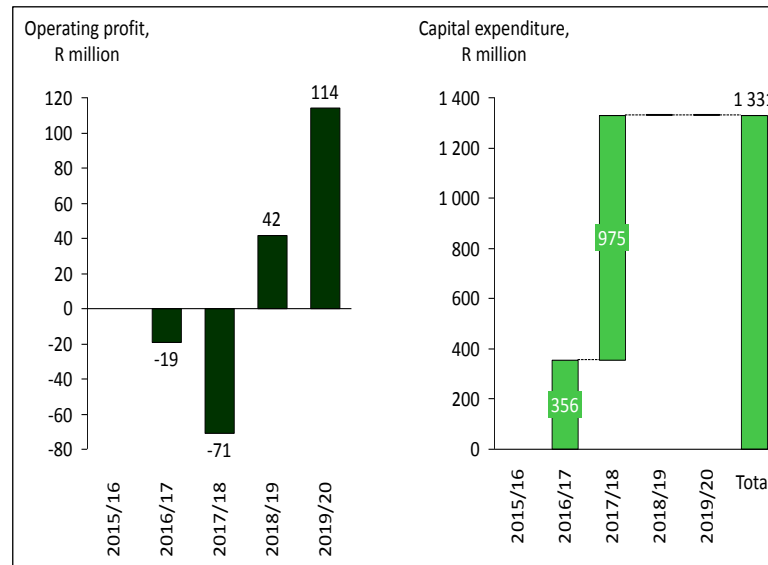
As part of this drive, the Timbadola upgrade is a priority investment that will increase processed lumber and improve profitability

- The modernisation of the Timbadola plant is critical as part of the strategy to extract further value from SAFCOL's sawlogs and increase efficiencies.
- An electricity co-generation plant that will use biomass residuals from the lumber processing facility and certain parts of plantation trees is also planned at Timbadola.
- The co-generation plant will further diversify SAFCOL's portfolio of products.
- The modernised milling plant will increase SAFCOL's profitability:



The planned high value added plant in Sabie is key to the development of new products

- This plant will produce clear wood products coupled with an electricity co-generation plant.
- The total investment in the plant is R924 million and the investment in Co-gen amounts to R407 million.
- There is an expected IRR of 11% and a payback period of between 9 and 10 years.
- Engagements with potential external funders is taking place.



Transformation of the value chain will result in socio-economic benefits as well as new products

- SAFCOL is adopting a holistic approach to transformation across the entire value chain:



- In addition to the employment equity drive, key interventions include:
 - **R&D** - skills development in a specialised/highly skilled area including bursaries and learner-ships.
 - **Procurement of inputs** – aggressive supply chain transformation including procurement and supplier development; black owned enterprises (including women, youth and disabled owned companies).
 - **Plantation management** - using local contractors, labour and skills development programmes for communities as well as workplace training including bursaries, learner-ships and apprenticeships - develops skills for the broader industry.
 - **Harvesting** - local contractors, labour, skills development and community ED projects (e.g. essential oils)
 - **Processing and downstream products** - ED initiatives in key areas (furniture manufacturing, agro-processing and timber-frame manufacturing) and skills development. Around 500 jobs to be created within SAFCOL including 340 skilled jobs as a result of new investments.
 - **Distribution** - using black owned transport and freight companies.
 - **Customers** - supply of sawlogs to small sawmillers including black enterprises.

In addition to new product development, SAFCOL is in the process of leveraging its strengths and diversifying its markets

CORE PRODUCT LINES	TARGET MARKETS	RATIONALE
Large diameter logs (class D logs)	<ul style="list-style-type: none"> SA sawmillers India China 	<ul style="list-style-type: none"> Focus on quality of logs SAFCOL has transport distance advantages to India Temporary lull in Chinese housing market - market expected to pick up again.
Other saw log classes (classes A to C)	<ul style="list-style-type: none"> SA market 	<ul style="list-style-type: none"> Construction sector picking up South African DIY and furniture markets
Softwood Lumber and Poles	<ul style="list-style-type: none"> South Africa SADC market Rest of Africa Asia (lumber) 	<ul style="list-style-type: none"> RSA market will continue to grow Weak Rand will also keep imports at bay SADC construction market growing SAFCOL to focus on product quality
High value clear wood products	<ul style="list-style-type: none"> Middle East and EU 	<ul style="list-style-type: none"> SAFCOL has a sustainability advantage – logs sourced from FSC certified forests SAFCOL can use the EU Free Trade Agreement to gain further advantage
Electricity co-generation	<ul style="list-style-type: none"> SA: off-take agreement with Eskom needed 	<ul style="list-style-type: none"> SAFCOL has a large renewable biomass resource

The marketing strategy includes a focus on driving business efficiency, branding, packaging and new marketing channels

- The **merchandising yard and log warehouse** will lead to greater supply chain efficiencies, including improved stock management.
- A branding campaign will be launched:
 - Focussing on SAFCOL's high quality sustainable products and its strong community development focus e.g. SAFCOL's lumber is used to build schools.
- The branding of certain lumber with a **"SAFCOL super-grade"** label will be explored.
- Digital marketing channels to end users will be investigated.
- New product packaging will be developed as part of the branding effort:



An action plan has been developed to ensure sustained implementation of the diversification strategy (1/2)

Action	Status
Existing product lines	<ul style="list-style-type: none"> • Market development for China and India underway: <ul style="list-style-type: none"> • Potential export of logs in 2016. • Highveld operations: <ul style="list-style-type: none"> • Continue with Custom Cut arrangements for the foreseeable future. • In-take volume target of 150 000 m³; significant strides made in achieving target. • Export of specialised custom cuts - 2015. • Increase domestic lumber sales - 2015. • Further access to SADC markets and rest of Africa - over the next 2 years.
New product lines	<ul style="list-style-type: none"> • Timbadola upgrade: <ul style="list-style-type: none"> • Already implemented parts of strategy - new intake volume; record achieved in 2015. • Co-generation feasibility at advanced stage. • Finalising PFMA application with Funding Plan. • Discussing possible co-operation with China FOMA. • Production from upgraded plant - 2017. • Sabie complex: <ul style="list-style-type: none"> • Pre-feasibility study has been done, includes downstream products and co-gen. • Full feasibility study to be done as a priority. • Discussing possible co-operation with China FOMA. • Production of high value products in 2018 and electricity co-generation in 2019. • Pole production: <ul style="list-style-type: none"> • Currently selling all raw material to 3rd parties. • Interaction with potential JV partners for possible pole and treatment plant. • Products from commercial ED programmes - furniture, agro-processing and timber-frames: <ul style="list-style-type: none"> • Programme has commenced - results over the next 3 years.

An action plan has been developed to ensure sustained implementation of the diversification strategy (2/2)

Action	Status
<p>Organisational streamlining, operational efficiencies and transformation</p>	<ul style="list-style-type: none"> • Closure of Nelspruit office: <ul style="list-style-type: none"> • Discussed with personnel in Nelspruit. • Option investigated – Swartfontein. • Architect had first site visit. • IFLOMA business in Mozambique: <ul style="list-style-type: none"> • Feasibility study on expansion opportunities completed. • Asset in Mozambique under review. • The SAFCOL board is communicating with the shareholder on plans. • Mechanised harvesting and tree merchandising: <ul style="list-style-type: none"> • Internal discussions have commenced. • Existing Mechanised harvesting operations are running well. • Teething problems have been addressed. • Transformation programme focussed on the entire value chain underway.
<p>Product branding & pricing</p>	<ul style="list-style-type: none"> • Define key brand - first quarter 2015/16. • Develop new product packaging - second quarter 2015/16. • Launch branding campaign through marketing channels - 2015/16. <ul style="list-style-type: none"> • Target local DIY market and selected export markets. • Ensure correct price points - 2015/16. • Establish enhanced after-sales service. <ul style="list-style-type: none"> • Potential call centre - 2016/17.
<p>Distribution channels</p>	<ul style="list-style-type: none"> • Investigate and establish digital marketing channel - April 2016. • Establish merchandising yard and log warehouse - over the next 2 years.



Thank you

Good standing- FSC Certified

Sustainable and looking at new growth opportunities