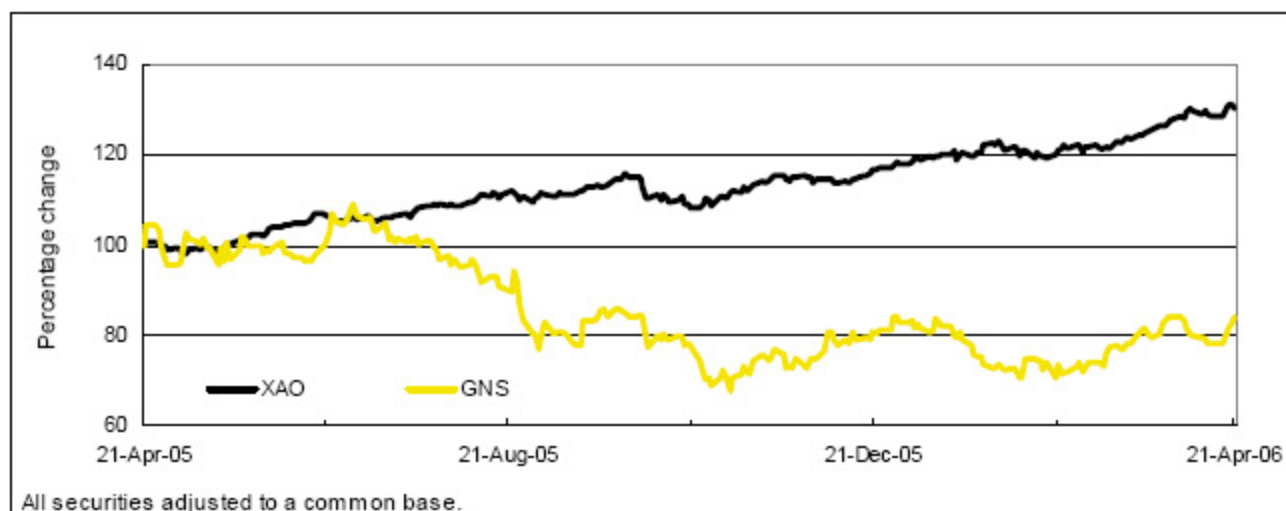


Point of view

Relative share price movements: the All Ords and Gunns Limited



Shift to plantations is causing Gunns' woodchip export volumes to fall

Gunns (GNS) is a forest products company located in Tasmania. The majority of its earnings and revenue comes from processing hardwood timber into woodchips and sawn timber. Most of Gunns' woodchips are exported to Japan.

Gunns reported a 20% fall in woodchip sales volumes in its first-half results in February. Gunns' management suggested that "external factors" such as the high Australian dollar and limited shipping capacity were to blame for the sharp decline in woodchip volumes.

We believe that neither of these factors is responsible for Gunns' falling woodchip volumes. There is a more fundamental problem: Gunns is losing market share to plantations.

There is evidence that Japanese paper manufacturers are shifting away from native forest woodchips to plantation woodchips. Plantation woodchips have a higher fibre content, lighter colour, and more consistent quality. In addition, environmental lobbyists have placed pressure on Japanese paper manufacturers to cease purchasing woodchips from old growth forests.

As plantations continue to mature in Australia, the supply of plantation woodchips will increase substantially. Japanese importers of hardwood woodchips will increasingly have a viable alternative to buying Gunns' native forest woodchips. Gunns' share of the woodchip export market will continue to fall.

Gunns' own hardwood plantations can provide only limited protection against this loss of market share. Gunns' plantations will not reach maturity until at least 2009. Further, Gunns will be competing against a number of large plantation developers, with no real competitive advantage.

Gunns plans to build a \$1.4 billion pulp mill in Bell Bay, Tasmania. Gunns' declining position in the woodchip export market makes investment in a pulp mill necessary, as the pulp mill will provide a market for Gunns' woodchips. However, the pulp mill is an extremely risky investment and the shift to selling pulp on the global market will increase the volatility of Gunns' earnings.

Gunns' proposed pulp mill will not be operational until 2009, if it goes ahead at all. Loss of market share of woodchip exports will, however, continue to weigh on Gunns' earnings over the next two years at least.

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