

Original Research Article

INVESTMENT ANALYSIS OF MEDIUM SCALE PRIVATE FOREST PLANTATION DEVELOPMENT IN OYO STATE

ABSTRACT

Forest and non-forests products are becoming scarce in Nigeria due to insatiable wants of the resources by the people. The performance of public sector forest plantation development in Nigeria has fallen short of expectations of various stakeholders, hence, the need for investment in Private Forest Plantation Development (PFPD), fostered towards increasing wood supply and reducing the pressure on natural forest. Consequently, investment analysis of medium scale PFPD was investigated to show feasibility of the investment. Measures such Net Present Value (NPV), Benefit Cost Ratio (BCR), Internal Rate of Return (IRR), Annual Equivalent Value (AEV), Land Expected Value (LEV), Return on Investment (ROI) and Discounted Payback Period (DPBP) were used to analyse the cash flow statement of the investment.

The study showed that medium scale of *Tectona grandis*, *Gmelina arborea*, with few *Terminalia spp.* plantation of 20ha with 18 year rotation had NPV of ₦1,504,841.70, BCR of 1.35, IRR of 24.03%, AEV of ₦316,016.76ha⁻¹, LEV of ₦2,186,997.89ha⁻¹, ROI of 35% and DPBP of 17.7years. The results showed that the investment is feasible based on economic returns indices. It is recommended that PFPD should incorporate multiple land use systems and apply appropriate silvicultural techniques in order to maximize the net return.

Keywords: Private investment, Cashflow, Investors, Forest stakeholders, Sustainable forest development

1. INTRODUCTION

The rapidly growing demand for forest products and non-forest products for industries, companies etc. are major factors contributing to decline in forest cover in African's natural forests [1]. According to the report of [2] the demand for wood raw material by industries in recent times in Nigeria has outstripped the production capacity of the forest. Nigeria's natural forest has been overexploited without adequate conservation and the depletion is as a result of urbanisation, industrialisation and, above all, human population growth. Thus, there has been a large gap in the supply-demand trend of the wood-based industries for wood raw material because of the inability of the forests to sustain the industries.

Afforestation and reforestation started in 1914 in Nigeria, and it was directed against desertification [3]. However, the oldest plantation recorded was that of Olokemeji Forest Reserve, near Ibadan, which was established in 1929; other plantations were later raised in 1936 in Ilorín Native Authority Forest Reserve. In addition, large scale planting of species was undertaken at Iwopin, Ogun State with the primary aim of providing raw materials to service the Nigeria pulp and paper mills in Niger and Ogun States. Federal government secured a loan from the World Bank in 1979, under Forestry 1 project to establish 25,000 hectares of forest plantation for the pulp and paper industry. Forestry 1 project was a success, which made the World Bank to advance another loan of US \$72 million for Forestry II project [4]. Furthermore, African Development Bank (ADB) was contacted for a continuation loan to proceed with the project towards the end of the World Bank loan in 1987. The loan was granted and became effective from 1989. [5] reported that by the end of the ADB assisted portion of the project around 1995/96, the project had established 23,130 hectares of plantation and only *Pinus spp*, *Tectona grandis* and *Gmelina arborea* were widely cultivated [6].

Nonetheless, [7] observed that after the end of the foreign financial assistance which include World Bank and ADB, the forestry sector in Nigeria became largely dependent on public funding. Incidentally, public funding of forest projects and programmes in Nigeria has been inadequate and untimely at both Federal and State government levels. Besides, studies have shown that the funded forest plantation projects has been invaded by crude exploitation and exported out of the country at a scandalous rate without any thought of reforestation

programme. Consequently, there is need for private investment in forest plantation development in the country.

Forest plantation development has the capacity of increasing wood supply and stemming the pressure in the natural forests in Nigeria [8]. It also contributes substantially to the economic, social and environmental development of country. Studies have documented that forest plantations are relatively simple production systems, typically even aged monocultures, with the capacity to produce wood yields many times greater than natural forest. Hence, private investment in forest plantations is an important means to sustainably mobilize forest resources for meeting the needs of the people. Similarly, assessing investment analysis is very important in forest plantation development because it helps forest stakeholders, policy makers and potential private investors understand and determine whether the investment make sense in terms of profitability and also help in determining where improvements could be made to increase the returns on investment.

According to [9] investment returns of forest plantations are indeed an important concern around the world. Appraising investment returns ensure that projects are using scarce capital well and meet the minimum economic standards expected by forestry communities and landowners, foreign aid donors, and technical assistance groups. It can also help identify which benefits are more valuable to society and local communities, which is useful for forest policy decisions, such as developing forestry programs for local communities, helping produce goods and services efficiently, making payments for environmental services, and helping conserve valuable ecosystems and community welfare. NPV, BCR, IRR and other measures were often used as indicators for assessing investment returns of forest plantations [10].

However, in Nigeria, investment analysis is one task that forestry professionals and private forest plantation owners in the country fail to undertake. There is little or no information on investment analysis done to show the feasibility in forest plantation development. In the absence of such facts, forest plantation investments have so far been undertaken without a critical look at efficiency and profitability issues. Therefore, this study assesses the investment analysis of medium scale private forest plantation in order to help forest industry, stakeholders and academics learn more about the opportunities in forest plantation investment and inform relevant policy makers and investors about economically sound forest plantation development.

2. METHODOLOGY

2.1 Study Area

Oyo state covers approximately an area of 28,454km². The state is located in latitude between 6°55' and 8°45'N and between longitude 2°50' and 3°56'E in southwestern Nigeria. The projected population of the state in 2011 was 6,596,392 in 2011 [11]. Average daily temperature ranges between 25⁰C and 35⁰C, almost throughout the year while the annual rainfall ranges from 1000 mm to 1500 mm with well drained and rich ferruginous tropical soils which favours production of crops. Oyo state had about 41.2% forestland area in 1978, but this diminished to 27.7% (783,221 ha) in 1995 as reported by [12].

2.2 Grouping of Forest Plantations

This study for the purpose of easy grouping of forest plantation sizes, adopted and modified [13] classification of private forest plantations into, between 0.5 ha and 3.99 ha as small; between 4 ha and 19.99 ha as medium and 20 ha and above as large. Thus, forest plantations of less than 5 ha (0.1 - 4.99), between 5 ha and 29.99; and 30 ha and above were classified as small, medium and large forest plantations for this study.

2.3 Location of Forest Plantation

The forest plantation covers a land area of 20 hectares, located in Erin Omu, Kajola, Oyo State.

2.4 Analytical Procedure

Analysis was carried out by critically assessing the cost and benefits associated with private forest plantation development in the study area. Major elements examined include the Net Present Value (NPV), Benefit Cost Ratio (BCR), Internal Rate of Return (IRR), Annual Equivalent Value (AEV), Land Expectation Value (LEV), Return on Investment (ROI), and Pay Back Period (PBP) of the investment. Hence, profitability of forest plantation investment was known using investment formulas to determine if the investment is profitable, economically efficient and socially acceptable.

2.5 Specification of Financial Analysis

The Net Present Value (NPV)

NPV is essentially the difference between the sum of discounted benefit and the sum of the discounted cost. The Net Present Value (NPV) converts a series of recurring revenue streams

into a single number that can be used to compare mutually exclusive investments at a given discount rate (cost of capital). For single investment decisions, positive NPVs indicate that the project is feasible [14]. The project with the highest positive NPV is usually considered most feasible and recommended. In the economic sense, it is the NPV that gives an indication of the investment activity to satisfy the given rate of discount (interest on capital) and still yields surplus income [15].

NPV can be written in equation form as:

$$NPV = \sum_{t=0}^{t=n} \frac{R_t}{(1+r)^t} - \sum_{t=0}^{t=n} \frac{C_t}{(1+r)^t} \dots\dots\dots Eqn.1$$

Where

- NPV = Net Present Value
- R_t = revenues in each year n,
- C_t = costs in each year n,
- r = discount rate,
- n = an index for years and
- t = number of years of discounting.

Benefit Cost Ratio

The benefit cost ratio is useful in allocating a fixed sum of money between different investment alternatives. The benefit cost ratio is used to compare total discounted benefits with total discounted costs [14]. If the benefit cost ratio for an investment project is one or greater, the project is feasible and acceptable. The criterion can be written in an equation form as

$$B/C = \frac{\sum_{t=0}^{t=n} \frac{Bt}{(1+r)^t}}{\sum_{t=0}^{t=n} \frac{Ct}{(1+r)^t}} \dots\dots\dots Eqn .. 2$$

- Bt = Benefits (revenue) in each project year
- Ct = Costs in each project year
- n = Duration of the project in years
- r = Discount rate
- t = Number of years of discounting

Internal Rate of Return (IRR)

This is the discount rate at which net present value of the project equals zero (NPV = 0). The Internal Rate of Return (IRR) is also defined as the discount rate that makes the present value of project revenues equal the present value of project costs. For individual investments, the IRR is usually compared to any alternative rate of return [14]. It is often times referred to in forestry as financial yield or economic rate of returns. The IRR is widely used and widely preferred because it is a better reflection of the productivity of capital in an investment [16]. It can be expressed as follows:

$$IRR = \sum_{t=0}^{t=n} \frac{R_t}{(1+r)^t} - \sum_{t=0}^{t=n} \frac{C_t}{(1+r)^t} = 0 \dots \text{Eqn.3}$$

IRR can be obtained either by calculation or by iterations which involve the use of different discount rates by trial and error. Two interest rates, one at which the NPV is positive, and the other one at which NPV is negative, need to be selected to calculate IRR. The discount rate between the two NPV which is equal to zero is the IRR.

IRR can be approximated by using the following formula:

$$IRR = \text{Discount rate resulting in the last positive NPV} + \left[\text{Difference between the two discount rates} \times \frac{\text{positive NPV}}{\text{incremental NPV}} \right] \dots \text{Eqn 4}$$

Annual Equivalent Value

AEV is useful for comparison to other investments that have an annual return, such as agricultural crops. Annual equivalent value is an indicator that expresses NPV in annual equivalents distributed equally over the years of the lifespan of the investment. Since AEV is calculated based on NPV, it is positive when NPV is positive and negative when NPV is negative. Annual equivalent value is useful in an agroforestry context because it allows for comparing alternatives on an annual basis, which is particularly helpful when comparing long-term tree investment with annual agricultural crop production [17]. The formula for calculating AEV is as follows:

$$AEV = NPV \left[\frac{r(1+r)^t}{(1+r)^t - 1} \right] \dots \text{Eqn 5}$$

Land Expectation Value

Land Expectation Value (LEV) is a financial tool used as an estimate of the value of a tract of land for growing timber and when calculating it the land cost is not included [18]. Thus, the LEV can also be used to establish the value of a specific land parcel based on costs and revenues associated with both tree and agricultural production. In this case, the LEV is interpreted as the maximum amount of money a land user can pay for the land and still earn the minimum acceptable rate of the return on the investment. LEV for timber production is calculated assuming the land will be used to produce a perpetual series of even-aged or uneven aged stands; each stand in the perpetual series is assumed to have the same revenues and costs that are projected for the first rotation or the first cutting cycle.

$$LEV = \frac{NPV (1+r)^t}{(1+r)^t - 1} \dots\dots\dots Eqn 6$$

Return on Investment or Rate of Return on Investment

The return on investment formula is mechanically similar to other rate of change formulas. It measures percentage return on a particular investment.

$$ROI = \frac{TR - TC}{TC} \times 100\% \dots\dots\dots Eqn 7$$

TC = Total Revenue

TR = Total Cost

Payback Period

Payback period refers to the period of time required to recoup the funds expended in an investment, or to reach the break-even point [19]. Payback period intuitively measures how long something takes to "pay for itself." Payback period is the time in which the initial cash outflow of an investment is expected to be recovered from the cash inflows

The formula to calculate payback period of a project depends on whether the cash flow per period from the project is even or uneven. In case they are even, the formula to calculate payback period is:

$$Payback\ Period = \frac{Initial\ Investment}{Cash\ Inflow\ per\ period}$$

When cash inflows are uneven, we need to calculate the cumulative net cash flow for each period and then use the following formula for payback period:

$$\text{Payback Period} = A + \frac{B}{C}$$

A is the last period with a negative cumulative cash flow;

B is the absolute value of cumulative cash flow at the end of the period A;

C is the total cash flow during the period after A

3. RESULTS

In Oyo State, relevant information on timber prices by product sizes /species were gathered through personal contacts with private forest plantation owner and the price of a tree at the time (girth from 0.8m and above) was ₦8000.

It is important to note that in a hectare of land, 1600 seedlings are used.

1 Hectare = 100 m x 100 m

Escapement = 2.5m x 2.5m (Standard spacing)

Total number of seedlings per hectare is derived as follows:

$$\frac{1 \text{ hectare}}{\text{spacing for planting teak seedlings}}$$

$$\frac{100m \times 100m}{2.5m \times 2.5m}$$

$$= 1600 \text{ seedlings}$$

Total number of seedlings per hectare = 1600 seedlings. 1600 seedlings represent the full stock per hectare of land

However, the forest plantation owner planted 1200 seedlings per hectare. Thus, 1200 trees per hectare are expected to be harvested from the forest plantation at the end of 18 year rotation.

Total trees from the plantations = 1200 trees x 20 hectares = 24000 trees.

Projected revenue for the forest plantation is therefore, 24000 x 8000 = ₦ 192,000,000.

Also, ₦ 500 is assumed to be used to harvest and transport a tree. Therefore, the total projected cost of harvesting and transporting 24000 trees is equal to ₦500 x 24000 = ₦12,000,000.

Table 1a: Medium Scale Forest Plantation's Cashflow for a 18 year Rotation Plantation

Year	Items	Cost (₱)	Revenue (₱)	NPV	r (23.44 %)	D.C	D.R	DNPV (23.44%)	DNPV (25%)
1	Land Survey, demarcation, land clearing and preparation, seedlings, pegs and pegging, planting.	2830000		-2830000	1	2830000		2830000	2830000
2	Cleaning, application of fertilizer, beating up Planting activities Planting exercise Tending& maintenance Monitoring supervision	559070		-559070	0.69	385758.3		385758.3	357804.8
3	Cleaning, beating up Tending& maintenance Monitoring supervision	320000		-320000	0.58	185600		185600	163200
4	Tending& maintenance Monitoring supervision	280000		-280000	0.48	134400		134400	114800
5	Monitoring&supervision	280000		-280000	0.40	112000		112000	92400
6	Monitoring&supervision	280000		-280000	0.33	92400		92400	72800
7	Monitoring&supervision	120000		-120000	0.28	33600		33600	25200

Table 1b: Medium Scale Forest plantation's Statement of Cashflow for a 18 year Rotation Plantation

Year	Items	Cost (₦)	Revenue (₦)	NPV	r (23.44 %)	D.C	D.R	DNPV (23.44%)	DNPV (25%)
8	Monitoring&supervision	120000		-120000	0.23	27600		27600	20400
9	Monitoring&supervision	120000		-120000	0.19	22800		22800	15600
10	Monitoring&supervision	100000		-100000	0.16	16000		16000	11000
11	Monitoring&supervision	100000		-100000	0.13	13000		13000	8600
12	Monitoring&supervision	100000		-100000	0.11	11000		11000	6900
13	Monitoring&supervision	100000		-100000	0.09	9000		9000	5500
14	Monitoring&supervision	100000		-100000	0.07	7000		7000	4400
15	Monitoring&supervision	100000		-100000	0.06	6000		6000	3500
16	Monitoring&supervision	100000		-100000	0.05	5000		5000	2800
17	Monitoring&supervision	100000		-100000	0.04	4000		4000	2300
18	Harvesting and transportation cost Timber	12000000		+18000000	0.03	360000	5760000	5400000	3240000
Total		192000000				4255158.3	5760000	1504841.7	-497204.8

Net Present Value

$$\text{NPV} = 5760000 - 4255158.3$$

$$= \text{₦}1,504,841.7$$

Benefit Cost Ratio

$$\text{BCR: } = \frac{5760000}{4255158.3} = 1.35$$

Internal Rate of Return

To calculate IRR, NPV must be negative. Since the NPV for this investment is positive, there is need to increase the discount factor to get negative NPV. Therefore, at 25% discount factor, NPV = -497204.8 and the last positive NPV = 17204.5 at 24% discount factor. The difference between the two discount rates is $25 - 24 = 1$

$$\text{IRR} = 24 + \left[1 \times \frac{17204.5}{497204.8 + 17204.5} \right]$$

$$\text{IRR} = 24 + [1 \times 0.03]$$

$$= 24 + 0.03$$

$$= 24.03\%$$

Annual Equivalent Value

$$= 1504841.7 \left[\frac{0.2(1+0.2)^{18}}{(1+0.2)^{18}-1} \right]$$

$$= 1504841.7 \times 0.21$$

$$= \text{₦}316,016.76\text{ha}^{-1}$$

Land Expectation Values

Land rent is 600000

$$\text{NPV without rent} = 5760000 - 3655158.3$$

$$= 2,104,841.7$$

$$\text{LEV} = \frac{2104841.7 \times 26.62}{25.62}$$

$$= 25.62$$

$$= \text{₦}2,186,997.89\text{ha}^{-1}$$

Return on Investment or Rate of Return on Investment

$$\text{Discounted ROI} = \frac{\text{Net Present Value}}{\text{Present value of cost}} \times 100$$

$$= \frac{1504841.7}{4255158.3} \times 100$$

$$= 0.35 \times 100$$

$$= 35\%$$

Payback Period

$$\text{Discounted Payback Period} = A + \frac{B}{C}$$

$$17 + \frac{3635158.3}{5400000}$$

$$17 + 0.67$$

$$\approx 17 \text{ years } 8 \text{ months}$$

N.B. A huge capital was expended at the initial stage of investment and no revenue was generated until the end of year of rotation. Hence, initial outlay will never be fully paid until the end of rotation when the investment will yield returns.

4 DISCUSSION

The forest plantation was established in 1999. The species planted were *Tectona grandis* and *Gmelina arborea* and the purpose of establishment was for timber production. The forest plantation has not been harvested at the time of this study, so the revenue from the investment, harvesting and transportation cost for 18 year rotation period were projected. Also, the lending rate of 1999 in Nigeria (20.29%) was used in this study [20].

The study revealed that because of the long production (and rotation) period timber prices can be affected by inflation and other factors in the country. As years goes by, the cost of silvicultural practices (tending and maintenance) reduces, but the prices of timber and labour are not equal throughout the production period and it is difficult to calculate them precisely. Due to various limitations of long term production, there was projection of prices for timber, silvicultural and administrative cost used. Corroborating this is the report of [14] which

stated, prices in financial analyses are based on current market prices, historical data, or future projections and changes. The study further stressed that when using this financial prices for forestry project, the changes should be small enough (marginal) that they do not distort current market costs and prices.

Nigeria lending interest rate (20.29%) for year 2001 was used to calculate the discounted rate from the 1st year to the 18th year. The result shows that when the costs and revenues were discounted from year 1 to year 18, the NPV was ₦1,504,841.70 with a corresponding B/C 1.35, IRR 24.03%, AEV ₦316,016.76ha⁻¹, LEV without land rent ₦2,186,997.89ha⁻¹, ROI 35%, DPBP 17.7 years. Based on the criterion of the economic measures, the NPV is positive while the corresponding B/C is greater than 1. This shows that the investment of large scale private forest plantation is profitable, economically efficient and socially acceptable.

5 CONCLUSION

Forest plantations are established because of the need to increase wood supply and reduce the pressure on natural forest in Nigeria. Hence, private investment in forest plantation development will be a major way of achieving sustainable forest development, income generation, increase wood supply and also reduce the pressure on natural forest in Nigeria. The study showed that investment in forest plantation development is profitable going by the economic returns indices. However, the payback period is relatively long compared to the rotation but the investment is socio-economically justified because the financial returns from the timber production is positive. It is expected that the findings of the study will have a positive contribution to professionals and researchers around the world dealing with forest plantation development.

6 RECOMMENDATION

There is no doubt that Nigeria has a high potential for forestry development that has not been adequately exploited. Private investors' interest can be stimulated through provision of incentives in order to fulfil Nigeria potentials in forest plantation development. Adequate government programs of incentives (financial support, free seedlings), good governance, secured land, established markets, coupled with good technical advice to private forest plantation owners, are needed to stimulate forest plantation establishment, especially among small and medium-sized private forest owners with limited financial resources.

Private forest plantation owners should endeavour to keep cash flow statements of their investments in order to find out the extent to which they stand to gain or lose from resources committed to the project. Also, to increase economic returns and reduce the payback period, it is recommended that private forest plantation development should incorporate multiple land use systems.

REFERENCES

1. Chamshama, S. A. O., Nwonwu F.O.C., Lundgren B. And Kowero G.S. Forest plantation in Sub Saharan Africa: Silvicultural, Ecological and Economic Aspects. SFM Special Edition No.1. 2009
2. FAO. Forestry Outlook Study for Africa – African Forests: A View to 2020. African Development Bank, European Commission and the Food and Agriculture Organization of the United Nations, Rome. 2003. Available: <ftp://ftp.fao.org/docrep/fao/005/Y4526B/y4526b00.pdf> (Accessed 23.12.2017)
3. Udofia, S. I., Akpan-Ebe, I. N., Uluocha, O. B. and Ekpoh, G. I. Survival Assessment of Forest plantations in Abak Local Government Area, Akwa Ibom State, Nigeria. Nigerian Journal of Agriculture, Food and Environment. 2011;7(4):92-96
4. World Bank. The World Bank Annual Report 1986 (English). Washington, D.C.: World Bank
5. World Rainforest Movement 2006 Available: www.wrm.org.uy. (Accessed 23.12.2017)
6. Oni P. I., Jimoh S. O., Adebisi L. A. Management of Indigenous Medicinal Plants in Nigeria using Phenological Information. *J Med Plants Res* 2014;8(16): 619-631. DOI: <http://dx.doi.org/10.5897/JMPR2013.5108>
7. FAO. The Impact of Forest Policies and Legislation on Forest Plantations. Report Based on the Work of C. J. K. Perley. Forest Plantation Thematic Papers, Working Paper 9. Forest Resources Development Service, Forest Resources Division. FAO, Rome 2001 (unpublished)
8. Udofia, S. I., Akpan-Ebe, I. N., Uluocha, O. B. and Ekpoh, G. I. Survival Assessment of Forest plantations in Abak Local Government Area, Akwa Ibom State, Nigeria. Nigerian Journal of Agriculture, Food and Environment. 2011;7(4):92-96
9. Wang Yangyang, Bai Guangxin, Shao Guofan, and Cao Yukun 2014. An analysis of potential investment returns and their determinants of poplar plantations in state-

- owned forest enterprises of China. *New Forests*. 2014;45:251–264. DOI 10.1007/s11056-014-9406-z
10. Keca L., Keca N. and Pantic D. Net present value and internal rate of return as indicators for assessment of cost-efficiency of poplar plantations: a Serbian case study. *Int For Rev*. 2012;14(2):145–156
 11. National Bureau of Statistics. *Social Statistics in Nigeria. Part III: Health, Employment, Public Safety, Population and Vital Registration 2012*.
 12. Forestry Management Evaluation and Coordination Unit (FORMECU). *Forest Resource Survey, Geomatics, Nigeria Ltd, Abuja*. 1998.
 13. Glen WM. *An Examination of Forest Ownership in Prince Edward Island. Resource Inventory and Modeling Section No. 28 2002*.
 14. Cabbage Frederick, Robert Davis, Gregory Frey, Diji Chandrasekharan Behr. *Financial and Economic Evaluation Guidelines for Community Forestry Projects in Latin America*. Washington, DC: Program on Forests (PROFOR) 2013.
 15. Klemperer WD. *Forest Resource Economics and Finance*; McGraw-Hill Inc.: New York, NY, USA, 1996.
 16. Cabbage F, Patricio MD, Gustavo B, Virginia MO, Adriana B, Rafael R, Rafael DL et al. "Global timber investments and trends, 2005-2011." In *New Zealand Journal of Forestry Science*, vol. 44, no. 1, p. S7. Springer, 2014.
 17. Straka TJ, Bullard SH, Dubois MR.. "Introduction to forestry investment analysis 2001. Part I. Basic investment characteristics and financial criteria". *Faculty Publications*. Paper 91. Available: <http://scholarworks.sfasu.edu/forestry/91>
 18. Bullard S. and Straka T. *Basic Concepts in Forest Valuation and Investment Analysis*. eBooks. Book 21, 2011.. Available: <http://scholarworks.sfasu.edu/ebooks/21>
 19. Wang Yangyang, Bai Guangxin, Shao Guofan and Cao Yukun. An analysis of potential investment returns and their determinants of poplar plantations in state-owned forest enterprises of China. *New Forests* 2014;45:251–264
 20. World Bank 2015. *Global Development Finance*. World Bank, Washington, DC