

INSIGNIS FOREST PARTNERSHIP

Forest & Joint Venture Particulars

+ 2016 Annual Report

Partnership Particulars

Year Established	1996
Number of Partners	70
Main Assets	275 hectares of plantation forest in 3 stands
Forest Manager	Warren Forestry Ltd
Partnership Management Committee	P Methven, M Tillman, D Barker
Accountants	Bartram's
Auditor	Grant Cameron
Bank	ANZ Bank
Independent Forestry Consultant	Patrick Milne, NZIF Registered Consultant
Supervisor	Covenant Trustee Services Ltd

INSIGNIS FOREST PARTNERSHIP

Forest & Joint Venture Particulars + 2016 Annual Report

Nature of Business

The sole business activity of the Partnership is to grow and then harvest a plantation forest in three forest stands on land provided pursuant to Joint Venture Agreements ('JVAs') by three landowners, two in Marlborough and one in Canterbury. The JVAs provide Forestry Rights, which are registered on the Landowners' titles, enabling and requiring the Partnership to establish, tend and manage forest regimes for one rotation on the land. The Partnership pays a fixed annual rent, although at harvest a small share of net forest proceeds may be due to Landowners based on a formula relating to inflation of forests costs compared to land values. The joint venture ends at harvest and the Partnership is dissolved.

Outline of Land, Forest Location, Species, Regimes & Land Rental

Chimney Creek: 800ha sheep, beef & cropping farm in the Waikakaho Valley, north of the Wairau River, inland of the Picton road, Marlborough. Owned by P & M O'Sullivan.

CC1: 156ha Radiata pine (seed lot GF28 cuttings & GF17 seedlings, 50:50 mix) planted in 1998 & 1999; 140ha clearwood regime, i.e. high pruned and thinned, to 380 sph (stems per ha); 16ha framing regime, i.e. unpruned, but thinned to 550sph. Expected harvest about age 29 (2027). Site rental is \$70 per ha per annum.



A view of Renwick from The Ramshead forest stand

Radiata pine aged 19.5

Jan 2017

The Ramshead: 2,776ha sheep & beef farm north of the Omaka River, in a branch of the Waihopai Valley, Marlborough foothills owned by P Huddleston.

RH1: 82ha Radiata pine (seed lot GF28 cuttings & GF17 seedlings, 50:50 mix) planted in 1997; All in a clearwood regime, i.e. high pruned and thinned, to 380 sph (stems per ha); Expected harvest about age 29 (2026). Site rental is \$64.61 per ha per annum.

Paratu: Sheep & beef farm south of Waimate, South Canterbury downs, owned by I & H Dickson and farmed by J & N Cooney.

PT1: 33ha Radiata pine (seed lot GF28 cuttings) planted in 1997; all clearwood regime, thinned to 390sph. Expected harvest about age 29 (2027). Site rental is \$100 per ha per annum.

Other General & 2016 Specific Information

Insurance & Valuation: The forest is insured for fire and storm losses, firefighting costs and levies, clearance and replanting costs, earthquake and Public Liability. All cover has excesses or upper limits judged as reasonable by the Forest Manager in consultation with the Independent Forestry Consultant. Taken into account in choosing the various heads of cover, apart from cost is the lower risk gained by having the forest in three separate stands, mostly bordered by grazed farmland and not particularly publicly accessible.

The policy is tendered annually by forest management and consultancy firm PF Olsen Ltd, the largest forest manager in NZ, as a group insurance plan for its many clients.

As part of the insurance contract service, Olsens provide a free valuation based on area, location, age, species and the regime of each individual forest stand.

As this value is 'broad brush' we compare it to a value arrived at by the Forest Manager and Independent Forestry Consultants' valuation calculator. This uses actual forest data which specifically produces forest stand values for the Partnership's forest, based on a growth model. This is straight forward to update annually.

The method used, is the same as Olsen's but from more detailed and specific information about our forest stands. It uses discounted cash flow from a calculation of forecast net harvest proceeds. Getting to that figure involves making several significant assumptions or 'judgment calls', the discount rate being the most significant. It is regarded in the industry as the best method for mid-rotation valuation even though it is by its nature quite theoretical, and the further out the more so. Forests are unusual and quite variable assets and there are insufficient sales of similar immature forests to give forests a market valuation, which if it existed would be better.

The insurance year runs from June to May so the sum insured is set in May. The insured value is an agreed value with the insurer. It does not have to be exactly Olsen's or the Consultant's forest value. It just has to be 'within acceptable boundaries' so probably could easily be 30% higher or lower, which would of course be reflected in the premium. And indeed it was, as the Manager decided to significantly increase fire cover in 2016 after two years of reasonably dry conditions which had resulted in major forest fires in Marlborough.

Actual sum insured for 2016/17:	\$5,057,300 (total fire cover)
Olsen's Insurance value for 2016/17:	\$4,223,713
Forest Valuation as at 31/12/15	\$3,721,158
Forest Valuation as at 31/12/16	\$4,753,607
Wind storm cover (the maximum offered)	\$1,000,000
Fire Fighting cover (the maximum offered)	\$1,000,000
Public liability	\$2,000,000
Earthquake	\$250,000
Clearance and replanting cover	\$2,500 per ha
Claims costs cover	\$10,000

The Emissions Trading Scheme ('ETS'). In 2010 the Partnership's Chimney Creek and Paratu forest stands were registered under the ETS. (The Ramshead, which is government pastoral lease declined consent). The Partnership received carbon credits, known as NZUs, until leaving the ETS in 2014. That was done to avoid having to return those NZUs in due course, as the rules required. This has been a significant windfall and we have received enough cash to cover all outgoings for about three years by selling down our NZUs.

The ETS continues, and is being reviewed for reforms which should keep the NZU price up and be favorable to forestry. But that was what we were told previously and it certainly was not true, with some exceptions such as our 'windfall'.

However we will re-join later in 2017 and not miss out on any of the NZUs we are entitled to as the current allocation period is 2013 to 2017. If we rejoin in that period we will get all credits earned from 2013 on. There is no longer an arbitrage opportunity but who knows what others may arise. It remains an option for us to take an income from carbon credits and then see what happens as we approach harvest age. However that would require a new agreement with our landowners which may or may not be feasible. But we must seriously look at it again. In theory we could earn more from carbon credits than log sales, or even have both.

We will try again to get consent to join The Ramshead in this time.

Forest Management and Partnership Administration. Warren Forestry Ltd carried out all forest management and partnership administration work for both parties to the joint venture until late 2016. Important forest matters are decided in AGMs or by the Independent Forestry Consultant pursuant to the Partnership's Deed of Participation and Joint Venture Agreements.

In November the Partnership changed its Deed to make its Manager a Management Committee elected by the Partners. So the Partnership is effectively self-managing now which means it is no longer regulated as a Managed Investment Scheme by the Financial Markets Authority.

Statutory Supervisor & Auditor. The Statutory Supervisor became 'the Supervisor' in 2016 following a change to the Partnership's Deed of Participation, with effectively the same role and will continue to hold the Forestry Rights and any NZUs as trustee. We appointed Grant Thornton as our new Auditor. Once the 2015 and 2016 audits are completed under the 'Tier One' auditing rules the Partnership will be able to select a less expensive and more fit for purpose audit from 2017 onwards.

Markets for Logs & Forests - General Comment. In 2016 log markets have mostly been quite good and ended the year higher than 12 months before. Chinese demand has held up well and not been so volatile. The log market is almost entirely export dependent, since 90% of NZ production is exported either as logs (50%) or product processed to some degree. The value of the NZ dollar is another significant factor and that has been down a bit. Shipping costs are very low and fuel costs which affect harvest and transport costs are lowish. Harvest and transport is still relatively costly so we hope new technology will lower these in future, and or log prices rise.

Overall the effect has been to significantly increase the forest valuations as at 31 December 2016, as they are based on expected harvest revenue, discounted back to now.

Comparison of Budget to Costs

Actual Expenditure compared to the 2016 Budget \$

Operating costs	Budget	Actual
Accountant's fees	2,000	2,000
Auditor's fees	1,800	2,500
Bank charges	-	411
Carbon credit and MC work by WFL	-	650
Contingency	1,500	-
Deed amendment work by WFL	-	1,000
Filing Fees	-	309
Forest Inventory & Modelling	1,500	1,800
Forestry Consultant	350	-
Insurance	10,000	13,079
Legal fees	-	1,667
Management & Administration by WFL	4,900	4,900
Rent	19,881	19,881
Statutory Supervisor & FMA annual fees	2,100	1,500
Subscriptions	-	200
Track maintenance	700	0
	<u>44,731</u>	<u>49,897</u>

Notes:

Accountancy & Audit. We would like to reduce these but the financial reporting rules we are subject to prevent that currently. Mostly this is the unreasonably involved auditing requirements mentioned above. We hope that from the 2017 audit onwards the costs will be lower.

Carbon credit and MC work by WFL. Extra work relating to selling our remaining NZUs and the setting up of a Management Committee was required in 2016. To date the Partnership has received just under \$125,000 from selling NZUs. It only has 31 left.

Deed amendment work by WFL + Legal fees. The Partnership resolved to amend its Deed in late 2016 to take it outside the jurisdiction of the securities law and become an independent private partnership. This required seeking legal advice and work from Anthony Harper, and liaising between them and the Supervisor. Warren Forestry Ltd did a lot of the routine drafting work together with Anthony Harper. It also required an Extraordinary General Meeting to approve the Deed of Amendment.

Forest Inventory & Modelling. Inventory work is taking plot samples from the forest stand to update our database. Then we put this in the forest growth modelling software we use called 'Calculator'. That then in turn provides a volume and log grade forecast at harvest which is fed into the valuation calculation spreadsheets.

Charles Etherington
Warren Forestry Ltd
Forest Manager & Administrator for the Partnership's Management Committee
March 2017