

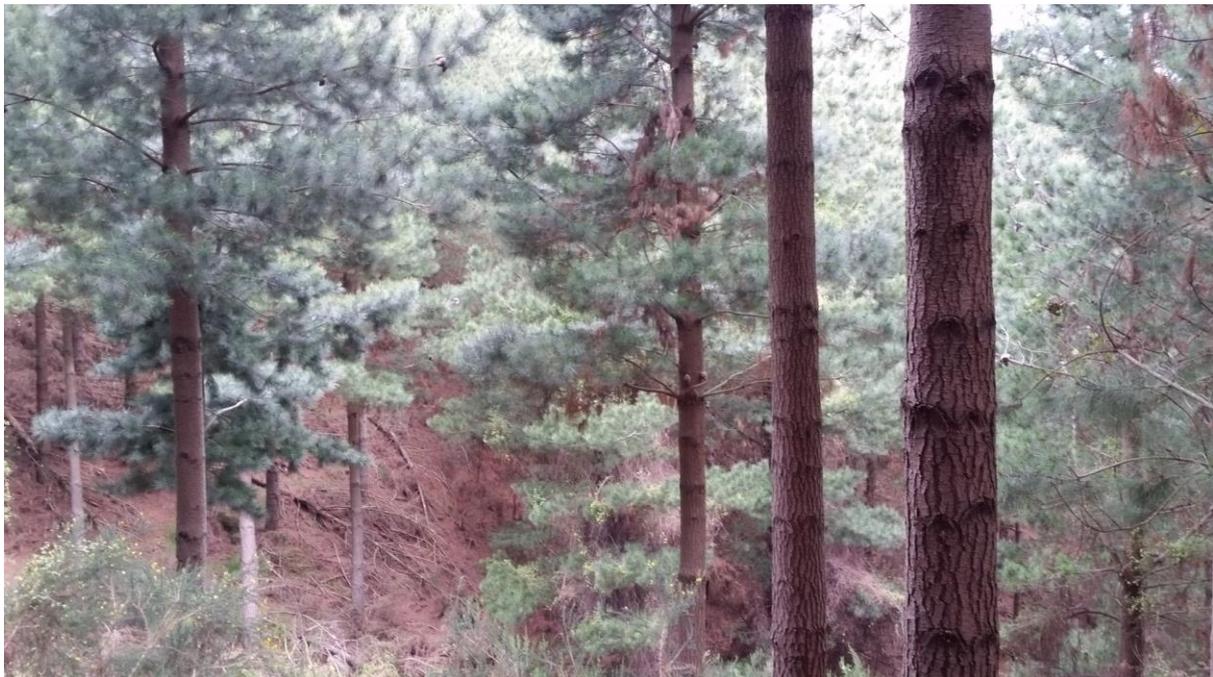
MT WHITNOW FOREST PARTNERSHIP

Forest & Joint Venture Particulars

+ 2016 Annual Report

Partnership Particulars

Year Established	2002
Number of Partners	43
Main Assets	151 hectares of plantation forest in 5 stands
Management Committee	I Geldof, J Andrews, J Exton
Forest Manager	Warren Forestry Ltd
Accountants	Bartram's
Auditor	Grant Thornton
Bank	ANZ Bank
Independent Forestry Consultant	Patrick Milne, NZIF Registered Consultant
Supervisor	Covenant Trustee Services Ltd



Inside AH3 at Ahuriri farm, 2016

Pinus radiata aged 15

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Nature of Business

The sole business activity of the Partnership is to grow and then harvest a plantation forest in five forest stands on land provided pursuant to Joint Venture Agreements ('JVAs') by three landowners 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.

At harvest, net forest proceeds are shared between the partnership and land owners with the split being 75/20% and 5% going to Warren Forestry Ltd. That split is fixed from the start by agreement and is arrived at from an assessment of the forest sites' merits, principally the cost of forest establishment and silviculture, likely forest growth & yield, and likely harvest costs. The joint venture ends at harvest and the Partnership is dissolved.

Outline of Land, Forest Location, Species & Regimes

Mt Whitnow: 4,440ha sheep & beef farm at the source of the Waitohi River, inland of Harwarden, North Canterbury foothills, owned by D & C Williamson and J & S Calder.

MW123: 100ha of Douglas-fir in three stands (seed lot Tramway) was planted in 2002 at 1370 stems per hectare ('sph'), as a framing regime i.e. unpruned, unthinned as yet. A decision about thinning may be made in 2017. Future production thinning for some of the site may be an option in a few years' time. Expected harvest at about age 40 (2041).

Glens of Tekoa: 7,800ha sheep & beef farm north of the Hurunui River inland of Culverden, North Canterbury foothills owned by W & G McRae.

GT8: 28ha Douglas-fir (seed lot Tramway) planted in 2001 at 1,370sph as a framing regime i.e. unpruned. It is unthinned as yet and this will be reviewed in 2017. Expected harvest at between age 35 to 40 (2041).

Ahuriri Farm: 1,400ha sheep & beef farm on the southern Port Hills, between Tai Tapu & Gebbies Valley, Banks Peninsula owned by P & A Graham.

AH3: 30ha Radiata pine (seed lot GF Plus aged cuttings selected for wood qualities) planted in 2001; all clearwood regime, thinned to 550sph, which is high but it is a very productive site. Expected harvest at about age 30 (2031) or a few years earlier.

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 several separate stands, of two species on grazed farmland not 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 a third higher or lower, which is of course reflected in the premium.

For the current cover the Forest Manager chose a higher value than Olsens as they tend to heavily discount their Douglas-fir valuations due to their length, but a lower value than our valuation, based on a lower risk assessment for Douglas-fir which is the Partnership's main species.

Actual sum insured for 2016/17	\$966,000 (total fire cover)
Olsen's Insurance value for 2016/17	\$701,372
Forest Valuation as at 31/12/15	\$1,485,353
Forest Valuation as at 31/12/16	\$1,803,936
Wind storm cover (the maximum offered)	\$483,000
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 forest was registered under the ETS and 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 (\$63,000) to cover all outgoings for about three years by selling down our NZUs. In 2017 we may sell our remainder.

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.

The fact that the Partnership has mostly Douglas-fir which not only has a longer normal rotation but

can be grown indefinitely is a considerable advantage. In theory we could earn more from carbon credits than log sales, or even have both.

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 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.

Expected Net Harvest Volume & Revenue. When running the valuation calculator software two significant figures generated are the forecast recoverable volume of logs, and how this translates into net harvest revenue. It's this revenue which will be the investment return divided between the Partnership and the Landowners according to their shares.

The first figure should be reasonably reliable, i.e. not change much from here on as the 'die is cast now' as it were. But the net harvest revenue we will get is 'anyone's guess' as so much depends on the markets and the costs of getting the logs to market. A 10% log price change can translate into a 30% net revenue change.

For the Mt Whitnow forest stands the current forecast volumes are between 15% & 20% higher than the original forecasts made in 2002. Perhaps the originals were conservative or the current ones optimistic. It is hard to tell until we get more actual forest measurement data, particularly for our Douglas-fir, which we will do in due course.

The net harvest revenue figure is, as at 31 December 2016, \$7.3 million in total, which means \$5.5 million to the Partnership. This is less than forecast in 2002 by about 30% but a lot better than a few years ago. Each year from now on we will give these figures and it will be interesting to see how much they change year to year.

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		-	141
Carbon credit and MC work by WFL		-	650
Contingency		1,500	-
Deed amendment work by WFL		-	1,000
Filing Fees		-	309
Forest Inventory & Modelling		2,500	2,500
Forestry Consultant		1,000	-
Insurance		3,250	3,113
Legal fees		-	1,667
Management & Administration by WFL		3,850	3,850
Statutory Supervisor & FMA annual fees		2,100	1,500
Subscriptions		-	100
Track maintenance		300	300
		<u>18,300</u>	<u>19,630</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 the Emissions Trading Scheme, our NZUs, and setting up the Management Committee was required. The MC will decide formally what to do with the remainder in 2017.

To date the Partnership has received over \$63,000 from selling NZUs. The remainder are currently worth around \$5,000 on an unpredictable market.

Forestry Consultant. We did receive advice from our Forestry Consultant, who does work for the other Warren Forestry partnerships too. However he did not bill this Partnership, or at least has not yet.

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**



Part of the larger of the three stands of Douglas-fir at Mt Whitnow in May 2007, aged 5 (green dots in the middle distance, not the white fluffy things)



The same view in May 2016, aged 14