



**Adviser Edge**

## W.A. Blue Gum Project 2016

INDEPENDENT ASSESSMENT

This report has been prepared for financial advisers only

7 June 2016



**Scope**

Adviser Edge independent assessments are conducted by Barik Pty Ltd trading as Adviser Edge Investment Research (Adviser Edge) which has developed a key industry sector review process that follows a methodology developed specifically for this asset class.

**Key Principles**

The underlying principles of the assessment process are to:

- identify the long term commercial potential of the project;
- evaluate project management's capabilities, previous performance in the specific industry and the stability of the organisation;
- evaluate identified markets (domestic and international – existence, stability and growth potential);
- benchmark key performance assumptions and variables against industry and other MIS projects;
- weigh up the relevant risks of the project against projected returns;
- assess project structure and ownership;
- compare and substantiate project fees and expenses;
- determine if the project is structured in such a way as to protect investor's interests; and
- allow an opinion to be formed regarding the investment quality of the project.

**Site Assessment**

Adviser Edge conducts a detailed site inspection of the project, meets with all levels of project management and inspects the project's infrastructure and market accessibility.

The site assessment considers the following areas:

- suitability of the project site for the purpose intended;
- performance of previous project stages located within close proximity to the proposed site;
- management skills, qualifications, capabilities and experience; and
- associated project risks and their management.

**Star Rating**

Star ratings applied to 2015-16 projects are independent of previous year's star ratings.

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**Report Date**

7 June 2016

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### Adviser Edge Rating



### Recommended Client Risk Tolerance

#### Project Details

Project Name	W.A. Blue Gum Project 2016
Product	Hardwood logs for pulp and paper manufacture
Responsible Entity	W.A. Blue Gum Limited
Plantation Manager	Ents Forestry Pty Ltd
Independent Forestry Expert	Don Spriggins

#### John Tredinnick

Investment Term	Approximately 10 to 12 years after planting, with ability to extend to 15 years
Investment Unit Size	1 hectare (ha)
Units Available	800
Application Fee	\$3,818 (excluding GST) per investment unit
Ongoing Fee Structure	Annual rent and maintenance fees
Annual Lease Fee	\$400/ha (ex. GST)
Annual Management Fee	\$110/ha ex. GST
Harvesting Supervision Fee	3% of harvest proceeds (ex. GST)
Incentive Fee	15% of net harvest proceeds above \$18,000/ha (including GST) (indexed)
Minimum Investment	Five units
Close Date for FY2016	30 June 2016
Investor Finance	Available through Albany Financial Pty Ltd
ATO Product Ruling	PR2016/4

#### Investor Returns

Potential Investment Returns (p.a., pre-tax)	-2.6% to 8.6%
Adviser Edge Base Case	4.1%

### Key Points:

#### Strengths of Project

- The Project is well structured, providing investor security and decreasing the reliance on the ongoing solvency of the Responsible Entity (RE).
- WA Blue Gum is not restricted to selling harvested timber to a single woodchip processor.
- It is expected that the sites for the 2016 Project will be in the high rainfall, south-west Western Australian sub-regions of Denmark and Walpole. Analysis of historical rainfall indicates highly stable annual rainfall across an average 10-year rotation.

#### Weaknesses of Project

- While the longer-term prospects for the industry are improving, the industry is currently suffering from high levels of global supply and consequently lower prices.
- It is unlikely that woodchip prices will quickly rebound to pre-GFC levels, with price growth likely to be subdued. Notwithstanding, there has been some recovery in woodchip prices during recent months, which has been factored into returns modelling for this report.

#### Key investment risks

- For the 2016 Project deliver a commercial return that reflects the risk of investment, there needs to be an improvement in global economic conditions, lower supply of woodchips, and a sustained low AUD exchange rate.
- The past two years have been dry in the selected region but an analysis of rainfall on a rolling ten-year basis for the last 50 years indicates that near-average rainfall can be expected over a rotation weather cycle.

#### Investor suitability

- Investment in agribusiness should represent a balance between the various potential risks and the forecast returns. The financial outcome for this Project is will be heavily influenced by future market conditions, which are not easy to predict. The Adviser Edge range of potential investment returns considers the impact of may variables but is most heavily influenced by prices paid for woodchips at harvest.

### Investment Specifications

Target Subscription	800ha
Location	South-west Western Australia
Investment Unit Size	1ha per unit
Minimum Application	Five units
Liquidity	Illiquid – no established secondary market
Insurance	Compulsory
Investor Finance Provider	Albany Finance Pty Ltd

W.A. Blue Gum Limited (W.A. Blue Gum) is offering investors the opportunity to participate in the plantation pulpwood industry through the offer of 800 Woodlots in the W.A. Blue Gum Project 2016. W.A. Blue Gum has the capacity to accept oversubscriptions, depending on the availability of suitable land.

The Project involves the establishment of Tasmanian blue gums in the south-west Western Australian forestry region for the production of timber that will be sold to domestic hardwood woodchip mills located in the region.

W.A. Blue Gum intends to establish 66% of the Project using coppiced plantations, with the remainder being replanted trees to provide establishment methodology diversification and maintain establishment costs at a reasonable level. It is intended that inclusion of all suitable coppiced sites will be completed in the 2016 calendar year and some (perhaps all) of the planted sites will be completed by October 2016. To the extent that this is not done, the planting will be completed over the winter period in the following year. Under the head lease, the maximum term of the Project is 15 years; however, it is expected that the trees will be harvested at between 10 to 12 years of age, with harvesting most likely to occur between 2025 and 2027. Net proceeds from the harvest will be pooled and distributed to investors on a pro-rata basis.

W.A. Blue Gum will outsource the management of the plantations to Ents Forestry Pty Ltd (Ents Forestry), an Albany-based forestry contractor. Ents Forestry will be responsible for all management operations required, from land preparation and sourcing seedlings, and preparation of harvested land for coppicing, right through to the management of harvesting.

The Project includes an off-take agreement with W.A. Chip & Pulp Company (W.A. Chip & Pulp), which is located in Bunbury. This company is a sister company to W.A. Plantations Resources Limited (WAPRES), a well-established and vertically integrated hardwood forestry business. Both W.A. Chip & Pulp and WAPRES are jointly owned by Japanese companies Marubeni and Nippon Paper. The off-take agreement is flexible in that it allows W.A. Blue Gum to seek out alternative offers for the timber on the basis

### Key Points

- Investors are required to pay ongoing annual lease and management fees, with a harvest supervision fee to be deducted as a percentage of harvest proceeds.
- The establishment fee has been increased by 7%.
- The annual rental and management fees have been maintained at 2015 levels.
- Head leases and sub-leases will be registered with Landgate, the Western Australia land titles office.

that W.A. Chip & Pulp has the right to match any higher offer. The importance of this contract is lower than in previous years as the trees are expected to be grown outside of the W.A. Chip & Pulp catchment area.

W.A. Blue Gum will lease land directly from farmers or potentially from established forestry companies. In all instances, W.A. Blue Gum will register the head lease or sub-lease with Landgate, the Western Australian land titles office.

Given the ongoing fee structure of the Project, investors have a very limited exposure to the major counterparties, W.A. Blue Gum and Ents Forestry, over the life of the Project. The fee structure incorporates sufficient cash flow to provide payments to a replacement Responsible Entity (RE) or third-party contractor over the life of the Project. W.A. Blue Gum advises that the rental fee should be sufficient to cover the ongoing lease payments to landlords W.A. Chip & Pulp and to ensure investors' tenure over the land throughout the rotation, irrespective of the ongoing solvency of the RE. The main risk to the Project is the ability of investors to pay annual rent and management fees to ensure leases are kept on a good footing. To date there have been no rent defaults associated with any projects managed by W.A. Blue Gum.

***The Project is structured in such a way that there is a very limited reliance on the ongoing solvency of W.A. Blue Gum, W.A. Chip & Pulp or Ents Forestry. While some benefits may accrue from the ongoing involvement of these parties, including the Wood Purchase Agreement, the Project should be able to attract an alternative manager and RE in the event that either of the management counterparties becomes insolvent. A number of W.A. Blue Gum projects have run their full investment cycle, supporting Adviser Edge's view that the risk of needing to change management is low.***

### Project structure and agreements

When investors are accepted into the Project, they will be bound by a number of legal agreements that outline the rights and responsibilities of each party involved in the investment scheme. These agreements are outlined in the Project's Product Disclosure Statement (PDS). It is recommended that each potential investor

and their adviser read and understand these agreements to ensure that the investment is suitable for the investor's objectives.

## Fee Schedule

The fees outlined in the following tables relate to an investment made on or before 30 June 2016. For additional information on fees and costs associated with this investment please refer to p25–27 of the Project PDS.

### Initial Cost to the Investor

Payment Type	Cost Per Woodlot (ex. GST)
Application Fee	\$3,564

Investors in the Project are required to pay an application fee of \$3,818 per unit, which covers the services associated with establishing the plantation, including land preparation, procuring the supply of seedlings, planting in accordance with good silvicultural practice, and preparing harvested plantations for coppicing.

### Annual Fees

Payment Type	Cost Per Unit (ex. GST)
Rental Fee*	\$400
Maintenance Fee*	\$110
Insurance <sup>^</sup>	Approximately 0.7% of insured value plus 10% of the premium as an administration fee (ex. GST)

\* Payable on 30 November 2016, and on 30 September in each year thereafter. Indexed to Western Australia's CPI from 30 June 2016.

<sup>^</sup> Payable on 15 November 2016, and on 15 November in each year thereafter.

From Project year one (FY2016), investors will be charged annual ongoing maintenance and rental fees. Insurance against fire is compulsory for investors over the term of the investment, and investors will be invoiced the actual cost of this insurance. W.A. Blue Gum will arrange insurance on behalf of investors, and will charge a fee equivalent to 10% of the premium for the service. Annual insurance premiums are expected to be around 0.7% (excluding GST) of the insured value.

A matter not previously considered by Adviser Edge has come to light in FY2016, concerning the implications of a requirement of the ATO that individual allotments be directly allocated to a grower. This has implications when harvesting is undertaken across two or more financial years, as growers whose woodlots are on blocks that are harvested will no longer pay rent but will still share in revenue on a proportionate basis. This places growers of remaining woodlots at a financial disadvantage.

Adviser Edge has held discussions with the RE about this matter and would like to see a practical solution to ensure some investors are not materially disadvantaged as a consequence.

### Deferred Fees

Payment Type	Cost Per Unit (ex. GST)
Harvesting and Transportation	Actual cost to be advised at harvest and deducted from harvest proceeds to provide investors with a stumpage price
Harvest Supervision	3% (ex. GST) of net harvest proceeds
Incentive Bonus	15% (inc. GST) of the value where net proceeds exceed \$18,000/ha (inc. GST)*

\* Indexed to Western Australia's CPI from 30 June 2016.

W.A. Blue Gum will deduct all of the costs incurred for harvesting, transportation and supervision from the proceeds of the sale of the timber prior to making any distributions to the investor. This price is referred to as a 'Stumpage Price' and is an accepted basis for the sale of standing timber to pulp mills in Western Australia. In addition to this, a harvest supervision fee of 3% (excluding GST) of net harvest proceeds will be deducted. 'Net harvest proceeds' means the proceeds from the sale of the timber, less the costs of harvesting and transportation.

An incentive fee is also charged if performance targets are reached. This fee equates to 15% (including GST) of the amount by which the net proceeds from the sale of the timber exceed \$18,000/ha (including GST), with the benchmark to be indexed from 30 June 2016. The net proceeds of sale are the proceeds received from the sale of timber, less the costs of harvesting and processing, and the harvest supervision fee.

## Fee Analysis

With any forestry MIS project, the application fee is generally dictated by the actual development cost incurred in establishing the plantation, other administration costs such as corporate overheads, marketing and PDS development expenses, and the profit margin taken by the Project manager.

The application fee for the 2016 Project offering has increased by 7% on 2015. Of the application fee, a significant portion is paid to the contractor, Ents Forestry, as consideration for providing the establishment services during the establishment period, in accordance with the plantation development and tending plan. The remainder is attributable to project development expenses and manager profit.

An ongoing annual management fee is also charged. This remains unchanged at \$110 per hectare (excluding GST) in year one, indexed to CPI thereafter. Of this fee, a portion is paid to

Ents Forestry for the annual tending of the plantations, with the remainder paid to W.A. Blue Gum to cover its expenses and administration margin.

The annual lease fee of \$400/ha (excluding GST, indexed to CPI after year one) represents the average lease costs expected to be incurred by the Project. Lease rates for highly productive land in high rainfall areas of south-west Western Australia have declined in recent years, reflecting the lower demand for such land from competing plantation managers. As a comparison, the lease cost for similar land under the 2005 Project is currently \$445/ha.

***The higher application fee has been a factor in Adviser Edge reducing its base-case return for the Project. This increase has occurred at a time when the industry is experiencing low prices, with a slow recovery expected by experts (refer Marketing section).***

The Project incorporates an incentive bonus fee, which is set at 15% of the amount by which the net proceeds exceed the \$18,000 net harvest proceeds benchmark. It appears that the bonus becomes payable when pre-tax IRR approaches 7%, which would be considered a good outcome for investors.

***Given that the Project's structure includes limited deferred fees, the incorporation of the incentive fee, and the level at which it becomes payable, are considered to be appropriate. This fee provides an incentive for W.A. Blue Gum to maximise Project returns but does not appear to influence management decision-making year-to-year.***

In addition to this, the Project agreements provide that if unforeseen expenses such as additional fertiliser and/or insect issues arise, W.A. Blue Gum may convene a meeting of investors. If the majority of the investors agree to meet such expenses, then these expenses will be borne by all the investors in proportion to their Project interests. Adviser Edge is not aware of such a call having been made in relation to previous W.A. Blue Gum projects and therefore considers the likelihood of future calls to be low.

### **Risk apportionment**

Risk apportionment refers to the level of risk that the Project Manager/RE shares with investors as a consequence of the Project fee structure. When ongoing Project fees are linked to harvest proceeds, and therefore Project performance, the risk sharing between investors and the Project manager is considered to be more evenly aligned.

Ongoing management and rent fees are unrelated to the performance of the plantation, although the Project manager is entitled to a performance-based incentive fee if net sales proceeds exceed the pre-determined benchmark.

The fee structure of the Project incorporates fixed management and lease fees, and links a limited portion of the manager's remuneration to harvest proceeds. This structure results in the investor shouldering the vast majority of the risks and benefits associated with the Project.

Notwithstanding, given the size of the RE, the fee structure is considered to be appropriate, and provides ongoing security to the Project in the event of insolvency.

## **Additional Information**

### **Taxation**

W.A. Blue Gum has applied for and received a Product Ruling from the Australian Tax Office (ATO): PR 2016/4. This provides certainty in relation to the taxation consequences of investing in the Project.

***Adviser Edge does not conduct detailed analysis on the implications of the Project's product ruling, and it is advised that investors seek appropriate professional advice in relation to the full financial and taxation implications of their investment.***

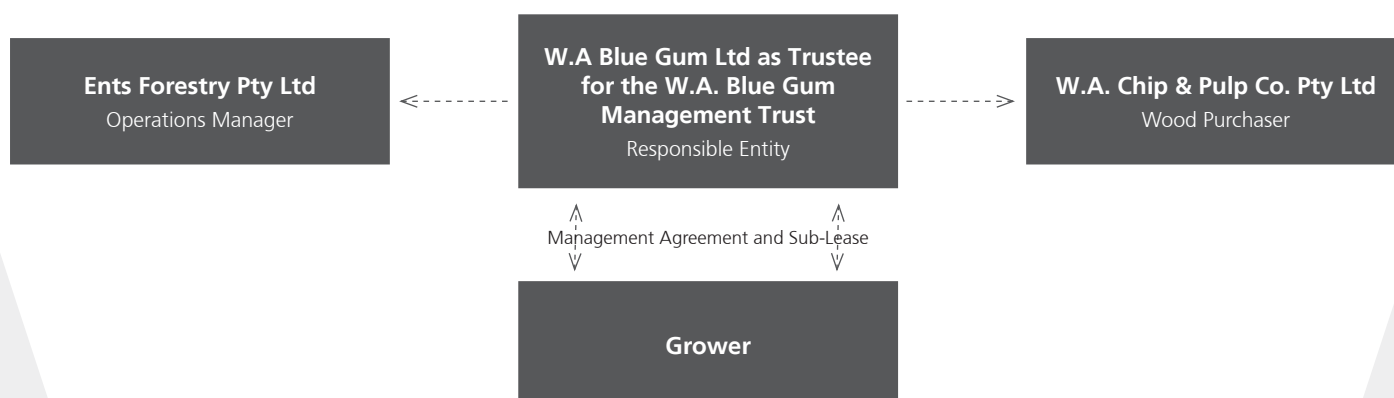
### **Joint growers**

Under the Project structure there is an option for investors to participate as a Joint Grower. Under this option, one Joint Grower is responsible for all the fees associated with the establishment of the plantation, while the other Joint Grower is responsible for all ongoing lease and management fees, including insurance. All other fees payable under the Project, such as harvest management, harvest costs and incentive fees, will be covered equally by each Joint Grower. The net harvest proceeds will be equally split between the Joint Growers.

***It is advised that investors seek appropriate professional advice in relation to the financial and taxation implications associated with becoming a Joint Grower.***



## Key Counterparties



## W.A. Blue Gum Limited (Responsible Entity and Project Manager)

W.A. Blue Gum Limited (AFS Licence No. 246264) (W.A. Blue Gum), as trustee for the W.A. Blue Gum Limited Management Trust, is both the Responsible Entity (RE) and Project Manager for the W.A. Blue Gum Project 2016. Incorporated in 1993, W.A. Blue Gum is an unlisted public company that focuses exclusively on MIS investments in blue gum plantations. The company was established to operate as the Responsible Entity for MIS forestry projects. W.A. Blue Gum is based in Melbourne and is managed by three directors, who together own 60% of the shares in the company.

W.A. Blue Gum has established over 10,000ha from the 15 offerings since 2000. All of these plantations are located in south-west Western Australia. W.A. Blue Gum Limited's Board of Directors is also involved in the management of Mediterranean Olives, which established MIS structured investments in olive groves between 2002 and 2008.

### Board of Directors

Board of Directors – W.A. Blue Gum Limited			
Director	Credentials	MIS	Director
Tom May – Executive Director	★	★	★
Leon Gorr – Non-Executive Director	★	★	★
Steven Smith – Non-Executive Director	★	★	★

All three directors of W.A. Blue Gum Limited have a legal background, bringing extensive regulatory and compliance experience to the board, and providing the company with high quality management. Each of these directors is a partner in a national law firm.

## Key Points

- W.A. Blue Gum is a very experienced Responsible Entity, with 15 years' experience in Western Australia.
- W.A. Blue Gum Limited outsources its forestry operations to Ents Forestry, reflecting the focus on sites nearer to Albany. Ents Forestry is a highly experienced forestry manager and investors should have confidence in its ability to manage plantations to a high level.
- The Project structure, which incorporates ongoing fees, reduces the risk of counterparty insolvency.

*Adviser Edge believes that the directors of W.A. Blue Gum Limited are suitably experienced and credentialed to provide effective leadership and management of the company in its role as RE, having fulfilled this role for a long period of time and for a number of projects. Although the board's experience is primarily legally oriented, Adviser Edge does not view this as a concern, as the operational requirements of the Project are fulfilled by externally contracted entities with deep experience in their fields. The board has successfully supervised forestry MIS projects in south-west Western Australia since 2000, including a number that have been harvested and concluded.*

### Corporate governance and compliance

W.A. Blue Gum's risk management system is managed as part of a corporate compliance strategy, coordinated by the Executive Director and Compliance Officer, Tom May. Mr May's role as compliance officer is to develop risk management strategies to effectively manage key business risks. These key risk areas are identified as agricultural, financial and regulatory.

A compliance committee for the Project has been established by W.A. Blue Gum, and is responsible for monitoring the RE in relation to the Project Compliance Plan, the Project Constitution and the Corporations Act.



### Compliance Committee

Committee Member	Position	Details
Paul Luntz	Independent Chairman	Mr Luntz is a chartered accountant, practising in Melbourne with a firm independent to W.A. Blue Gum's directors. He is also a Registered Tax Agent, and a Registered Company Auditor.
Manish Sundarjee	External Member	Practicing in Melbourne, Mr Sundarjee is also a chartered accountant.
Tom May	Internal Member	Compliance Officer

The compliance committee is comprised of two external members, including an independent chairman, and one internal member, Compliance Officer Tom May. The committee meets at least once every quarter.

The PDS sets out its compliance with ASIC benchmarks and disclosure principles (PDS p13), specifically RG 232. W.A. Blue Gum meets each of the five disclosure requirements under RG 232 and explains how it meets these disclosure requirements in the PDS.

### Financial performance – W.A. Blue Gum Management Trust

W.A. Blue Gum Limited acts as the trustee for the W.A. Blue Gum Management Trust, through which the trading activity occurs. Generally, the financial performance of W.A. Blue Gum over the years has demonstrated its ability to successfully maintain a profit under different levels of MIS sales. This success is largely due to the manner in which W.A. Blue Gum structures its MIS project offerings; these projects are largely self-funded through ongoing management fees. Accordingly, credit risk to the RE is predominantly confined to the willingness and ability of other investors in other W.A. Blue Gum projects to meet ongoing lease and management fees, in the unlikely event that W.A. Blue Gum substantially departs from its previous business model.

As discussed in the 'Structure and Fees' section of this report, the Project's reliance on the financial strength and ongoing solvency of W.A. Blue Gum is limited, largely due to the ongoing fee structure and comparably low up-front establishment fee. It is a requirement of W.A. Blue Gum Limited's AFS Licence that it maintains a minimum capital level of \$150,000. Due to the fee structure, W.A. Blue Gum is not required to maintain significant working capital levels to ensure that the plantations are adequately managed and lease payments are met.

### Responsible entity financial requirements

W.A. Blue Gum has stated in the PDS (p29) that it complies with the financial requirements for responsible entities of managed investment schemes. While these changes are not designed to prevent REs from becoming insolvent, they do provide some protection from REs taking on too much liquidity risk. The minimum amount of liquid assets that must be held by W.A. Blue Gum is \$150,000.

It should be noted that the financial requirements imposed on REs will not necessarily prevent the failure of forestry MIS managers, as has occurred in recent years. Many of these managers failed, in part, because their project structures resulted in a cash flow mismatch due to high up-front fees and ongoing fees substantially deferred and taken by the project manager as a proportion of harvest proceeds. Also, with respect to projects with ongoing fees, RE solvency can be affected if a significant number of investors, or a single significant investor, defaults on their rent and management fee obligations.

***As already noted, the Project's reliance on the ongoing solvency of the RE, W.A. Blue Gum, is mitigated by the fact that the fees and costs are not charged up-front, but rather annually to match the cash obligations of the Project. This means counterparty risk to the RE is reduced. However, it should be noted that counterparty risks affect the Project indirectly, by the risk that other growers in the Project (or other projects managed by W.A. Blue Gum) may default on their obligations. Should this occur, this will affect W.A. Blue Gum's ability to perform its obligations.***

### Ents Forestry (Operational Manager)

Headed by experienced qualified forester and former General Manager at Elders Forestry, Andy Wright, Ents Forestry manages forestry plantations for a variety of corporate and private owners, including for W.A. Blue Gum. Prior to being awarded the management contract for the 2015 Project, Ents Forestry acted as an independent consultant for W.A. Blue Gum. As a consequence of the involvement of Ents Forestry there has been a shift in focus to more southerly parts of the south-west region of Western Australia, with the company now managing the vast bulk of the estate located south of Manjimup.

Andy Wright has a very good reputation in the industry and his company Ents Forestry is considered to be an ideal choice to manage the high quality sites that have been or will be identified for the project.

Ents Management will assist in sourcing and securing high quality land for this and future plantings through leases from third parties. It will manage the land portfolio, provide silvicultural advice, liaise with contractors and prepare the annual fire insurance schedule on behalf of 2016 Project investors.

In its role as Operational Manager, Ents Forestry will be responsible for the following:

- Identify and secure suitable high quality new or second rotation sites.
- Undertake inventory to determine whether selected sites meet the requirements for coppicing or will need to be established as new plantations.
- Source improved seedlings from Forest Products Commission of Western Australia (FPC).
- Manage the plantation design process, including planting contours and location of roads.
- Appoint and coordinate contractors for planting and coppice management.
- Undertake fire control maintenance across the 2016 estate each year.
- Monitor plantation growth rates and plantation health and take action as deemed appropriate to ensure plantations are maintained in as healthy a state as possible (e.g. fertiliser application or pest control).
- Undertake harvest planning, execution and logistics management, including liaising with the buyer of the timber.

The Independent Forester Don Spriggins, in his expert report included in the PDS (p32–36), has expressed a positive opinion on the capabilities of Ents Forestry as the Operational Manager for the Project (PDS p33).

***Adviser Edge considers the appointment of Ents Forestry to be in the best interests of 2016 investors. The proposed scale of the Project at 800ha makes it ideally suited to a boutique forestry management firm with extensive experience in the region. There are numerous contractors located in the Albany and Manjimup regions that can be drawn upon to meet the operational needs of the project, which include site preparation, coppice management, plantation establishment, pest and weed control, and harvest-related activities. Ents Forestry, and in particular its head Andy Wright, has experience across the entire spectrum of activities that will be required to achieve good results for investors in the 2016 Project.***

## Independent Expert

W.A. Blue Gum has engaged Don Spriggins as Independent Forester. The Independent Forester will provide an expert opinion on plantation forestry in Western Australia to be included in the PDS, giving consideration to the objectives of the Project. Mr Spriggins does not have an ongoing role with the Project.

### Independent Expert

Focus	Responsible Person
Forestry Consultant	Don Spriggins

Don Spriggins is a consultant forester with more than 30 years of professional forestry experience. He has extensive experience in the development and management of blue gum plantations in south-west Western Australia, having worked for the Conservation and Land Management division of the Western Australian government (CALM) between 1976 and 1994. Mr Spriggins has acted as an independent consultant since 1995.

***Adviser Edge believes that Don Spriggins retains the necessary qualifications, knowledge and expertise required to provide the independent expert report. Adviser Edge recommends that potential investors read the Independent Forester's reports prior to considering an investment in this Project.***



On 21 March 2016, Adviser Edge travelled to south-west Western Australia to inspect a range of W.A. Blue Gum project plantation sites managed on behalf of investors by Ents Forestry. Adviser Edge was accompanied by W.A. Blue Gum Director Tom May and Ents Forestry's managing director Andy Wright.

The site inspection focused on plantations located in the Albany port catchment, reflecting an expectation that the 2016 Project will include sites in this sub-region. In past years there was a much stronger emphasis on planting in the Bunbury port catchment; however, WAPRES has moved away from contract management for third-party growers to concentrate on its own estate. This necessitated the development of the relationship between W.A. Blue Gum and Ents Forestry, which has led to a stronger focus on the Albany port catchment. Planting within 75km of port is critical to maintaining costs at a reasonable level, as longer haulage distances quickly eat into profits for growers (e.g. approximately \$1 lower mill door stumpage price for each 10km increase above 75km).

The symbiotic business relationship between WAPRES and W.A. Blue Gum has waned over the past three years, which has in Adviser Edge's view diminished the value of the off-take agreement. Previously there was an expectation that W.A. Blue Gum projects would benefit from a close relationship with WAPRES, allowing growers to gain through higher stumpage prices. This is now no longer the case, which makes Albany a better option due to the presence of more woodchip buyers. Anecdotally, there appears to be a near to 10% difference in the stumpage price paid in Albany (higher) relative to Bunbury (lower).

Ents Forestry is now entrenched as the preferred manager of sites located within the Albany catchment and it is unlikely that W.A. Blue Gum would consider planting anywhere else for the 2016 Project. Ents Forestry has a very good reputation in the region. The company has adequate resources, good links to the forestry contractor community, and has a strong commitment to fire management.

### Key Points

- Plantation will be established in high rainfall zones in south-west Western Australia.
- The independent expert indicates that plantations are likely to be located in the highly productive Albany sub-region that includes the towns of Denmark and Walpole.
- Operational Manager Ents Forestry will select the Project land in consultation with the Forestry Supervisor and RE. Ents Forestry will oversee establishment and carry out all plantation management activities.
- The 2016 Project will be established on second rotation sites with known productivity and will incorporate new plantings and coppiced trees.

As with the 2014 Project, 66% of the Project land area will be coppice sites. There have been advances in coppice management and the independent expert and Ents Forestry are both supportive of its inclusion in the planting mix. The focus on high productivity sites will be critical to achieving the level of productivity required to deliver strong returns for investors. Nevertheless, Adviser Edge continues to build some conservatism into the modelling of returns to reflect the lack of historical performance data for coppice sites.

Plantation sites were inspected throughout the Albany region. Despite rainfall being well below average for the past two years most sites were in good condition, with mature plantations reaching productivity levels in the range of 25 to 30 MAI. A significant rainfall event in early 2016 has provided an excellent start to the year following a dry 2015.

Coppice sites that were inspected were growing strongly and certainly well in advance of seedlings of the same age, reflecting the advantage available from growing coppice from an established stump. Coppice sites are left to manage their own stem density, with two to three stems being normal. It is cost prohibitive for W.A. Blue Gum to manually prune coppices and advances in harvesting equipment and techniques have largely overcome issues associated with harvesting several stems at a time.

Achieving the targeted 280m<sup>3</sup> by year ten will be achievable on parts of the plantations; however, the overall level of productivity is likely to fall in the range of 250m<sup>3</sup> (+/- 10%). If trees are growing strongly at ten years of age and market conditions are conducive, then a decision to extend the rotation length would be supported by Adviser Edge.

Overall, Adviser Edge remains confident in the ability of W.A. Blue Gum and Ents Forestry to identify high productivity sites in high rainfall areas and to manage trees to best practice standard. Management of the plantations is proactive, with sites receiving fertiliser applications to allow trees to take advantage of improved seasonal conditions. Investors in the 2016 Project



should be confident that their trees will be managed well, within the constraints of seasonal conditions. The inclusion of coppiced sites into the Project does have commercial merit but comes with some additional risk, predominantly relating to the shallow pool of information pertaining to yield.

### Planting regions

The independent expert Don Spriggins has noted specific sites that he believes will be included in the 2016 Project. These sites will be all second rotation sites with known productivity and are located in the Albany Port wood catchment and near to Denmark and Albany. Chipped logs harvested from plantations in the Denmark areas will be transported 80km–90km to a chip facility at Albany. Keeping cartage distances as short as possible will allow W.A. Blue Gum to achieve a higher mill door price than plantations with a larger haul distance.

Rainfall in this region, which also includes the town of Walpole, is high, with long term averages of between 931mm (Albany) and 1,311mm (Walpole). Rainfall reduces depending on the proximity to the southern coastline in this region.

Adviser Edge has completed an in-depth analysis of the rainfall data for both Albany and Walpole. The past two years have been particularly dry relative to the long-term average, with rainfall at around 70% to 75% of the long-term mean. Despite this, the first four months of 2016 have delivered good rains and provided for strong tree growth across the region.

Throughout Australia there is concern about the impact that climate change is having on rainfall. Adviser Edge has examined the data sets to determine whether there has been a step change in rainfall in the Albany region, focusing on 20-year mean annual rainfall relative to the long-term mean. In the case of Walpole the 20-year mean is 5% lower than the long term (65 years of data), while Albany is 8% lower. When Adviser Edge assessed the data sets on the basis of an 11-year rolling average to reflect an average rainfall pattern over the course of a full rotation, the result was a 5% reduction for both locations over the period from 1980 to 2015.

Clearly there has been an impact from climate change over the past 20 years. Whether this trend continues is unknown; however, the analysis of the 11-year rolling average would support lower rainfall expectations of around 5%. This in fact supports the decision by W.A. Blue Gum to focus on sites located in high rainfall sites. Seeing a 1,200mm site reduce by 5% to 1,140mm is vastly different to a 800mm site falling back to 760mm on average over the course of a rotation. Even the 11-year rolling average that included the decile one years of 2014 and 2015 still had an 11-year mean above the long-term average in Albany.

***Locating the plantations on second rotation sites with annual rainfall or around 1,000mm and within 75km of the port of Albany is critical to the financial outcomes of the***

***Project. Adviser Edge has confidence that Ents Forestry and W.A. Blue Gum will be able to secure sites meeting these criteria (among others), but as sites are not secured until after the closing of the subscription period on 30 June 2016 there remains some uncertainty as to site location.***

### Site selection

Land for the 2016 Project will be selected based on a number of key criteria, with the aim of achieving a weighted average mean annual increment (MAI) of no less than 28m<sup>3</sup>/ha/year over ten years. W.A. Blue Gum will consult with Dr Chris Shedley (independent soil expert) and the supervising forester, prior to making any final decision on land lease agreements.

The productivity target for the 2016 Project of 28m<sup>3</sup> MAI is the same as for the 2015 Project. The most recent inventory data provided by W.A. Blue Gum for the estate under WAPRES management indicates average productivity of 24m<sup>3</sup> MAI; however, these sites did not include coppiced trees, making direct comparison a challenge.

Adviser Edge has been provided with the site selection protocols developed to incorporate coppiced sites into the planting mix. The following outlines the key site criteria that are evaluated by W.A. Blue Gum when selecting land for the Project.

- Sites that are capable of achieving 28m<sup>3</sup> MAI, including coppiced sites.
- Land must have a mean annual rainfall of greater than 900mm.
- Second rotation sites, or properties with strong fertilisation history, are preferred.
- Soils must have sufficient water-holding capacity and acceptable depth. Impeding layers need to be either in the rip zone or deep enough to allow appropriate root development.
- Deep sands, waterlogged soil and saline soils are to be avoided.
- Sites should be established within 100km of either the Port of Bunbury, or a chip mill close to the Port of Albany.

Site productivity estimates will be based on site characteristics, including the major factors of rainfall, soil type and topography. Historical yields are considered when estimating site productivity for second rotation sites, with a genetic gain assumption often incorporated to account for increased production as a result of tree breeding and improved silvicultural knowledge and practices. The inclusion of coppiced sites negates the impact of genetic improvement to a large extent.

***Adviser Edge has confidence in the site selection criteria employed by W.A. Blue Gum, with recent land selection reinforcing the company's ability to secure quality land. The relatively small, boutique nature of the Project ensures that site quality is not compromised in the search for large tracts of plantation land. Adherence to the site selection protocols will be critical to coppice outcomes, as it will be very important that only high quality coppiced sites are brought into the Project. Adviser Edge believes that all sites should be within 100km of port and that this should not be an average distance, as this will lead to increased costs and lower investment returns for growers.***

#### **Species and seedling supply**

The Independent Forester advises that, Ents Forestry has purchased high quality seed (Genetic factor 26, western blue gum seed, purchased from FPC) for the new planting component of the 2016 Project to ensure only high quality seedlings will be used. The required seedlings will be raised in a local contract nursery under the supervision of Ents Forestry.

#### **Site development and maintenance**

Ents Forestry will be responsible for site development and stand management. It is likely that local contractors will perform the tasks of planting and tending under the supervision of Ents Forestry. New plantations will have an average of 900 to 1,000 stems per hectare, with the majority of planting expected to take place in July and August following rain, to ensure that soil moisture is sufficient for successful establishment.

Coppiced sites will be selected from recently harvested sites in the targeted region. Sites that do not have the density of coppices required to achieve the target productivity will not be included. Coppiced sites will target 1,400 stems per hectare, with pruning to achieve this to occur at about two years of age. It is expected that each coppiced tree will have two or more stems, which is required to maximise site productivity.

Site development methods will be similar at each site, although there will be some variation to account for differences in soil types, the pest and weed spectrum, and whether the site is ex-pasture or second rotation. Planting lines will be deep-ripped and mounded, and various measures will be employed to minimise weed growth prior to planting.

The Independent Forester has noted that one of the advantages of establishing second rotation sites is that existing roads and firebreaks, water points for fire control and other infrastructure are already in place, thus reducing the costs of re-establishment on the same location.

Following establishment, Ents Forestry will monitor the plantations on a monthly basis for the first six months, gradually increasing the period between inspections as the plantations mature (refer PDS p38), and will implement appropriate control

measures if insect damage and weed invasion adversely affect the development and growth of the plantations. Each site will be analysed for nutrient deficiencies, and suitable fertilisers will be applied when necessary. Given the quality of sites selected for past projects, with high average rainfall and deep soils, the availability of nutrients has generally been the inhibiting factor to growth.

Inventory via permanent sample plots (PSPs), where every tree within the plots is measured for height and diameter at breast height, will be carried out at four-and-a-half years and again at seven-and-a-half years. The first inventory provides information on growth to date, and is early enough to signal any management action needed, such as the application of fertiliser. The second inventory provides a reliable forecast of the expected yield at harvest time.

***Ents Forestry's management team has extensive experience in the establishment and management of blue gum plantations in the south-west region of Western Australia. It will draw on the resources of experienced local contractors to fulfil its operational responsibilities.***

#### **Harvesting and processing**

It is expected that harvesting and processing operations will be coordinated by Ents Forestry. Depending on the location of the plantations the harvested timber may be transported to wood chip mills at Bunbury Port, Manjimup or Albany. If the selected plantation sites are located in the Denmark/Walpole sub-region, then it is likely that the logs or woodchips (if logs are chipped in-field) will be transported to the mill near Albany or directly to Albany Port.

The timing and precise method of harvest are to be determined by negotiation with the purchaser, with all preparation for harvest to be undertaken by Ents Forestry. While the expected time of harvest is at 10 years of age, the Project Agreements provide flexibility to allow plantations to be grown on well past the estimated 10-year term, where it can be shown that trees are growing at a still-increasing rate, or if market conditions dictate (as has been the case in 2013). However, harvesting must occur within 15 years.

The south-west region of Western Australia is well serviced by harvesting contractors and transport companies experienced in pulpwood logistics. Consequently there is an expectation that the contracting rates agreed between W.A. Blue Gum and any contractors will be competitive and reflective of the contracting market at the time of harvest.

In his Independent Expert's report Mr Spriggins notes that, "Haulage costs are the greatest contributor to the total cost of production to the mill door (effectively the stumpage price). Chip logs will either be converted into woodchips at APEC's static chipper at Down Road, Albany, or be chipped in the field and transported to the Albany Chip Terminal at Albany Port."

### Market Overview

Product Type	Eucalypt hardwood timber
Primary Use	Pulpwood
Key Target Market	Japanese and Chinese pulp and paper manufacturers
Australia's Competitors	Vietnam, Brazil and South Africa
Product Sales Agreements	Off-take agreement with W.A. Chip & Pulp Company

### Marketing strategy

W.A. Blue Gum has entered into a Wood Purchase Agreement with W.A. Chip & Pulp for the purchase of all timber grown in the Project.

Under the Wood Purchase Agreement, W.A. Chip & Pulp will offer W.A. Blue Gum a purchase price for the timber delivered to the relevant chip mill or port facility, dependent on the harvesting method used. In addition to this, W.A. Chip & Pulp will provide a fixed quote for the harvesting and delivery of the timber, including the costs of roading and other activities. W.A. Chip & Pulp will also provide W.A. Blue Gum with a harvesting plan, which will outline the timing of harvest and the harvesting method.

The Wood Purchase Agreement does not specify a particular pricing structure for the wood. The price paid is expected to reflect the actual market conditions at the time of harvest and will be heavily influenced by the level of competition in the region at that time. If the timber is produced too far from the Bunbury port, then it is likely that W.A. Chip & Pulp will decline to offer a price. Given that there is a high likelihood of at least part of the Project being established in the Albany port catchment, this is a likely scenario.

W.A. Blue Gum can elect to accept the price offered by W.A. Chip & Pulp, or can negotiate a higher price if it does not accept the initial offer. In the event that the two parties disagree on the price offer, W.A. Blue Gum can seek a higher offer for the timber from a third-party wood chip processor. W.A. Blue Gum can only sell to that third party if W.A. Chip & Pulp does not exercise its right to match the price offered by the other interested party.

While there remains merit in having a Wood Purchase Agreement in place, Adviser Edge considers its value to have diminished. The price premium for woodchips sold into Japan has evaporated, taking away one of the key benefits of the Wood Purchase Agreement. This, coupled with the high likelihood that some or all of the plantations will be established in the Albany port wood catchment, makes the off-take agreement less relevant than was historically the case.

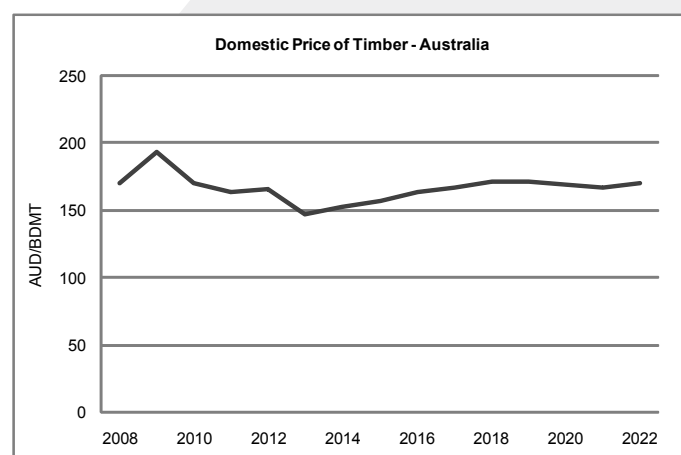
### Key Points

- An off-take agreement has been entered into with W.A. Chip & Pulp which, through parent WAPRES, is wholly Japanese-owned.
- W.A. Blue Gum can negotiate a higher price with another buyer; however, W.A. Chip & Pulp has the right to match any price.
- China has surpassed Japan as the world's largest importer of woodchips.
- The premium paid for Australian woodchips by Japan has evaporated over the past three years.
- Australia is now the second largest woodchip exporter behind Vietnam.

### Australian woodchip market outlook

About a third of the world's traded hardwood chips are currently originating from eucalyptus plantation forests in Australia. Eucalyptus chip export volumes from Australia were up 15% in 2015 year-on-year to reach a record high of 5.2 million tons, valued at almost A\$1 billion. Shipments have increased for three consecutive years, and in 2015 were about 58% higher than they were in 2012. (Wood Resources Quarterly and Fordaq 2015)

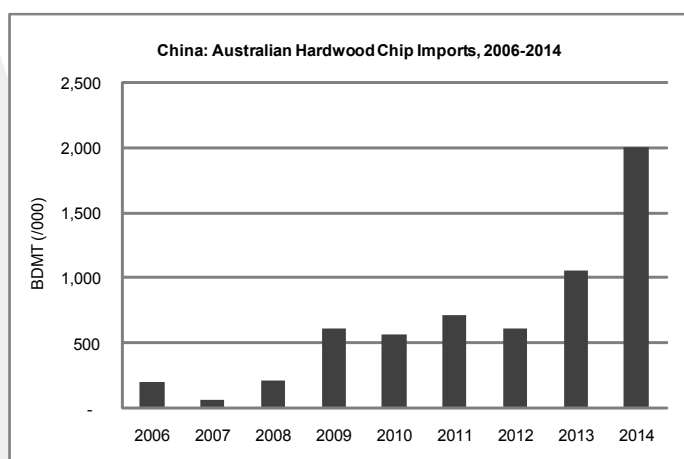
The industry was highly profitable in the years prior to Japan's Fukushima nuclear disaster in March 2011. The disaster resulted in large revenue declines across several major Japanese industries, including paper manufacturing. This reduced demand for Australian woodchips, causing industry revenue and profit to slump in FY2012-13. With woodchip demand from Japan increasing in subsequent years, industry profit margins have improved from their FY2012-13 low. Overall, industry profit declined from an estimated 20.1% of industry revenue in FY2010-11 to 12.1% in FY2015-16. (IBISWorld, December 2015)



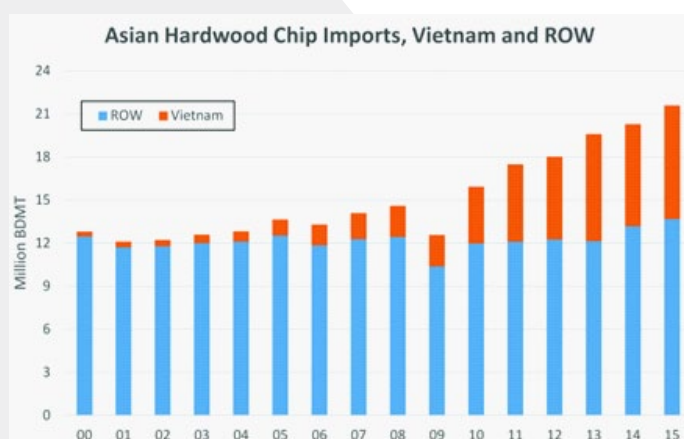
Source: IBISWorld, 2016.



In recent years Australian hardwood woodchip exports have been affected by strong price and volume competition from South East Asian countries, particularly Vietnam. However, at the same time, increased demand in China has allowed Australia's shipments of hardwood woodchips to China to expand rapidly, from a low of 67,000 bone dry metric tonnes (BDMT) in 2007 to 2.0 million BDMT by 2014. (DANA, 2015)



Vietnam has emerged as the top global hardwood chip exporter, having surpassed Australia, although there is now evidence that Vietnam's exports have peaked, with a fall in exports in 2014. This is partly the result of government policies to limit woodchip exports in favour of domestic processing. This suggests that high volumes exported by Vietnam in 2013 and 2014 may not be sustainable in the future. (New Forest, 2015)



Source: RISI, 2016.

Historically, Japan has been the main source of demand for hardwood woodchip in the Pacific Rim due to limited local supply and trade barriers to competing paper imports. Demographic trends and technological change are leading to declining demand in Japan. In contrast, the growth of pulp and paper production in China has increased almost threefold since 2003, and China is forecast to surpass Japan in total woodchip imports in 2016. (RISI, 2015)

Between 2008 and 2013, woodchip imports into China grew by more than 50% per annum. However, in 2014 the growth rate in Chinese market for hardwood chips slowed, reflecting a change in government licensing of new pulp mills in China. China's demand for hardwood chips will continue to expand in 2015 and beyond, albeit at a slower pace. (RISI, 2015) China is expected to account for 23.3% of industry revenue (Australia) in FY2015-16, up from 10.5% in FY2010-11. (IBISWorld, December 2015)

Another noteworthy development is how the costs for Australian chips delivered to pulp mills in China and Japan have changed over the past few years. During much of the period from 2011 to 2013, the price discrepancy for chips exported to China was about US\$50/odmt lower than chips delivered to Japan. However, since early 2014 the delivered costs converged between the major consuming countries of Australian hardwood fibre. They have remained practically the same since then, only changing marginally in 2015. (Wood Resources Quarterly and Fordaq 2015)

The Japan price premium appears to have evaporated, which supports Adviser Edge's view that Australian woodchip prices will not rebound to pre-GFC levels, but will instead rise gradually off the current lower base.

After several years of strong headwinds there appears to be some positive signs for the Australian industry. Respected international forestry consultancy DANA (Now part of RISI) has identified a range of factors they believe will favour the Australian woodchip industry in the near term. These include:

- The distinct possibility that Vietnam's climate change woes may worsen,
- The Vietnam government's increasing irritation over large volumes of woodchips being exported (which hit a peak of 7.4 million BDMT in 2013, but dropped in 2014),
- A belated recognition by Chinese pulp mills of the superior qualities of both *eucalyptus globulus* and *eucalyptus nitens* woodchips relative to lower yielding and lower quality South East Asian woodchips,
- A big new pulp mill due to start up in China in late-2015 which will need high quality woodchips, and
- The rapid change in Australia's competitiveness due to a weakened AUD.

The Japanese premium is likely to be a thing of the past, which means resetting price expectations to lower levels. The implications for this at the plantation level are significant, as only high productivity sites within close proximity to port are profitable at current stumpage prices.

For investors in the 2016 Project to achieve a commercial return on their investment there will need to be a material improvement in market fundamentals for plantation timber producers over the ensuing decade through to 2027. China is likely to further entrench its position as the number one importer of woodchips during this period.

During the first half of 2016 market conditions have improved for pulpwood growers in south-west Western Australia. This has resulted in a lift in stumpage prices in the region, providing much needed relief for pulpwood producers. Information provided to Adviser Edge under confidentiality confirmed that improved prices are being achieved in both the Albany and Bunbury port wood catchments. The information also confirmed that Albany is delivering a stumpage premium of around \$2 to \$3/GMT.

Higher prices at the stump are reflective of a number of the prevailing factors at any given time. These will include the AUD:USD exchange rate, global economic growth (which is a key determinant of paper demand), supply side dynamics, and harvesting costs (a function of labour and fuel costs).

The level of economic activity in East Asia, particularly Japan, which is the main destination of the industry's exports, is a major demand determinant for the industry. The industry's revenue growth is largely linked to the level of activity in the Japanese, Chinese and other Asian paper and paperboard product manufacturing industries. This is influenced by economic growth in these countries, consumer and business confidence, trends in packaging and advertising, and, demand for newspapers and magazines. (RISI, 2016)

While a reduction in exports from Vietnam is expected and would be beneficial, RISI (2016) has noted that there is a risk that expanded low-cost pulp exports from Brazil could negatively impact the market.

***The combination of expanded supply here in Australia and internationally, and low demand from Australia's key value market, Japan, drove prices to unprofitable levels for plantation owners in 2014 and 2015. While there has been some improvement in market conditions since then, the industry remains exposed to ongoing global financial uncertainty and subdued economic growth in key markets. The externalities that effect global woodchip prices are largely beyond the control of industry participants and as such investors in the 2016 Project must accept the heightened industry risk associated with the investment.***

### Compliance

While the woodchip export industry has historically relied on native forest timber, these woodchip markets are beginning to show a preference for ethically and environmentally-accredited plantation woodchip resources.

Two recognised forestry accreditation systems currently exist in Australia: the Forest Stewardship Council (FSC) and the Australian Forestry Standard (AFS). At present, there is little evidence to suggest that a price premium can be obtained from forestry accreditation. However, many export customers are indicating a preference for certified products, and it is possible that in the future a premium could be obtainable. Lack of an environmental standard or chain of custody may create barriers to entry for less sophisticated woodchip producers overseas.

To further substantiate the sustainability credentials of plantation timber, chain of custody certification can be obtained to the Australian standard (AS4707-2006). This certification provides users with certainty regarding the origin of the product as it moves through the value chain.

WAPRES has an Environmental Management System in place, which is accredited to ISO 14001 and the Australian Forestry Standard. WAPRES also has certification for Chain of Custody and Controlled Wood with the FSC.

The following section provides an analysis of the potential investment returns for the Project. Please note that this analysis is based on Adviser Edge's estimated performance assumptions, after taking into account assumptions provided by W.A. Blue Gum, which may change during the Project term. Investors need to be aware of the way in which these assumptions may influence investment returns, and should seek additional professional advice to determine whether or not this investment is suitable for their own risk and return objectives.

#### Adviser Edge Returns Modelling

	Pre-Tax	Post-Tax <sup>3</sup>
Adviser Edge Base Case <sup>1</sup>	4.1%	4.1%
IRR Range <sup>2</sup>	-2.6% to 8.6%	-2.6% to 8.6%
Median Return	4.3%	4.3%
Percentage of results that are break even or better	71.9%	71.9%
Percentage of results with an IRR of 10% or better	12.0%	12.0%

<sup>1</sup> The Adviser Edge Base Case return reflects the base return using static investment modelling, based on the key Adviser Edge performance assumptions outlined in this section.

<sup>2</sup> The IRR range represents the range of results that occur within the 20th and 80th percentile in the simulated model. The range is based on Adviser Edge's modelling of potential outcomes for the Project using Monte Carlo simulations. These are subject to a number of limitations, which are discussed further below. Accordingly, the range is provided as a guide only. Investors should seek additional professional advice regarding the impact of changes in key variables on Project returns given their individual financial circumstances. The analysis does not consider investor finance arrangements.

<sup>3</sup> The analysis assumes a 46.5% marginal tax rate, that investors are registered for GST, and that all GST is rebated in the year paid.

### Scenario Testing

In reviewing the Project, Adviser Edge has undertaken scenario testing of potential returns from the Project using Monte Carlo simulations. The scenario testing is based on variations in key assumptions relating to price, yield, costs, and the potential for severe adverse events to occur, as well as the relative impact of these events on returns. Investors should be aware of the limitations associated with this kind of scenario testing. The model used incorporates a number of subjective judgements made by Adviser Edge, which may not be empirically verifiable and does not include all the variables that affect returns. Accordingly, the predictive capability of financial modelling is limited. Nonetheless, Adviser Edge believes that the use of such modelling practices provides an improved insight into the risk-return profile of a particular investment when compared with static investment modelling techniques.

Returns modelling undertaken by Adviser Edge suggests that the Project displays a median internal rate of return of 4.3% p.a. on a pre-tax and post-tax basis, assuming that an investor maintains

### Key Points

- Market conditions for Australian woodchip exports are currently poor but there are signs of improvements. As has been the case for W.A. Blue Gum projects harvested in recent years, market conditions at harvest represent a significant risk to financial outcomes.
- The Project will be located in a well-established forestry region with high average rainfall. Selected sites will have known productivity (second rotation sites), providing greater certainty regarding the volume of wood that will be grown.
- Historically W.A. Blue Gum project plantations have underperformed relative to the W.A. Blue Gum expected yield. Many of these sites were first rotation and the WAPRES growth curve appears to overestimate productive potential based on actual results being achieved.
- The combination of yield and distance to port are critical to stumpage prices paid in any given market cycle. Higher yielding sites can be located further from port and remain profitable. However, if yields fall below expectation, then longer haulage distances will impact profitability.

the same tax rate throughout the life of the Project. This is not dissimilar to Adviser Edge's base case return.

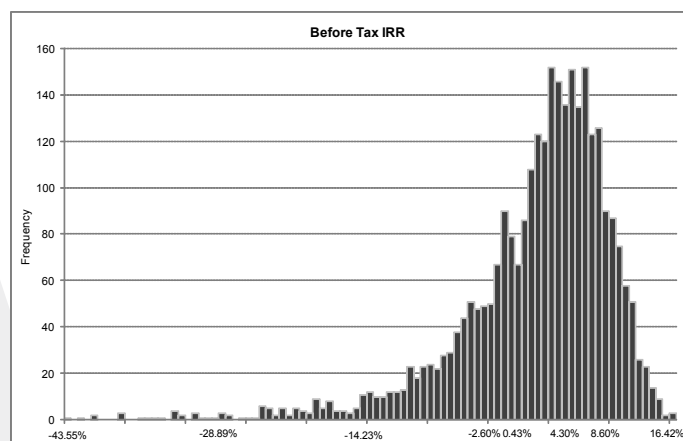
Returns modelled by Adviser Edge indicate that the Project has an imbalance in the risk and return profile as a consequence of the increased reliance on a woodchip market recovery to achieve a commercial return. This is reflected by a low base case and median return

Given that, historically, woodchip prices have been heavily influenced by economic conditions, an investor in the 2016 Project would need there to be a significant improvement in global economic conditions if there is to be a material step change in woodchip prices. In the past there has been a premium paid for woodchips sold into Japan. This premium is no longer guaranteed and, further to this, woodchips grown by the 2016 Project may in fact be sold to Chinese buyers.

***Adviser Edge modelling indicates that there is a high likelihood that the Project will not achieve a positive return. Further, the risk associated with achieving a positive return does not compensate for the high risk of investment.***



### Pre-tax investor returns probability analysis



### Key Performance Assumptions

The estimated Project returns provided by Adviser Edge have been calculated using various performance assumptions. The key assumptions adopted by Adviser Edge are presented in the following table and a comparison is made to the assumptions used by W.A. Blue Gum. These assumptions have been determined from information provided in the PDS, directly by W.A. Blue Gum, from the independent forester's report, and from independent research performed by Adviser Edge. The following table includes the performance assumptions adopted by W.A. Blue Gum, in terms of expected performance parameters. A detailed summary of the assumption used by both Adviser Edge and W.A. Blue Gum follows this table.

Performance Assumptions	Adviser Edge	W.A. Blue Gum
Age of trees at harvest	10	10
Year Planted:		
- 2015	66%	66%
- 2016	33%	33%
Woodchip yield	280m <sup>3</sup> /ha	At least 280m <sup>3</sup> /ha*
Average Mean Annual Increment (MAI)	28m <sup>3</sup> /ha/year	At least 28m <sup>3</sup> /ha/year
Average implied hardwood stumpage price (\$/GMT)	\$36.50	No forecast
Stumpage Price Inflation	2.9%	No forecast
Cost Inflation	2.9%	3.0%

\* Sites selected by the forestry supervisor will be required to have capacity to achieve at least 280m<sup>3</sup>/ha.

### Yield assumptions

As with the 2015 Project, the 2016 Project will target second rotation sites with known productivity and potential to grow coppiced trees from the stumps of the previous rotation. While

the science around the growing of coppices is far from settled, the selection of sites that have already produced a crop of trees is a much better way of estimating future productivity.

An examination of the historical growth data provided by WAPRES and W.A. Blue Gum indicates that first rotation sites have on average significantly underperformed relative to the predicted volume using the WAPRES derived growth curve. There have been some years of significant rainfall deficit; however, this likely to occur in any given 10 year rotation and should be factored into modelling to ensure greater realism. To a large extent the use of actual performance in the site selection process eliminates the margin for error that appears to be present in models used at present.

Once sites are established the ongoing monitoring of growth rates, most notably the 7.5 year inventory, will provide the best guide to harvest productivity.

Without a great body of published research on blue gum coppices in the target regions, the selection of only the best sites for coppicing makes a lot of sense. Adviser Edge inspected a range of sites that incorporated coppices and was in the main pleased with the standard of coppices (growth and density). Having clear guidelines on minimum coppice densities makes the site selection process very objective.

The final average yield achieved by the blue gum plantations grown under the Project will ultimately depend on in-rotation rainfall, soil quality and the ability of W.A. Chip & Pulp, the blue gum operations manager, to effectively manage the plantations (i.e. apply fertiliser to stimulate growth and control pests, weeds and diseases effectively). Climatic conditions will be the major factor in the performance of the plantations over the investment term based on Adviser Edge's observations and actual performance of plantation sites already harvested or in rotation.

Based on the Independent Expert's report included in the PDS, sites have been identified in the Albany Port forestry catchment. However, W.A. Blue Gum is not limiting its selection to this region, which means trees could be also established on sites in the Bunbury Port forestry catchment. These sites are located within the preferred range of 100km to the nearest mill/port.

The targeted average productivity is above what has been achieved historically by W.A. Blue Gum for projects that have completed a full rotation, or had their 7.5-year inventory. On average these sites achieved an average MAI of between 23 MAI and 24 MAI. This is lower than the target annual productivity as per the site selection protocol (which for the 2016 Project is 28 MAI), because sites that do not meet the minimum requirement of the protocol are excluded. However, Adviser Edge is confident that 28m<sup>3</sup> MAI is an achievable productivity target.

Previously Adviser Edge has made some allowance for productivity gains where new plantations are established using seedlings with higher growth factors. Based on the discrepancy between actual harvest and modelled outcomes, Adviser Edge is not convinced that the theoretical gain translates into actual higher growth at commercial scale.

***The focus on including second rotation sites with known productivity is beneficial as it increases the likelihood of meeting or exceeding the 280m<sup>3</sup>/ha benchmark set out in the site selection protocols. The focus on the southern part of the south-west Western Australian region, where rainfall is higher, is also a positive element of the Project. Careful consideration needs to be given to the average distance to the nearest commercial port, as haulage costs will eat into profits if sites located above 100km fail to deliver expected volumes. While Adviser Edge has modelled returns on the basis of an average of 100km, the preference would be for all sites to be within this distance, giving a much lower average haulage distance.***

Adviser Edge notes that, under the Project Management Agreement, W.A. Blue Gum must establish the plantation by 31 December 2016. However, for investment modelling purposes, Adviser Edge has assumed a 10-year rotation, with 66% of the trees being planted in calendar year 2016 and 33% in 2017. Despite this, W.A. Blue Gum will aim to establish 100% of the plantations in 2016, which is plausible given the relatively small scale of the Project and the fact that there is a large coppiced component.

### **Past performance**

A number of W.A. Blue Gum plantations have been harvested in recent years, with varied results. The 2005 and 2006 Projects are currently being harvested. The most recent inventory indicates that average yields across the W.A. Blue Gum estate are likely to produce timber volumes that are approximately 30% below the target productivity of 340m<sup>3</sup>/ha. For those plantations that have been harvested over the past two years, the lower productivity combined with poor woodchip market conditions is likely to mean that investors will suffer net losses over the duration of the investment.

Rainfall over the past two years has been well below average, which will have influenced the rate at which all plantations grow. However, over the average ten-year cycle rainfall can be generally expected to fall within 5% to 10% of mean. What this appears to indicate is that forecasting growth rates for first rotation sites is at best an inexact science, as there will always be years of below average rainfall in a 10-year rotation and the models should give reference to this likelihood.

Adviser Edge has now observed underperformance relative to modelled outcomes across a significant data set, including the most recent 7.5 year inventory (10 sites), which averaged 23.3

MAI (with one severely underperforming property excluded from the data set) against the original PDS estimate of 34 MAI and 340m<sup>3</sup>/ha at age 10 years.

The issues associated with estimating first rotation productivity are not so relevant for the 2016 Project, with all trees to be grown on second rotation sites. While there is some uncertainty relating to coppices, the lower cost to re-grow coppiced trees makes this approach lower risk when compared to planting on sites with no production history and the risk that the growth curve will overestimate productive potential.

Market conditions over the past 12 months have improved but are still below what is required to deliver a profit to growers in projects that are being harvested. This illustrates the timing risk that investors need to consider, in that market conditions could be unfavourable at the time harvest is anticipated. Many of the sites included in earlier W.A. Blue Gum projects lacked flexibility to continue growing trees rather than harvesting at unprofitable stumpage prices. While there are holding costs, principally rent, the high rainfall in the region where the trees will be grown will allow trees to continue growing strongly, which should negate holding costs.

Prior to 2012 the W.A. Blue Gum projects had performed well, with good prices making up for lower productivity. As soon as the prices came off following the 2011 tsunami in Japan, the lower productivity issue came to the fore. The woodchip market experts have noted the convergence of the Japanese and Chinese prices, which has also reduced the value of the W.A. Chip & Pulp Wood Purchase Agreement. This has been borne out in the last two years, with investors receiving what appears to be the general market price, with no premium attributable to the Wood Purchase Agreement.

***Poor woodchip market conditions and lower productivity have weighed heavily on the profitability of recently harvested projects managed by W.A. Blue Gum. Average actual productivity is well below targeted productivity, which may reflect an over-estimation of site productivity potential prior to establishment and the affects of low rainfall in 2014 and 2015. The value of the W.A. Chip & Pulp Wood Purchase Agreement has been diminished as the Japanese woodchip premium has been virtually eliminated from the market.***

### **Price assumptions**

Adviser Edge has adopted a stumpage price of \$36.50 per green metric tonne (GMT). The adopted price reflects recent changed market conditions for woodchips, which have shown improvement as the industry continues to recover from reduced demand from the higher value Japanese market.

Previously Adviser Edge had expected that woodchip prices would recover more quickly as a consequence of the direct access to

Japanese market via the W.A. Chip & Pulp off-take agreement. It is now evident that the premium previously paid for woodchips exported to Japan relative to China has evaporated. This means that there is no real likelihood that woodchip prices will rebound to pre-GFC levels, and as such Adviser Edge has adopted a lower starting market price for modelling purposes, which more closely reflects the current market conditions for blue gums grown in south-west Western Australia. This view is supported by the IBISWorld forecast for woodchip prices through to 2022, with prices expected to track at or around the level required to deliver a \$36.50/GMT stumpage price (see Marketing section, page 14).

There are numerous factors that will influence market conditions over the ten-year (or longer) period of the project. These include but are not limited to:

- AUD exchange rate
- Global woodchip and pulp supply, most notably out of Vietnam (woodchip) and Brazil (pulp)
- Level of demand in the Chinese pulp and paper industry
- Japanese economic conditions
- Global economic growth
- Australian woodchip supply
- Trends in paper consumption, particularly in developing countries such as China and India

The Australian woodchip industry is coming off the lows reached in 2015 and experts believe that there are signs of recovery, albeit without a return to a situation where Japan dominated the market and paid a premium for woodchips exported out of Australia. A sustained low AUD will be highly beneficial in any part of the market cycle; however, predicting where the exchange rate may be in 10 years time is not possible.

When the trees are harvested, the timber will be processed into woodchips and exported from the nearest port, which is likely to be Albany. Timber may be sold on the stump or on a delivered to port/mill basis. All proceeds are pooled, with investors receiving a proportionate share of revenue. The pooling arrangement spreads risk for investors and is common in agriculture projects of this type. Most notably, pooling reduces the risk that the property where an investor's trees are located underperforms relative to other plantations.

Under the off-take agreement with W.A. Chip & Pulp, investors will be offered a mill-door price for the harvested timber. A mill-door price represents the price that investors receive for logs delivered to one of W.A. Chip & Pulp Company's processing

facilities, with growers incurring the cost of harvesting and transporting the logs to the mill.

The stumpage price represents the log price that is received by growers once all costs incurred to the point of sale are factored in. It is determined by subtracting these costs from the mill-door price, and accounting for relevant conversion factors.

Other factors, including yields, distance to port, topography and existing road standards, as well as macro factors such as oil prices, inflation rates, and advances in harvesting technology, will also have an influence on costs. An inverse relationship exists between the harvesting costs and the plantation yield, due to the lower cost associated with harvesting larger piece sizes (i.e. larger logs equate to lower costs per GMT). Additionally, the further a plantation site is located from the port or chip mill, the higher the cost of transport of the logs to the mill.

Adviser Edge's price estimate includes the 3.0% harvest supervision fee. While W.A. Blue Gum intends to sell the timber produced from the Project at the mill door, for comparative purposes Adviser Edge has calculated an implied stumpage price.

To determine the implied stumpage price, Adviser Edge has assumed an average distance of 100km to the nearest processing facility. While W.A. Blue Gum's selection criteria require sites to be within 100km of the nearest processing facility, it is likely that 100km will be the average

Adviser Edge has incorporated variations in woodchip prices, as well as harvest, processing, and transport costs, into its investment modelling process in order to determine the potential returns range.

Due to the time until harvest, Adviser Edge has assumed that woodchip prices will increase in line with its inflation forecast of 2.9%. This reflects long-term price trends, which show no real price increases.

***Adviser Edge has adopted a net stumpage price of \$36.50/ GMT. This reflects the current market conditions, which have risen off the 2015 lows. Supply is currently high but there is expected to be an easing of supply pressure as Vietnam reduces exports and focuses more on in-country processing. Australia has moved to become the second largest export of woodchips behind Vietnam. This reflects high volumes of ex-MIS land being harvested throughout the country. The absence of a Japanese premium means that the recovery in woodchip prices is likely to be steady as opposed to the step-changes of the past.***

#### **Other assumptions**

As well as assessing the key variables of yield, price, and harvesting and processing costs, Adviser Edge has incorporated

the potential for RE insolvency and its expected impact into the investment modelling.

In assessing the likelihood of an insolvency event, Adviser Edge has taken into account W.A. Blue Gum's balance sheet, its access to capital, its ability to generate future cash flow, and the comparatively small scale of the projects. Adviser Edge has applied a relatively low default rate in its investment modelling, as the nature of the company's business means that all projects managed by W.A. Blue Gum are largely self-funded.

The Project is structured in such a way that, in the event of the RE's insolvency, it is likely that a replacement RE will be appointed. This is due to the incorporation of ongoing rent and management fees. As a result, Adviser Edge has assumed that an insolvency event will result in the replacement of the RE at a small additional cost to the investor in that particular year.

The modelling of Project returns has also incorporated the cost of insurance, the probability of an insurable event occurring, and the proceeds should an insurable event occur.

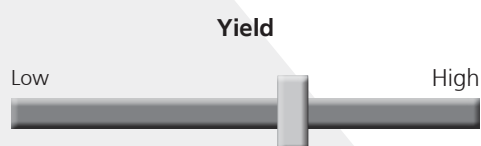
***It is difficult to estimate the probability and impact of these assumptions on investment returns due to the limited information available to verify the underlying assumptions.***

***However, Adviser Edge believes that by including its judgment on the potential impact of these events, investment returns modelling will be more reliable when compared to static assessments.***

## Sensitivities

The Project's ability to achieve key assumptions is a function of both the inherent volatility of the underlying activity as well as the assumption risk, which is the accuracy of the initial estimate. Accordingly, the volatility used in Adviser Edge's modelling depends on the quality of the data supporting the assumptions, and an assessment of the expected volatility of the underlying activity during the course of the Project.

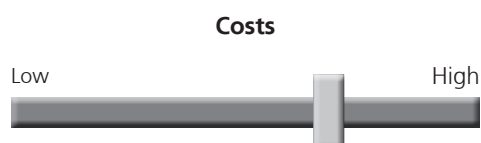
The two factors that have the most impact on investment outcomes are timber yield and the price paid at mill door. The Operations Manager and W.A. Blue Gum can have some influence over both outcomes through good site selection and good management. Selecting highly productive sites that are close to port and in areas with high and secure rainfall, will influence timber yields and ensure lower harvesting and freight costs. To a great extent however, the actual price paid will be dictated by prevailing market conditions at the time of harvest.



Yield risk is considered to be moderate. The 2016 Project will incorporate second rotation sites with known productivity, which provides a good guide to future performance. There does remain some uncertainty relating to coppice growth rates, which needs to be balanced with the strong early growth achieved from coppices, coupled with lower cost of re-establishment. The factors most likely to affect yields are years of low rainfall, and pest and disease pressure.



Variations in price are considered to pose the most risk to Project outcomes. There has been significant market volatility since the GFC, illustrating the impact that changes in global and market economic conditions can have on woodchip demand and prices. China emerged as the leading buyer of woodchips and a stronger Japan is required to bring some balance back into the market for woodchip producers.



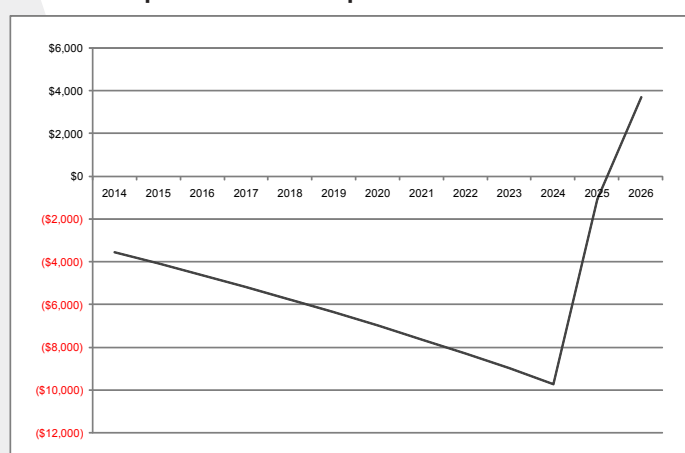
Rent as a proportion of gross revenue has increased significantly as a consequence of the lower stumpage prices being achieved in the Albany and Bunbury regions. While rents have declined over the past three years, the decline does not reflect the current difficult trading environment. Harvesting costs are lower for high productivity sites and haulage costs increase in line with distance from port. Locating highly productive sites close to port will help to contain costs.



## Pre-tax Cash Flow per Woodlot

The W.A. Blue Gum Project 2014 aims to harvest the plantations at age ten. W.A. Blue Gum is likely to establish the plantations over two years, depending on land availability and seasonal conditions. Adviser Edge has assumed that 66% of the plantations will be established in 2013 and 33% in 2014, providing returns to investors in Project years 11 and 12. An indicative cumulative pre-tax cash flow is presented in the following charts. These cash flows have been calculated using the performance assumptions adopted by Adviser Edge.

### Cumulative pre-tax cash flow per unit



## Post-Tax Potential

The post-tax returns earned by an investor will depend on the investor's marginal tax rate when harvest returns are received. The post-tax IRR range provided by Adviser Edge assumes that the investor maintains the same marginal tax rate of 46.5% throughout the investment term.

However, it is likely that an investor's tax status will change over the life of the Project. A change in tax status may result from a change in circumstance for the investor, or a change in tax policy administered by the Australian government. It is important that investors are aware of how these changes may affect the Project's post-tax performance.

***Adviser Edge recommends that investors consult with qualified specialists who understand how changes to an investor's tax status may affect investment returns.***

Investors in the W.A. Blue Gum Project 2016 will be subject to the risks associated with short to medium-term forestry investments.

All potential investors should carefully consider the risks outlined in the Project PDS, and the specific risks outlined in the Adviser Edge research report.

#### **Management, structure, and fees risks**

MIS management encompasses not only the operational capabilities of the Project counterparties, but also the corporate abilities of W.A. Blue Gum to monitor operational performance, and to meet the regulatory and statutory responsibilities required of it as Project RE.

For all MIS projects there is a risk that if the financial position or performance of management deteriorates, asset condition, project outcomes and/or regulatory outcomes may be temporarily or permanently compromised.

The fixed ongoing fee structure of the Project means that investors are protected from unexpected increases in plantation management costs over the Project term.

The continued solvency of W.A. Blue Gum is required to ensure that any land repayments are made to provide security over investors' sub-leases. However, it is likely that, in the event of an insolvency of the RE, a replacement RE would be appointed, and the ongoing rent fee would be sufficient to cover the head-lease payments. Should the RE fail to meet any rental payments under any head lease, there is a risk that investors' interests in the Project will be terminated. Should this occur, this may result in individual investors not being able to participate in the Project pool.

#### **Site and silvicultural risks**

Investors should be aware of the risks associated with the site and management of the Project. Key areas of risk identified by Adviser Edge are as follows:

##### *Site selection*

There is a risk that the selected land may not be suitable for the Tasmanian blue gum, or that the targeted growth rates may not be achievable due to externalities. Even where strict controls are placed on land selection, there is a risk that the land may not perform to expectation. This is mitigated by the fact that the Project will use second rotation sites with known harvest performance. The inclusion of coppiced sites in the planting mix has moderately increased the Project's production risk due to the limited data supporting projected yields.

##### *Pests and weeds*

Insect damage and weed invasion can have an adverse impact on yield. Weeds can also affect growth rates through competition for water and nutrient supplies, or may introduce unwanted insects or diseases to the plantation site. While the operational manager endeavours to limit the impact of pests and weeds, there is a risk

that these control measures could fail to prevent damage to a plantation.

##### *Environment*

Forestry is exposed to similar risks as those that are inherent in other agricultural production systems. Risks relevant to the timber industry include climate-related issues such as low rainfall, excessive heat, frost and wind, and seasonal aspects such as fire, pests and diseases. These threats can be mitigated through good site selection, a comprehensive management program and an ongoing focus on fire control maintenance. Some risks can be insured against and Adviser Edge would recommend investors consider the benefits of the insurance cover offered and organised by W.A. Blue Gum at investors' cost.

#### **Performance risks**

##### *Information risk*

In addition to the site and silvicultural risks discussed, investors' returns can be adversely affected if the assumptions used to estimate returns and determine sites are incorrect due to incomplete information and/or lack of knowledge. As Tasmanian blue gum is a well-recognised plantation species, and south-west Western Australia is an established hardwood region, this risk is largely mitigated. The use of second rotation sites with known production levels also acts to mitigate this risk to some extent. Investors should be made aware that while past performance is a guide to future performance, it cannot be guaranteed due to the broad range of factors that ultimately influence plantation productivity.

##### *Price and costs*

Investors' returns will be directly affected by the stumpage price received, which will be directly affected by market conditions and the costs of harvesting and transport. While prices and costs are generally dictated by the dynamics of supply and demand, changes in certain macroeconomic factors can also have an impact. Such factors include exchange rates, interest rates, and inflation. Investors need to be aware that these factors can negatively affect investor returns.

There is a strong link between paper consumption and economic growth. Any negative impact on the economy of a key buyer or a general global economic slowdown could be expected to dampen demand for Australian hardwood woodchips. This was particularly evident after the GFC, and following the Japanese 2011 tsunami and subsequent Fukushima nuclear disaster.

##### *Marketing*

As with any MIS project, there is a risk that the market for the woodchip resources will encounter a significant downturn at the time of harvest. This may be due to factors such as competition, regulation and/or market preferences. A reduction in demand or a significant expansion in supply may have an impact on woodchip prices, which could potentially reduce investors' returns.

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