

Spring 2017 Update

Hello,

I'd like to start by thanking everyone that attended our 5th Harvest and Beyond conference in Napier a few weeks ago. We had record attendance with 360 delegates attending and unfortunately plenty more turned away because of capacity issues - I'll cover more about the conference later including where you can watch the presentations.

After nine years, we've had a change of government. I think for a lot of us things will just go on, the coalition and large opposition will ensure that their policies remain pretty 'centralist' and perhaps bring some positive changes. As far as forestry goes, we're very happy with the re-establishment of the Forestry Service based in Rotorua. A dedicated office, Minister of Forestry and increased voice in parliament is something much needed for us as foresters - after all we are still the third largest primary sector. There has been some talk around ensuring wood is supplied to local sawmills. The government needs to be very careful how they go about this, to stipulate where we can and can't sell our logs could be going down the wrong path and turn off investors.



Investors at the Forestry Conference watching clearfell operations at Tangoio Forest.

The increased planting goals are ambitious, in order to encourage this level of planting, they will need to support land purchases or replanting costs, which could be of benefit to our forests after harvest.

We have been trying to arrange a meeting with the Minister of Forestry Shane Jones to discuss the direction our sector is heading.

INSURANCE

You will recall last year that we had a significant lift in our insurance premium (around 25%), so we are very happy to report after firm negotiations with the AON that we have seen no increase this year per unit of insurance (as our forests grow, we are insuring a larger asset). As you know insurance makes up a significant part of our annual running costs - particularly as our trees get more valuable.

With the insurance sub-committee we discussed ways to reduce the premium. The only way this could happen is by reducing the amount of wind cover that we have (we hold around 80% of the wind premium cover in New Zealand), if we surrendered that cover other foresters would take it up. i.e. we are told that the underwriters have a certain amount of cover that they want in any market and our forests hold the majority in our region. By holding a greater percentage of wind cover it means our premium costs per ha are higher than some other foresters have, but we also have much more cover in the event of a Bola type wind event.

We are not inclined to reduce the wind cover, particularly after the Cyclone Cook wind event this year. We have made a claim on wind damage of around \$750,000 and this will be settled in the coming months.

This year we have seen an increase in our public liability insurance from \$414 per partnership up to \$841. At the moment we are being tested by the power line companies who want us to remove trees that are outside the power corridor but could still damage the lines. We have asked for compensation to remove the trees, as we are not at fault .

Finally, we have been using the money from the investment fund to cover our insurance premiums for the last few years. In most forests, the last of this money was allocated for the current premium with the remainder being paid from the sale of Liability Free NZUs

CARBON MARKET

At the beginning of the financial year the carbon credits were worth \$17.75, over the course of the last 8 months prices have remained relatively steady, with a low of \$16.40 and recently reaching a high of \$19.00, which is where it sits in the current market.

As agreed at the AGMs, we are selling down 50% of the NZUs that the partnerships hold. FMNZ have been selling our liability free NZUs in small parcels so as to not flood the market. At this stage FMNZ are about half way through this process.



NZ Carbon Price for the last few years - currently sitting at \$19.00

OM Financials head of markets, Nigel Brunel, expects the credits to hit \$20.00 before Christmas. On the 6th of November the credits finally went above the \$19.00 mark since the new government was formed. If Nigel is correct, it will be the first time the credits have hit \$20.00 in the New Zealand market since 2011. Further to this Nigel believes that the government is pointing towards climate change, a stronger ETS and a higher carbon price in the future, all of which bodes well for our NZUs moving forward.

Please note. As we sell down these NZUs your partnership will make a profit - this is important to note for tax purposes. We will be making a payment to you to cover this tax liability. We will be contacting partnerships in due course to obtain / confirm your bank details.

ROGERS'S TRIP TO CHINA

Immediately before the conference I spent four days in China, looking at timber processing and talking to users of New Zealand logs in China. The country never ceases to amaze me and growth is continuing at a very fast pace. The shutting down of the Chinese indigenous harvest (about twice the size of New Zealand exports) has been a factor influencing demand for our New Zealand logs.

Everybody wants more logs from New Zealand and they see this demand continuing. With year on year wage increases of around 15% there have been some dramatic moves into added value

processing in China (what we should be doing in New Zealand!). However, longer term I can see problems arising for wood users as the short sighted policies of the last six Labour and National governments mean that our harvested volumes will hit the wall after about 2030, owners of trees planted between 2000 and now will be able to name their price is my prediction.

LOG MARKET UPDATE

Log markets remain very strong, and the sentiment is that they will stay this way for the short term. Paul Burrige's conference presentation indicates longer term positive drivers for demand as well - his presentation is worth watching.

Demand is underpinned mainly by China who are facing a growing timber supply deficit. Its growth is still unchecked and with their policy implementation to stop harvesting their own forests, imports (of our logs) will need to rise to meet demand.

Shipping costs have been very low - did you know that it costs more to move a log 50km from the skid to the port than it does from the port to China! We have seen an increase in bulk shipping rates as well as some fluctuation in the exchange rate.

Local demand for logs remains steady with local mills matching the higher prices offered by the exporters to satisfy their milling requirements and local growth.

Overall logs prices remain strong and the outlook positive, we only hope this continues as we begin to harvest more of our forests

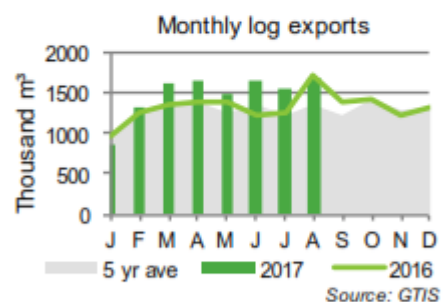
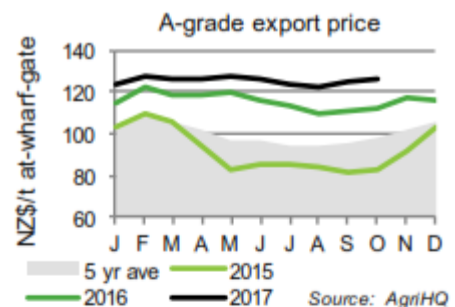
HARVEST AND BEYOND CONFERENCE

As I mentioned earlier we held our 5th Roger Dickie conference - this one was again based on Harvest and Beyond. It was fantastic to have so many delegates attend - over 350 of you. As we move towards harvest, we are encouraged to see interest and participation from you.

One of the attendees noted that upon entrance to the main conference hall you could be mistaken for thinking it was a meeting of grey power! 26 years does come around quicker than you think.

The conference was an opportunity for our clients to be informed on what lies ahead for their forest as we look to harvest and the next rotation.

We had the pleasure of hosting three informative speakers. Steve and Rory from FMNZ who covered the infield operations as your forest is preparing for harvest, there is a lot of planning and scheduling that takes place years in advance of the first logs being harvested.



Tom Boon spoke on the progressive stance of Taranakipine, a sawmill currently sawing some of our logs from Waikare and Maxwell forest into engineered timber products, including hardwood treating pine from Waikare and Maxwell forest to go to Netherlands to be used in a cycling velodrome that they think will produce world records! Most of their engineered wood products leave the mill with a coat of primer paint, and they don't produce one piece of 4x2 lumber!



Paul Burrridge of Summit Forests (NZ division of Sumitomo, one of the world largest log traders) spoke on the export market and demand for timber in Asia moving forward. Paul Burrridge led an interesting discussion on the demand their parent company and trading house see for timber moving forward, and where Radiata pine fits into it all. It certainly left a very positive picture for demand for our logs into the future.

I completed the morning by presenting possible options and scenarios for your forest beyond harvest and into the next rotation. The option to prefund the next rotation by retaining some harvest receipts was well received by many. The result being a fully funded, unencumbered legacy that can be left for your beneficiaries.

The feedback from the conference has been very positive - thank you to all those who attended, we will look to hold another one in a few years. We are very grateful for the support from our sponsors which help make it such a fantastic event. For those who did not attend, video footage of the presentations will be available on our website soon, well worth a watch.

HARVESTING

The Forest Mangers have had a busy winter scheduling roading and skid construction for more of our forests to begin harvesting this summer. Between the rain clouds, this has been mostly uneventful, and FMNZ now have nine harvesting crews working in, or about to begin work in your forests.

SECONDARY MARKET

We have an active secondary market. If you are looking to buy or sell please contact us to see what is available.

EASTBOURNE DAIRY FARM

We still have a few shares remaining at the original offer price. Eastbourne has been performing above our expectations for the last few seasons and will pay a dividend this year. If you are interested in finding out more about Eastbourne Dairy farm, please contact Richard at the office.

As we move into some more settled weather, I hope everyone enjoys good health and time with friends and family.

Regards,

A handwritten signature in blue ink, appearing to read 'Roger', written in a cursive style.

Roger

September 2017

Sovereign Forest *Forest Managers Report*

The winter of 2017 will be remembered as the winter it did not stop raining. While the temperatures were the 11th warmest on record, the rain kept falling. Many areas in Hawkes Bay, Gisborne, Whanganui, Taranaki and Wairarapa have already received more than their usual annual rainfall and there is more wet weather forecast.

Cyclone Cook swept through the country in mid April and caused sufficient damage in half a dozen of our Hawkes Bay forests to trigger an insurance claim. During May we saw the remnants of Cyclone Donna bring heavy rain and strong winds to many parts of the North Island. In mid July we had a high wind event in the Wairoa region which caused scattered damage around the forests including broken out tops and toppling however, the damage was not significant enough to warrant an insurance claim.

Generally the forests have withstood the conditions well. Possibly the greatest concern is the amount of red needle cast (RNC) we are seeing scattered around the forests as it seems the warm and wet conditions are conducive to the spread of RNC.

The causal agent of RNC is phytophthora pluvialis which is an algae like, foliar based pathogen believed to originate

from Oregon, USA. Normally a soil borne pathogen, ten years ago there were no known foliar diseases caused by phytophthora on pine trees worldwide. It was first observed in New Zealand in 2008 and is now quite common and widespread.

Severe disease can almost totally defoliate affected trees but they seem to recover and in the year following infection, the one year foliage is unaffected. Growth losses are not significant unless repeated defoliation occurs.

Research is ongoing as to the control of RNC. Given that the timing and severity of the disease can be very variable it has been challenging both evaluating its impact on forest production and developing disease management strategies. A combination of chemical control, host breeding programmes and biological control at this stage look to show the most promise in controlling RNC.

Forest health at Sovereign is generally good and the trees are well into their spring growth flush.

There are a few pockets of scattered damage from Cyclone Cook and this includes toppled trees and broken out tops and branches. Due to the very scattered nature of the damage it is difficult to quantify however, from our aerial survey carried out following the storm, the damage was not sufficient to warrant an insurance claim. It is none the less disappointing to see the toppled trees when visiting the forest.

The difficult weather conditions have also had an effect on the Lidar project and delayed much of the aerial data capture. It now looks unlikely it will be completed prior to the end of October. The plot imputation can then be completed once the Lidar data is available.

Tracks remain in reasonable order although access is difficult in some areas due to a combination of dropouts, slips, scouring and storm damaged branches and tree tops strewn across the tracks. These will be tidied up later in the year when the tracking maintenance is carried out. Each time we visit the forest we try and check that the culverts are clear and move a bit more slash off the tracks.

The power company approached us about felling some trees on either side of the powerline leading to the lifestyle block to prevent ongoing power outages. Given the proximity of the trees to the line we need to engage a felling crew who are certified to work around powerlines. They have quoted \$8,000 to carry out the work and while we think this is exorbitant, have little choice but to proceed. This work was not allowed for in the budget.



At the beginning of the financial year NZUs were worth \$17.75, they had fallen to \$16.40 by the end of June and by the end of August, had climbed to \$18.25.

We have continued to sell small tranches of units as required to fund operating expenses. On behalf of Sovereign Forest we have made the following transaction:

30/03/2017 1000 NZUs @ \$17.15

In addition to the NZUs we have been selling to fund operating expenses, we have also been slowly selling down 50% of the liability free units. Up to the end of August we had sold 9,130 NZUs on behalf of Sovereign Forest for an average price of \$17.61. We are approximately half way through the sale of 50% of the units and provided we can keep selling on an improving market, will continue to sell down these liability free partnership units.

Pest control remains under the auspices of the Animal Health Board (AHB). There is presently little sign of possums in the forest so the AHB contractors continue to do a good job.

The NES (National Environmental Standards for Plantation Forestry), part of the government's broader Resource Management Act reforms, were gazetted on 3rd August and come into force on 1st May, 2018. The new standards mean that all local authorities will need to control plantation forestry activities in a more consistent manner and provides a "licence to operate" for the forestry sector by allowing most day to day activities to occur as permitted activities, albeit subject to compliance with quite strict permitted activity conditions.

District and regional plans will need to be amended to remove rules that duplicate or conflict with the NES as soon as possible after the 1st May. The NES will generally raise environmental standards when compared with existing rules however, should also simplify the forest sectors ability to manage environmental compliance and performance as all planning controls will be contained within one document, the NES.

Land will be classified into four categories of erosion susceptibility depending on the erosion risk. The control on plantation forestry activities increases as the erosion risk increases. Most forest activities will be permitted in the green and yellow zones. In the orange zones forestry activities are also permitted but are subject to additional controls around land slope and location. In the red zones, forestry activities may be permitted, controlled or restricted discretionary depending upon the scale of the forestry activity and the slope of the land.



The regulations also cover afforestation, pruning and thinning to waste, earthworks, harvesting, quarrying, re-afforestation and the installation of stream crossings and sediment control.

The Napier/Wairoa rail initiative continues to make progress. It was originally intended that trains would be running by the end of the year however, as much of the log volume starts to come on stream from next year onwards, the delay in opening the rail link is not a negative. Negotiations with Kiwirail as to the cost of the repairs required to the rail are ongoing. It is now hoped trains will be running by the end of 2018.

Fire and Emergency NZ (FENZ) has been operative since the beginning of July and is now responsible for all rural fire fighting in NZ. In the Hawkes Bay region, Bay Forests, the former rural fire authority, now subcontract to FENZ and will continue to do so until the details surrounding rural fire fighting in the region can be finalised.

In the meantime, if there is a fire in the region that is outside the old Bay Forests Rural Fire area, the Bay Forests team will be the ones responding to the fire callout.

A handwritten signature in black ink, appearing to read 'Steve Bell'.

Steve Bell
Forest Manager

FMNZ:

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