17th November 2017

Waikare Post Harvest Options

Hello,

We will soon have finished enjoying the pleasant times of harvesting Waikare forest. How quickly the 28 1/2 years has passed for us all, we hardly look a day older!! Hopefully you, like myself are happy with the outcome of this investment. For some time we have been discussing what happens after the Waikare forest harvest has been completed, below I have outlined some points to consider as we move forward.

To discuss our future we will hold a meeting (notice of meeting attached with this letter) on Monday December 4th at the forest, with a forest visit in the morning, and discussion and a vote on the future in the afternoon.

Points to consider:

- The outlook for forestry.
- The Waikare situation up until now.
- The next rotation at Waikare, prefunding and how it would work.
- Option to sell the newly planted Waikare forest.
- Decisions to be made now for the future.

The outlook for Forestry

Recently we have been in discussions over a different forestry matter with a wide range of NZ log exporters and Chinese log importers. There is no doubt the short, medium and long term market expectations in China are very bullish. This is brought about partly by the closing up of all the Chinese indigenous forest harvest for an indefinite (long term) period. As well, the improvement in the American housing market has resulted in less logs available for Asian markets from the eastern pacific rim. This has resulted in a number of new players (purchasers) looking at New Zealand log purchases. My trip to China in late October shows that they are automating their processing and production and demanding increasing volumes of log. As I write this letter we have representatives of a Chinese company here in New Zealand. They have a NZ $20 billion annual turnover, presently import 600,000 cubic metres of logs from Russia and want to add 1 - 2 million cubic metres of logs annually from New Zealand to their business. On my trip I met two other major log importing companies who are looking to substantially increase their import of New Zealand logs.

The large forest plantings in New Zealand from 1990 to 2003 have been followed by very low levels of new planting and I feel that owners of trees planted now will be in a very strong position when the next harvest comes round.

The current situation at Waikare.

Waikare was planted in 1989 and began harvesting early in 2015 (At age 26). Harvesting is expected to be completed at the end of this summer (approximately March 2018). Since February 2015 we experienced two brief log price falls where forecast stumpages dropped to around $10,000 per hectare. However, we have experienced steady and rising log prices since then.

When we began harvest we forecast stumpage returns of $16,200 per hectare. We are currently averaging returns of $25,521 per hectare (Oct 17). As the roading and skid formation is nearly completed we expect this to rise slightly towards the end of the project. The wet weather has seen engineering costs above forecast, but overall the grade outturn and steady log prices have kept returns well above our initial harvest forecast.

Replanting of the forest has occurred each winter following harvest. Planting will occur in winter 2018 and any of the remaining forest harvested after Christmas of this year will be planted in winter of 2019.

In August of this year partners voted to commence retaining earnings to fund the replanting and to prefund next rotation, should that be what partners ultimately vote to do.

The forecast retained earnings have been budgeted conservatively. If partners vote to continue with a second rotation then we anticipate there will be another distribution to partners when harvesting is completed, on current prices this may be up to $45,000 per 4% share. This amount will depend on log prices from now until harvest is completed.

Waikare also has a one off allocation of 16,671 Liability free NZUs. These are being sold to fund the replanting. Currently 10,000 have been sold at $18. The remainder are still to be sold, the current price is $19.25 and we are watching the market to see if further rises are a possibility. If we achieve the current price then NZU income will be $23,000 better than the figure we gave Olsen's to use in their budget.

Projected IRR of the present crop. If stumpages remain at the same level for the rest of the harvest. The pre tax IRR of cash out and cash in is 7.24%. As well, not included in this IRR calculation would be the retained earnings to fully fund the next rotation, the freehold land, the newly planted forest and the roading network.

Moving forward there are two options.

1. We prefund the next rotation, this means leaving in $2,427 per hectare of our present harvest receipts to fully fund the next rotation and create income in perpetuity. Those that want to sell their Partnership Interests can do so to either other partners or on our secondary market.
2. If a majority of partners vote at our December meeting to sell Waikare forest when harvesting is completed and compulsory replanting is finished. Then funds from the sale of land and trees and any retained earnings would be distributed to partners, winding up the investment.

The next rotation at Waikare, prefunding and how it would work.

Our investor database is older - after all, we have been in this investment for 28 1/2 years! The most frequently asked question is what happens after harvest, and how can I leave this to my beneficiaries without the annual calls.

The obvious answer is to prefund the next rotation, this leaves an unencumbered legacy to your beneficiaries, creating income in perpetuity. This is a concept we have been considering for a long time and is identical to the prefunding model we have used successfully with our 300 ha Granity and Woodleigh forests. So how would it work? At the AGM we circulated a forecast cash flow on how funding the next rotation might look.

We have subsequently had an independent feasibility study carried out on the next rotation by our forest consultants PF Olsen. In principal they largely agreed with our model - there were slight differences in log revenues as they used 12 quarter log pricing vs our model which used average prices achieved at Waikare. The full feasibility report is attached. We ask that this is not distributed beyond the Waikare partners.

I will refer to the figures and information provided by Olsen's rather than our internal calculations as Olsens offer an independent view.

In summary the report findings to prefund the next rotation are as follows:

	Total	Per Hectare	Per 4% Share
Income retained from Harvest receipts	$800,000	$1,797	$32,000
Income from Sale of NZUs	$280,000	$629	$11,200
Total Retained Earnings	**$1,080,000**	**$2,427**	**$43,200**
Forecast Harvest Revenue - second rotation (pre tax)	$16,647,544	$37,410	$665,902

Waikare second rotation nominal Pre Tax IRR 8.68%

Assumptions:

All revenues and costs have been inflated at 2% per annum

Cash held at the bank earns interest of 3.35%

The forecast cash flow shows a minimum bank balance in year 23 of $306,442. We think it is good practice to carry forward a cost buffer.

So what does this really mean?

To date Waikare Forest has an average return of $25,521 per hectare. Because the roading is almost completed (96%), and a larger portion of the harvest still remains to be completed (18%) we expect this figure to rise if the current log prices remain.

There is a legal requirement to replant the forest. This cost ($1,550 per ha) is deducted from the $25,521. The last planting will occur in the winter after harvest is completed (potentially a small amount in winter 2019)

The cost to fully fund the planted forest for the next rotation, including a cost buffer as mentioned above, but not allowing for pruning, is $2,427 per ha. $629/ha of this will come from the one off sale of NZUs. This is effectively a bonus to us as partners. The remaining $1,797 per ha would need to be retained from harvest income to fully fund the next rotation.

In non inflation adjusted terms, the forecast harvest revenue for the next rotation is $22,117 for an un-pruned tree crop and $27,526 for a pruned tree crop using Olsen's 12Q prices.

Forecast harvest revenue after inflation is $37,410 per ha for the next harvest beginning in 24 years time (2042)

It will be sensible to make sure that the partnership agreement allows partners to have smaller holdings so that if partners decide they can split them up among their beneficiaries.

Option to sell the newly planted Waikare forest

If the majority of partners vote at our December meeting to sell Waikare forest, then the forest will be listed for sale.

There are a number of considerations here. Firstly we know a sale takes a willing buyer and a willing seller. Typical forest land sells for around the CV. Waikare has a CV of $1,150,000 ($2,584 per hectare). Historical sales evidence shows a newly planted tree crop will be valued for around the establishment costs of $586,510 ($1,318 per hectare).

In our experience buyers like to wait until the tree crop is established, say after two to four years, so they can bid in confidence knowing the survival count of the planted tree crop. The point to note here is that (when one looks at other sales evidence) the cutover forest market gives little value to the 18.8 km of roading and skid infrastructure already established in the forest - in Waikare's case this equates to $3,782,500 ($8,500 per hectare).

In either case we would be trying to achieve the maximum sale price for investors on the open market. Ultimately we don't know what this would be until offers are received.

We would advocate funds be retained to fund the forest until such time as a buyer is found, we would not ask partners for cash input.

Options for an individual partner wishing to exit the Waikare investment

The greatest liquidity for a partner wanting to exit is at the time when the cost or value of their share in the partnership is at its lowest level i.e. immediately after replanting.

After initial discussions with partners at the last AGM and a straw poll it appears that most people want to prefund the next rotation creating income in perpetuity. A number of partners have indicated they would like to increase their holding and have an interest in buying out departing partners.

As well, our secondary market has become much more active in the last few years and we have a number of external purchasers interested in acquiring more Partnership Interests.

For partners wishing to exit Waikare we will facilitate the sale of their Partnership Interests. We understand that everybody has different drivers in their investment portfolios.

A comment on pruning.

For eight of the last ten years pruned log prices have not received sufficient premium over A grade log prices to justify the cost of pruning when the forest is 4 to 8 years old.

An unpruned forest will have more stems per ha at harvest time and a yield of around 15% or 100 tonne/ha more than a pruned forest. For this reason we have based our assumptions on a framing grade (unpruned) forest.

Growing the forest under a framing regime does not mean we cannot covert to a prune regime at year five if it becomes financially viable.

Where to from here?

I would encourage partners to attend the Wanganui meeting. We will consider the investment and then vote on their preferred course of action. You will be able to vote by proxy or by attending the December meeting at the forest.

If you have any questions please call Roger, Richard or Will to discuss.

Regards,

Roger