



**Adviser Edge**

## W.A. Blue Gum Project 2014

INDEPENDENT ASSESSMENT

This report has been prepared for financial advisers only

28 May 2014



**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**

Projects are awarded a star rating out of a possible five stars and placed on the Adviser Edge web site [www.adviseredge.com.au](http://www.adviseredge.com.au)

The Adviser Edge web site provides a service to subscribers, allowing them to view the final assessment reviews. Only subscribers are permitted access to download completed assessment reviews.

Star ratings applied to 2013/14 projects are independent of previous year's star ratings.

**Licensed Investment Adviser**

Barik Pty Ltd trading as Adviser Edge Investment Research is licensed as an Australian Financial Services Licensee, Licence No. 236783, pursuant to section 913B of the Corporations Act 2001. The licence authorises Barik Pty Ltd, trading as Adviser Edge Investment Research to carry on a financial services business to:

provide general financial product advice only, for the following classes of financial products;

- interests in managed investment schemes excluding investor directed portfolio services limited to;
- primary production schemes to wholesale clients.

**Privacy Policy**

Adviser Edge collects only a limited amount of personal information from its clients. Our privacy policy can be viewed at [www.adviseredge.com.au](http://www.adviseredge.com.au) This will enable you to understand your rights, our obligations and what Adviser Edge does with any information that it collects about you.

**General Financial Product Advice**

This advice will not take into account your, or your clients, objectives, financial situation or needs and will not be provided in respect of any other financial products. Accordingly, it is up to you and your clients to consider whether specific financial products are suitable for your objectives, financial situation or needs.

**Reproduction**

Adviser Edge assessment reviews cannot be reproduced without prior written permission from Adviser Edge. Each assessment review completed by Adviser Edge is held under copyright. Extracts may not be reproduced. Requests to reproduce or use an Adviser Edge assessment review should be sent to [info@adviseredge.com.au](mailto:info@adviseredge.com.au)

**Disclosure**

Adviser Edge (or any associated persons) does not have any material interest in the financial products (or product issuer advised upon) that are subject to this report. This assessment has been undertaken by Adviser Edge on an independent basis and does not constitute an investment recommendation. It is designed to provide investment advisers with a third party view of the quality of this project, as an investment option.

Adviser Edge charges a standard and fixed fee for the third party review of MIS projects. This fee has been paid under the normal commercial terms of Adviser Edge. Adviser Edge (or any associated persons) has not or does not expect to receive any further benefit or compensation as a consequence of writing this report.

**Report Date**

28 May 2014

Project Summary	4
Structure and Fees	5
Management	8
Site Inspection	12
Marketing	15
Investment Analysis	18
Investment Risks	23
Disclaimer	24



### Adviser Edge Rating



### Recommended Client Risk Tolerance

#### Project Details

Project Name	W.A. Blue Gum Project 2014
Product	Hardwood logs for pulp and paper manufacture
Responsible Entity	W.A. Blue Gum Limited
Plantation Manager	WACAP Tree Farms Pty Ltd
Independent Forestry Operations Overview	Andy Wright

#### Investment Details

Investment Term	Approximately 10 years
Investment Unit Size	1ha
Units Available	800
Application Fee	\$3,563.64 (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 (including GST) (indexed)
Minimum Investment	Five units
Close Date for FY2014	30 June 2014
Investor Finance	Available through Albany Financial Pty Ltd
ATO Product Ruling	Pending

#### Investor Returns

Potential Investment Returns (p.a., pre-tax)	1.55% – 10.65%
Adviser Edge base case	7.00%

### Investor suitability

Investment in agribusiness should represent a balance between the various potential risks and the forecast returns. This Project offers a moderate risk profile over the long-term, with moderate pre-tax returns across the estimated range. This Project should be considered as part of a well-diversified portfolio.

### Key Points:

#### Strengths of Project

- The Project is well structured, providing investor security and decreasing the reliance on the ongoing solvency of the RE.
- The contractual relationships with WA Plantation Resources (WAPRES) via subsidiaries WACAP Tree Farms (WACAP) and WA Chip and Pulp Company provide high quality forestry management and direct access to the Japanese woodchip market.
- Second rotation sites will be selected in high rainfall areas of south-west Western Australia that have known productivity. This reduces the likelihood of poor sites being included in the Project.

#### Weaknesses of Project

- The Project is subject to default risks with respect to subleases should investors fail to meet annual rent obligations. There has not been a case of default on any lease to date.
- Difficult global economic conditions coupled with the impact of the Japanese tsunami in March 2011 have depressed demand for Australian wood chips, which has also affected prices in the recent past.

#### Key investment risks

- While there is expected to be a recovery in global demand for Australian woodchips in the future, the impact this will have on prices paid at the stump is still uncertain. The close relationship with WAPRES is expected to ameliorate these risks to some extent by providing direct access to the higher value and quality-focused Japanese market.
- There remains a risk that one or more years of significantly below average rainfall will limit the ability of trees to fulfil their productive potential. This risk can be mitigated through the conservative application of the site selection protocols.
- Forestry is exposed to similar risks as those that are inherent in other agricultural production systems.

#### Other Project considerations

- A liquid secondary market does not currently exist for MIS forestry investments.

### Investment Specifications

Target subscription	800ha
Location	South-west Western Australia
Investment unit size	1ha (one 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 2014. W.A. Blue Gum has the capacity to accept oversubscriptions, depending on the availability of suitable land. The plantation management agreement does not specify a minimum stocking guarantee; however, the plantation manager is required to plant a sufficient number of trees to meet the stocking rate/spacing that is set out in the Plantation and Development Plan.

The Project involves the establishment of Tasmanian blue gums for the production of hardwood chips for export and, potentially, domestic pulp markets (although the latter is unlikely). The trees will be a combination of replants and coppiced trees. The units will be located in south-west Western Australia, in the forestry region near Manjimup, Bunbury and Albany.

The trees will be grown for a period of approximately 10 years. 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. It is intended that inclusion of all suitable coppiced sites will be completed in the 2014 calendar year and some (perhaps all) of the planted sites will be completed by October 2014. To the extent that this is not done, the planting will be completed over the winter period in the following year. The plantations are forecast to be harvested in 2024, with the Project agreements providing some flexibility for harvesting to be delayed providing the Head Lease allows such action. 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 WACAP Tree Farms Pty Ltd (WACAP), a subsidiary of WA Plantation Resources Pty Ltd (WAPRES). WACAP 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. W.A. Blue Gum has entered into a Wood Purchase Agreement with another WAPRES subsidiary, WA Chip and Pulp Company, for the

### 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 considerably reduced from the previous years' projects.
- The annual rental fee has also declined relative to the previous years' projects.
- W.A. Blue Gum intends to establish 66% of the project using coppiced trees, however, it maintains flexibility to determine the exact proportion of the project that will be coppiced.

purchase of all timber grown in the Project. WAPRES, WACAP and WA Chip and Pulp Company are all ultimately owned by Marubeni Corporation of Japan.

W.A. Blue Gum will sub-lease land from WA Chip and Pulp Company or WACAP, or lease land directly from farmers. In all instances, W.A. Blue Gum will register the head-lease or sub-lease with Landgate, the Western Australia 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 WACAP, 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 WA Chip and Pulp Company, WACAP or various farmers, 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 good footing. To date there have not been any rent defaults associated with any W.A. Blue Gum-managed projects.

***The Project is structured in such a way that there is a very limited reliance on the ongoing solvency of either W.A. Blue Gum or WAPRES. While benefits are expected to 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.***

### 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 2014.

### Initial Cost to the Investor

Payment Type	Cost Per Woodlot (ex. GST)
Application Fee	\$3,563.64

Investors in the Project are required to pay an application fee of \$3,563.64 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^	Approximately 0.7% of insured value plus 10% of the premium as an administration fee (ex. GST)

\* Payable on 30 November 2014, and on 30 September in each year thereafter. Indexed to Western Australia CPI from 30 June 2014.

^ Payable on 15 November 2014, and on 15 November in each year thereafter.

From Project year one (FY2015), 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.

### Deferred Fees

Payment Type	Cost Per Unit (ex. GST)
Harvesting and transportation	Actual cost to be advised at harvest and deducted from harvest proceeds
Harvest supervision	3% (ex. GST) of net harvest proceeds
Incentive bonus	15% (inc. GST) of the value where net proceeds exceeds \$18,000/ha (inc. GST)*

\* Indexed to Western Australia CPI from 30 June 2014.

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. In addition to this, a harvest supervision fee of 3% (plus GST) of net harvest proceeds will be deducted and paid to the wood purchaser, WA Chip and Pulp Co Pty Ltd. 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% (inc. GST) of the amount by which the net proceeds from the sale of the timber exceed \$18,000/ha (inc. GST), with the benchmark to be indexed from 30 June 2014. 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 2014 Project offering has substantially decreased from W.A. Blue Gum's previous offering. The application fee has been reduced by approximately 35%, or \$1,936.36, to \$3,563.64 per unit (excluding GST). W.A. Blue Gum has indicated that this decrease is mainly due to the change in the plantation mix to include 66% of the area as second rotation coppicing. The cost of managing coppiced plantations for inclusion into the Project is substantially lower relative to new plantings.

Of the application fee, a portion is paid to the contractor, WACAP Tree Farms, 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. Of this fee, a portion is paid to WACAP 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) represents the average lease costs expected to be incurred in the Project. This is the second consecutive year in which lease fees have been lowered, after the lease fee was reduced to \$420/ha in 2013. The decline can be attributed to the lack of competition for land from other forestry companies and the increasing age of farmers in the target region.

***Adviser Edge considers that the proportion of the application and ongoing fees used to remunerate the external service providers is reasonable, and that the ongoing fee structure helps to provide investor security throughout the life of the Project.***

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, is considered to be appropriate. This fee provides an incentive for W.A. Blue Gum to maximise Project returns.***

In addition, 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 majority of the risks and benefits associated with the Project.***

***However, 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 manager insolvency.***

## **Additional Information**

### **Taxation**

W.A. Blue Gum has applied for a Product Ruling from the Australian Tax Office (ATO), which will provide 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.

### **Finance**

Finance is available from Albany Financial Pty Ltd to approved applicants. Basic loan details are provided below, and interested investors should contact the finance provider for full loan terms and conditions.

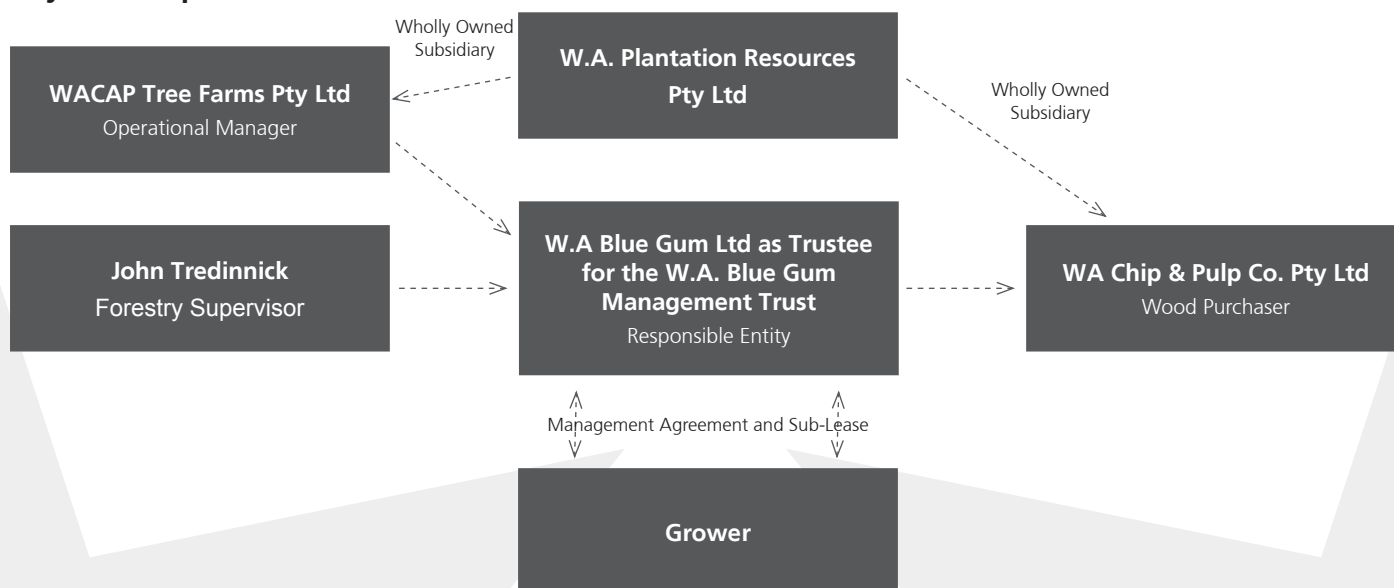
#### **Finance Options**

Financier	Term	Interest Rate	Repayment Option
Albany Financial Pty Ltd	5 years	12.15%*	Equal monthly principal and interest payments

\* Indicative rate.  
Source: W.A. Blue Gum.



## 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 WA Blue Gum Limited Management Trust, is both the Responsible Entity (RE) and Project Manager for the W.A. Blue Gum Project 2014. 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 established over 10,000ha from the previous 15 offerings since 2000. All of these plantations are located in south-west Western Australia. W.A. Blue Gum Ltd'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 – W.A. Blue Gum Limited

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	★	★	★

## Key Points

- W.A. Blue Gum Limited outsources its forestry operations to WACAP Tree Farms Pty Ltd. The relationship between the two companies is strong.
- Experienced forester Andy Wright is engaged to independently oversee the forestry operations of WACAP.
- W.A. Blue Gum is a very experienced Responsible Entity, with good resources.
- The Project structure, which incorporates ongoing fees, reduces the risk of counterparty insolvency.

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.

*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 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 the assistance of URS Forestry and now Andy Wright, the board has successfully supervised forestry MIS projects over the last twelve years.*

## 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



### 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 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

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. 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 RG 232, the regulatory guide with respect to disclosure of agribusiness investment schemes. W.A. Blue Gum meets each of the five disclosure requirements listed in the guide and explains how it meets these disclosure requirements in the PDS.

**Adviser Edge believes that the compliance committee consists of members with extensive experience in accountancy and compliance, thereby maximising their effectiveness. Adviser Edge has reviewed a number of documents in relation to W.A. Blue Gum's corporate governance, and is satisfied that the risk management and compliance procedures adopted by the company are of a high standard and are suitable for the scale and size of the company's operations.**

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

#### Key Financial Data\* – As at 30 June

Financial Profitability	2013	2012
Revenue (\$m)	5.12	3.97
Net profit (\$m)	0.54	.03
Profit margin (%)	10.54	0.86
Financial Liquidity/Solvency	2013	2012
Current Ratio	0.72	0.75
Quick Ratio	0.41	0.45
Debt	Nil	Nil

Source: W.A. Blue Gum Management Trust 2013 Financial Report.

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.

Adviser Edge has reviewed the financial accounts of the W.A. Blue Gum Management Trust and is satisfied that it is in sound financial position with no deterioration in key liquidity measures and significantly improved operating performance. Revenue increased by \$1.15 million to \$5.12 million, with net profit up by over \$500,000 year-on-year (relative to breakeven result in FY2012). The Trust's performance reflects a slight improvement in market conditions for MIS sales and recurrent revenue from past schemes still in operation.

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. W.A. Blue Gum Limited has confirmed that it meets this requirement. 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 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 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 failures of forestry MIS managers

as has occurred in recent years. Many of these managers failed, in part, because their project structures provided a cash flow mismatch due to high up-front fees and ongoing fees substantially deferred. 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.***

### **WACAP Tree Farms Pty Ltd (Operational Manager)**

WACAP Tree Farms (WACAP) is a subsidiary of WA Plantation Resources Pty Ltd (WAPRES). WAPRES was acquired by Marubeni Corporation (Japan) to be the holding company for the plantation and woodchip business that it bought from Wesfarmers Ltd in September 2000. The contracted wood purchaser, WA Chip and Pulp Co Pty Ltd (WA Chip and Pulp), is also a wholly-owned subsidiary of WAPRES.

WACAP is a major grower and manager of blue gums in south-west Western Australia, and targets the pulp and paper industry centred on hardwood chip exports to Japan. The company currently manages around 40,000ha of plantations.

WACAP carried out the first operational harvesting of blue gums in the region in 1994, when it exported 40,000 tonnes of hardwood chips via its sister company WA Chip and Pulp Co. Since 2003 WACAP has exported approximately 650,000 tonnes of woodchips per year from the company's Bunbury facilities. However, exports have declined due to the economic downturn and the Great East Japan Earthquake and tsunami disaster in 2011. As a result, only 520,000 tonnes of woodchips were exported in 2013.

The company has extensive experience across all stages of plantation management, specialising in the production of seedlings and subsequent plantation establishment, right through to harvesting and the eventual export of woodchips. WACAP employs a team of qualified foresters and local contractors to meet its operational requirements.

WACAP has acted as the Independent Contractor for all of the MIS projects operated by W.A. Blue Gum Limited. Investors can

have confidence that the relationship between W.A. Blue Gum and WAPRES is strong and that W.A. Blue Gum has a good strategic fit with the WAPRES business, which benefits all parties involved. This relationship is particularly important given the tough trading conditions experienced by woodchip exporters over the past three years.

***With extensive experience across all areas of forestry management, combined with a high level of familiarity with MIS, Adviser Edge is confident that WACAP is suitably qualified to complete its required responsibilities under the operational contract for the Project. Adviser Edge views the strong relationship with WAPRES as being a highlight of the Project and of significant benefit to investors.***

### **Andy Wright (Forestry Supervisor)**

Andy Wright has been engaged by W.A. Blue Gum to provide advice on the operational activities of the Project, and to supervise the forestry establishment and ongoing management undertaken by WACAP, for both this and earlier projects. Mr Wright's supervision will include advice on marketing the timber produced. Mr Wright, or another forester supervised by Mr Wright, will provide an annual independent report to W.A. Blue Gum on behalf of investors, which will report on the progress of the plantations and the quality of operations.

Mr Wright has extensive experience and was previously General Manager at Elders Forestry. Based in Albany, Mr Wright has over 20 years' experience in the Australian forestry industry. He brings regional and industry experience to the Project and is considered an ideal addition to the team that will manage the Project on behalf of investors. He holds a Bachelor of Forest Science from the University of Melbourne and an MBA from the University of Western Australia.

### **Independent Expert**

Independent Expert	
Focus	Responsible Person
Forestry consultant	Don Spriggins

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.

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 20 March 2014, 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 WAPRES. Adviser Edge was accompanied by W.A. Blue Gum Executive Director Tom May and experienced supervising forester Andy Wright.

The site inspection focused on inspecting advanced rotation sites in the Manjimup and Pemberton area, most notably the 2005 Project plantations, which are scheduled to be harvested over the next six to 18 months. Adviser Edge's intent was to gain an overall impression of growth rates in this region and the success of coppicing, which is already occurring on WAPRES sites.

WAPRES has further refined its wood production strategy over the last 12 months and has taken steps to reduce the footprint of its forestry operations to focus on the Bunbury wood catchment. Adviser Edge expects W.A. Blue Gum plantations for the 2014 Project to be established in high rainfall areas approximately 150km south of the Bunbury port.

The move to include 66% coppiced sites in the planting mix is more evidenced-based than in the past. Improvements in knowledge of coppice management and harvest and haulage systems are expected to lead to improved outcomes relative to historical performance. This is not to say that there are no risks associated with having this level of coppicing in a rotation; however, with stringent site selection in place to ensure suboptimal coppices are not included in the Project, Adviser Edge is more confident than in the past on yield meeting RE expectations. Notwithstanding, Adviser Edge has built some conservatism into the modelling of returns to reflect the lack of historical performance data.

The 2005 plantation sites were all in good health despite a relatively dry six months leading up to the inspection. The trees, now aged around 8.5 to 9 years, will be drawing moisture from the subsoil to sustain them during drier times. Harvesting for some

### Key Points

- Plantation will be established in high rainfall zones in south-west Western Australia.
- The Forestry Supervisor will select the Project land in consultation with the RE and carry out all plantation management activities.
- The Project will be established on second rotation sites with known productivity and will incorporate both new plantings and coppices.

sites is expected to commence in FY2015, which is earlier than Adviser Edge would prefer but necessary due to lease restrictions. Ideally plantations should be grown out to at least ten years and potentially as long as 11.5 years due to the high growth rates being achieved late in a rotation by trees grown in high rainfall sites.

Adviser Edge remains impressed with the standard of plantation management and maintenance. Investors can have confidence that the relationship between W.A. Blue Gum and WAPRES is strong and that W.A. Blue Gum has a good strategic fit with the WAPRES business, which benefits all parties involved. This relationship is particularly important given the tough trading conditions experienced by woodchip exporters over the past three years, providing investors with access to woodchip markets via tag along to WAPRES contracts.

WAPRES has recently announced that it will not be seeking to expand its plantation estate beyond its current level and has further refined its strategy to exclude some regions from future forestry operations. With the absence of competition from other MIS players (all have failed or exited the industry), W.A. Blue Gum is able to negotiate better lease arrangements for investors. This was first reflected in the 2013 Project and continues to be the case for the 2014 Project.

Overall, Adviser Edge remains confident in the ability of W.A. Blue Gum and WAPRES 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 2014 Project should be confident that their trees will be managed well, within the constraints of seasonal conditions. The move to introduce 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. The trade-off is a lower priced project and potentially higher rates of returns if the coppice strategy delivers as expected by the RE.

### Planting regions

W.A. Blue Gum has indicated that the Project will be established

exclusively in temperate region of south-west Western Australia. This region is characterised by warm, dry summers and cool winters. Rainfall is winter dominant, with over 75% of rainfall occurring between May and October. The long-term average rainfall for region is between 900 to 1,000mm, which is capable of supporting high productivity plantations.

Forestry, viticulture, horticulture, cropping and livestock grazing currently account for the majority of land-use in south-west Western Australia. Forestry has played an important role in the economic development of the region.

### Site selection

Land for the 2014 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 supervising forester Andy Wright prior to making any final decision on land lease agreements.

The productivity target for the 2014 Project of 28m<sup>3</sup> MAI is significantly lower than the 2013 target of 34m<sup>3</sup> MAI. Inventory data collected by WAPRES for the W.A. Blue Gum estate indicates average productivity of 24m<sup>3</sup> MAI.

As part of the assessment process, Adviser Edge has been provided with a copy of the new 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 one of the three major chip mills in the south-west of Western AUstralia – the Diamond Chip Mill near Manjimup, chipping facilities at the Port of Bunbury, or the 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.***

### Species and seedling supply

The Project will be planted with *Eucalyptus globulus* (Tasmanian blue gum). Tasmanian blue gum is widely used as plantation species in Australia, and has shown strong growth rates across a broad range of sites. While some forestry managers, including WAPRES, have elected to coppice harvested plantations on sites that have not performed well, all second rotation sites utilised for the Project will be replanted. This approach allows investors to benefit from any genetic improvements gained through breeding programs.

For the new planting component, W.A. Blue Gum will source seedlings from the WACAP nursery, 10km west of Manjimup. The nursery has the capacity to produce between 7 million and 10 million seedlings per year, and has the appropriate capacity to meet Project requirements. The nursery is supported by extensive blue gum orchards used in a selective breeding program.

### Site development and maintenance

WACAP will be responsible for site development and stand management, with local contractors likely to perform the tasks of planting and tending under the supervision of WACAP. WACAP will establish new plantations at an average of 900 to 1,000 stems per hectare (spha), 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 WAPRES sites. Sites that do not have the density of coppices required to achieve the target productivity will not be included. Coppiced sites will be pruned in the first year, with dominant stems retained. 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.

WACAP maintains a minimum-stocking guarantee of 90% of the original stocking rate for a period of approximately one year from planting.

Following establishment, WACAP will monitor the plantations 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. As a result, W.A. Blue Gum has conducted regular fertiliser applications, at its own cost, to ensure that the sites' full potential is achieved.

WACAP will develop permanent sample plots (PSPs) on every plantation to monitor the performance of the site, and to improve growth models for predicting yields in future projects. Trees from these PSPs will be measured for height and diameter at seven-and-a-half years, as well as pre-harvest.

***WACAP is a highly experienced forestry manager, and Adviser Edge is confident in its ability to manage the Project plantations. The large estate managed by WAPRES in the region ensures that adequate resources are maintained despite the relatively small size of the W.A. Blue Gum projects.***

#### **Harvesting and processing**

It is expected that the harvesting and processing operations will be outsourced to WAPRES. WAPRES has developed a chip mill at the Bunbury Port site to supplement its existing chip mill at Manjimup and the chip loading facility at Bunbury. WAPRES is expected to utilise mobile chippers to process logs onsite at the plantations.

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 WAPRES. While the expected time of harvest is at 10 years of age, the Project Agreements and WAPRES have the flexibility to allow plantations to be grown on 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 12 years. Given the expected time until harvest of at least 10 years, it is possible that current harvesting technology will change prior to harvest.

The majority of blue gums in the region are currently whole-log harvested, although more efficient and economical methods will be explored if these become available.

The W.A. Blue Gum plantations are an integral part of the WAPRES woodchip export business. As such, the Project will have, in effect, a tag-along to the contracts that are in place between WAPRES and the relevant contractors used for harvesting.



### Market Overview

Product type	Eucalypt hardwood timber
Primary use	Pulpwood
Key target market	Japanese pulp and paper manufacturers
Australia's competitors	Other major producers of hardwood woodchips are Vietnam, Chile, Brazil and South Africa
Product Sales Agreements	Off-take agreement with WA Chip and Pulp Company

### Marketing strategy

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

Under the Wood Purchase Agreement, WA Chip and Pulp Company 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, WA Chip and Pulp Company will provide a fixed quote for the harvesting and delivery of the timber, including the costs of roading and other activities. WA Chip and Pulp Company 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. Instead, the price negotiated between the two parties will take into account a range of factors, including the price paid by the purchaser and other wood processors in Western Australia for timber of the same species, quantity, grade and quality. The proposed purchase price must be greater than the price paid for wood delivered at the same time to any other facility operated by the Marubeni Group. Furthermore, if a third party offers a higher price, W.A. Blue Gum can sell to that third party only after first allowing WA Chip and Pulp Co the option of matching the price offered by the other interested party.

W.A. Blue Gum can elect to accept the price offered by WA Chip and Pulp Co, 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 sell the timber to a third party.

***The Wood Purchase Agreement appears to provide a level of market security for the timber to be produced from the Project, given the relatively small resource size.***

### WA Chip and Pulp Company

As with the operational manager, WACAP, the WA Chip and Pulp Company is a subsidiary of WAPRES. The WA Chip and Pulp Company was formed in 1969, and was originally a part of the Bunnings Group before being acquired by WAPRES in 2000. The

### Key Points

- An off-take agreement has been entered into with W.A. Chip and Pulp Company which, through parent WAPRES, is wholly Japanese-owned.
- It is expected that all woodchips produced from timber grown by the Project will be exported to Japan.
- There has been a recent slump in Japanese demand stemming from the global economic crisis and exacerbated by the 2011 Tsunami.
- Future growth in export sales to Japan is expected as its economy rebounds and demand for paper products improves.

company has expanded to play a major role in processing timber from a number of blue gum plantations across Western Australia.

WA Chip and Pulp Company accounts for around 10% of Australian woodchip exports and is the fourth largest export in the country behind Midway Limited (18.5%), South West Fibre (13%) and South East Fibre Exports (14%).

The company has two permanent milling facilities located at Bunbury and Manjimup. The majority of the woodchips exported by the company go through the Bunbury chip export facility in Bunbury. The company also operates a mobile chipper to process logs onsite at the plantations in order to reduce handling costs.

As a subsidiary of WAPRES, it is expected that all woodchips produced by the Project will tag along with existing contracts to supply predominantly Japanese pulp and paper companies.

### Australian woodchip market outlook

Despite recent declines in its economic health, Japan remains the focal point of the woodchip industry in Australia. The industry's biggest clients are large paper producers in Japan, which import high volumes of hardwood woodchips each year. Japan has invested heavily in forestry plantation in Australia and controls an estimated 125,000ha, or 7.2%, of the total plantation area, with WAPRES accounting for in excess of 30,000ha of this total. Total exports as a proportion of industry revenue increased from 70.6% in FY2009 to an estimated 90.9% in FY2014, as industry revenue declined at a faster rate than exports.

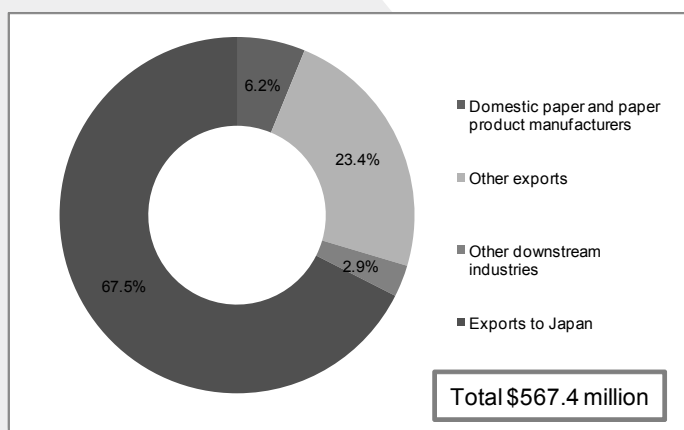
The March 2011 Great East Japan Earthquake and subsequent tsunami had a major negative effect on the woodchip industry's exports for the later months of FY2011 and throughout FY2012. This follows declines in exports to Japan in FY2009 and FY2010, due to Japanese papermaking companies sourcing woodchips from other countries and reducing overall demand. As demand from Japan decreased in most of the five years through FY2014, industry revenue is expected to decline by an annualised 10.0% for this period.

In FY2014 the Australian woodchip industry is forecast to generate revenue of \$567.4 million, up 4.8% from the previous year as a result of some export growth and higher domestic demand. Due to stringent regulations, the woodchip industry is comprised of a small number of forestry-associated companies that produce woodchips mostly for export. It also includes smaller firms that operate next to sawmillers and use their residue for conversion into woodchips. Major players are either integrated forest companies, or plantation managers that have expanded into logging and woodchipping.

The demise of many forestry managed investment schemes has resulted in a much-changed landscape for plantation ownership, with international institutional investors taking major stakes in the sector. It is expected that there will be significant areas within the estates acquired that will not be replanted due to the unsuitable location of the plantations relative to woodchip processing and export hubs, and non-commercial productivity.

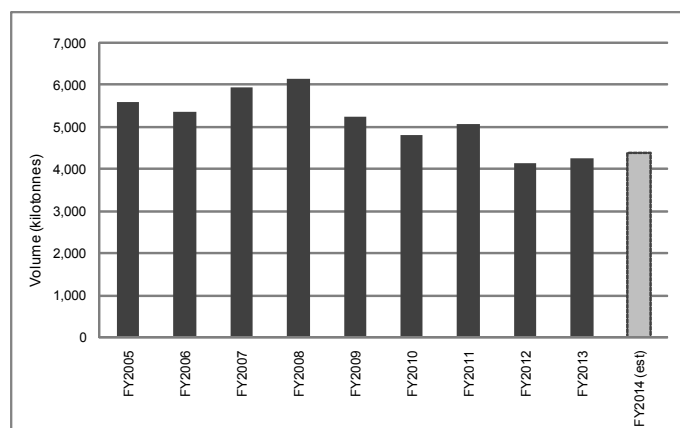
Despite recent struggles, the woodchip industry is forecast to return to growth in the five years through FY2019. Following projected declines in FY2015 and FY2016, industry revenue is expected to increase from FY2017 as Japanese demand increases. As the Japanese economy continues to recover from the 2011 earthquake and tsunami, the country's paper manufacturing industries are expected to expand strongly, driving large growth in woodchip demand in future years. Overall, industry revenue is forecast to increase an annualised 1.3% in the five years through FY2019, to reach \$606.7 million. (Source IBISWorld)

### Major market segmentation



Source: IBISWorld.

### Woodchip export market



Source: ABARE and IBISWorld.

Although Europe and North America account for the bulk of global hardwood demand, the most important export market for Australian grown hardwood chips is the Asia-Pacific region. The major markets for Australian hardwood chips are pulp and paper producers in Japan, South Korea, China, and Taiwan.

Japan has traditionally dominated the Asia-Pacific woodchip trade. However, South Korea and Taiwan are the other major pulpwood importers, with China set to become increasingly prevalent in the pulpwood market over the next decade. Up until FY2005, Japan accounted for virtually all of Australia's export of hardwood chip exports. However, since that time Japan's share of exports has declined, largely due to decreased shipments to Japan rather than any increase in shipments to other countries in the region. Although Japan's demand for Australian hardwood chips has been steadily declining, it still accounted for almost 70% of hardwood chips shipped from Australia in FY2013. (ABARES, 2013)

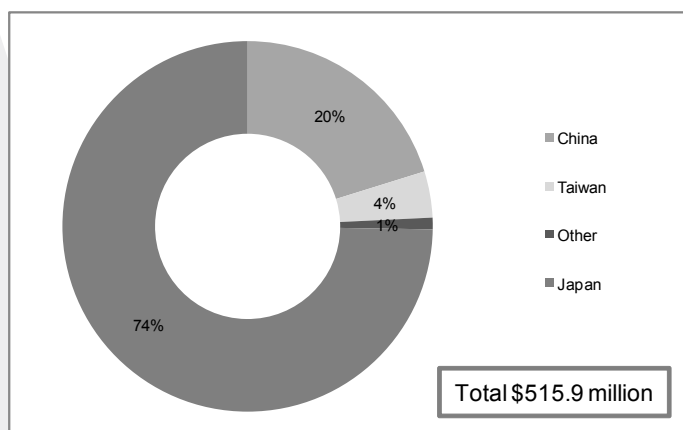
While the proportion of Australian woodchip exports destined for Japan continues to shrink, China has begun to account for a greater share of Australian exports. The following graph shows the trend in exports of Australian woodchips to the three major destinations in the Asia-Pacific.

The Japanese pulpwood market is structured in a way that requires pulpwood buyers to source one-third of their requirements from natural forests and two-thirds from plantation forests. Of the two-thirds to be sourced from plantations, one-third, or around 22% of the total pulpwood requirement, is to come from Japanese-owned plantations that are located overseas, 125,000ha of which are located in Australia. The remainder, 44% of the market, is available to foreign owned plantation supply, such as Australia. W.A. Blue Gum has advised that its plantations are treated as Japanese-owned, due to the company's relationship with WAPRES and the fact that it tags along on its contracts.

The Australian woodchip industry has endured a very difficult period but there are signs of improvement. With Japan's recovery

from the 2011 tsunami well underway and improving global economic conditions more generally, analysts are expecting the industry to return to growth, albeit modest. In the longer-term the industry may be held back by the lack of new plantation establishment as a result of the industry adjustment that occurred post the collapse of the major forestry MIS companies.

#### Australian woodchip exports (FY2014)



Source: ABS.

Woodchip exports to Japan increased in value and volume in the first half of FY2011. However, the devastating tsunami in March 2011 caused exports to Japan to decline, and this has affected subsequent total export values and industry revenue full-year results. As demand from Japan fluctuated over the past five years, so did the industry's revenue. This lower demand has forced operators to find new markets for woodchips, such as Korea and China, although Japan remains the industry's focal point.

As a result of these factors, the Australian woodchip industry has faced export declines and falling domestic demand over the past five years. However, despite this industry profitability is predicted to increase overall for the five years through FY2014, up from 11.0% in FY2009 to a forecast 16.1% in FY2014. Lower operational costs and improved efficiency have offset lower prices and volumes over these years. (IBISWorld)

#### Demand drivers

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, Korean and other Asian paper and paperboard product manufacturing industries. This is generally determined by economic growth in these countries, consumer and business confidence, trends in packaging and advertising, and demand for newspapers and magazines. The level of paper recycling in East Asia is also a key demand determinant for the industry's products. As recycling becomes more popular, the use of virgin paper may decrease. As a result, local paper manufacturers will require fewer woodchips.

The price and quality of woodchips relative to substitutes (that is, wood pulp and finished paper products) is also a demand determinant, as is the worldwide woodchip (mainly hardwood) supply. Since most woodchips are exported, the Australian industry competes with other major global producers, such as the United States, Chile, South Africa, China, and more recently Vietnam.

International transport costs are demand determinants for the industry. This affects the cost of woodchips on the global market and therefore has a direct impact on export demand. Domestic paper manufacturing capacity is another demand determinant; although the domestic market represents only a small part of the industry's sales, it is nevertheless a stable and important source of demand. (IBISWorld)

#### 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 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>	7.00%	7.00%
IRR Range <sup>2</sup>	1.55% – 10.65%	1.55% – 10.65%
Median Return	6.55%	6.55%
Percentage of results that are break even or better	85.39%	85.39%
Percentage of results with an IRR of 10% or better	24.2%	24.2%

<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 on the risk-return profile of a particular investment when compared with static investment modelling techniques.

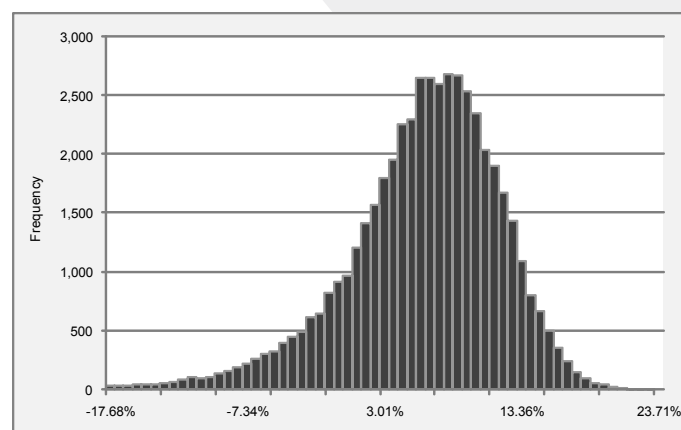
Returns modelling undertaken by Adviser Edge suggests that the Project displays a median internal rate of return of 6.55% p.a. on a pre- and post-tax basis, assuming that an investor maintains

### Key Points

- Yield estimates are based on an analysis of past performance of previous W.A. Blue Gum projects and are dependent on land selection in the current project being comparable with historical projects.
- Historical and current harvest yields achieved on W.A. Blue Gum sites provide credence to the yield assumptions and the use of second rotation land means reduced estimation risk with respect to the yield potential of the land.
- The recent reduction in fees has resulted in an improvement in estimated returns.

the same tax rate throughout the life of the Project. This is lower than Adviser Edge's base case return of 7.00% p.a., which is based on the assumptions outlined below. This is partly due to the relationship between yield and harvest costs, as well as the incorporation of a potential insurable event (e.g. bushfire) or a potential insolvency event into the returns modelling process.

### Pre-tax and post-tax investor returns



### 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 and WAPRES, from the independent forester's report, and from independent research performed by Adviser Edge. The table below 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:		
- 2014	66%	66%
- 2015	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	28m <sup>3</sup> /ha/year
Average implied hardwood stumpage price (\$/GMT)	\$46.00	\$49.00
Stumpage Price Inflation	2.9%	3.0%
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

The PDS does not state the yield which W.A. Blue Gum will target. Adviser Edge has based its yield estimate of 280m<sup>3</sup>/ha on historical plantation inventory data collected from a range of W.A. Blue Gum projects established between 2002 and 2006. This inventory data was collected in 2011. A further measurement was scheduled for early 2014, which Adviser Edge has requested. At the time of finalising this report the most recent inventory data had not been made available for analysis.

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 WACAP, 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.

As the land to be utilised has yet to be sourced, it is difficult to accurately forecast the potential yield performance of the Project. However, the past performance of the operations manager, and the historical yields achieved in the intended planting region, improve the likelihood of the plantations achieving the estimated yield.

An analysis of the 2002–07 Project inventories provides a highly useful guide to the likely performance of the 2014 Project in the future. The average across all sites, bar those located in areas where WAPRES no longer intends to plant trees, shows an average MAI of 24m<sup>3</sup> MAI.

While this is lower than the target annual productivity as per the site selection protocol, if sites that do not meet the minimum requirement of the protocol are excluded, then Adviser Edge is confident that 28m<sup>3</sup> MAI is eminently achievable.

***From past performance and site inspections conducted by Adviser Edge, W.A. Blue Gum and WACAP have shown that they employ comprehensive site selection protocols resulting in the achievement of high yields. Even though the blue gum yield estimates adopted by W.A. Blue Gum are higher than other previous MIS pulpwood projects, Adviser Edge considers the estimates to be realistic and much lower than in previous years. The plantations are to be located on high quality land in higher rainfall zones and fertiliser will be applied to stimulate tree growth mid-rotation. In addition, information regarding past harvest results increases confidence in the accuracy of estimated yield potential of the land.***

***Adviser Edge notes that under the Project Management Agreement, W.A. Blue Gum must establish the plantation by 31 December 2015. However, for investment modelling purposes, Adviser Edge has assumed a 10-year rotation, with 66% of the trees being planted in calendar year 2014 and 33% in 2015. While W.A. Blue Gum will aim to establish 100% of the plantations in 2013, the Project documents allow planting over two years.***

### Past performance (Yield)

A number of W.A. Blue Gum plantations have been harvested in recent years with varied results. The most recent harvest results have achieved an MAI of between 26 m<sup>3</sup>/ha/year and 42.8m<sup>3</sup>/ha/year. Adviser Edge has requested the most recent harvest results for the 2002 Project, which were pending at the time the report was finalised.

While most of these plantations have been harvested at age 10, the higher yields have generally been harvested slightly later at 11 years of age. The weighted average MAI of all the recently harvested plantations is in excess of 31m<sup>3</sup>/ha/year.

However, measurements on more recently-planted stands suggest growth rates are not as strong as earlier planted projects, with MAI being closer to the bottom of the range for the most recent harvests, and even below. However, with some flexibility with respect to the timing of harvest, the Project has some scope to achieve yield targets where growth rates are not as high as expected.

***W.A. Blue Gum projects that have been harvested have performed well to date, despite some below-average rainfall conditions experienced in the planting regions. While some plantations harvested in previous years have exhibited production below the initial yield estimates on***

*average, this Project with its focus on second rotation land is likely to have lower yield estimation risk when compared with earlier projects.*

### Price assumptions

Adviser Edge has adopted a stumpage price of \$46/GMT. This price has been adopted due to an expectation that the woodchip industry will return to growth after an extended period of declining demand following the twin hurdles of the GFC and Japanese Tsunami. The industry has been forecast to return to positive growth in the five years to FY2019, driven largely by increasing demand from Australia's main customer, Japan. (IBISWorld, July 2013)

Notwithstanding, there is obviously some risk to price if there is deterioration in global market conditions around the time of harvest. In addition to general economic improvement globally, there is also potential for the Australian dollar to move lower relative to international currencies, which would be expected to stimulate demand for Australian woodchips and may lead to higher woodchip prices and subsequently stumpage prices.

When the trees are harvested, the timber is processed into woodchips and exported from the port of Bunbury. Timber is sold on the stump, meaning that WAPRES bears all costs associated with harvesting and haulage to port. This is a common approach for the industry. 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 WA Chip and Pulp Company, 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 WA Chip and Pulp Company's processing facilities, with growers incurring the cost of harvesting and transporting the logs to the mill.

W.A. Blue Gum has not included an indicative mill-door price for chip logs delivered to a WA Chip and Pulp Company chip mill at either the Port of Bunbury or the Diamond facility near Manjimup. Adviser Edge has requested woodchip pricing information from W.A. Blue Gum, which was not forthcoming (most likely due to privacy constraints).

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.

The harvesting and transport costs are primarily a function of volume and haulage distance to the processing facilities. High

productivity and less than 100km average cart distance allow W.A. Blue Gum to capture economies that are reflected in lower average costs and higher average stumpage prices relative to lower productivity plantations or more remote sites. Any increase in the average haulage distance will have a direct impact on the stumpage price.

Other micro 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, with some sites well outside this criteria.

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 \$46.00/ GMT. In recent years woodchip prices have remained stagnant; however, with continued economic growth in the Asia-Pacific region and an expectation of increased demand from Australia's most important customer, Japan, Adviser Edge anticipates recovery in woodchip prices will occur in the medium to long-term.***

### 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

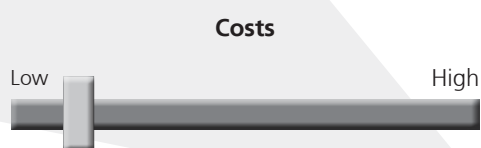
The Project's ability to achieve key assumptions is a function of both the inherent volatility of the underlying activity as well as the assumption risk, which is the accuracy of the initial estimate. Accordingly, the volatility used in Adviser Edge's modelling depends on the quality of the data supporting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



Yield risk is considered to be moderate, given W.A. Blue Gum's land identification and plantation management track record, and the high quality of sites which are targeted using established protocols. The shift in production strategy to incorporate coppiced sites has increased the yield risk moderately. The factors most likely to affect yields are years of low rainfall, and pest and disease pressure.



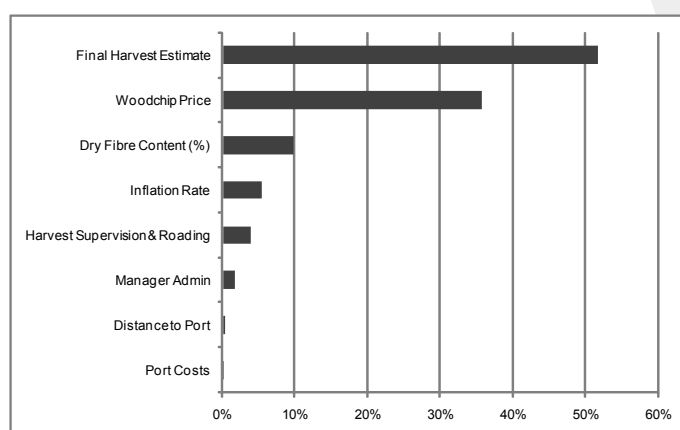
Variations in price are considered to pose a risk to Project outcomes. While there is an expectation that improving market conditions and renewed demand from Japan will support price growth, there remains considerable risk in this area.



Ongoing management and rent costs are fixed to CPI, and as such the risk of achieving the cost outcomes budgeted is substantially mitigated. However, the cost of harvesting, processing and transport will be deducted from the proceeds of sale of the timber, and will therefore affect returns through a lower stumpage price.

## IRR sensitivity

The table above is the resulting sensitivity of investment returns to the various assumptions used in Adviser Edge's financial model. This table indicates that variations in harvest yields and woodchip prices account for the majority of the variance in modelled returns. The high sensitivity to the final harvest yield is to be expected, as this drives the resulting stumpage price.

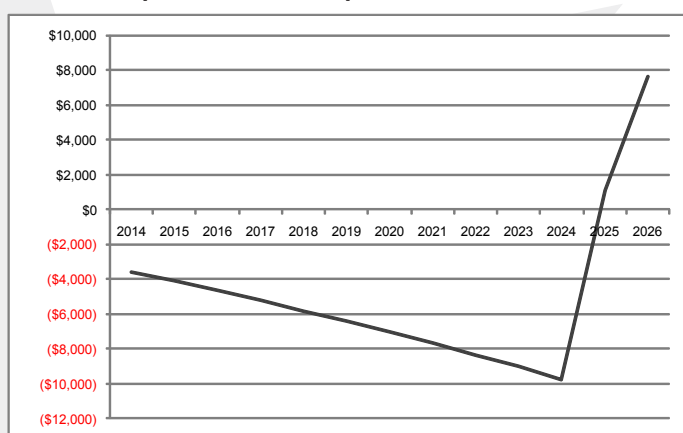


## Pre-tax Cash Flow per Woodlot

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 2014 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 are not 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.

##### *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 and a comprehensive management program

#### **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 blue gum is a well-recognised plantation species, and south-west Western Australia is an established hardwood region, this risk is largely mitigated.

##### *Price and costs*

Investors' returns will be directly affected by the price received for the Project resources, and indirectly by the costs of harvesting and processing. While prices and costs are generally dictated by the dynamics of supply and demand, changes in certain macro-economic 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.

##### *Marketing*

As with any MIS project, there is a risk that the market for the Project 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 may have an impact on resource prices, which could potentially reduce investors' returns.

Although all reasonable care has been taken to ensure that the information contained in this document is accurate, neither the Adviser Edge Investment Research nor its respective officers, advisers or agents makes any representation or warranty, express or implied as to the accuracy, completeness, currency or reliability of such information or any other information provided whether in writing or orally to any recipient or its officers, advisers or agents. Adviser Edge Investment Research and its respective officers, advisers, or agents do not accept:

- any responsibility arising in any way for any errors in or omissions from any information contained in this document or for any lack of accuracy, completeness, currency or reliability of any information made available to any recipient, its officers, advisers, or agents; or
- any liability for any director or consequential loss, damage or injury suffered or incurred by the recipient, or any other person as a result of or arising out of that person placing any reliance on the information or its accuracy, completeness, currency or reliability.

This document contains statements which reflect current views and opinions of management and information which is current at the time of its release but which may relate to intended or anticipated future performance or activities. Such statements and financial information provided have been estimated only and are based on certain assumptions and management's analysis of the information available at the time this document was prepared and are subject to risk and uncertainties given their anticipatory nature. Actual results may differ materially from current indications due to the variety of factors. Accordingly, nothing in the document is or should be relied upon as a promise or representation as to the future or any event or activity in the future and there is no representation, warranty or other assurance that any projections or estimations will be realised.

By accepting the opportunity to review this document the recipient of this information acknowledges that:

it will conduct its own investigation and analysis regarding any information, representation or statement contained in this or any other written or oral information made available to it and will rely on its own inquiries and seek appropriate professional advice in deciding whether to investigate further the business, operations and assets of the business; and

to the extent that this document includes forecasts, qualitative statements and associated commentary, including estimates in relation to future or anticipated performance, no representation is made that any forecast, statement or estimate will be achieved or is accurate, and it is acknowledged that actual future operations may vary significantly from the estimates and forecasts and accordingly, all recipients will make their own investigations and inquiries regarding all assumptions, uncertainties and contingencies which may affect the future operations of the business.

In providing this document, Adviser Edge Investment Research reserves the right to amend, replace or withdraw the document at any time. Adviser Edge Investment Research has no obligation to provide the recipient with any access to additional information or to release the results of or update any information or opinion contained in this document.





11.08, 9 Yarra St,  
South Yarra, VIC 3004  
Telephone: 03 8849 0003  
Facsimile: 03 8849 0006  
Email: [info@adviseredge.com.au](mailto:info@adviseredge.com.au)  
Web: [www.adviseredge.com.au](http://www.adviseredge.com.au)