



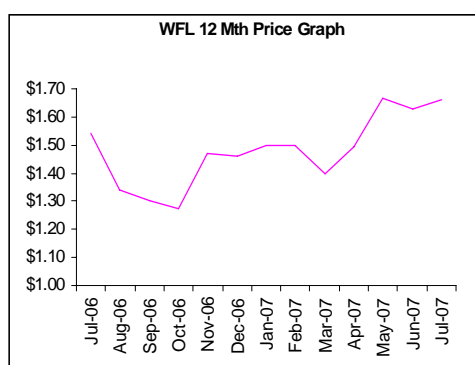
## Willmott Forests Limited (WFL) Initiation of Coverage

**Recommendation - BUY**

**Date: 2 August 2007**

**Valuation - \$2.22**

### Price graph



### Security details

**ASX code:** WFL  
**Last price:** \$1.70  
**12 Mth High/Low:** \$1.22 - \$1.90  
**Market cap:** \$98.66M  
**Shares on issue:** 54.7M

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- Willmott Forests Limited (WFL) has been in operation since 1980 and is a quality endorsed company that establishes, manages, harvests, processes and supplies timber products from plantation grown resources on behalf of their growers (investors) and shareholders. WFL now own in excess of 40,000 hectares of land for plantation and natural resource management.

Earnings growth is forecast to be driven by:

- The recent agreement signed with Hancock Victorian Plantations (HVP) making harvested plantation lands available to be replanted for new woodlot sales (~10,000 hectares) over the next 3 years.
- Demand for Softwood timber both domestically and internationally is increasing due to a number of factors.
- Legislative changes in Forestry Managed Investment Schemes (MIS) including Secondary Market Trading whereby investors can now sell their interests in forestry MIS after 4 years & and new taxation legislation whereby investors are still entitled to a tax deduction provided that 70% of the project expenditure constitutes 'direct forestry expenditure'.
- Significant Growth Opportunities for WFL includes but is not limited to; Long Term supply agreement with NSW State Forests; Visy agreement that secures a market for pulpwood for existing and future WFL plantations; Bioforest; Eden deep water port facility and WFL Sandy Lane mill capital works.

- FY07 forecasts: Revenue \$63.4, EBITDA \$19M, NPAT \$8.4M
- FY08 forecasts: Revenue \$71.4M, EBITDA \$22.9M, NPAT \$10.1M.
- Our DCF valuation results in \$2.44 per share, however applying a conservative 12 times PE multiple to FY08 earnings results in a valuation of **\$2.22 per share**.
- Our valuation of \$2.22 per share represents a 30% premium to the current share price. We initiate coverage with a **BUY recommendation**.

### Key Financials

	NPAT (\$M)	EPS (c)	P/E (x)	EV/EBITDA (x)	Yield (%)
As at June					
2006A	8.1	14.9	11.4	8.7	4.7%
2007E	8.4	15.3	11.1	7.6	5.9%
2008E	10.1	18.6	9.1	6.8	5.9%
2009E	12.5	22.9	7.4	5.8	5.9%

# SWOT Analysis

<u>Strengths</u>	<u>Weaknesses</u>
<ul style="list-style-type: none"> <li>• WFL manages 25 year old softwood plantations via Managed Investment Schemes (MIS). These fundraising activities have given rise to in excess of 102 <i>Pinus radiata</i> plantations in the Bombala Region (NSW). WFL is the largest developer of newly established softwood plantations in Australia;</li> <li>• HVP Agreement will increase woodlot sales over the next three years;</li> <li>• Government support - Plantations for Australia: The 2020 Vision have targeted a trebling of Australia's timber plantations by the year 2020; Secondary Markets for Forestry MIS; Forestry MIS Tax Changes and tax incentives for Carbon Sink Forests; and</li> <li>• CBA Agreement WFL will receive 100% cash upfront for new woodlot sales. Previously WFL funded a large portion of its grower loans, the agreement will provide adequate cash for growth and increase return to shareholders (dividend payout rate increase of 67%).</li> </ul>	<ul style="list-style-type: none"> <li>• Closure of Bright street mill and ability of WFL to increase efficiency and increase output levels;</li> <li>• Exposure to timber pricing fluctuations, residential building commitments and competition within the sawmilling industry;</li> <li>• Timber exporters have to contend with high shipping costs, high fuel prices, export costs and a shortage of space on ships (In the future WFL may export their products internationally).</li> </ul>
<u>Opportunities</u>	<u>Threats</u>
<ul style="list-style-type: none"> <li>• Future softwood saw log demand is expected to exceed supply;</li> <li>• WFL plantations are surrounded by ~50,000 hectares of NSW State Forests (NSWSF), WFL hold a long term timber supply contract with NSWSF;</li> <li>• Sandy Lane mill - once the major capital works are completed, capacity will double and margin will return; and</li> <li>• Bioforest - forestry/renewable energy model whereby a renewable energy fuel resource and a quality wood resource (wood pallets) for charcoal can be delivered to the market within 2 to 3 years.</li> </ul>	<ul style="list-style-type: none"> <li>• Legislative Changes - highly regulated industry;</li> <li>• Industry revenue is highly cyclical with variations reflecting the level of domestic demand; and</li> <li>• Exposure to agricultural cycles, including seasonal conditions and natural catastrophes (e.g. Fire, drought and hail.)</li> </ul>

Source: Bridges Institutional Broking

## Industry Overview

Although there are forestry operations in all states and territories, forests are mainly restricted to a narrow geographic zone with relatively high and reliable rainfall. This includes Tasmania, the Green Triangle Region across the South Australian and Victorian borders, the south and east coast of Victoria, coastal New South Wales and Queensland and the south-west of Western Australia. The forest industry in Australia comprises two main sectors, hardwood and softwood. Within each sector there are native and plantation forests.

### Softwood v Harwood

Softwood is a generic term used in the forestry industry for wood from conifers (needle-bearing trees from the order Pinales). Softwood-producing trees include pine, spruce, cedar, fir, larch, douglas-fir, hemlock, cypress, redwood and yew. Softwood is easy to work with and has a large range of uses such as residues of wood chips, shavings and sawdust. From the production of softwood products comes pulp, wood panels or reconstituted fibre such as Medium Density Fibreboard (MDF), Oriented Strand Board (OSB), and a wide range of pulp and paper products. The primary use of softwood sawlogs sold in Australia is the production of structural sawn timber used in housing construction. Demand for sawn timber is highly correlated with new housing demand.

Hardwood is of higher density and hardness than softwood, has broad leaves and enclosed nuts or seeds such as acorns. They grow in subtropical regions like Africa and also in Europe and other regions such as Asia.

The dominant feature separating hardwoods from softwoods is the presence of pores or vessels. Hardwood species are more varied than softwood as their vessels may show considerable variation in size, shape of perforation plates (simple, scalariform, reticulate & foraminate), and structure of cell wall (e.g. spiral thickenings). Hardwoods are employed in a large range of applications including construction, furniture, flooring, utensils, etc.

Table 1: Shows that the consumption of hardwood has fallen (due to the decline in hardwood log availability from Australia's public and private native forests and the housing construction market) and softwood has risen.

Consumption (cubic metres)			
Year	Softwood	Hardwood	Total
1996	2,675,871	1,472,083	4,147,954
1997	2,752,262	1,496,020	4,248,282
1998	2,998,266	1,536,522	4,534,788
1999	2,979,750	1,487,943	4,467,693
2000	3,429,297	1,550,049	4,979,346
2001	3,200,615	1,360,299	4,560,914
2002	3,465,124	1,404,102	4,869,226
2003	3,741,766	1,397,140	5,138,906
2004	4,072,583	1,359,210	5,431,793
2005	3,990,587	1,338,381	5,328,968
2006	3,887,590	1,277,735	5,165,326

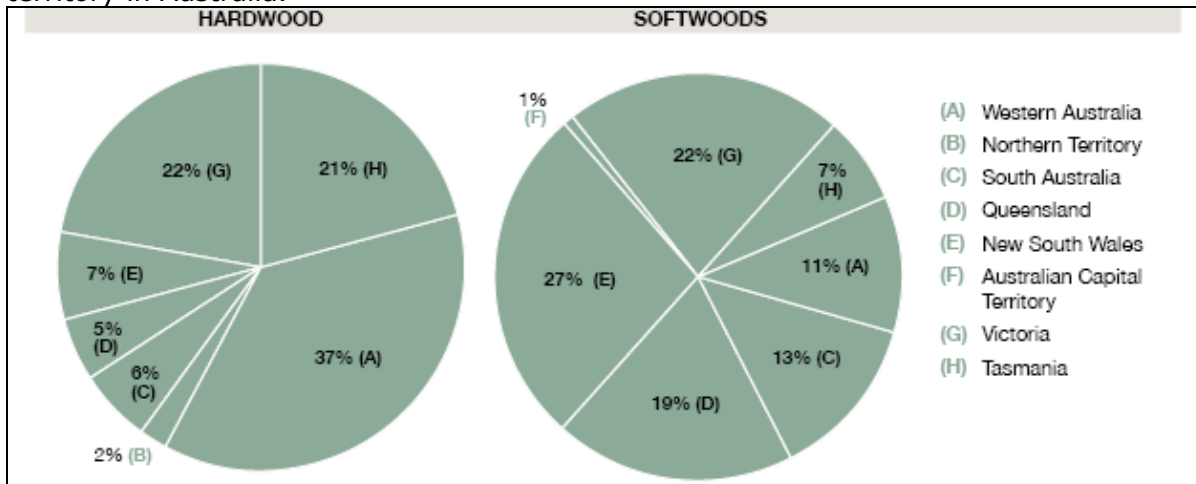
**Source:** ABARE

Source: ABARE (The Australian Bureau of Agricultural and Resource Economics)

## Plantations

The world's natural forest area is declining and environmental constraints are impacting heavily on large areas of existing production forest. As a result, plantation timber is being called upon to play a greater role in world industrial wood supply. A viable alternative to harvesting Australia's native forest resource is the supply of timber from plantations. These plantations contain either softwood or hardwood trees. The current taxation treatment of genuine investments in such plantations encourages private sector investment (see section on legislative changes).

Table 2: Shows the proportion of hardwood and softwood plantations in each state and territory in Australia.

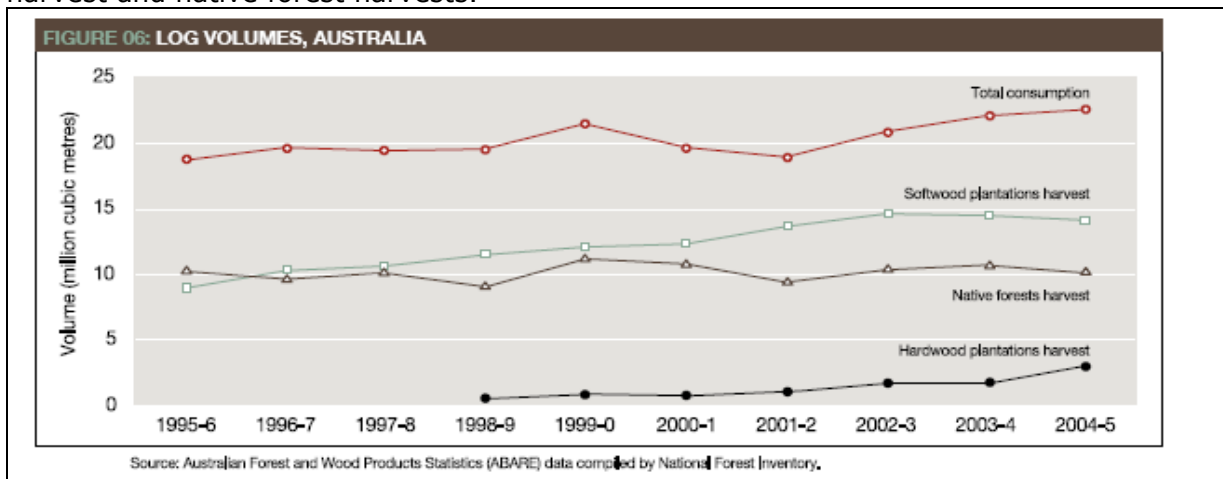


Source: ABARE

Australia's total plantation area has increased to nearly 1.74 million hectares in 2006. That area includes about 990,000 hectares (56.9%) of softwood species and about 740,000 hectares (42.6%) of hardwood species. 75% of the softwood plantations are radiate pine and 61% of the hardwood plantations are blue gum. Private ownership of plantations increased from about 30% in 1990, when it was equal to public ownership, to over 57% in 2005.

There are three overlapping phases of plantation industry development: the **establishment** phase, when new plantations are being planned and established but are not ready for harvest; the **transition** phase, when harvesting and processing are beginning; and the **mature** phase, when the cycle of harvesting and replanting of plantations is ongoing and processing industries are operating fully.

Table 3: Shows total log consumption v softwood plantation harvest, hardwood plantations harvest and native forest harvests.



Source: ABARE

## Wood Processing

The wood processing industry in Australia can be segmented into softwood and hardwood producers. Although the majority of participants within the industry are hardwood mills, plantation softwood has become the main source of sawn timber due to:

- (a) The price differential between softwood and hardwood. Softwood prices are generally about 10% lower than hardwood prices;
- (b) The shorter maturing period for softwoods, which reach sawlog size in approximately half the time taken by hardwoods;
- (c) Environmental pressures to preserve native hardwood and
- (d) Softwood sawn timber being a satisfactory substitute for some hardwood applications.

The Australian log sawmilling industry produces about 4.8 million m<sup>3</sup> of sawn wood per year.

Production unit costs are much lower for softwood sawmills than the smaller hardwood mills. Major hardwood producers include Boral, Sotico, Neville Smith (now owned by Futuris) and Gunns. These larger producers tend to have sawmills in several locations, with production focused on the domestic market (in part due to the high freight costs associated with transportation). In contrast most of the softwood in Australia is produced by a small number of very large sawmills, each with a production capacity of between 300,000 and 600,000m<sup>3</sup>. As a result, production unit costs are generally much lower for softwood sawmills than for the smaller hardwood mills. Major softwood producers include Hyne Timber, Highland Pine, Weyerhaeuser, Auspine, Wespine, Carter Holt Harvey (CHH) and Associated Kiln Dryers.

## **Factors affecting timber industry**

Major factors affecting the timber industry demand, include:

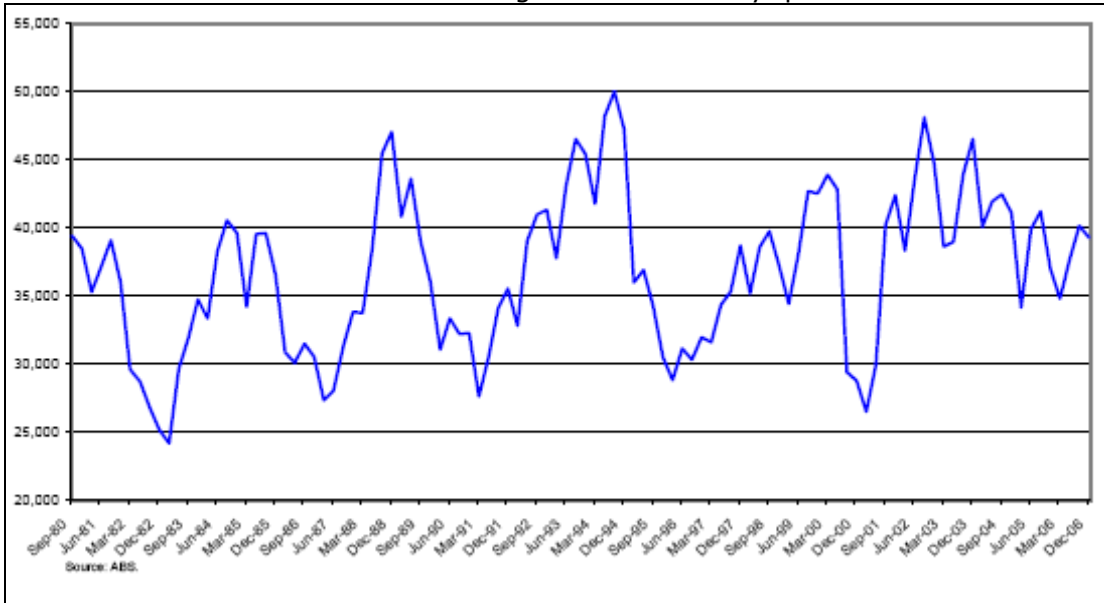
- (a) The level of activity in the commercial and residential building industries, which are the largest users of structural wood products;
- (b) Less than 45% of sawlog output conversion ends up as construction grade structure timber;
- (c) The relative price of hardwood versus softwood timber, as higher prices for hardwood have led to increased demand for softwood structural timber products; and
- (d) Pressure from environmental groups, which reduces the demand for hardwood sourced from old growth forests, encouraging greater product substitution with plantation hardwood and softwood.

## Residential building industry

Total residential building commencements in Australia fell by 4.4 per cent in 2005-06. Commencements rose only in Western Australia and the Northern Territory. Therefore sawnwood declined by 3.1 per cent in 2005-06. In contrast, apparent consumption of wood based panels increased by 3.5 per cent, driven largely by strong growth in consumption of medium density fibreboard (MDF). The consumption of paper and paperboard also declined slightly in 2005-06.

The key drivers for residential housing commencements include interest rates, availability and affordability of land and consumer sentiment which can be influenced by a myriad of factors including more recently petrol prices and employment.

Table 4: Shows the number of dwelling commitments by quarter.



Source: Australian Bureau of Statistics (ABS)

The number of finance commitments for the construction of dwellings for owner occupation (seasonally adjusted) fell 0.7% in May 2007, following a 1.3% decrease for April 2007. The trend series fell by 0.4% in May 2007. Due to population growth, it has been assumed that dwelling commencements would increase in the medium term, which will have an affect on the housing construction industry. However key drivers continue to be interest rates and availability of land.

### Timber Prices

There is a lack of availability of log price information due to the structure of the forest sector in Australia. The Relatively small number of buyers and sellers, together with the fact that logs are generally sold by long-term contracts, means that pricing information is commonly commercial-in-confidence. The situation has improved with the publication of the Australian Pine Log Price Index (APLIPI). A large proportion of plantation log sales are still based on administratively determined prices with allocation to long term contracts.

Table 5: Log prices are measured in 'stumpage', which refers to the price of standing trees prior to harvest.

Log Grade	Estimated stumpage prices (\$/m <sup>3</sup> )
Pulpwood	\$9.27
Preservation	\$22.65
Small Sawlogs SED < 24cm	\$35.26
Intermediate Sawlogs SED < 24-32 cm	\$47.43
Medium Sawlogs SED 32-45cm	\$68.17
Large Sawlogs SED 45cm	\$80.15

Source: Based on APLIPI weighted average (\$A) (Jan-Jun 2005).

For Australian radiata pine growers, the NZ export and domestic log market prices are a window on the world market situation. NZ is a leading world producer and exporter of radiata pine logs. The Agri-Fax New Zealand log price index shows average log prices have jumped 23 per cent in the last year due to price increases globally in Asia, USA, and the UK, and the industry is bracing itself for timber price increases. It is understood that NZ will face a timber shortage, which will ultimately lead to more price increases and more opportunity for Australian producers.

### Government Initiatives

Plantations for Australia: The 2020 Vision is a strategic partnership between the Commonwealth, State and Territory Governments and the plantation timber growing and processing industries.

The overarching principle of the Vision strategy is to enhance regional wealth creation and international competitiveness through a sustainable increase in Australia's plantations, based on a notional target of trebling the area of commercial tree crops to around 3 million hectares by 2020. The Plantations 2020 was launched in 1997 and revised in 2001 by the Private Forestry Development Committee.

### Legislative Changes

The new taxation arrangements for investments in **forestry MIS** recently passed through parliament came into effect on 1 July 2007. Which meant investors are still entitled to a tax deduction provided that 70% of the project expenditure constitutes 'direct forestry expenditure' i.e. costs associated with planting, harvesting etc.

Under the new arrangements the timeframe from receipt of investor funds to planting has been extended from 12 to 18 months, enabling companies to account for seasonal conditions.

This is critical for MIS's within the forestry industry as:

- It sends a signal to the community that the Government is serious about viable plantation development;
- It addresses perceptions that these schemes have been structured for the purposes of tax minimization; and
- It will remove promoters who have been charging excessive fees and commissions.

It is expected that the new arrangements, will encourage further investment in forestry MIS. These arrangements are to be reviewed in two years time.

### Secondary Markets for Forestry Managed Investment Schemes

Consistent with the Australian Government's announcement on new taxation arrangements for forestry MIS, the Treasury and Department of Agriculture, Fisheries and Forestry completed a review of options for secondary markets in forestry MIS, and reported back to Government on 22 March 2007. As a result of this review the Government has decided to allow investors in **forestry MIS** to trade their interests once they have been held by the initial investor for a period of four years. This measure applies to interests in pre existing schemes, meaning that taxpayers who invested in a forestry MIS prior to 1 July 2003 will be able to trade their interests from 1 July 2007.

WFL products are long rotation (20-25 years to maturity), as opposed to 10 years for hardwood, previously this made WFL products less attractive, now with secondary market trading, and WFL will be more attractive to investors.

## Tax Changes for Carbon Sink Forests

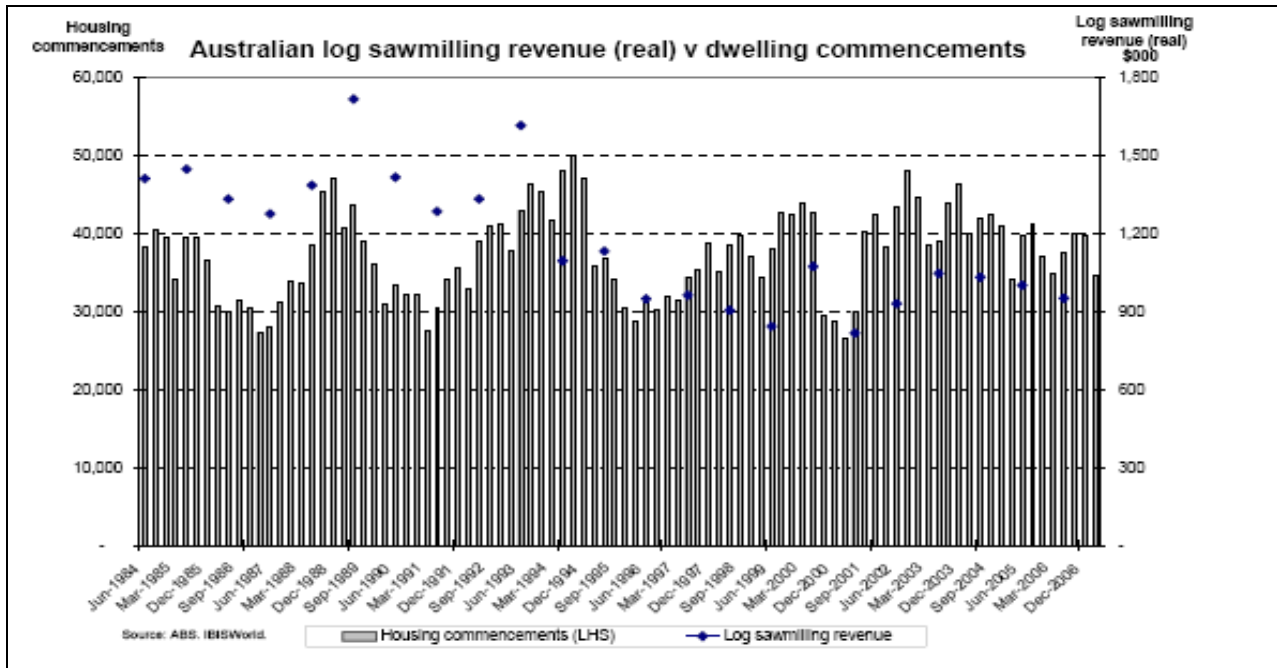
This initiative encourages the establishment of forests to act as carbon sinks and help mitigate greenhouse gases. For the next five years these arrangements will allow for the full tax deductibility of the establishment costs of carbon sink forests. Carbon sink taxation arrangements came into effect on 1 July 2007 and will significantly enhance the attractiveness of Forestry MIS Schemes.

All three legislative changes are significant for WFL, as it enhances the attractiveness of the WFL MIS offering.

### Historical performance

Production of sawn softwood has increased in most years, however, the decline in 2000/01 was as a result of the introduction of the GST and before the First Home Owners Scheme was introduced and in 2002 and 2003, the sawmilling industry grew due to the housing boom. Imports have risen slowly but steadily since 2001. Exports have remained small as a proportion of total production.

Table 6: Shows the correlation between the timber industry revenue and dwelling commencements



## Outlook

Industry revenue is highly cyclical with variations reflecting the level of domestic demand.

Over the last decade the apparent consumption of softwood has been rising at 2.8% pa, while the equivalent figure for hardwood sawn wood has been declining at an average annual rate of 4.4%. In 2005, the softwood sawn wood market was more than three times the size of the hardwood sawn wood market. Internationally the trends are similar, with the market for softwood growing at an average rate of 1% pa, while hardwood is falling by 2% pa.

Future softwood saw log demand is expected to exceed supply within the next few years. However, while there is not a perfect balance between supply and demand in all growing regions, qualified estimates show there will be an impending shortfall in the supply of sufficient sawlogs and pulp logs in selected major wood baskets of south eastern Australia unless forest growers and investors undertake continued planting.

## Shortage

BIS Shrapnel long term forecasts estimate GDP will increase by 53% between 2005 and 2020, which, based on historical correlation, will mean a 32% rise in demand for sawn softwood by 2020. Based on the above figures, the current long-term average rise in apparent consumption of sawn softwood would be approximately an additional 100,000 m<sup>3</sup>/annum. Using an industry estimate of close to 40% of a sawlog being recovered as sawn timber, then the production of sawlogs will need to increase at a rate of at least 240,000 m<sup>3</sup>/annum, or an additional 2 Mm<sup>3</sup> above the current level within ten years. In stark contrast, based on figures from the National Forest Inventory, production of softwood sawlogs, over the same period, is estimated to increase by only 300,000 m<sup>3</sup>.

Table 7: Potential Log Supply from Softwood Plantations:

Potential Log Supply From Softwood Plantations			
	Potential Softwood Supply (thousand cubic metres pa)		
	2005-09	2010-14	2015-19
Sawlogs total	9,207	9,376	9,509
Pulpwood total	5,751	5,503	5,463

Source: National Forest Industry

Coupled with the recent social and political focus on carbon emissions targets, the '2020' vision by government, new taxation initiatives and recent competitor activity (Gunns Limited and Auspine Limited ) sees an exciting time for this industry.

# Company Overview

Willmott Forests Limited (WFL) has been in operation since 1980 and has total assets in excess of ~\$260 million as at 30 June, 2007. WFL is a quality endorsed company that establishes, manages, harvests, processes and supplies timber products from plantation grown resources.

Since 1989, WFL has managed 25 year old softwood plantations via Managed Investment Schemes (MIS). These fundraising activities have given rise to in excess of 102 *Pinus radiata* plantations in the Bombala Region (NSW).

Other competitors within the industry are Timbercorp (TIM), Great Southern Plantations (GTP) and Gunns (GNS) – however these competitors utilise 10 year hardwood schemes. In addition to WFL MIS operations, WFL is the largest developer of newly established softwood plantations in Australia, operated through its forestry division.

The Company currently operates in south east New South Wales predominantly in the Bombala and Murray Valley regions and throughout the major softwood growing regions of Victoria. WFL is recognised as a market leader in the proven and recognisable long term softwood plantation industry. WFL directly employs over 125 people and manages plantations, ranging from new plantings to mature trees on behalf of their growers (or investors).

The principal activities of WFL are:

- Marketing of Woodlot investment projects to the public through complying offer documents;
- Identification and acquisition of suitable land for plantation establishment combined with planting and maintenance of *Pinus radiata* plantations pursuant to Woodlot sales;
- Management of the loan book generated by Woodlot sales;
- Production, processing and sale of landscape and structural timber products; and
- Maintenance of plantations.

## Background

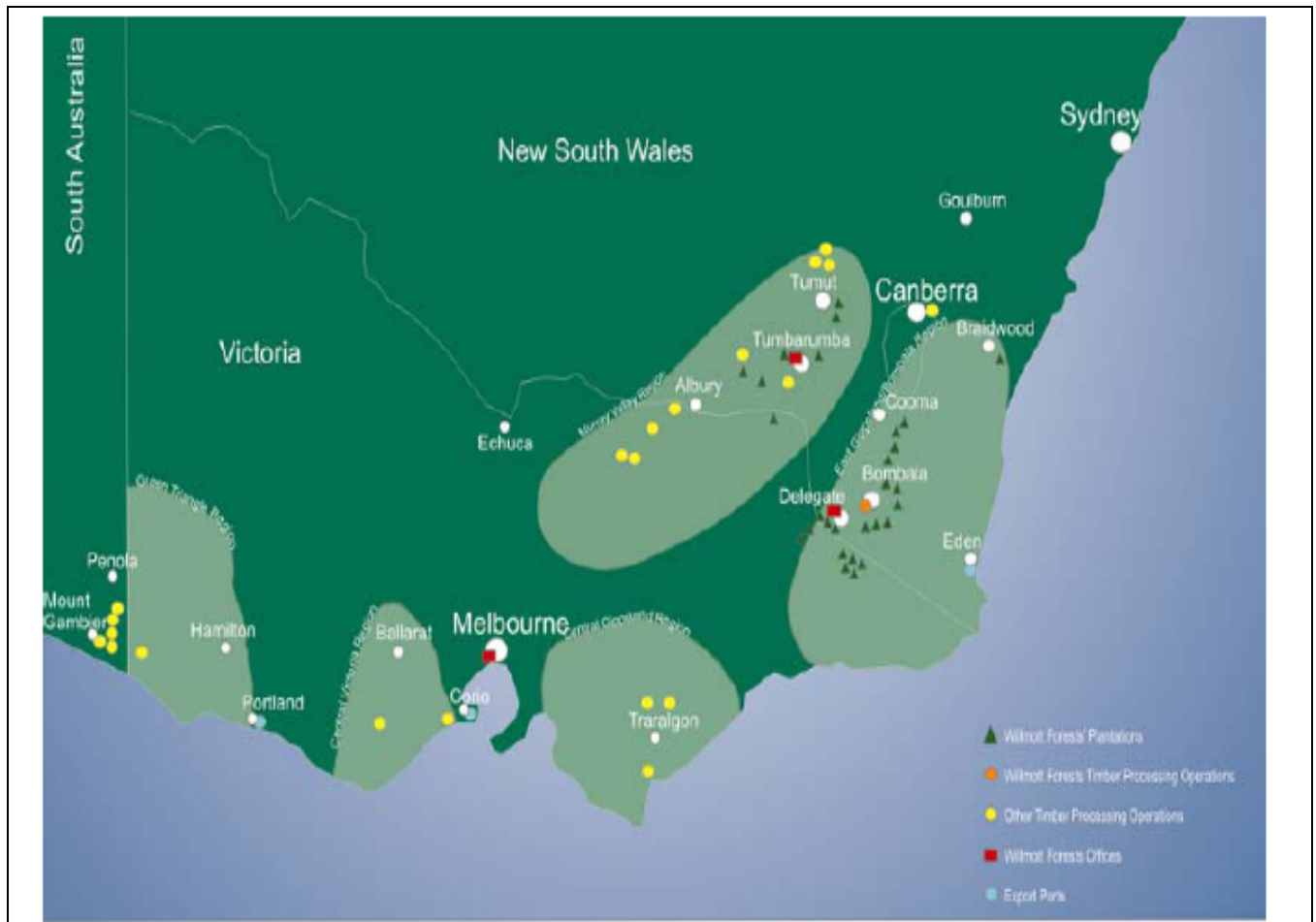
In 1979 the late Hector Willmott founded the business now named after him. WFL continues to develop the vision of its founder by providing future generations of Australians with a sustainable supply of softwood timber products.

Over its many years of experience, WFL has established long-standing and strong Government and community links. Mr Derham (CEO) is affiliated with a number of industry associations and is Chairman of an industry-based chapter of the Australian Forest Growers (AFG) called Treefarm Investment Managers Australia (TIMA). Mr Madgewick (Company Secretary and Non executive director) represented the industry based chapter of the AFG in successfully negotiating and drafting the provisions related to the extension of the 12 month taxation rule for plantation investment activities with Treasury and the Australian Taxation Office.

WFL derives its revenue from the following two core business divisions:

1. Timber Processing & Sales through the sale of landscape and structural timber products for the Australian market; and
2. WFL acts as a Responsible Entity for forestry MIS and receives revenue from investors via upfront fees, ongoing fees and previously offered a loan facility to investors whereby WFL finances up to 100% of investors MIS costs (referred to throughout this report as 'loan book').

WFL is dedicated to creating a sustainable and revolving plantation resource and land base, servicing the major domestic markets of Melbourne, Sydney and Canberra. The map below highlights the regions that WFL operates:



Source: WFL

WFL uses advanced technology called The Private Plantation Management Information System (PPMIS) that provides WFL with a 'state of the art' decision-support system. The system has been assembled and is operated by WFL and uses remote sensing (satellite/aerial photography) which is geo-referenced against a number of layers such as cadastre data (title boundaries, road infrastructure etc.), elevation and rainfall data.

The PPMIS assists WFL to:

- Identify suitable land for plantations;
- Evaluate properties prior to plantation establishment;
- Streamline the approvals process for planning applications;
- Prepare accurate allocation plans for Growers;
- Monitor existing plantation performance; and
- Monitor contractor progress and performance.

The satellite technology is able to provide photographic evidence of any variations in plantation quality. This is a major advantage because such variations may not have been detected by human inspection techniques. As a result, WFL is able to identify, evaluate, monitor and, if required, act upon such variations to enhance plantation health and performance.

### The Boombala Region (NSW)

The region has over 45,000 hectares of softwood plantations currently growing, production of 200,000m<sup>3</sup> of sawlog p.a. and over 112,000 hectares of land suitable for new plantations. WFL is a major processor in the region, processing ~90,000m<sup>3</sup> p.a. of salvage sawlog and preservation timbers. WFL plantations are surrounded by ~30,000 hectares of NSW State Forests (NSWSF), and WFL hold a long term timber supply contract with NSWSF. In addition, the Boombala Region has a specialist built deep water port facility in Eden that is funded by the Federal Government. WFL shares this port access with the Navy.

### The Murray Valley Region (NSW)

West of the Great Dividing Range extending from Melbourne to Tumut in NSW and the North East of Vic, the region is one of the largest plantation sites in Australia (~170,000 hectares), and processes ~30% of Australia's sawlog harvest and pulpwood harvest. Average rainfall in the region is 650-1200 mm/p.a. WFL geographical expansion into the Murray Valley region has continued with in excess of 7,000 hectares of new softwood plantations established in the region during the past 2 years.

### The Victorian Regions

In FY06, WFL announced that it had executed a commercial arrangement with Hancock Victorian Plantations Pty Ltd (HVP) – Australia's largest private timber plantation company, will make available 10,000 hectares of harvested plantations lands to be replanted for new Woodlot sales over the next three years, with HVP establishing the plantations, maintenance and log marketing for these lands. This is significant for WFL as they will manage these plantations in the long term positioning them to be one of the principal future softwood supplies to South-Eastern Australia. This will allow WFL growers access to premier plantation lands that will achieve higher end-market product prices.

The HVP agreement will provide access to;

- The Green Triangle Region (South-West Vic & South-East South Australia), known for its high end product prices and low cost operations with 161,000 hectares of softwood, production of 1,200,000 tonnes of sawlog and 2,400,000 tonnes of pulpwood of which 50% is exported;
- Central Gippsland – 60,000 hectares of softwood plantations, 515,000 tonnes of sawlog, 523,000 tonnes of pulpwood and high rainfall;
- Ballarat-Otways – in excess of 30,000 hectares of softwood plantations, domestic and export markets producing 360,000 tonnes of sawlog and more than 200,000 tonnes of softwood export woodchips p.a.

### Threats

Drought has been a recent factor in agricultural sectors of late, however in FY2006 annual rainfall in the Boombala and Tumbarumba regions was 119% and 88% respectively of long term historical rainfall averages, although conditions are not ideal, due to WFL's land selection criteria, the company was some what protected from adverse effects.

WFL is a registered Forestry Industry Brigade of the Country Fire Authority (CFA). CFA is one of the world's largest volunteer-based emergency services and WFL is a ready and willing contributor to the regional fire fighting efforts in Vic and NSW. Under the Forestry Rights Act 1996 plantations must maintain adequate fire fighting equipment and by being a registered forestry industry brigade of CFA means WFL are able to fight their own plantation fires, if the need arises.

# Divisional Overview

## WFL MIS Business Model

1. WFL source the land, obtain product rulings from the ATO and offers Retail Woodlots via MIS to investors.
2. Upfront fee - The investor participates by signing forestry Management Agreement and Land Tenancy Agreement. The investor pays a once only upfront payment for preparation and planting of \$3,900 net of GST (up from \$3,500 in FY06). Investors can pay the balance by cash, have 12 months interest free to pay the balance or obtain finance from WFL for 100% of the woodlot investment. Investor receives a tax deduction from the ATO (see industry overview under legislative changes).
3. Maintenance fee – investor pays to WFL 7% of gross Timber proceeds at years 13, 18 and 25.
4. Land Rental fee – investor pays 2% of Gross Timber Proceeds to WFL at years 13, 18 and 25. Land sourced by WFL is held in trust by WFL on behalf of the investor (grower).
5. Harvesting fee – investor pays 1% of Gross Timber Proceeds to WFL for marketing and harvesting of timber at years 13, 18 and 25.
6. Insurance fee – payable by the investor of 1.15% of the sum insured post 5 years.
7. Investor receives proceeds at years 13, 18, 25 (less fees paid to WFL = 10%).
8. Process begins again.

## Woodlot investment projects

WFL now manages ~30,000 hectares of softwood plantations (of which 6,020 new hectares was established in 2006 an increase of 18% pcp), predominately in the Boombala and Murray Valley regions. Retail woodlot sales experienced strong growth in excess of 40% in the last four years. Woodlot investment projects contributed ~70% to WFL revenue in FY06

WFL trees will reach maturity 25 years after planting (known as long rotation plantations as opposed to 10 years – short rotation plantations) and will be thinned at 13 years and 18 years with clear fell at 25 years. The 1<sup>st</sup> thinning process for WFL is forecast to occur in FY10.

Thinning provides a financial return (to the grower and WFL) and leads to an improvement in the value of the remaining crop. The material removed during the first thinning (13 years) is pulpwood, the raw material for paper, mainly newspaper and cardboard production. The second thinning (18 years) and clear fell (the final cutting down or logging at 25 years) is used for higher quality sawn products or veneer together with pulp. WFL manages these processes and the majority of output distribution on behalf of their growers.

During 2006, WFL circulated two complying offer documents (Willmot Forest Project and The BioForest Sustainable Timber and Biofuel Project 2007) that were highly rated by independent research houses. WFL are currently looking to launch a SMSF product in FY08. WFL has also increased the actual number of advisers using their woodlot project of which it currently pays a brokerage fee of not more than \$215 per woodlot to financial advisers.

## Loan book

During 2006 WFL ceased its finance company operations and all future facilities will be provided by a special purpose vehicle wholly owned by CBA. Under this arrangement WFL will receive 100% of cash upfront from future Woodlot sales (in the past WFL funded a large proportion of grower loans from its own resources). WFL has also recently sold part of its loan book to the CBA i.e. \$63.4M of funds raised from the sale of loans, which were originated from woodlot sales over the past 5 years. This reduced senior debt for WFL and we have forecast the loan book value to be ~\$70M in FY07.

## Timber processing activities

WFL timber processing operations are situated in Broomball and are involved in the three main facets of milling operations; processing, refinement and treatment. The softwood timber products produced by the company's milling operations include treated landscape products, structural and visual grade timber, stress boards, sleepers and palings to service the domestic timber markets throughout New South Wales, the ACT and Victoria. Timber processing activities contributed ~30% to WFL revenue in FY06.

The company operated two timber processing facilities in Broomball, however continuing weakness in the housing sector, particularly in NSW, led to slower sales and a further softening of margins. With the structural timber market depressed WFL's closed its Bright Street Sawmill during 2H06. The remaining mill is Sandy Lane that produces landscape products.

### Sandy Lane Mill

The Sandy Lane Mill is 37 ha, positioned well between Vic, ACT and NSW. This site is situated close to major highways. Output of this mill is ~42,000 m<sup>3</sup> p.a. Wood supply comes from Forests New South Wales (NSWSF) under long-term supply contracts and wood in-take was also received from plantations managed by the company. Distributors of these landscape products include Flower Power and Hudson Building Supplies.

In 2H06, management decided to expand their timber processes operations at Sandy Lane and stage one of an expansion has been completed with finalisation of a \$1.7 million upgrade with further upgrades to the site of an additional \$11 million in capital works over the next 2 years.

The rationale behind this expansion was that the landscape products market is one where WFL are a much larger player and their future contracted wood supply (predominantly from Forests NSW) is well matched with the production of landscape products. Capacity of the mill will run at 40% once capital works are completed and will allow for further capacity. This site also offers excellent export opportunities.

### Visy Agreement

In addition to the NSWSF Agreement, WFL has also signed a long term agreement with Visy. This arrangement sees WFL supplying pulpwood to Visy's Tumut kraft-linerboard pulpmill from 10,000 hectares of new plantations established in the South-west slopes region of NSW and north-eastern Victoria. The agreement secures a market for pulpwood produced from existing and future plantations and ensures that first thinning operations will be undertaken on schedule enabling maximum returns to be obtained from future sawlog yields.

## Bio forest

On 14 March 2007, WFL announced that its offer to acquire a controlling interest for \$2.9 million in the BioForest group of companies has been accepted. WFL now holds a majority stake in BioEnergy Australia Limited (the parent company) and board representation commensurate with that stake.

BioEnergy has developed a forestry/renewable energy model whereby a renewable energy fuel resource and a quality wood resource for charcoal can be delivered to the market within 2 to 3 years of planting and a quality sawn wood product can be delivered at shorter rotations of 10 to 15 years. The 'BioForest Sustainable Timber and Biofuel Project 2007' MIS secured ATO product ruling and the Product Disclosure Statement was launched in 2007.

This is significant for WFL as it enables them;

1. Entry into the high value renewable energy market;
2. Income is delivered earlier to investors and WFL will receive revenue from investor fees associated from the new product;
3. The model is the first of its kind in Australia and delivers diversification to WFL branching out into other species silky oak, she oak etc and the opportunity to enter different geographical regions;
4. the technology is expected to have world-wide application; and
5. Solves the emerging 'fuel v food' debate.

BioEnergy have recently entered into a Memo of Understanding (MoU) with Tomen Australia to investigate and develop energy production facilities and charcoal markets. The MoU incorporates a charcoal off take component as Tomen has an intention to market the charcoal produced to the various international charcoal markets. Tomen have recently announced their merger with Toyota Tsusho, the trading company of the Toyota Motor Group.

The first planting took place in 1H07; therefore this product is still ~3 years from harvest.

## Ethanol Technologies Limited

On 16 March 2007, WFL announced that it had acquired an interest in Ethanol Technologies Limited ('Ethtec') representing 51% of the paid up capital in the company for a total cost of \$2.75m. Ethtec has a world-wide exclusive licence from Apace Research Limited ('Apace Research') to further develop and commercialise technologies developed by and under the direction of Apace Research for the production of ethanol from lignocellulosic material such as wood, bagasse (waste from sugar production), crop stubble and municipal green waste. This is generally referred to as 'cellulosic ethanol'.

Ethtec has been raising funds to build a pilot plant, designed by Apace Research, to demonstrate the commercial application of these technologies and WFL sees enormous potential for cellulosic ethanol technology to be used in the timber industry, and intends to seek further non-shareholder funding to assist in commercialising the technology via active participation in the development of the pilot plant and representation on the Boards of both Ethtec and Apace Research.

The Ethtec pilot plant project will span over three years by which time the value of these new technologies should be realised. This new process is expected to have immediate application world-wide in all new and existing ethanol distilleries that utilise traditional sugar, corn or starch feedstocks. There are more than 300 of these plants worldwide, either in operation or in the final stages of construction.

In February 2007, the Australian Senate Rural, Regional Affairs and Transport Committee reported on its inquiry into Australia's future oil supply and alternative transport fuels. The Committee concluded:

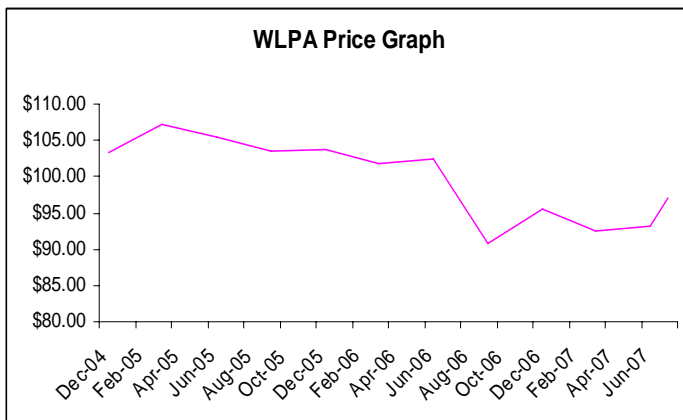
*"Lignocellulosic ethanol production is the only realistic way that the [ethanol] industry can become more than a niche player. If large scale production of ethanol using feedstock that is available in volume becomes commercially feasible in the medium term, ... it could make a worthwhile contribution to Australia's transport fuel requirements."*

## PINES

On 12 October 2004, WFL announced an issue of Perpetual Income Exchangeable Securities ('PINES'). WFL raised \$40 million through the issue of 400,000 PINES at the unit price of \$100 each. Monies raised were used to fund land acquisitions and to allow further growth of the company.

The key feature of PINES is a non-cumulative fully franked dividend payable semi-annually in arrears on 30 September and 30 March of 7% p.a. (10% pre-tax equivalent at current corporate tax rates). The dividend is fixed until the first Reset Date, which is 30 September 2009.

Current share price of PINES (WFLPA) is \$97.00 (as at 1/08/07).



# Key Drivers

Bridges Institutional Broking has highlighted the following key drivers for WFL:

## 1. HVP and CBA

Due to the arrangement with HVP (arranger for land leasing) and CBA (sale of loan book and special purpose vehicle for future funding), we believe WFL will increase MIS sales. We have forecast ~\$52M of MIS sales in FY08. The HVP relationship has the capacity to be developed further in the future and allows WFL to concentrate on establishing and managing plantations. In addition, the CBA arrangement will provide adequate cash for growth and increase return to shareholders (dividend payout rate increase of 67%).

## 2. Agreements

WFL have the following output agreements that are significant to its growth opportunities

- a. Long Term supply agreement with NSW State Forests; WFL plantations are surrounded by ~50,000 hectares of NSW State Forests (NSWSF), (30,000 ha in the Boombala region and 20,000 ha in the Tumut region). WFL have a strong relationship with NSWSF and NSWSF may outsource the management of these plantations in the future, WFL is a strong contender for this role.
- b. Visy agreement, this long term agreement secures a market for pulpwood for existing and future WFL plantations.

## 3. The demand for softwood both domestically and internationally is increasing due to a number of factors

- a. Lower cost of production than hardwood (approx 10% lower);
- b. Increasing awareness of environmental issues i.e. non native forestry, carbon credits available from government, government initiatives and consumer preferences for environmental products;
- c. Versatility of softwood; and the
- d. Decline in hardwood native forests.

## 4. Legislative change

Secondary market trading now secures the support of the governments in that investors can now sell their interests in forestry MIS after 4 years. As the WFL product is long rotation (20-25 years to maturity), as opposed to 10 years for hardwood, this made WFL products less attractive.

## 5. Opportunities -

- a. Bioforest - forestry/renewable energy model whereby a renewable energy fuel resource and a quality wood resource for charcoal can be delivered to the market within 2 to 3 years of planting and sawn wood product can be delivered at shorter rotations of 10 to 15 years;
- b. Further opportunities with exporting woodchips and the use of the Eden deep water port; and
- c. Sandy Lane mill - once the major capital works are completed, capacity will double and margin will return. The site also offers excellent export opportunities.

## Financial Forecasts

Table 8: Below shows the revenue model for WFL:

Land Sales	FY06	FY07	FY08	FY09
Ha Purchased	3,100	2,968	3,324	3,723
Ha Leased	2,200	2,968	3,324	3,723
Total Sold	5,300	5,936	6,648	7,446
<i>% change on pcp</i>		12%	12%	12%
Total Planted & Managed	54,200	65,459	78,184	92,406
Price per Ha sold (\$)	7,000	7,800	7,800	7,800
<b>Plantation/ Woodlot Rev</b>				
MIS Sales (\$)	37,100	46,301	51,857	58,080
MIS booked in current period	7,400	9,260	10,371	11,616
MIS booked in previous period	37,100	29,800	37,041	41,486
<b>Total Plantation/Woodlot Rev</b>	<b>44,130</b>	<b>39,060</b>	<b>47,412</b>	<b>53,101</b>
<b>Timber Processing</b>	<b>20,011</b>	<b>18,142</b>	<b>18,629</b>	<b>21,106</b>
<b>Finance income</b>	<b>11,834</b>	<b>4,673</b>	<b>3,851</b>	<b>3,748</b>
<b>NMV</b>	<b>723</b>	<b>792</b>	<b>800</b>	<b>900</b>
<b>Other Income</b>	<b>569</b>	<b>750</b>	<b>761</b>	<b>780</b>
<b>TOTAL REVENUE</b>	<b>77,267</b>	<b>63,417</b>	<b>71,452</b>	<b>79,635</b>

Source: Bridges Institutional Broking

- We have forecast Land Sales to increase due to the HVP agreement signed in 2006 and management goals.
- The nature of MIS sales sees that sales revenue is brought into account in proportion to the work performed, thereby recognising the various stages of plantation.  
Unearned revenue is derived from various stages of the contract that are yet to be completed. Therefore approximately 20% of revenue is recognised in a current financial year and 80% of revenue is carried forward to the next financial year.
- We have forecast Timber processing to decline in FY07 due to the closure of the Bright Street Mill. FY08 and FY09 increasing due to demand in softwood consumption and the output efficiencies achieved through the major capital spend on the Sandy Lane mill.
- We have forecast finance income to decline due to the sale of the loan book to CBA.
- Net Market Value (Biological Assets) is carried to revenue from grower assignments once recognised at the time of transfer by growers under management. Whilst the company has a reasonable expectation that future assignments will continue, no recognition within the accounts is made until assignment. Management have assumed ~\$1M p.a.
- Other Income to increase at 5% pa.

## Valuation

Table 9: Below shows WFL valuation using DCF:

Valuation	\$M	\$ Per Share
NPV Cash Flows	11.04	0.20
Terminal Value	29.31	0.54
Net Cash (Debt)	-51.20	-0.94
Land & Receivables	144.10	2.63
Total	133.25	2.44

\* We have valued WFL land at cost on the balance sheet, although this does not reflect the full value of WFL land, we believe this is the best way to value the land as the majority of WFL land assets are tied up in long term (14-17 year) leases with growers.

WACC	11.66%
Risk free rate	6.25%
Cost of Debt	7.00%
Beta	1.20
Equity Risk Premium	6.00%
Cost of Equity	17.95%
Terminal Growth Rate	2.85%

Table 10: Industry Peer P/E Multiples:

Name	ASX Code	Current Share Price	Market Cap	P/E Multiple
Auspine Limited	ANE	6.38	344.2	24.1x
Timbercorp Limited	TIM	1.96	597.7	7.3x
Great Southern Limited	GTP	2.38	762.5	5.7x
Forest Enterprises	FEA	0.66	267.3	9.0x
Australia Limited				
Gunns Limited	GNS	3.32	1271.4	13.9x
			Average P/E Multiple	12

Applying a conservative 12 times PE multiple to FY08 earnings results in a valuation of **\$2.22 per share**. Based on the current share price of \$1.70, WFL is trading on a FY08 PE of ~9 times.

Applying a 12 times PE multiple to FY09 earnings results in a valuation of **\$2.73 per share**.

Our valuation of \$2.22 per share represents a 30% premium to the current share price.

## Share Registry

Nanmar Pty Ltd	45.67%
Commonwealth Bank Group	13.32%
Acorn Capital Limited	9.60%

