

Willmott Forests

Underlying Interim Result as expected

WFL reported a 22.7% increase in normalised profit (adjusted for the gain on Pines conversion) to \$5.1m, on an 18.6% fall in revenue to \$35.2m. This includes a positive adjustment to provisions for forest management. Key features of the result were:

- The underlying result was around our expectations, considering a 22.6% fall in carry-over Forestry MIS revenue from FY2009, following a 31.7% fall in Forestry MIS sales. The results are highly seasonal, with a higher level of revenue recognition in each second half.
- Adjusted Woodlot/Forestry MIS profit fell with a lower level of revenue recognition, reflecting both the lower FY2009 Forestry MIS sales and lower plantation establishment in 1H FY2010.
- The contribution from timber processing fell by \$0.4m, due to weaker market conditions for the Willmott Timbers processing Joint Venture.
- The reported result of \$9.6m includes a one-off gain of \$4.6m on conversion of the Pines.

The Balance Sheet was strengthened by:

- In November 2009, WFL raised \$20.5m through a \$6.3m institutional placement at \$0.45 ps and a \$14.2m rights issue at \$0.40 ps.
- In September 2009, 56% of its PINES converted to equity, resulting in the issue of a 32.8m shares, but a \$1.6m pa interest saving.

Gearing (treating the Pines as Equity) was flat at 19.7%, with the full impact of the equity issues was tempered by seasonally weak 1H cashflows. Cash flow increases substantially in the 2H with woodlot sales.

The operations and Balance Sheet are supported by the new banking facilities with CBA of \$135m, completion in March 2009.

Outlook

The FY2010 result is very much dependent on Forestry MIS sales in 2H FY2010, although high level of carryover revenue recognition is expected. With WFL now the leader in the Forestry MIS sector, with a superior business model and limited competition, its expecting an improved level of Forestry MIS sales, despite the impact of problems with other participants.

In response to an ASX query, WFL has advised that it believes the FY2010 result will not vary from the FY2009 result by more than 15% and does not expect to report any material abnormal or extra-ordinary item.

Recommendation

Maintain BUY. The attractions of WFL are:

NTA - A large share price discount to NTA of 195%, predominantly of land asset backing, conservatively valued.

Market Position - WFL is now the leader in the Forestry MIS sector, operating a superior model to other participants.

Balance Sheet – The prepaid land leasing deals support the model's sustainability.

Cash Flow – WFL has a contracted future cash flow surplus of over \$130m from its various plantation operations.

Our Target Price has been reduced to \$0.60 and is set at a PER of under 6 times FY2011 earnings.

WFL.ASX

BUY

Thursday 11 March, 2010

Price	\$0.39
Target price	\$0.60
Valuation method	PE Relative

GICS sector	Forest Prods
12 Mth Price Range	\$0.34 -0.76
Avg monthly t/o	3.4m
Market Capitalisation	\$56m
Shares on issue	142m
Enterprise value	\$137m
Previous rating	BUY

Year Ended June 30		08A	09A	10E	11E
Operating Revenue	\$m	91	121	107	118
EBITDA	\$m	25.8	31.2	29.9	33.5
EBITDA margin	%	28.7	25.9	25.9	25.9
EBIT	\$m	24.0	29.8	28.2	31.9
EBIT margin	%	26.8	24.8	24.8	24.8
NPAT	\$m	11.3	14.7	12.7	15.3
EPS	¢ps	18.0	23.2	10.9	10.8
EPS growth	%	-33.6	28.8	-52.9	-1.3
DPS	¢ps	9.4	7.5	4.0	4.0
Franking	%	100.0	100.0	100.0	100.0
PER	x	2.2	1.7	3.6	3.6
Dividend yield	%	24.1	19.3	10.3	10.3
NTA/share	\$ ps	161.3	178.8	117.6	124.4
EV/EBITDA	x	2.0	4.2	4.6	4.5
Gearing (D:E)	%	30.3	99.1	50.3	55.9
P/OCF	x	0.6	-1.0	9.9	7.9
ROA	%	6.0	6.2	5.7	6.1
ROE	%	11.4	13.4	9.0	8.8
Interest cover (EBIT)	x	3.8	3.8	3.8	3.8



Source: IRESS

Activities

WFL is an integrated forestry group, that plants, manages harvest and supplies plantation timber to domestic markets
www.willmottforests.com.au

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Current Price \$0.39

FINANCIAL PERFORMANCE

Year Ended Jun 30		2008(A)	2009(A)	2010(E)	2011(E)
Sales Revenue	\$m	90.7	121.2	106.6	118.5
Expenses	\$m	-65.0	-90.0	-76.7	-85.0
EBITDA	\$m	25.8	31.2	29.9	33.5
Depreciation & Amort	\$m	-1.7	-1.4	-1.5	-1.6
EBIT	\$m	24.0	29.8	28.2	31.9
Interest	\$m	-6.3	-7.9	-9.3	-9.9
Pre Tax Profit	\$m	17.7	21.9	18.9	22.0
Tax	\$m	-5.7	-7.5	-6.0	-6.9
Minorities	\$m	-0.7	0.3	-0.1	0.2
Normalised Profit	\$m	11.3	14.7	12.7	15.3
Adjustments	\$m				
Sig Items & Costs	\$m	-3.1	0.0	4.5	0.0
Reported Profit	\$m	8.3	14.7	17.2	15.3

CASH FLOW

		2008(A)	2009(A)	2010(E)	2011(E)
Operating EBITDA	\$m	25.8	31.2	29.9	33.5
Net Interest Paid	\$m	-4.9	-5.1	-8.1	-9.1
Tax Paid	\$m	-3.1	-16.4	-7.5	-6.0
Chg WorkCap & Other	\$m	26.1	-33.8	-9.7	-11.4
Operating Cash Flow	\$m	43.9	-24.1	4.6	7.0
Capex	\$m	-32.4	-48.1	-15.0	-15.7
Free Cash Flow	\$m	11.5	-72.2	-10.4	-8.7
Acquisitions/Asset Sales	\$m	0.0	0.0	0.0	0.0
Dividends Paid	\$m	-5.9	-6.0	-4.6	-5.7
Equity	\$m	0.0	0.2	41.0	0.0
Debt	\$m	9.5	39.7	-19.6	10.6
Other	\$m	0.0	0.0	0.0	0.0
Change in Net Cash	\$m	15.2	-38.2	6.4	-3.8

Growth		2008(A)	2009(A)	2010(E)	2011(E)
Revenue	%	31.2	34.0	-11.3	11.2
EBIT	%	41.0	24.1	-5.4	13.1
Normalised Profit	%	-33.2	30.3	-13.5	20.4
EPS	%	-33.6	28.8	-52.9	-1.3

BALANCE SHEET		2008(A)	2009(A)	2010(E)	2011(E)
Cash	\$m	61.4	23.2	29.6	25.8
Receivables	\$m	37.2	36.7	43.6	47.9
Inventory	\$m	2.5	3.8	3.9	4.0
Other Current Assets	\$m	39.9	45.7	47.0	52.0
Current Assets	\$m	141.0	109.4	124.1	129.7
NC Receivables	\$m	66.6	75.5	78.0	75.0
Property, Plant & Equip	\$m	111.7	134.1	145.6	151.7
Intangibles	\$m	1.6	1.6	1.6	1.6
Other NC Assets	\$m	30.8	47.2	55.4	58.0
Non Current Assets	\$m	210.7	258.3	280.6	286.3
Total Assets	\$m	351.7	367.7	404.6	415.9
Payables	\$m	36.0	32.7	38.0	47.0
Current Debt	\$m	1.6	1.1	1.1	1.1
Other Current Liabilities	\$m	103.0	66.4	65.9	48.0
Current Liabilities	\$m	140.5	100.2	105.1	96.1
Non Current Debt	\$m	89.0	129.6	110.0	120.6
Other NC Liabilities	\$m	18.5	22.4	20.4	20.5
Non Current Liabilities	\$m	107.5	152.0	130.4	141.0
Total Liabilities	\$m	248.0	252.2	235.5	237.2
Shareholder Funds	\$m	103.7	115.5	169.1	178.8

Ratios		2008(A)	2009(A)	2010(E)	2011(E)
EBITDA / Sales		28.7	25.9	25.9	25.9
EBIT / Sales	%	26.8	24.8	24.8	24.8
Effective Tax Rate	%	32.3	34.4	32.0	31.2
Interest Cover	x	3.8	3.8	3.8	3.8

Per Share		2008(A)	2009(A)	2010(E)	2011(E)
Issued Shares (Wt Avg)	m	59.4	59.8	142.4	142.4
EPS	¢ps	18.0	23.2	10.9	10.8
EPS (dil C/Notes & Opts)	¢ps	10.6	13.3	9.5	11.4
Operating Cash Flow ps	¢ps	69.8	-38.0	3.9	4.9
Free Cash Flow	¢ps	18.3	-113.6	-8.9	-6.1
DPS	¢ps	9.4	7.5	4.0	4.0
Franking	%	100.0	100.0	100.0	100.0
Dividend Payout Ratio	%	52.2	32.4	36.6	37.1

Parameters		2008(A)	2009(A)	2010(E)	2011(E)
PE Ratio	x	2.2	1.7	3.6	3.6
Enterprise Value / EBITDA	x	2.0	4.2	4.6	4.5
Cash Flow ratio	x	0.6	-1.0	9.9	7.9
Dividend Yield	%	24.1	19.3	10.3	10.3

Ratios		2008(A)	2009(A)	2010(E)	2011(E)
Receivables turn	x	2.7	3.3	2.7	2.6
Net Debt	\$m	29.2	107.5	81.6	96.0
Gearing (D:D+E)	%	23.3	49.8	33.5	35.9
Gearing Adj for Pines ¹	%	0.0	30.3	25.5	28.5
Current Ratio (CA / CL)	x	1.0	1.1	1.2	1.3
Net Assets	¢ps	152.1	170.2	113.8	125.5
Net Tangible Assets	¢ps	161.3	178.8	117.6	124.4
Price to Book Value	x	0.3	0.2	0.3	0.3
Return On Assets	%	6.0	6.2	5.7	6.1
Return on Equity	%	11.4	13.4	9.0	8.8

SEGMENTS

		2008(A)	2009(A)	2010(E)	2011(E)
Sales Revenue (A\$m)					
Woodlot	\$m	71.7	103.5	90.1	101.0
Processing	\$m	18.1	16.7	16.5	17.5
EBIT (A\$m)					
Woodlot	\$m	27.1	34.5	32.1	35.3
Processing	\$m	0.1	-0.6	0.3	0.8
Corporate	\$m	-3.1	-4.1	-4.2	-4.2
EBIT GROWTH (%)					
Woodlot	%	24.4	27.4	-6.9	10.0
Processing	%	-103.3	-1066.7	-153.6	166.7
EBIT MARGIN (%)					
Woodlot	%	37.8	33.3	35.6	35.0
Processing	%	0.3	-3.4	1.8	4.6

VALUATION

Valuation Method	¢ps	Premium/Discount (%)
PE Relative	61.4	156.4
Sum of The Parts	60.9	155.3
Current Price	39.0	

Major Shareholders

	m	%
Marcus Derham (MD)	27.3	19.1
Colonial First State	13.9	9.8
Clime Asset	6.1	4.3
Top 20 (10/11/09)	86.1	60.4

¹ Treats Pines as Equity

Interim Result

Interim result around expectations

The result was around our expectations, considering the lower level of Forestry MIS sales in FY2009, although revenue recognition was below expectations. The results for WFL are highly seasonal with the majority of revenue recognised in the second half (FY2009 64%).

Profit & Loss				Balance Sheet			
6 Mths to Dec (\$m)	1H 09	1H 10	% Ch	At Dec (\$m)	1H 09	1H 10	% Ch
Total Revenue	43.1	35.2	-18.4	Current Assets	79	69	
Expenses	-33.0	-22.2	-32.6	Non Current Assets	245	276	
Operating Profit	10.1	12.9	28.1	Total Assets	323	345	6.5
Depreciation	-0.7	-0.7		Current Liabilities	76	54	
EBIT	9.4	12.2	29.5	Non Current Liabilities	139	130	
Interest (net)	-3.1	-4.7		Total Liabilities	216	183	-15.0
Pre-Tax profit	6.3	7.5	19.1	Shareholder Funds	108	161	49.4
Tax	-2.1	-2.8		Return on Equity (%)	7.9	7.4	
Minorities	-0.1	0.3		Return on Assets (%)	4.4	5.3	
Normalised Profit	4.2	5.1	22.7	Net Debt	101.8	94.2	
Significant Items	0.0	4.5		Gearing D:D+E (%)	50.3	38.0	
Reported Profit	4.2	9.6	130.5	Gearing - Pines as Equity (%)	29.5	29.7	
EBIT Margins (%)	21.9	34.7		Interest Cover (x)	3.0	2.6	
Effective Tax Rate (%)	33.0	36.5		Ent Value / EBITDA	6.2	5.7	
EPS (cps)	7.0	5.4	-22.4	NTAV (cps)	179.8	112.5	-37.4
Cash Flow (cps)	8.1	32.3	299.2	Net Assets (cps)	169.3	107.9	-36.2
DPS (cps)	5.0	2.0	-60.0	Receivables Turn	2.6	2.5	
Franking (%)	100.0	100.0		Inventory Turn	4.2	4.5	
Dividend Payout Ratio (%)	71.6	2.7		Current ratio (x)	1.0	1.3	

Key Aspects of the result were:

Results impacted by a lower level of revenue recognition

➤ The lower revenue was mostly due to a 22.6% fall in the level of revenue recognition on carryover activities relating to Forestry MIS sales in FY2009 and lower plantation management, both activity related (see page 4).

Provision for maintenance reduced with lower outlays

➤ Expenses were steady, with control of the cost base. The higher interest cost comprises higher debt levels prior to the equity raising, partly offset by a lower level of Pines interest/dividends, with the substantial conversions to ordinary shares.

Reported profit impacted by one-off items from conversion of Pines

➤ A result included a \$10.2m (1H FY2009 \$1.6m) positive reversal of a plantation maintenance provision from previous years, mainly FY2009. This reflects a reversal of previous provisions for plantation management relating to plantings from the 2008 sales. Following experience in planting and maintenance, these provisions were deemed excessive.

➤ The significant item relates to a benefit of \$4.48m from the conversion of the Pines with a face value of \$22.4m into 32.8m WFL ordinary shares with a face value of \$17.9m.

Gearing falls with equity issues

While gearing has been reduced and adjusted gearing (treating the Pines as Equity) was flat with the \$20.5m Placement and Rights Issue, these don't reflect the full impact of the capital raising. This was due to typically weak 1H cashflows, requiring additional borrowing. Cash flows are expected to improve substantially in 2H FY2010.

NTA fall with dilution from issues & Pines conversion, but still at a substantial premium to the share price

The 37.4% fall in NTA to \$1.125 ps is a result of the dilution from the equity issue and Pines conversion. However, the NTA is at a 195% premium to the current share price, remaining mostly backed by cash and property, the property conservatively valued and significantly below replacement cost.

Sector Breakdown

Division	Revenue (\$m)			EBIT (\$m)			Margin (%)	
	1H 09	1H 10	% ch	1H 09	1H 10	% ch	1H 09	1H 10
Woodlot	34.0	26.3	-22.6	11.5	14.8	28.2	34.0	56.3
Processing	9.2	8.9	-4.0	-0.1	-0.5	484.8	-0.9	-5.2
Corporate				-2.2	-2.2			
Total	43.2	35.2	-18.6	9.3	12.1	30.5	21.5	34.5

Forestry MIS/Woodlot

The revenue fall comprises;

- A 23.8% fall in the revenue recognition related to planting activity for Forestry MIS/woodlot sales in F2009, falling from \$26.4m to \$20.1m. This was due to:
 - The lower levels of Forestry MIS/Woodlot sales in FY2009 under the 2009 project, with MIS sales falling by 31.7% from \$97.3m to \$66.5m.
 - Lower planting establishment activity, with \$28.3m in revenue carried into 2H FY2010.
- A fall in plantation management and leasing revenue from \$6.1m to \$3.7m, partly due to the timing and extent of revenue recognition, including the reversal of the plantation management provisions, and seasonal conditions.

The increase in profit was mostly due to a \$10.2m (1H FY2009 \$1.6m) positive reversal of the forestry management provision, with forestry management expenses falling from \$9.2m to \$1.4m. Changes in these provisions have occurred in most recent results, especially with higher levels of planting, reflecting conservative cost assumptions. These reversals are offset by reduced revenue recognition on plantation management in FY2010 and later years.

Timber Processing

The revenue fall was due to a \$0.4m lower contribution from the Willmott Timbers processing Joint Venture, to a loss of \$0.31m (1H FY2009 profit of \$0.6m). The Joint Venture operations suffered from weak demand in the housing materials market.

Corporate

Costs were steady, although the plantation harvesting contribution fell to \$0.08m (1H FY2009 \$0.13m).

Willmott Timbers Joint Venture

Willmott Timbers is awaiting environmental approval from the NSW Government to allow it to proceed to financial close for the Bombala Sawmill Development. The development is important for WFL, as it provides scale to Willmott Timbers' existing milling operations, provides a significant diversification to its earnings base and establishes a platform for future growth.

Construction is expected to commence in 2010, with full capacity reached around mid 2012. The plant will cost around \$65m, 50:50 Debt:Equity financed, to produce 150,000m³ pa at full production. This equates to Joint Venture sales of around \$60m pa and an EBITDA of over \$16m, resulting in a net profit of in excess of \$6m (a minimum of \$3.0m to WFL). The development is backed by a 20 year wood supply agreement with Forests NSW.

Ethtec Technologies

Ethtec has successfully completed Phase 1 of the Pilot Plant development of its ethanol plant. This is the most critical stage of the four Phase program (commenced in late 2007), enabling the efficient conversion of components of the feed stock to sugars, enabling ethanol to be produced.

Ethtec has commenced planning and preliminary work to enable Phase 2 to commence, mostly funded by a \$3.0m Commonwealth Government Grant. The program is aimed at development and commercialisation of its licenced technology, with construction of second generation 'cellulosic' ethanol plant on the North Coast of New South Wales to produce ethanol from lignocellulosic material, such as wood waste, sugar cane bagasse, crop stubble and municipal green waste.

Lower carry-over of FY2009 Forestry MIS sales reduces revenue

JV results hurt by weak building materials market

Corporate costs steady

Willmott Timbers JV to have a major benefit in FY2012 onwards

Proceeding with Phase 2 to of pilot plant development program

Strong interest still expected in Forestry MIS

Outlook

WFL expects to release its 2010 Woodlot project in Q4 FY2010 and is anticipating strong sales interest, with:

- WFL is the leading player in the forestry investment sector in FY2010, reflecting the strong support for its product in the market.
- A lack of competition, due to the removal of Timbercorp and Great Southern and problems experienced by Gunns and Forest Enterprises.
- Initiatives including a Timberland Fund targeted at SMSF's, a carbon offset product aimed at corporates, as well as the upgrade to the Willmott Timbers' mill.
- An increase in plantation harvesting revenue is expected in 2H FY2010 and FY2011, with harvesting expected to become a consistent revenue stream over the next 3 years, highlighting the value inherent in the harvesting rights WFL has over its owned and managed plantations.
- WFL has a strong funding position, placing it at an advantage to other participants, through:
 - Completion in March 2009 of new banking facilities of \$135m, comprising a \$55m 2 year revolving debt facility and a \$80m 3 year core debt facility.
 - The land supply agreement with Forests NSW and Hancock Victorian Plantations.

Smaller Forestry MIS industry to suit leading players

We believe that the Forestry MIS industry will not recover to peak levels reached in FY08, instead settling at more sustainable sales around the current level.

The industry troubles should increase investor focus on higher quality products and managers, with WFL falling into this category. Calls for increased scrutiny in the financial planning industry should also benefit leading providers, with a likely reduction in external commissions.

WFL to have a larger presence in a smaller MIS Market

Forecasts

Basically unchanged, but highly dependent of Forestry MIS sales, especially in Q4 FY2010. Our forecasts assume FY2010 woodlot sales of \$75m, which includes around \$5m of completed Timberland sales. Furthermore, WFL will carry \$29m of FY2009 Forestry MIS sales into 2H FY2010 revenue. WFL has adjusted its revenue recognition on new woodlot sales in line with industry practise, now recognising around 40% of revenue in the year of sale.

Forecasts unchanged, but dependent on 4Q Forestry MIS sales

We have adjusted interest costs for the PINES conversions, which reduces interest/dividend expense by \$1.57m pa and lower interest as a result reduced debt from the equity raising.

In response to an ASX query, WFL has advised that it believes the FY2010 result will not vary from the FY2009 result by more than 15% and does not expect to report any abnormal or extraordinary item, other than the gain on conversion of the Pines.

Recommendation

Maintain BUY.

With WFL now the standout in the Forestry MIS sector, supported by our valuation, which is a blended DCF and asset valuation methodology, falls to around \$0.60, reflecting our changed sales assumptions and the additional shares on issue. Our land valuation component is carried at historical cost, which we believe is significantly below replacement value. Our Target Price remains at \$0.60.

Maintain BUY with price target of \$0.60 ps

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RATING

BUY – anticipated stock return is greater than 10%
 SELL – anticipated stock return is less than -10%
 HOLD – anticipated stock return is between -10% and +10%
 SPECULATIVE – High risk with stock price likely to fluctuate by 50% or more

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