EQUITY RESEARCH

VERITAS SECURITIES LIMITED

Willmott Forests

Successful Wood License Tender

WFL to form JV for regional manufacturing plant

- WFL has won preferred tender status for wood supply contracts with Forests NSW which will lead to a wood licence for at least 20 years
- The preferred tender status will trigger the formation with WFL and Dongwha Holdings (a Korean based global timber and milling company) of a 50-50 JV for the construction and operation of a 500,000m^3 sawmill
- WFL's existing Sandy Lane mill ($5-$6m value) will be included in the JV with Dongwha to contribute initially $5-$6m in cash for their 50% equity
- The mill is forecast to cost $50-$60m, will be fully debt funded and is likely to be in operation by 2010 in Bombala, NSW

Milling operations provide scale

- The manufacturing facility will allow WFL to become an integrated forestry company with scale in milling which is sufficient to be competitive in the long term, and establishes Bombala as an important timber region
- We value WFL's share of the JV at $0.45, derived through our DCF valuation. We continue to forecast that the Sandy Lane mill will remain marginal until F10Y. With first full year of production from the new mill we estimate the NPAT contribution to WFL in FY11 will be $2.9m

Earnings Revision

- After reviewing our earnings forecasts we have reduced our interest revenue assumptions in FY08 and FY09 due to a faster than expected expenditure on land and assets, which is reducing the cash balance at a higher rate than we forecast
- This has led to a change in our forecast NPAT in FY08 by 11.8% to $9.0m and in FY09 by 11.0% to $12.1m. However our EBITDA forecast in FY08 is unchanged at $21.6m and our FY09 EBITDA is marginally higher at $27.3m

Recommendation

- We have upgraded our valuation and price target from $2.31 to $2.74 as a result of the scale provided by the new mill and maintain a BUY

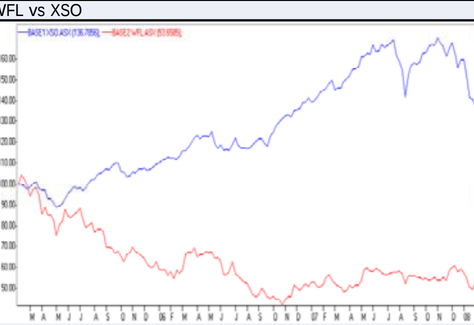
WFL.ASX BUY

Monday 4 February, 2008

Price		$1.52
Target price		$2.74
DCF valuation		$2.74
Target valuation method		DCF
GICS sector		Materials
Avg monthly t/o	m	0.9
Diluted mkt capitalisation	$m	90
Shares on issue	m	59
Enterprise value	$m	143
Previous rating		Buy

Year Ended June 30		07A	08E	09E	10E
Operating revenue	$m	69.1	74.7	70.4	83.6
EBITDA	$m	19.0	21.6	27.3	30.4
EBITDA margin		27.5%	29.0%	38.8%	36.3%
EBIT	$m	17.0	19.3	24.6	27.6
EBIT margin		24.7%	25.9%	35.0%	33.0%
Adjusted NPAT	$m	8.1	9.0	12.1	13.8
EPS adj	c	14.3	15.0	21.2	23.7
EPS adj growth		-31%	5%	42%	12%
DPS	c	10.0	10.0	11.0	11.0
Franking		100%	100%	100%	100%
PER	x	10.6	10.1	7.2	6.4
PER rel Ex-100 ex Fins	x	52%	55%	44%	44%
Dividend yield		6.6%	6.6%	7.2%	7.2%
NTA/share	$	1.55	1.50	1.58	1.73
EV/EBITDA	x	6.6	6.6	5.3	4.7
P/OCF	x	10.3	9.2	6.8	6.1
ROA		4.2%	4.5%	5.2%	5.3%
ROE		8.8%	9.8%	13.1%	13.3%
ROIC		9.6%	10.2%	12.3%	12.6%
Interest cover (EBIT)	x	4.0	3.7	4.6	4.4

WFL vs XSO



Source: IRESS

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Willmott Forests Ltd (WFL)

Analyst: Wassim Kisirwani

Profit & Loss

Year ending June	**2007A**	**2008E**	**2009E**	**2010E**
Revenue:				
Operating revenue	69.1	74.7	70.4	83.6
Operating expenses	50.1	53.1	43.1	53.2
EBITDA	**19.0**	**21.6**	**27.3**	**30.4**
D&A	2.0	2.3	2.7	2.8
EBIT	17.0	19.3	24.6	27.6
Net interest	-4.2	-5.2	-5.4	-6.2
EBT	12.8	14.1	19.3	21.3
Tax	-4.4	-5.1	-6.6	-7.2
Reported NPAT	8.4	9.0	12.6	14.1
Non-recurring items	0.3	0.0	0.0	0.0
Equity Accounted Profit	0.0	0.0	-0.5	-0.3
Adjusted	8.1	9.0	12.1	13.8

Cashflow

Year ending June	**2007A**	**2008E**	**2009E**	**2010E**
EBITDA	19.0	21.6	27.3	30.4
Increase in working capital	-6.8	-1.6	-2.1	-2.1
Net Interest	-1.2	-5.2	-5.4	-6.2
Income taxes paid & other	-2.2	-5.1	-6.6	-7.2
Cashflow from ops	**8.8**	**9.8**	**13.2**	**14.8**
Capex	-18.1	-19.2	-19.7	-19.5
Total FCF	**-9.3**	**-9.4**	**-6.5**	**-4.7**
Other investing cashflows	92.7	-2.9	0.0	0.0
Borrowings	-44.7	0.0	0.0	0.0
Equity raisings/(buybacks)	0.4	0.0	0.0	0.0
Dividends paid	-5.9	-5.9	-6.2	-6.5
Net change in cash	33.3	-18.2	-12.8	-11.3

Balance Sheet

Year ending June	**2007A**	**2008E**	**2009E**	**2010E**
Cash	46.2	28.0	15.2	4.0
Debtors	30.2	22.2	27.8	32.3
Other current assets	20.0	22.0	22.8	23.9
Current assets	96.4	72.2	65.8	60.2
Debtors	56.2	55.7	55.1	54.6
PPE	88.6	104.1	121.2	138.0
Intangibles	2.7	2.7	2.7	2.7
Other non-current assets	19.1	27.6	37.6	51.6
Non-current assets	166.7	190.1	216.6	246.8
Total assets	263.0	262.3	282.5	307.0
Payables	17.7	14.2	17.1	21.0
Short term borrowings	3.1	3.1	3.1	3.1
Other current liabilities	48.0	52.5	66.1	69.3
Total current liabilities	68.9	69.9	86.3	93.4
Long term borrowings	77.9	77.9	77.9	77.9
Other non-current liabilities	21.2	17.8	16.9	16.1
Total non-current liabilities	99.1	100.7	99.5	107.9
Total liabilities	167.9	170.5	185.8	201.3
Net assets	95.1	91.8	96.6	105.7

Market Measures

Year ending June		**2007A**	**2008E**	**2009E**	**2010E**
EPS reported	cps	13.8	15.0	20.4	23.2
EPS adjusted	**cps**	**14.3**	**15.0**	**21.2**	**23.7**
EPS growth	%	-31%	5%	42%	12%
PE multiple	x	**10.6**	**10.1**	**7.2**	**6.4**
PE relative (ex-100)	%	**52%**	**55%**	**44%**	**44%**
EBITDA per share	cps	32.0	36.4	45.9	51.0
EBITDA growth	%	-14%	14%	26%	11%
P/OCF	x	10.3	9.2	6.8	6.1
FCF per share	$	-0.16	-0.16	-0.11	-0.08
FCF yield	%	nm	nm	nm	nm
DPS	cps	10.0	10.0	11.0	11.0
Dividend yield	%	6.6%	6.6%	7.2%	7.2%
Franking	%	100	100	100	100
Enterprise value	$m	125.2	143.4		
EV/EBITDA	x	6.6	6.6	5.3	4.7

Profitability & Liquidity Ratios

Year ending June		**2007A**	**2008E**	**2009E**	**2010E**
ROE	%	8.8%	9.8%	13.1%	13.3%
ROA	%	4.2%	4.5%	5.2%	5.3%
ROIC	%	9.6%	10.2%	12.3%	12.6%
NPAT/sales	%	12.1%	12.1%	18.0%	16.9%
EBITDA/sales	%	27.5%	29.0%	38.8%	36.3%
EBIT/interest	x	4	4	5	4
Gearing (ND/[ND+E])	%	27%	37%	40%	42%
NTA/share	$	1.55	1.50	1.58	1.73

Valuation

	$m	$/share
NPV of Cash Flows	-0.8	-0.01
Terminal Value	35.8	0.62
Net Cash (Debt)	-34.8	-0.60
Land and receivables	133.4	2.30
DCF value	133.7	2.30
DCF JV (50% share)	26.2	0.45
DCF Total	159.6	2.74
Price target*		$2.74
Upside/downside		80%
DCF		

WACC

Risk free rate of return	6.0%
Post-tax cost of debt	6.3%
Equity risk premium	5.5%
Beta target	1.0
Cost of Equity	12.6%
Terminal Growth Rate	2.0%
WACC	10.1%

Company Statistics

Current share price	$ps	**$1.52**
Ordinary shares	m	59.5
Options	m	0.0
Diluted market capitalisation	$m	$90.4

Willmott successful in wood supply tender

Willmott Timbers Pty Ltd (WT), a wholly owned subsidiary of WFL, has been selected as the preferred tenderer for the long term purchase agreement of timber from Forests NSW in the Monaro region.

The main supply contract is for a sawlog parcel 250,000 m^3 pa and a further biomass parcel of 70,000 m^3 pa reducing to 40,000 m^3 pa after year 10. These contracts are expected to run for 20 years.

The tender process involved a submission on price and volume. WFL was selected as preferred tenderer and will proceed to negotiate a wood license with Forests NSW. The negotiations will focus on the details such as price rise and fall, delivery, logistics, log sizes etc.

WFL's milling operation to undergo major transformation

Dongwha to partner WFL in 500,000m3 facility

WFL intends on forming a JV on a 50-50% basis with Dongwha Australia Holdings Pty Ltd, a subsidiary of Dongwha Holdings, an international timber player and trading house. The JV will construct a manufacturing facility for timber decking products, with a total capacity to process in excess of 500,000 m^3 of timber p.a.

Willmott Timbers Pty Ltd (WT) will be the JV vehicle with WFL's existing Sandy Lane milling assets (including land, equipment stock and receivables) forming WFL's initial equity contribution. Dongwha will contribute cash as its equity contribution, to a value equal to the assets. The net value of WFL's equity in WT is expected to be $5-$6m. The JV will require an additional $50-$60m in funding to complete the facility. It is expected that this will be fully debt funded, with preliminary indications from funders encouraging.

Proximity to Eden port presents export capability

The facility will produce landscape products (including decking) as well as structural timber products. The JV will target the Australian market, however, the potential for export is apparent.

Dongwha

Dongwha Holdings is a Korean based holding company that has investments in timber and milling assets globally. It has operated in Australia since 1996, when it was part of a consortium that formed The Australian Sawmilling Company Pty Ltd (TASCO), which it now fully owns. TASCO's production facility at Lara Victoria processes pine to produce small intersection log, with the current throughput approximately 100-200k tonnes pa in. TASCO produces a range of products including industrial, untreated appearance, untreated and treated structural, decking and woodchip. TASCO is one of the largest producers of pine decking boards in Australia.

Dongwha a credible partner with established markets

The inclusion of Dongwha as the JV partner enhances the prospects of the JV and reduces the risks, in our view. Dongwha is an established operator with significant resources and experience.

Significant step for WFL

The recognition as preferred tenderer and the proposed JV validate WFL as a credible forestry and timber player in our view.

JV addresses future of Sandy Lane assets

The manufacturing facility will allow WFL to become a truly integrated forestry company with substantial presence in the market. WFL's existing timber assets lacked the scale necessary to be viable in the long term. They represented a marginal operation in a niche segment. The proposed facility can become a dominant player in the decking and landscape timber segment.

The manufacturing facility in Bombala allows WFL to offer MIS investors and prospective investors an integrated solution with a viable end market. This will establish the Bombala region as an important timber region. The facility will have capacity that greatly exceeds the Forests NSW supply agreement.

The JV will produce 150,000m^3 pa at full production in one production shift, which will equate to sales of approx $75m annually

Valuation

We value WFL's share of the JV at $0.45, derived through a DCF valuation. Our specific assumptions include:

-Explicit forecasts from FY10-FY20

-FY10 operating at 60% capacity. FY11 is first year at 100% production

-JV initial D/E ratio is 4:1

-FY11 NPAT of $5.8m. FY11-FY20 NPAT CAGR of 5.3%

-Annual maintenance capex of $4m

Changes to forecasts

We have adjusted our forecasts to reflect WFL's structure post the JV. We have assumed that the JV will be established in FY08 at which point WFL will transfer its milling operation into the JV. This will impact FY09 revenues and costs. This division was forecast to generate $20.5m in revenue and a loss of approx $0.5m in FY09. We have therefore reduced FY09 revenue by 22%.

We have assumed that the JV will be equity accounted and will contribute a loss of $0.5m in FY09 and $0.3m in FY10. The JV is forecast to become profitable in FY11 and is expected to contribute $2.9m to WFL's NPAT.

FY08 and FY09 NPAT downgrades not related to core earnings – lower interest revenue assumed.

We have also made adjustments to our net interest expense assumptions which have led to changes in our NPAT forecasts. We have reduced FY08 NPAT by 11.8% to $9.0m and FY09 NPAT by 11.0% to $12.1m. OUR EBITDA forecast in FY08 is unchanged and our FY09 EBITDA increases slightly. The change in net interest expense is related to expenditure on land and assets occurring at a faster than expected rate, which is reducing the cash balance at a faster rate, therefore reducing interest revenue assumptions. This is consistent with WFL's stated intention of applying the cash to purchasing land and assets.

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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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