

### Forestry Companies Put Best Foot Forward

By Victor Bivell

The high profile collapses of Great Southern Plantations and Timbercorp have prompted a flurry of information from other forestry and managed investment scheme (MIS) companies about why they are financially sound and can continue with business as usual. How do these claims stack up?

Before we look at their financials, it is worth stating that not all forestry companies are environmentally equal. Great Southern and Timbercorp have some terrific forestry assets that contribute to the environment by providing an alternative resource to Australia's old growth forests. But the companies did not meet Eco Investor's criteria for environmental focus and environmental commitment as their diversification into other agricultural products meant forestry was a declining share of their asset bases and revenue streams.

So far the only two forestry companies to meet Eco Investor's environmental criteria are Willmott Forests (ASX: WFL) and Forest Enterprises Australia (ASX: FEA). Both are focused on their forestry businesses and seek additional growth through vertical integration, ie by adding value to their forest products.

On the investment side, both are outside the S&P ASX 300 Index, but are emerging companies with significant sales, profits (apart from a December half blip by FEA), and dividends.

WFL and FEA have both issued a number of state-

ments that aim to differentiate themselves from their failed larger competitors by dealing with the key issues of debt, diversification, and the future of managed investment schemes.

#### Debt

Research by Eco Investor comparing the four companies' most recent reports shows that their ratios of total liabilities/ net assets and borrowings/ net assets are not dissimilar, with FEA ahead on both counts.

Where there is a significant difference is in their ratio of revenue/ borrowing costs, with WFL and FEA

having significantly more room to move. WFL's revenue was 11.5 times greater than its borrowing costs, while FEA's was 10.2 times greater. In contrast, Timbercorp's revenue was six times its borrowing costs and Great Southern's only 5.8 times.

Even more telling perhaps is cash at hand. WFL had enough cash to cover its borrowing costs 4.6 times, FEA enough to cover it 1.3 times, Great Southern 1.2 times and Timbercorp only a very skinny 0.4 times.

The data for WFL and FEA are based on their latest half year accounts to 31 December, while for Great Southern and Timbercorp they are based on their full

#### Forestry Companies - Debt Positions

	Willmott Forests <sup>1</sup>	Forest Enterprises <sup>1</sup>	Great Southern <sup>2</sup>	Timbercorp <sup>2</sup>
	\$m			
Total Assets	323.5	633.7	1,790.1	1,729.4
Total Liabilities	215.5	336.0	1,083.7	1,133.8
Net Assets	107.9	297.7	706.3	595.6
Total Liabilities/ Net Assets	2.0	1.1	1.5	1.9
Borrowings	119.2	206.8	829.3	808.3
Borrowings/ Net Assets Ratio	1.1	0.7	1.1	1.3
Revenue	43.9	72.7	424.4	494.4
Borrowing Costs	3.8	7.1	72.6	82.0
Revenue/ Borrowing Costs Ratio	11.5	10.2	5.8	6.0
Cash	17.5	9.6	91.4	32.6
Cash/ Borrowing Costs Ratio	4.6	1.3	1.2	0.4
Profit/ Loss	4.1	-4.1	-64.3	44.6

1. For Half Year to 31 December 2008

2. For Full Year to 30 September 2008

Source: Eco Investor

year reports to 30 September as neither has yet produced a half year report.

FEA says it has a “relatively conservative net debt to equity ratio of approximately 40 per cent”. It calculates this using net debt divided by net debt plus equity - with net debt at \$197 million (bank debt of \$207 million less cash of \$10 million) and net debt plus equity equalling \$495 million

Although at 31 December it had only 1.3 times cash to cover borrowing costs, chief executive Andrew White said this was due to the seasonal nature of the company’s cash flow which is stronger in the June half.

Although he is comfortable with the headroom, FEA is nonetheless in the process of reducing its net debt by selling its loan book and non-core land assets. It recently sold a portion of its loan book for \$13 million - at 100 cents in the dollar - with another \$6 million sale expected to settle in June. It plans to sell around \$50 million of freehold land, which would leave it with about \$250 million worth.

Mr White said the December half loss was due to a one-off timing factor now under control.

New WFL chairman, Jonathan Madgwick, said that

in 2006, “Long before the downturn in debt and equity markets”, the company implemented a conservative capital management strategy to “create a cash positive business model”.

The key elements were the sale of non-core assets which it completed in June 2006; no longer using its balance sheet to fund grower investments and since March 2006 grower finance has been via external financiers; use of pre-paid land leasing arrangements at known cost on proven plantation land; and having over 70 per cent of its land requirements secured going forward. “This strategy has delivered Willmott Forests the lowest capital intensive business model in the plantation forestry sector,” he said.

At 31 December 2008, it was “conservatively geared at 44 per cent with net debt in the order of \$62 million against equity of \$140 million and total assets of \$324 million. We note that this is based on a reclassification of our PINES hybrid securities as equity for the purposes of our analysis.”

“Willmott Forests should be considered as the lowest geared company in the MIS Forestry sector when revenue recognition and asset revaluation measures are

also taken into account,” said Mr Madgwick.

The company also points to increasing cash flow from operations of \$48 million in 2007-08, up from \$8 million the previous year, and it expects another increase for 2008-09.

“Unlike some other sector participants, Willmott Forests has not needed to raise additional equity from the market (the company’s last capital raising was in December 2005) and will not need to renegotiate any bank debt facility until 2011,” said Mr Madgwick.

In March WFL proved it had the confidence of the banks and completed a \$135 million debt syndication with the Commonwealth Bank and St George Bank “in the face of possibly the toughest debt markets ever seen”.

#### Diversification

Both FEA and WFL regard their focus on forestry and their diversification strategies as superior to those of Great Southern and Timbercorp.

While Great Southern and Timbercorp expanded by applying the MIS model to a wide range of other agricultural products, Great Southern in 2003 and Timber-

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corp in 2000, FEA and WFL maintained their focus on forestry and expanded into value added forest products. This is a case where remaining an environmentally positive company also proved to be a better business strategy.

FEA chairman, Will Edwards, said the company's focus on forestry is a key fundamental difference. FEA is "exclusively a forestry company – unlike some other

companies in the managed investment sector that have been involved in forestry and non-forestry horticultural activities such as olive oil, almonds, walnuts, grapes, citrus, mangoes or avocados, for example. FEA has a record of over 23 years as a successful forestry company. It has a proven track record in plantation forestry and processing and value adding of wood products."

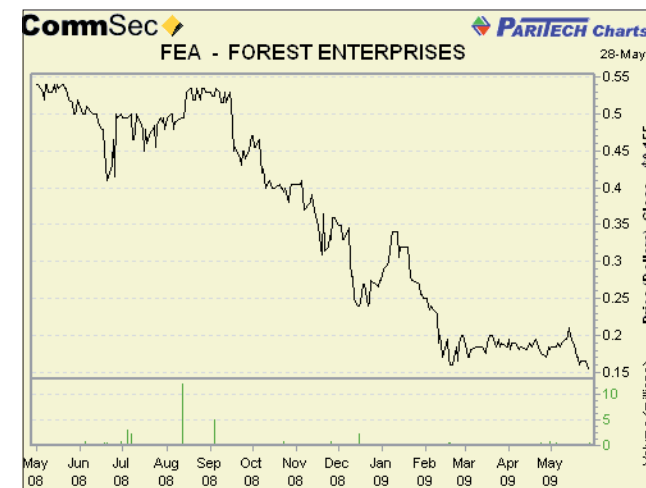
In 2001-02 the company realized it had to move beyond "a business model that relied on exponential growth of a single revenue stream of year-on-year sales of managed investment scheme investments" and committed to becoming a vertically integrated forestry and forest products company.

By 2007-08 approximately half of its revenue was from manufacturing. It has a new \$72 million sawmill at Bell Bay in Tasmania that will be able to process between 350,000 and 400,000 tonnes of FEA's BassPine and EcoAsh branded timber products by 2010.

Its 50 per cent owned SmartFibre Pty Ltd wood fibre processing and marketing operation profitably exported over 500,000 tonnes of wood fibre in 2007-08, and is a preferred supplier to the Japanese pulp and paper market.

WFL chief executive, Marcus Derham, said WFL is a pure play forestry company that has diversified its income streams into complementary areas that add value to its forest products. Downstream processing accounted for over 20 per cent of revenue in 2007-08 and should continue to grow with further investment in timber processing.

"Willmott Forests' timber processing facility in Bombala, NSW is operated under a 50:50 Joint Venture with Dong-



**Financial performance - Willmott Forests Limited**

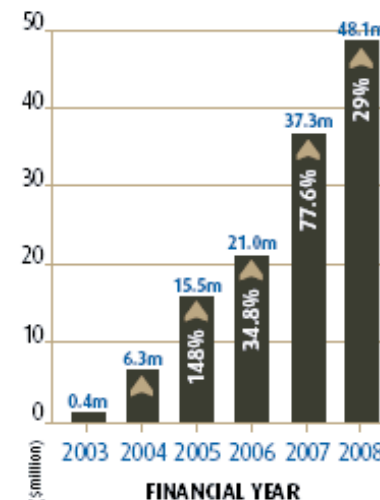
		FY07	FY08	Change	HY08	HY09	Change
Revenue	(\$m)	70.3	90.8	+ 29%	34.3	44.0	+ 28%
NPAT (underlying)	(\$m)	8.1	11.3	+ 40%	3.1	4.2	+ 35%
Total Assets	(\$m)	263.0	351.7	+ 34%	247.4	324.0	+ 31%
Equity <sup>1</sup>	(\$m)	135.1	143.7	+ 6%	136.8	148.0	+ 8%
Gearing <sup>2</sup>		(-4%)	(-8%)		28%	44%	

<sup>1</sup> Equity includes PINES

<sup>2</sup> Gearing = Net Debt / Equity direct from statutory accounts adjusted for PINES reclassified as equity

**WFL's 12 month share price and recent financial results**

**FEA PROFIT AFTER TAX up 29%**



**FEA's 12 month share price and recent financial results**



**FEA's Bell Bay saw mill and processing plant**

wha, a global manufacturer of wood materials. A wide range of softwood timber products are produced from the Sandy Lane site which - underpinned by a 20 year wood supply agreement with the NSW Government - is being redeveloped." The \$60 million redevelopment is now awaiting approvals so it can move to financial closure and construction.

WFL has also entered the bio-fuel market with construction of a second generation 'cellulosic' ethanol pi-



**Some of WFL's forest products**

lot plant on the north coast of NSW. Subsidiary, Ethanol Technologies Ltd, plans to produce bio-fuel on a commercial scale within three years and also benefit from licensing its technology to ethanol producers around the world.

### **MIS Model**

It remains to be seen how Great Southern and Timbercorp's growers fare from the collapses and how the MIS sector is affected long term.

Meanwhile, FEA says it is "very confident in the future of the Australian plantation forestry and forest products sector" as the Federal and State Governments remain committed to the Plantations for Australia: The 2020 Vision which aims to achieve three million hectares of forestry plantations by 2020.

The company quotes the Australian Plantation Products and Paper Industry Council which said "Timber plantations funded through managed investment schemes (MIS) are now an integral part of Australia's plantation industry, and will continue to grow a large proportion of our future wood resource, despite the decision by leading agribusiness MIS manager, Timbercorp, to go into voluntary administration. Timbercorp's decision was a response to the convergence of several factors directly affecting that company's business, and does not indicate an impending collapse in plantation forestry investment or some inherent problem with the MIS business model."

WFL, which has been in plantation forestry for 30 years, agrees, echoing that the troubles of Timbercorp and Great Southern are due to company specific issues only. Mr Derham said there is nothing wrong with the MIS model when managed properly.

With MIS forestry responsible for around 80 per

cent of new plantations, no major structural change will happen soon.

FEA and WFL also emphasize that the quality of individual MIS offerings is important.

FEA says it has grown its forestry investment sales and distributor base, and "is committed to continuing to offer a superior product and service" to growers. Its latest Plantations Project 2009 "is widely anticipated in the market" and it has received an \$80 million commitment from a major bank to fund the preferred finance package for growers.

WFL also develops its MIS products and has launched what it says is a new styled investment product, the Willmott Forests Premium Timberland Fund No.1, which provides a diversified investment in forestry by investing in both forestry and land assets. "We see this product having great appeal to the superannuation fund market," it said.

Despite the evolving MIS products, many will be watching to see how this season's MIS sales go, and how they affect the companies and forestry sector.

Mr Edwards said a new condition in the Australian Financial Services Licence requires that all MIS forestry Responsible Entities must secure the land within a set time or offer the investor a refund, and that each investor's interest must be registered on the land title.

Mr White says it is likely that other measures will emerge to protect the interests of MIS investors and develop a better MIS business model.

Many think one that needs changing is the widely quoted 10 per cent commission to financial salespeople, which seems excessive by any measure.

Meanwhile, when it comes to the business model of forestry companies, both WFL and FEA say they already have a good one.