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Dear Advisor & Growers

Willmott Forests Update

Since the market for credit in Australia began to tighten in December 2007, there has been considerable focus by investors on company balance sheets and in particular gearing levels as there is a shift of funds away from highly geared companies to those that have more conservative debt levels. This focus is particularly important in our sector given the recent voluntary administration of Timbercorp and Great Southern due to company specific issues - not sector specific issues.

Recent difficulties faced by Timbercorp and Great Southern do not indicate an impending collapse in sound plantation forestry investment or some inherent problem with the MIS structure, as prescribed in the Corporations Act.

Willmott Forests' business model

Willmott Forests has been actively involved in plantation forestry for 30 years.

Over this time we have come to learn that there are a number of key elements that make up a successful and sustainable plantation forestry business and we have structured our business model accordingly.

These include:-

- sound corporate governance;
- a rigorous compliance culture;
- strict cost control and capital management;
- conservative financial management and accounting policies;
- experienced management team;
- extensive forestry expertise;
- access to suitable land;
- investment products that are well structured and highly rated; and of course
- forecast high demand for our end products.

Long before the downturn in debt and equity markets, in fact in 2006, Willmott Forests implemented a sound and conservative capital management strategy. The purpose of this was to create a cash positive business model going forward.

The key elements of the capital management strategy were:-

- sale of non-core assets at face value - completed in June 2006;
- ceased using Willmott Forests' balance sheet for funding of grower investments - since March 2006 grower finance has been via external financiers;
- pre-paid land leasing arrangements at known procurement costs on proven plantation land - since March 2006; and
- in excess of 70% of land requirements secured going forward.

This strategy has delivered Willmott Forests the lowest capital intensive business model in the plantation forestry sector.

Financial management

In March 2009 Willmott Forests completed a $135m debt syndication with Commonwealth Bank of Australia and St George Bank in the face of possibly the toughest debt markets ever seen - a further testament to the financial stability of the Willmott Forests business model.

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.

Willmott Forests FY2008 financial statements show cash flow from operations of $48m up from $8m in the previous year.

As at 31 December 2008, Willmott Forests is conservatively geared at 44% with net debt in the order of $62m against equity of $140m and total assets of $324m. We note that this is based on a reclassification of our PINES hybrid securities as equity for the purposes of our analysis.

The company's hybrid security (ASX Code: WFLPA) known as PINES will be reset later this year at prevailing market rates. Should an investor wish to exit their investment in PINES, Willmott Forests has the right to…

- convert PINES into ordinary shares; or
- procure the acquisition of PINES by a third party; or
- buy back or cancel PINES.

At no time can an investor demand a cash payment for PINES and as such PINES does not represent a refinance risk to Willmott Forests and should be treated as equity for gearing purposes, despite PINES classification as debt for statutory reporting purposes.

Willmott Forests' recent financial performance is summarised in the table below:-

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 ($m)	263.0	351.7	+ 34%	247.4	324.0	+ 31%
Equity[1] ($m)	135.1	143.7	+ 6%	136.8	148.0	+ 8%
Gearing[2]	(-4%)	(-8%)		28%	44%	

[1] Equity includes PINES
[2] Gearing = Net Debt / Equity direct from statutory accounts adjusted for PINES reclassified as equity

Forestry operations

On the forestry operations front, as outlined in our recent Company Announcement dated 11 May 2009, Willmott Forests' plantation management continues to follow best industry practices to optimise results, which includes regular monitoring for growth, health and nutritional status and applying treatments as necessary.

It should be noted that a specific condition has been inserted in the Australian Financial Services Licence for all MIS forestry Responsible Entities (RE), designed to protect the interests of MIS forestry investors in the underlying land used in the project.

- This condition requires that the RE must secure the land within a set time after issuing the interest in the scheme to the investor, or must offer the investor a refund.
- The condition requires that each investor's interest must be registered on the land title, as a covenant that the investor's rights to the trees on that land are protected in the event of any transfer of the ownership of the land.

Importantly, in its capacity as RE, Willmott Forests can report that for all projects…

- land was secured and Forestry Rights were registered by 30 March 2009 in line with regulatory requirements; and
- plantation insurances are in place and current.

In addition and specific to 2008 Growers, Willmott Forests can report that all…

- site preparation and planting works are on schedule for completion by 30 June 2009; and
- scheduled operations have been conducted in accordance with best industry practices and in line with the ATO Product Rulings PR 2006/128 and PR 2007/82.

Diversified Income streams

Willmott Forests is not only reliant on Forestry MIS revenue and has diversified its income streams into complimentary areas that fit with our overall strategy.

- Downstream processing operations represented in excess of 20% of total revenue in FY2008 and will continue to grow with planned further investment in timber processing. Willmott Forests' 50:50 joint venture with Dongwha is proceeding with the development of a $60m state of the art plantation timber fed saw mill and landscape products plant. The mill project is awaiting necessary approvals required to move to financial closure and commencement of construction.
- Willmott Forests recently launched its new styled investment product, the Willmott Forests Premium Timberland Fund No.1 ('the Fund") which provides a diversified investment in the Australian forestry sector by investing in both forestry and land assets. We see this product having great appeal to the superannuation fund market.
- Willmott Forests is entering the bio-fuel market with the construction of a second generation 'cellulosic' ethanol pilot plant on the North Coast of NSW. With the all important Phase 1 nearing completion Willmott Forests' subsidiary, Ethanol Technologies Ltd, plans to be producing bio-fuel on a commercial scale within 3 years and benefiting from the income gained from the exclusive licensing of its technology to ethanol producers worldwide.

Benchmarking

Willmott Forests regularly benchmarks itself against other sector participants and is confident that its:-

- forestry operations are efficient, low cost and utilise industry best practises;
- capital expenditure is low relative to peers;
- debt / gearing levels are conservative; and
- accounting policies are both conservative and reflect industry best practises.

A recent detailed analysis conducted by Willmott Forests has benchmarked its gearing and the relevant key accounting policies against its competitors in the MIS Forestry sector.

It is not our normal practise to release information on other companies; such analysis is for our own internal purposes to ensure that Willmott Forests continues to position itself at the forefront of the industry.

Due to the unprecedented speculation regarding both Timbercorp and Great Southern being placed in voluntary administration we have decided to present the findings of our analysis from the perspective of gearing and accounting policies (income recognition and asset valuation) on the basis of the Industry Average, Timbercorp (TIM) and Great Southern (GTP) compared to Willmott Forests (WFL).

The basis and findings of our analysis can therefore be summarised as follows:-

Full Year accounts

Measure	TIM	GTP	Industry Average	WFL
Gearing statutory[1]	155%	108%	68%	30%
Gearing pro-forma[2]	155%	61%	55%	(-8%)
Income recognition	Aggressive	Aggressive	Standard/Aggressive	Standard
Asset valuation	Standard	Standard	Standard	Conservative

[1] Gearing statutory = Net Debt / Equity direct from statutory accounts
[2] Gearing pro-forma = Net Debt / Equity from statutory accounts adjusted for hybrid security reclassified as equity

Due to the tightening of credit markets, and the fact that it is no longer reasonable to assume that any company will necessarily be able to refinance its debts in these current credit markets, there has been considerable focus by investors on the relative gearing levels of companies.

Whilst it is common for investors to consider only the statutory measures of gearing, these measures alone do not accurately display the effect of hybrids or preference shares on gearing or for that matter, differing accounting policies (that can affect equity), which are common in the MIS Forestry sector.

Analysis of gearing

In response, Willmott Forests has based its analysis on both a statutory measure and a pro forma measure that treats any hybrid security that converts as a result of an event by, or at the option of, the issuer as equity for gearing purposes. In contrast, a hybrid that has a fixed maturity date, or that converts at the option of the holder into cash, has been treated as debt.

We note that this pro forma measure is generally accepted by the major Australian trading banks for use in gearing calculations for setting and testing banking covenants.

Due to the cyclical nature of our industry, Willmott Forests considers that it is necessary to compare gearing at the respective financial year end of each company.

We note that, should the comparison be undertaken at the most recent reporting date, Willmott Forests remains in the top two lowest geared companies in the sector with a Net Debt / Equity gearing of 44% on a pro-forma basis.

Analysis of accounting policies

Revenue recognition

Revenue recognition policies of different Forestry MIS companies are not always clearly appreciated by analysts due to the nature of the contracts underlying the schemes. Australian accounting standards allow for a wide variation in revenue recognition. It is common practice for a component of revenue to be recognised upfront (when a contract is signed), and the remainder to be recognised as establishment activities progress.

However, should a materially large proportion of revenue be recognised upfront, without an appropriate matching of expenses to that revenue, this overstates profits and, in turn increases the book value of equity in retained profits. This aggressive accounting practise decreases both statutory and pro forma gearing (as defined above).

Willmott Forests' policy is to recognise revenue in proportion to the work performed. This gives rise to more than 75% of revenue being carried forward into the period where the majority of plantation expenses are incurred. This is considered by Willmott Forests to be a 'standard' approach by matching income with expenditure.

Our analysis of accounting policies across the sector finds that some, but not all, companies (including Timbercorp and Great Southern) have applied a more 'aggressive' revenue recognition policy where a relatively high percentage of revenue is recognised in the year of sale even though the majority of the plantation expenses are incurred in the following year.

Land valuations

Australian accounting standards allow for flexibility on valuation of assets which, given the nature of the MIS Forestry industry in relation to plantations, provides the opportunity for "paper" (i.e. non-cash) profits to be made should land be revalued up, again resulting in increased retained profits and equity.

The three land valuation methodologies that are most common are Market Value being the most 'aggressive', Fair Value being 'standard' and At Cost being the most 'conservative'.

Our analysis of accounting policies across the sector finds that most companies use the Fair Value methodology while Willmott Forests is the only company to use the At Cost methodology.

Conclusion

The detailed analysis shows Willmott Forests to be well positioned in relation to its competitors with a low level of gearing and use of conservative accounting policies.

Willmott Forests should be considered as the lowest geared company in the MIS Forestry sector when revenue recognition and asset revaluation measures also be taken into account.

Willmott Forests is committed to delivering sustainable returns to shareholders and growers which will be achieved by implementing our prudent and sound long-term strategy - our key operational differentiator to other MIS Forestry companies. This strategy includes:-

- ✓ A focus on our core competency of plantation forestry only
- ✓ Sound and conservative financial management as demonstrated by our low gearing
- ✓ Access to quality forestry land
- ✓ External grower finance off balance sheet
- ✓ Long term wood supply arrangements
- ✓ Expansion through the softwood value chain, with niche sawmills and our recent entry into renewable energy market
- ✓ Development of long-term relationships with other financially strong forestry and industry participants

In FY2009, Willmott Forests remains on track to deliver another sound financial result in relation to sales, net profit and cashflow.

I trust that this analysis will assist advisers in providing recommendations to clients in the MIS Forestry sector, as well as our growers in their renewed confidence in the financial strength of the company. I look forward to your continued interest and involvement with Willmott Forests.

Yours sincerely

Jonathan D Madgwick
Chairman
Willmott Forests Limited