Company	Phaunos Timber Fund Limited
TIDM	PTF
Headline	Management agreement/strategic review
Released	08:00 24-Jun-2014
Number	3547K08

RNS Number : 3547K
Phaunos Timber Fund Limited
24 June 2014

Phaunos Timber Fund Limited

Management Agreement and Strategic Review

24 June 2014

Phaunos Timber Fund Limited ("Phaunos" or the "Company"), the Authorised Closed ended investment scheme established to invest in timberland and timber related assets on a global basis, today announces that it has reached an agreement with Stafford Timberland Limited ("Stafford") to manage its portfolio of assets. The Company also announces the completion of Stafford's strategic review into its portfolio of assets.

Strategic Review

Stafford was initially engaged by the Board of Phaunos in December 2013 to carry out a strategic review of the Company's assets. The key findings of that review are as follows:

- Phaunos has interests in good quality timberland assets in Matariki, Aurora Forestal and Mata Mineira. Combined, these assets represent 56% of the Net Asset Value (NAV) and present a solid base upon which to build out the Phaunos portfolio;
- 36% of the portfolio is represented by higher risk assets, which is a greater proportion than would normally be expected in a balanced timberland portfolio;
- There are a large proportion of greenfield 'venture capital' style investments;
- Phaunos is reliant on a relatively small number of mature timberland assets for annual cash flows and these assets are subject to export or single product market risk;
- There are several assets whose valuations are subject to significant uncertainty and a forced liquidation value could be more than 30% below the December 2013 NAV;
- Weaknesses in log prices in China have occurred recently, which may have an impact on cash flows in the second half of the year; and
- The Company should seek an exit from some higher / medium risk components of the portfolio and should seek a suitable loan facility in order to make its cash position more robust.

Details of the results of Stafford's review and recommendations are in the Appendix below.

Ongoing Management

After considering carefully all options for the management of the Company's portfolio of assets, the Board concluded that shareholders' interests would best be served by continuing and expanding the relationship with Stafford.

Stafford comprises a team of 11 people with offices in London, Sydney and New Hampshire, USA. Stafford has interests in over 138 timberland assets worldwide, with assets under management of USD 1.5bn from 23 institutional investors across 7 comingled funds & one co-investment.

The Board believes that the appointment of Stafford is the best way to maximise shareholder value. In particular, the Board concluded that:

- Stafford's investment team which includes a number of foresters with on-the-ground operational experience, has the relevant experience to manage the various different asset types included within the Phaunos portfolio;
- Stafford has extensive market knowledge through strong local networks created from its existing investments which include significant assets in South America, North America and New Zealand, which are regions that overlap with the Phaunos assets;
- Stafford's investment activity in its institutional fixed-life funds has created impressive performance which is significantly better than has been achieved by the Phaunos portfolio; and
- Phaunos will have the benefit of personnel within Stafford who have significant previous experience of managing listed investment companies.

The Board has negotiated a remuneration package which provides strong alignment with shareholders' interests. As part of this package, the Board is recommending the issue of warrants and this will be subject to shareholders' approval at a general meeting (GM). Full details of the agreement with Stafford will be set out in a circular to shareholders, which, together with the formal arrangements for the GM, will be despatched in due course.

The Board has sought to minimise the near-term cash payment to Stafford, which is consistent with an ongoing significant cost reduction programme being undertaken in all areas of the Company's activities.

Key elements of the remuneration package are outlined below:-

1. An annual management fee of 0.35% of market capitalisation of the Company's shares, payable quarterly in arrears. To assist the Company with management of its cash flow, the first payment will be made in December, 2014.

2. A warrant package consisting of:-
   - 10 million five year warrants to purchase shares at 50 cents per share, to be issued immediately after the GM;
   - 10 million four year warrants to purchase shares at 58 cents per share, to be issued on 1st July 2015; and,
   - 10 million three year warrants to purchase shares at 63 cents per share, to be issued on 1st July 2016.

In the event that shareholders do not ratify the issue of warrants at the GM, the terms of Stafford's contract will automatically convert such that their remuneration will be 1% p.a. of market capitalisation, payable quarterly in arrears.

3. In the event that shareholders vote to wind up the company at the continuation vote to be held in 2016, the base fee will rise to 1% p.a. of market capitalisation from the date of the vote. Further, all warrants will lapse and an incentive fee with a similar return profile to the warrants will be payable, based upon the actual net proceeds returned to shareholders.

As a result of these changes, the individuals currently employed by Phaunos Boston Inc. as investment managers will leave the Company in due course. The Board would like to express its gratitude to those individuals for their assistance in the transition period over the last six months.

Phaunos will retain its subsidiary company Phaunos Boston Inc. This company will continue to be responsible for the accounting and day to day administration of its assets. By maintaining these functions the Company will achieve continuity, particularly in the day to day management of its wholly owned subsidiary investments. Phaunos' costs of maintaining its presence in Boston will partly be mitigated by an agreement to share office space with Stafford, which already has a presence in the region.

Meeting for Analysts

The Company will hold a meeting for analysts at 10 am on Tuesday 24th June. At this meeting, Stafford will present the results of their strategic review into Phaunos' portfolio of assets. A copy of the presentation used at that meeting will be available on the Company's website at www.phaunostimber.com. For those unable to attend the meeting, dial in details are as follows: +44 (0) 20 3003 2666; access pin: 9353082.

Appendix -Summary of the Results of the Strategic Review

The presentation referred to above contains the following key information:-

Stafford analysed the risk of each investment according to the criteria set out in the table below:-

Risk	Higher	Medium	Lower
Productivity	New species, green field	Known species, green field	Known species, 2nd rotation
Market	Single product, single buyer or new market	Single product, multiple buyers	Multiple product, multiple buyers
Cash flow	Green field or >10 years from harvest	Young estate or >5 years from harvest	Even aged, mature or <5 years from harvest
Sovereign	Higher risk of government intervention, complex legal system	Medium risk of government intervention, good but difficult legal system	Lower risk of government intervention, transparent legal system

Liquidity at exit	Isolated estate with limited markets, or low HBU*	Part of broader estate with moderate markets, or medium HBU*	Part of broader regional estate, multiple markets, or high HBU*
Infrastructure	No port and no processing operations	Port or single processing operation	Port and single/multiple processing operations
Overall	= 4 or more rated as higher risk, or = 3 higher risk & 1 or more medium risk	= 4 or more rated as medium risk, or = 3 medium risk & 1 higher, 1 lower risk	= 4 or more rated as lower risk, or = 3 lower risk & 2 or more medium risk

*Potential for "higher or better use"

In overview, the Phaunos portfolio has:

- A relatively high percentage of higher risk assets (36%)
- A large proportion of greenfield 'venture capital' style investments
- Is reliant on several mature timberland assets for annual cash flows and these assets are subject to export or single product market risk
- Good quality timberland assets in Matariki, Aurora Forestal and Mata Mineira. Combined, these assets represent 56% of the Net Asset Value (NAV) and represent a solid base upon which to build out the Phaunos portfolio

Example Lower Risk Investment: Matariki:

- Is the entire 35% (NAV) of lower risk assets in the Phaunos portfolio
- Is a high quality timberland asset
- Has benefitted from strong domestic and export markets
- Has a mature well spread age class
- Second rotation sites of known productivity
- Performance is subject to export demand which can be volatile

Risk criteria	Rating	Comments
Productivity Risk	Low	Known species, mature trees
Market Risk	Low	Multiple products, multiple buyers
Cash flow Risk	Medium	Correlated to volatile export market prices
Sovereign Risk	Low	Low risk of government intervention
Liquidity at Exit Risk	Low	Mature estate that is part of a broader regional estate
Infrastructure Risk	Low	Multiple port, multiple processing operations
Overall Rating	Low	Known species, mature estate, multiple products, multiple markets

- Matariki is a strong cornerstone investment for Phaunos
- Currently working through an age class gap with volumes expected to increase after 2016
- Variable export markets can lead to cash flow and valuation volatility

Example Medium Risk Investment: Mata Mineira:

- Is 14% of the Phaunos NAV and almost half of the 28% of the medium risk assets in the portfolio
- Is a high quality eucalypt plantation estate with excellent growth rates
- Currently market supply exceeds demand
- Has the potential to produce 400,000 m^3 per annum but harvesting is limited by market access to between 130,000 m^3 and 235,000 m^3

Criteria	**Rating**	**Comments**
Productivity Risk	Low	Known species, mature trees
Market Risk	Medium	Single product, multiple buyers in an oversupplied market
Cash flow Risk	Medium	Mature even aged estate, but oversupplied market
Sovereign Risk	Medium	Medium risk of government intervention
Liquidity at Exit Risk	Low	Mature estate that is part of a broader regional estate
Infrastructure Risk	Medium	Multiple markets but all >350km. Charcoal production partners needed to improve market access
Overall Rating	Medium	Known species, mature estate, single product, oversupplied market

- Mata Mineira has the potential to provide consistent annual cash flows
- Production is focused on a single product (charcoal) in an oversupplied market
- Mata Mineira provides diversification to the Phaunos portfolio

Example Higher Risk Investment: Eucateca:

- Is 12% of the Phaunos NAV and a third of the 36% of the higher risk assets in the portfolio
- Greenfield eucalypt and teak plantations
- Variable plantation quality due to poor early survival
- Eucalypts approaching maturity and new markets need to be developed
- Teak plantations very young and of small scale

Criteria	**Rating**	**Comments - teak**
Productivity Risk	High	A developing species on greenfield sites
Market Risk	High	Developing international markets but undeveloped regional markets
Cash flow Risk	High	Greenfield and >10 years from harvesting
Sovereign Risk	Medium	Medium risk of government intervention
Liquidity at Exit Risk	High	Part of a broader estate with limited markets and low HBU
Infrastructure Risk	High	Limited local value adding, single port that is >1,600km by road/rail
Overall Rating	High	Greenfield asset with a single export market that is still to develop.
		Comments - Eucalyptus

Productivity Risk		Known species but greenfield sites
Market Risk		Single product, single market and markets to be developed
Cash flow Risk		Single aged estate with markets to be developed
Sovereign Risk		Medium risk of government intervention
Liquidity at Exit Risk		Relatively isolated with limited markets
Infrastructure Risk		Limited access to harvesting contractors and processing operations
Overall Rating		Greenfield sites with no specific product market

Cash flow review - short term revenue forecast

- FourWinds 2014 revenue forecast considered to be optimistic
- Mata Mineira and Eucateca 2014 forecast revenues likely to reduce from USD 13m to between USD 3m to 6m due to limited market access
- Removal of FourWinds has reduced management expenses by USD ~3.0m
- Potential for additional management savings of between USD 1.0m to USD 3.0m
- It is important that annual costs are largely met by annual revenues
- Asset sales should not be relied upon for covering annual operating costs

Cash flow review - 2015 to 2020

- The Phaunos portfolio includes a number of timber assets with mature or maturing age class profiles
- Assuming the necessary cost reductions are put in place, net annual cash flows are expected to improve in the period 2015-2020
- The extent of this improvement is highly variable and dependent upon:-

a. Ongoing strength of New Zealand export log markets (Matariki)
b. The development of new log markets (Eucateca)
c. Increasing market access for eucalypts into an oversupplied charcoal market (Mata Mineira)
d. The profitability of sawn timber operations (GTFF and Aurora Forestal)

Valuation review

Criteria assessed for each asset in Stafford's valuation review included:

- Growth rate assumptions
- Harvest volume assumptions
- Log price assumptions - starting point and modelled price increases
- Market development assumptions
- Valuation methodology - Sales comparison, liquidation/cost and discounted cash flows
- Discount rates
- Possible reasons why the market price might be more or less than the appraisal forecast

Each valuation was then assessed in terms of whether it was considered conservative, realistic or has high potential for variation

Conclusions were that:

- The portfolio has experienced a large amount of valuation volatility
- Higher risk assets typically have higher levels of appraisal uncertainty

Asset	NAV Dec 2013	% change in NAV 2012 -2013	Appraisal opinion	Comment
Matariki	144.8	+19%	Realistic	Appraisal metrics are in the range expected for NZ
Aurora Forestal	31.3	-14%	Realistic	Conservative log price and timberland discount rate assumptions
Mata Mineira	58.8	-31%	Realistic	Realistic log price assumptions given present market oversupply
Pradera Roja	29.3	+14%	High variability	Uncertainty over planted area, growth rates and markets
Eucateca	51.8	-5%	High variability	Unconstrained wood flows in a market that is yet to develop
Greenwood Tree Farm	36.2	+4%	High variability	Valuation assumes continued increases in average log/lumber recovery rates.
Green Resources	49.7	-49%	High variability	No external third party appraisal to date. Considerable variability around growth rates and markets
Total NAV reviewed	*401.9*			

- 2013 reduction in Net Asset Value (NAV) was most notable in higher risk assets
- NAV upside in short term is associated with lower and medium risk assets and potential for NAV downside on higher risk assets
- A forced liquidation value could be more than 30% below the 2013 NAV, noting that Stafford's review did not include the development of a detailed valuation model and the estimate provided is based on experience and Stafford's assessment of the underlying asset valuations

Stafford's recommendations to the Phaunos board:

- Reduce corporate expenses, operating expenditure and capital costs so as to align with annual revenues
- Maintain cash reserves of two times annual operating costs
- Rebalance the portfolio through the sale of some of the higher risk assets
- Implement independent annual valuations across all assets and request appraisers to undertake sensitivity analysis around key valuation assumptions
- Develop a flexible portfolio cash flow model to assist with divestments and estate planning

In summary the Phaunos portfolio

- Has a relatively high percentage of higher risk assets
- Is reliant on several mature timberland assets for annual cash flows and these assets are subject to export or single product market risk
- Has good quality timberland assets in Matariki, Aurora Forestal and Mata Mineira. Combined these assets represent 56% of the net asset value and represent a solid base upon which to build out the Phaunos portfolio

Looking ahead

- Subject to cost reductions and the prevailing market conditions, cash flows should improve over the period 2015-2020
- Valuations for the lower and medium risk assets are considered to be realistic although appraisal variability should be expected for the higher risk assets
- Rebalancing the portfolio through the sale of some of the higher risk assets and, subject to board and shareholder support, rebuilding out the portfolio with lower risk, higher yielding assets

Ends

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Notes to Editors

Phaunos is a Guernsey-domiciled closed-ended investment company authorised by the GFSC. Its ordinary shares are listed on the Main Market of the London Stock Exchange. The Company is self-managed. Its investment objective is to provide shareholders with attractive long term total returns, expected to be in the form of capital appreciation but with some income, through a diversified portfolio of timberland and timber-related investments.

The Company's portfolio consists of timberland and timber-related investments across 5 continents. As at 31 December 2013, the Company's audited NAV was US$419.0 million (being US$0.78 per ordinary share).

The Company intends to seek investments that meet or exceed the guidelines set out in the Sustainable Forestry Initiative and, wherever possible and practicable, to certify the lands under the Forest Stewardship Council guidelines.

The Company's ticker is PTF.

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