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Phaunos Timber Fund Limited - PTF Response to Stafford AGM Questions
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6 September 2018

Phaunos Timber Fund Limited ("Phaunos" or the "Company")

Response to Stafford AGM Questions

The board of directors of Phaunos (the "**Board**") notes the announcement made on 4 September 2018 by Stafford relating to the 14 questions it is asking Phaunos to answer at the forthcoming annual general meeting of the Company.

Phaunos would like to reiterate its view that Stafford's Offer of US\$0.49 per Phaunos share does not provide an attractive exit opportunity for Phaunos shareholders. The Asset Realisation Process is progressing well and is the best strategy for maximising shareholder value over a reasonable timeframe. The view of the Board, as mentioned in the Response Circular, is unchanged: Stafford's Offer significantly undervalues Phaunos and you should take no action in relation to Stafford's Offer and you should not sign any document which Stafford or its advisers send to you.

The Board has an agenda for the upcoming AGM and will only reply to questions from Stafford or its advisers if it judges that answering those would be in the best interest of Shareholders (see Appendix A for Phaunos's responses). The Board does not believe it is in the best interest of Shareholders however for Phaunos to answer each of the 14 questions asked by Stafford as:

- many questions have already been answered in the Response Circular and subsequent announcements; and
- other questions could put value at risk for Phaunos Shareholders - Phaunos has no intention of disclosing confidential information that may prejudice the Asset Realisation Process or its ongoing legal dispute with Rayonier.

As a result, other than the update on the timing of the disposal of Matariki provided under Appendix A, the Board does not intend to comment further on the Asset Realisation Process or Rayonier's claims at this time. Shareholders will however be kept informed of any material developments in accordance with its legal and regulatory obligations and after appropriate consultation with the UK Takeover Panel should these happen following Day 39 (or 8 September 2018) of the Offer Period.

Unless otherwise stated, defined terms used but not defined in this announcement have the meanings set out in the Response Circular.

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Appendix A - Response to Stafford's questions ahead of Phaunos 2018 Annual General Meeting

(A) General

1. Have the potential bidders in the Asset Realisation Process been through more than one round of indicative offers? Have the bidders already commenced their due diligence and what is the deadline for binding offers?

Answer: We refer you to the announcement from Phaunos published on 5 September 2018 for an update on the status of the Asset Realisation Process.

2. In the Phaunos 2017 Annual Report, Ernst & Young LLP ("EY") stated that one of the judgements that Phaunos management has made is the anticipation that *"the realisation of the assets will take between fourteen to twenty months from the date of this report [30 April 2018], although there are material uncertainties inherent in the disposal process which may result in this time period being extended"*.

Have EY been consulted on the updated timetable for the Asset Realisation Process given the statement by Phaunos in its defence circular to the Offer (the "**Defence Circular**") that the Phaunos Board *"expects the sale of all the assets to complete within 6 to 9 months, which would cover the sale of assets comprising 92% of the Portfolio Value"*?

Answer: EY's scope of work has never covered timing of the Asset Realisation Process and the timing referred to in the Phaunos 2017 Annual Report is out of date.

The Board's view and basis for making the statement on timing it made in its Response Circular have been clearly described in the announcement made by Phaunos on 21 August 2018.

In its Response Circular, the Board estimated that completion of the Matariki disposal would be between Q1 and Q2 2019. As announced on 28 August 2018, the Board intends to defend itself vigorously against the claims brought by Rayonier, which it continues to believe are without merit. It will endeavour to have a Court deal with these claims urgently, including by taking a pre-emptive step such as a strike out application if necessary. The Board's view (on advice) is that depending on what steps are taken, the matter could take between two and seven months to reach a judgment in the Court (assuming the Court treats the matter with urgency). Phaunos notes that it is a very early stage in the litigation process and that these timings are inherently uncertain. However, in light of the guidance received, the Board now estimates that completion of the Matariki disposal may extend to Q3 2019.

3. Do the Phaunos Directors intend to pay themselves an incentive fee associated with the sale of assets in the Phaunos portfolio in addition to their annual remuneration and their additional fees charged at £300 per hour per Phaunos Director for time spent which is in excess of their monthly minimum hours?

Answer: Please note that no incentive fee associated with the sale of assets in the Phaunos portfolio is currently in place. As mentioned in the Response Circular, any such a fee, if agreed during the Offer Period will need to be approved by Shareholders. The Phaunos Directors' remuneration for the period ending 30 June 2018 will be disclosed in the interim financial results to be published shortly after the AGM. These are paid according to the Directors' respective service contract (under the terms disclosed in the Response Circular) and there is no reason for Phaunos to make any additional disclosure.

4. Has the OIO given the Phaunos Board written assurances that it is able to process applications in the timeframe indicated by the Phaunos Board in its Defence Circular?

Answer: As mentioned in the Response Circular and in subsequent announcements from Phaunos, all bidders for Matariki have indicated to the Board that they are expecting the OIO process to take between 3 and 6 months. They are experienced in dealing with the OIO and have a detailed understanding of what is required to effectively navigate the consent process. The Board also notes the new overseas investment rules applying to forestry transactions were passed by the New Zealand parliament last month and will come into effect by around mid to late October 2018. The Board has been advised by its New Zealand legal counsel that the new rules should result in an easier and quicker OIO consent pathway for prospective bidders who meet the new criteria.

5. When will Phaunos release its interim financial statements for the period ended 30 June 2018 and will these statements disclose the additional fees that the Phaunos Directors have received over and above the quarterly fees and quarterly supplementary fees that the Phaunos Directors receive?

Answer: It is the Board's intention to release the interim financial statements for the period ended 30 June 2018 shortly after the AGM.

(B) Matariki dispute

6. Is Phaunos able to enter into binding agreement(s) for the sale of the Matariki Interest whilst the proceedings issued by Rayonier Canterbury LLC ("**Rayonier**") in the Auckland High Court are on-going?
7. Has the Phaunos Board received legal advice relating to the expected duration of the proceedings issued by Rayonier?
8. In its announcement on 28 August 2018, the Phaunos Board states that "*Rayonier has also written to Phaunos purporting to serve in accordance with the terms of the Shareholders Agreement an Acquisition Notice on Phaunos in response to the alleged breach*".
- What other rights or remedies may be available to Rayonier pursuant to the shareholders agreement in relation to Matariki that could impact on the timing of any proposed disposal of Matariki?
9. If Rayonier were to be entitled to purchase the Matariki Interest for NZD 225 million, it is estimated¹ that Phaunos' Updated Break-Up NAV (as such term is used in the Defence Circular) would fall from US\$0.51 to US\$0.43 per Phaunos Share and the Updated Going Concern NAV (as such term is used in the Defence Circular) would fall from US\$0.58 to US\$0.51 per Phaunos Share. Would the Phaunos Board like to comment on this?

Answer: The Board has received legal advice from UK and New Zealand counsel in relation to the proceedings issued by Rayonier and reiterates that it believes Rayonier's claims are without merit and the acquisition notice purported to be served by Rayonier is invalid. The Board does not intend to comment further on the dispute at this time, but will of course keep shareholders informed of any material developments in accordance with its legal and regulatory obligations and after appropriate consultation with the UK Takeover Panel should these happen following Day 39 (or 8 September 2018) of the Offer Period.

(C) Potential inaccuracy.

10. In the Phaunos 2017 Annual Report, revenue from timber operations for the year ended 31 December 2017 was shown as US\$6.535 million from Mata Mineira (note 4 to the accounts). Stafford previously questioned whether this figure represents a potentially significant inaccuracy relative to the actual revenues for this period. Please could the Phaunos Board confirm that revenue received from the timber operations of Mata Mineira did indeed amount to US\$6.535 million for the year ended 31 December 2017?

Answer: Stafford is indeed correct in their assertion that the revenue from timber operations contained an inaccuracy. The inaccuracy, however, relates to the accounting treatment employed by Stafford in prior years, whereby sales were accounted for on a cash received basis, as opposed to the accruals basis required under IFRS and generally accepted accounting practice. The result of this treatment was an accumulation of unreported sales and under-stated trade receivables, totalling US\$2.7m for prior years. This was corrected in the 31 December 2017 Financial Statements, in agreement with the Company's auditors. Timber sales of \$3.6m were recorded in 2017, with \$1.8m harvested in 2017 and \$1.8m accrued at year end. The appraised biological value for Mata Mineira was adjusted to reflect this change, with the NAV remaining flat as a result.

It should be noted, with the exception of 2015, timber sales were immaterial in prior years and were thus not subject to audit. EY performed an analytical review at year end 2017 and, in discussions with Phaunos, determined revenues were under-stated.

Offer Document

In addition, the following questions for the Phaunos Board which were included in the Offer Document have not been specifically addressed in the Defence Circular.

11. Will there be any cash distribution this year?

Answer: As mentioned in the Response Circular and subsequent announcements from Phaunos, cash will be distributed as assets are sold under the timeline provided by the Board.

12. When will the Phaunos Board publish its estimates of the general running costs and costs of the Asset Realisation Process through to its completion, including:

- a. ongoing management and operational costs;
- b. audit, valuation, sales agents and other professional fees;
- c. directors' remuneration, including directors' fees, additional consultancy fees and any other fees, costs or expenses payable to, or incurred by, the Phaunos Board; and what these costs will be if the Offer is accepted; and
- d. liquidators' fees?

Answer: As mentioned in its Response Circular and in a further announcement on 21 August 2018, the Board has confirmed that these costs had been assessed and taken into account in the computation of the Asset Realisation Range.

13. What are the Phaunos Board's estimates of the retentions required following the disposals under the Asset Realisation Process and the future cash costs of maintaining those assets not included in this process?

Answer: This is not material in the context of the Updated Asset Realisation Range

14. What are the Phaunos Board's estimates of the timing and costs of the eventual liquidation of Phaunos?

Answer: Please refer to the Response Circular, which provides an update on timing for full liquidation of the fund structure.

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Response to Stafford AGM Questions - RNS