

# **Phaunos Timber Fund Limited**

**Annual Report and Consolidated  
Financial Statements  
for the year ended  
31 December 2008**

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## ABOUT THE COMPANY

### **INTRODUCTION**

**Phaunos Timber Fund Limited (the “Company” or “Phaunos”) is an Authorised Closed-ended investment company domiciled and incorporated in Guernsey on 28 September 2006 with an unlimited life. As an existing closed-ended fund the Company is deemed to be granted an authorisation declaration in accordance with section 8 of the Protection of Investors (Bailiwick of Guernsey) Law 1987, as amended and rule 6.02 of the Authorised Closed-ended Investment Schemes Rules 2008 on the same date as the Company obtained consent under the Control of Borrowing (Bailiwick of Guernsey) Ordinance 1959 to 1989.**

The Company has two classes of shares in issue: US\$ denominated Ordinary Shares (“Ordinary Shares”) and US\$ denominated C Shares (“C Shares”). The Ordinary Shares are admitted to the Official List of the UK Listing Authority and to trading on the Main Market of the London Stock Exchange plc (“LSE”) and to listing and trading on the Channel Islands Stock Exchange (“CISX”).

At launch, in December 2006, the Company raised approximately US\$115 million through a placing of 115,150,000 Ordinary Shares at a price of US\$1 each. On 20 December 2006 these shares were admitted to trading on the UK Alternative Investment Market (“AIM”) and to listing and trading on CISX.

The Company raised a further US\$370 million in June 2007 through a placing of 355,769,230 Ordinary Shares at a placing price of US\$1.04 each. These Ordinary Shares began trading on both AIM and CISX on 5 June 2007.

On 10 January 2008, the Company received approval from shareholders to de-list from AIM, conditional upon the UK Listing Authority granting admission of the Ordinary Shares to the Official List and on the LSE admitting the Ordinary Shares to trading on the Main Market of the LSE. The admission of the Ordinary Shares to the Official List was granted, and trading on the LSE commenced on 11 June 2008.

On 10 July 2008, the Company raised a further US\$33 million through a placing of 31,480,376 Ordinary Shares at a placing price of US\$1.05 each. These Ordinary Shares were admitted to the Official List and to trading on the LSE and CISX on 10 July 2008.

## ABOUT THE COMPANY (continued)

On 21 April 2008, the Company's shareholders in general meeting authorised the Company to create and issue, for a period of 5 years, C Shares of no par value up to an aggregate amount of US\$1.6 billion. The C Shares currently in issue will convert to Ordinary Shares at a conversion ratio determined by reference to the respective net asset values of the Ordinary Shares and the C Shares on a date which is on or before 31 December 2009, with actual conversion occurring shortly thereafter. The C Shares are not listed on the Official List or traded on the LSE, nor are they listed or traded on CIXX.

The Company raised US\$18.5 million through a placing of C Shares at a placing price of US\$1 each on 9 October 2008 and a further US\$20,370,000 through a placing of C Shares again at a placing price of US\$1 each on 22 December 2008.

### **Investment Objective and Policy**

The Company's investment objective is to provide shareholders with attractive long term total returns, predominantly expected to be in the form of capital appreciation but with some income, through a diversified portfolio of timberland and timber-related investments.

#### *Diversification*

The Company's portfolio is, and will continue to be, diversified through investment in a broad range of investment strategies and vehicles including, but not limited to, investment in a variety of tree species, tree age classes and a diversified range of geographic timberland markets and timber-related investments in order to provide sustainable returns, control volatility and manage risk.

In order to maintain flexibility, there are no predetermined geographic limits on investments made by the Company. The investment focus of the Company includes both investments in well established markets and investments in less developed timberland markets or countries where the Company's Investment Manager, FourWinds Capital Management (the "Investment Manager") believes the benefits of the timberland and timber-related investments outweigh any country risk. The Company will invest in at least four different regions of the world. No single country (or region of the US) will represent more than 40 per cent. of the gross assets of the Company and no continent more than 60 per cent. of its gross assets.

## ABOUT THE COMPANY (continued)

### *Asset Allocation*

The Investment Manager seeks to accomplish this investment objective by (i) seeking exposure to timberland and timber-related investments on a global basis; (ii) seeking to control risk through portfolio diversification, investment vehicle selection and implementation of risk control strategies and (iii) seeking portfolio diversification by tree species, age classes and geographic timberland markets

Generally, the Company will not invest in securities carrying unlimited liability and no single investment or investment in the securities of one company may, at the time of acquisition, exceed 30 per cent. of the gross assets of the Company. For these purposes, where the Company invests in a portfolio of assets, each underlying individual asset shall be treated as a single investment and where the Company invests by means of a holding company, joint venture or similar investment or investment vehicle, each underlying property or similar asset shall be treated as a single investment.

Where the above restriction is breached subsequent to the acquisition of an investment as a result of an event outside of the control of the Investment Manager or the Board, no further relevant assets may be acquired by the Company until it can comply with the restriction.

It is the intention of the Company 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.

### *Hedging*

In order to hedge against interest rate risks or currency risk, the Company may, where appropriate, also enter into forward interest rate agreements, spot or forward currency agreements, interest rates and bond futures contracts and interest rate swaps and, in addition, purchase and enter into put or call options on interest rates or currency rates and put or call options on futures of interest rates or currency rates.

Although the intention is to remain substantially invested, the Investment Manager may exercise its discretion to hold cash or cash equivalent instruments (including but not limited to bank deposits, bonds or government issued treasury securities) for the purpose of protecting the capital value of the Company's cash assets.

## ABOUT THE COMPANY (continued)

### *Gearing*

The Company's Articles of Incorporation permit maximum borrowings of up to 25 per cent. of the Company's net asset value. The Directors do not intend to borrow, save for short term liquidity, working capital requirements, to facilitate the Company's over-commitment policy and to fund share buybacks. However, if the Directors deem it prudent, the Company may borrow for longer term purposes.

The Company may also use timber-related instruments such as financial futures, options, warrants and swaps, the return on which is linked to timber-related indices or other timber-related instruments or vehicles. Such timber-related instruments may be used either for cash management purposes or as part of the Company's investment structures.

Since not all of the Company's investments are income generating the Company may also retain a proportion of the Company's assets in cash or near-cash investments for working capital purposes.

### *General*

The Company will comply with certain investment restrictions for so long as they remain requirements of the UK Listing Authority as set out in more detail below.

The Directors do not currently intend to propose any material changes to the Company's investment policy, save in the case of exceptional or unforeseen circumstances. As required by the Listing Rules, any material change to the investment policy of the Company will only be made with the approval of shareholders.

### *Investment Restrictions*

The Company will comply with the following investment restrictions for so long as they remain requirements of the UK Listing Authority:

1. the Company and any of its subsidiaries will not conduct a trading activity which is significant in the context of its group as a whole. This does not prevent the businesses forming part of the Company's portfolio from conducting trading activities themselves;
2. not more than 10 per cent. in aggregate of the value of the total assets of the Company at the time of its admission to the Official List and to trading on the London Stock

## ABOUT THE COMPANY (continued)

Exchange may be invested in other listed closed-ended investment funds, except that this restriction shall not apply to investments in closed-ended investment funds which themselves have published investment policies to invest no more than 15 per cent. of their total assets in other listed closed-ended investment funds;

3. the Company will notify to a regulatory information service, within five business days of the end of each quarter, a list of all investments in other listed closed-ended investment funds, as at the last business day of that quarter, which themselves do not have stated investment policies to invest no more than 15 per cent. of their total assets in other listed closed-ended investment funds; and
4. to ensure a spread of investment risk the Company will avoid:
  - (a) cross financing between the businesses forming part of its portfolio including, for example, through the provision of undertakings or security for borrowings by such businesses for the benefit of another; and
  - (b) the operation of common treasury functions as between the Company and investee companies.

In the event of any breach of investment restrictions applicable to the Company, shareholders will be informed of the actions to be taken by the Investment Manager by an announcement issued through a regulatory information service.

### **Net Asset Value per Share (NAV)**

As at 31 December 2008, the net asset value per Ordinary Share was US\$0.99 and the net asset value per C Share was US\$0.97.

## DIRECTORS

During the year, the Company had five Directors. The Directors are responsible for the determination of the Company's investment policy and strategy and have overall responsibility for the Company's activities, including the review of investment activity and performance. All of the Directors are non-executive and, save for Kimberly Tara and Liane Luke, are independent of the Investment Manager.

**Keith Oates (British)** Mr Oates, aged 66, was Executive Deputy Chairman of Marks & Spencer plc from 1994-1999, having joined as Finance Director in 1984 and being appointed joint Managing Director in 1991. He was the founder, and then Chairman of Marks & Spencer Financial Services for 15 years. In addition to Marks & Spencer, he has held executive positions with the Reed Paper group, IBM, Black and Decker and TBG. A Governor of the BBC from 1988 to 1993, he has also been a Non-Executive Director of B.T. plc, MCI, the Financial Services Authority, the G.B. and English Sports Councils, John Laing plc and Chairman of Quest. He was a Non-Executive Director and Chairman of the Audit Committee of Diageo plc, whose brands include Smirnoff, Johnny Walker, Guinness, Gordons, Captain Morgan and Baileys for nearly 10 years until 2004. He was also a special adviser to Coutts Bank in Monaco from 2002-2005. He has been a Member of Council (Governor) of Wycombe Abbey School since 1995. He was appointed a Non-Executive Director of the English National Committee of the Forestry Commission in 2007. Mr Oates graduated with a B.Sc (Econ) from the London School of Economics, a business diploma at UMIST and an M.Sc from Bristol University. In 1998, he was awarded an honorary Doctorate of Science (D.Sc.) from UMIST and an honorary Doctorate of Laws (LLD) from Bristol. Mr Oates is resident in the United Kingdom and Monaco.

**Liane Luke (American)** Ms Luke, aged 58, is Chief Timber Officer at the Investment Manager and where she heads timberland investment and timber portfolio management. With more than 20 years experience in real asset investing, she has spent the last 12 years working exclusively in timberland investing. As a Vice President of Hancock Timber Resources Group from 1996 to 1998, she developed timber investment products for US tax-exempt institutional investors with first investments made within six months. From 1998 to 2005, she was a Principal and Managing Director of Resource Management Services, one of the largest privately held timber investment management organizations in the United States, where she designed tax efficient structures for US and international clients. In 2005, she formed Greenway Investments to focus on structured finance and other novel timberland investment projects for a major US insurance company.

## DIRECTORS (continued)

In her role as the Investment Manager, she sits on the Boards of several international forestry-related companies. Ms Luke earned her BA magna cum laude from the University of New Hampshire and her MBA in finance from the Yale University School of Management. She is resident in the United States of America.

**Peter Niven (British)** Mr Niven, aged 54, has worked in the financial services industry in the UK and offshore for 33 years. His career with the Lloyds TSB Group spanned 29 years where latterly he was Chief Executive of the group's offshore banking operations, until his retirement from the bank in June 2004. A Fellow of the Institute of Bankers and a Chartered Director, he is currently a director of a number of Guernsey based investment funds and captive insurance companies. This includes his role as Chairman of F&C Commercial Property Trust Limited, a UK listed property investment trust and a director of Dexion Trading Limited, a UK listed Fund of Hedge Funds. He is also Chief Executive of Guernsey Finance LBG, the international promotional body for Guernsey's finance industry. He is a resident of Guernsey.

**Kimberly Tara (American)** Ms Tara, aged 39, has spent the last 17 years negotiating, executing and managing investments and projects, with a focus on cross-border transactions. She has executed deals in Europe, the US, Latin America, and Asia. She began her career in Mergers & Acquisitions at Morgan Stanley. In 1995 she joined Value Partners, a McKinsey spin-off in Italy. In 1999, she began working as an alternative investment consultant, providing financial and advisory services for clients in Europe and the US. She also worked as Chief Financial Officer for a US-based biotech company focusing on CNS drug development and memory enhancement. Since 2005 as Chief Executive Officer of the Investment Manager, Ms Tara has successfully raised and managed more than US\$1billion in commodities and natural resources. She graduated magna cum laude from Brown University with a degree in Business Economics and received her MBA from INSEAD in France. She is resident in France.

**Sarah Evans (British)** Appointed on 30 January 2009. Mrs Evans, aged 53, is an Oxford graduate and a Chartered Accountant. She has worked for many years in the financial services industry in London including working for Kleinwort Benson as head of Group Finance and latterly for Barclays Bank Plc as a director of Treasury and then as Finance Director of Barclays Mercantile. Mrs Evans is a member of the Institute of Directors and is currently a non-executive Director of a number of Guernsey based investment funds, including HSBC Infrastructure Company Limited which is listed on the LSE, two AIM listed companies, of which she is chairman of the audit committees and two unlisted funds of hedge funds. She is resident in Guernsey.

**John Le Prevost (British)** John Le Prevost resigned as a Director on 30 January 2009.

## INVESTMENT MANAGER, ADMINISTRATOR AND COMPANY SECRETARY

### **Investment Manager**

FourWinds Capital Management (FWCM) has been appointed Investment Manager of the Company. The Investment Manager's management team has a proven track record of generating competitive returns from timberland and timber-related investments across multiple geographic locations. The Directors consider such broad timberland and timber-related experience to be beneficial as the Company and its wholly owned subsidiaries (together the "Group") seek to execute the Company's investment strategy.

FWCM is a Cayman Islands exempted company with offices in Boston, London, Hong Kong and Geneva and was incorporated on 14 March 2005 with registration number CB-146307. The Investment Manager has discretionary authority to invest the Company's assets and is responsible for all investment decisions made on behalf of the Company, subject to the control and policies of the Board of the Company.

FWCM is also primarily responsible for researching, selecting and monitoring the Company's investments and making decisions on when and how much to invest in or withdraw from a particular investment, subject to the control and policies of the Board.

The Investment Manager focuses on the development and risk management of investment vehicles for natural resources, commodities and real assets.

FWCM currently has other products under management, including Aqua Resources Fund Limited, Ceres Agriculture Fund Limited and the Zephyr Commodity Fund.

### **The Administrator and Company Secretary**

Anson Fund Managers Limited was Administrator and Company Secretary of the Company during the year to which the enclosed financial statements relate. HSBC Securities Services (Guernsey) Limited ("HSBC") has been appointed, with effect from 20 February, 2009, as Administrator and Company Secretary, to replace Anson Fund Managers Limited.

## CHAIRMAN'S STATEMENT

### CHAIRMAN'S STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2008

#### HIGHLIGHTS

- Issued an additional US\$33 million of Ordinary Shares
- Issued an additional US\$38.9 million of C Shares
- Net asset value per Ordinary Share was US\$0.99 at 31 December 2008
- Net asset value per C Share was US\$0.97 at 31 December 2008
- Total capital raised since inception in December 2006 is US\$556.9 million
- As at year end the Company is fully committed to invest capital raised (US\$659.6 million)
- US\$187.1 million of portfolio commitments drawn down as at 31 December 2008
- Since 31 December 2008 a further US\$33.8 million committed and further US\$13.9 million drawn down
- Continuing due diligence on an extensive pipeline of properties to confirm the commitments already made and to build on the global footprint we have established
- Migrated to London Stock Exchange main market on 11 June 2008

Dear Shareholders

#### INTRODUCTION

**I am pleased to have the opportunity to update our shareholders on the progress of the Company over the last financial year.**

**Phaunos' timberland assets were acquired only very recently, and are for the long term, therefore no formal project re-valuations have been included in the audit as at 31 December 2008. However, we have seen a fall in the Net Asset Value (the "NAV") of the Company's Ordinary Shares from 31 December 2007 and this now stands at US\$0.99.**

**The fall in NAV per Ordinary Share of US\$0.03 is mainly due to the loss on financial assets and increased operating costs due to start up costs and execution expenses in excess of realised earnings. Execution costs are paid upfront and generally recovered over time. On the other hand, whilst the portfolio is fully committed it is not**

## CHAIRMAN'S STATEMENT (continued)

**yet fully income and growth generating, which is to be expected at this stage of development.**

**Additionally, there were losses on the translation of subsidiary companies' currency net assets of US\$6.8m and US\$1.3m in respect of Eucateca and Forest Enterprise doo respectively. In contrast, there has been an increase to the overall NAV through the issue of Ordinary Shares and the share buy back programme at prices lower than the NAV.**

In these turbulent economic times, we are also glad to report that Phaunos is stable and that our long-term outlook remains very positive. We have continued to add to our portfolio with new investments diversified by country, maturity and wood type. Full details of the individual investments are contained in the Report of the Investment Manager.

Timberland, especially young plantations similar to those already in the Group's portfolio, is ideally positioned to ride out the immediate market downturn and continue to grow and add volume and value while markets recover. Our new plantations will be marketable either as timberland assets to be sold to other timberland investors, or to be held to maturity and sold into wood markets. Timberland is a long-term investment, and a young portfolio is uniquely well suited to times like these, since we do not expect to harvest from these assets for 7 or more years.

Capital market conditions have put downward pressure on the Company's share price and the Company has therefore executed a limited share buy-back in the fourth quarter of 2008 accumulating 1.34 million Ordinary Shares. Some existing investors are also accumulating Ordinary Shares in the market. However, the low trading volume of shares available supports the position that the share price discount is attributable to general market conditions and not to a lack of confidence in the future performance of the Company. Most investors have retained their original holdings.

Phaunos is dollar-denominated and aims to provide a globally diversified basket of currencies through its investment in timberland and timber-related projects. Our general policy is not to hedge the currency position. We are directly invested in more than 13 countries in the local currencies, and we therefore believe that our currency exposure contains a balancing mechanism over the long term.

## CHAIRMAN'S STATEMENT (continued)

Wood markets are not immune to recessions, and wood prices have declined everywhere. In response to that market, we are delaying harvest of mature trees that we had planned to be harvesting now. The fact that trees "store on the stump" allows us to wait out the present downturn, delaying harvest until markets strengthen. This is the unique advantage of timberland that decouples timberland returns from other assets. In addition we are being very careful about adding mature timberland to the portfolio, demanding very good value for any investment. However, if wood prices remain depressed for an extended period of time, they could negatively impact the projections used to value our properties in future appraisals.

We have committed capital beyond that immediately available to the Company in anticipation of additional capital being raised, in particular through our C Share offering. We are comfortable with this strategy as we believe we would be able, if necessary, to sell the right to invest to other timberland investors. It is also true that some projects can be curtailed, and even cancelled, if necessary. When good projects are available, we secure them.

In addition, we are evaluating very closely those opportunities in our pipeline from distressed sellers, and have had success in several instances already. Both mature and evolving markets are experiencing contraction of capital availability and this works in our favour. We are using the market power of cash to negotiate better prices, and being extremely disciplined in selecting assets, valuing projects based on very conservative assumptions. We are conserving cash while cautiously accumulating well priced assets.

### **NET ASSET VALUE**

As at 31 December 2008, the Company's audited NAV per Ordinary Share was US\$0.99 and its audited NAV per C Share was US\$0.97.

### **DIVIDENDS**

The Board is not currently proposing a dividend for the year but will continue to review the situation.

## CHAIRMAN'S STATEMENT (continued)

### APPOINTMENTS

Since the year end, following a detailed appraisal, we have moved the Company's Administration and Secretarial requirements from Anson Fund Managers Limited to HSBC Securities Services (Guernsey) Limited and our Registrars from Anson Registrars Limited to Capita Registrars (Guernsey) Limited. In addition, we have appointed Sarah Evans as a non-executive Director to replace John Le Prevost from 30 January 2009.

### OUTLOOK

In our first two years, we have established Phaunos' strategic global footprint and we are now proceeding to execute projects within these commitments. Our intention has been to achieve a diversified "basket" of timberland and timber-related assets and this we have accomplished. We have also developed the infrastructure necessary to roll out our plans. Our goal now is to complete the portfolio commitments with the best value assets we can find.

Our strategy continues to be to emphasise young plantations, which provide the greatest value in the long-term. These investments are balanced by the addition of mature forests, which tend to be more costly and with less long-term upside, but usually provide cash flow in the short and intermediate term. In the current economic climate, we are adding mature forests very cautiously since we do not wish to harvest at reduced timber prices.

We are still in the investment stage and therefore expect expenses to exceed income for at least the next few years, especially as interest rates on cash held are low and harvesting income delayed. In the long term, we believe our investments will show good capital growth but it is difficult at present to know when asset values will recover across the world.

In conclusion, while the current economic crisis may provide opportunities it does not fundamentally alter our long term strategy.

Keith Oates

Chairman

29 April 2009

## REPORT OF THE INVESTMENT MANAGER

FourWinds Capital Management is pleased to report that we have committed all of Phaunos' capital as at 31 December 2008. As indicated in the Chairman's Statement, we have established Phaunos' global footprint and are rolling out our investment strategies in each target market. Preserving capital and implementing the Company's conservative long-range strategies have been the Investment Manager's primary goals in 2008.

Turbulent markets provide opportunity to the well positioned. Phaunos began 2008 with a strong cash balance invested in US Treasuries. As capital market constrictions began to work their way into our target markets we became increasingly cautious, discounting price expectations and reducing projected harvest volumes. We are maintaining our analytic discipline in evaluating projects and have been able to bring in some excellent opportunities on very favourable terms. There are additional attractive projects in the acquisitions pipeline that we expect to announce within the next few months. We are moving forward aggressively in all our target markets, but with very conservative underwriting standards.

Conventional timberland transactions have slowed in most markets. Pricing remains very sticky; sellers seem to be unwilling to discount properties, and buyers are unwilling to pay last year's prices. However, especially in those markets where we are buying "greenfield" properties, we are seeing some reduction in prices. This is fortuitous since it facilitates purchasing bare land and planting seedlings which is an important part of our strategy, especially in South America. Sellers with mature timber, which is more immediately convertible to cash, seem to be more reluctant to adapt to new pricing. However, we are working our way through very robust pipelines in all our markets and holding our discipline. We are actively seeking out distressed sellers. In a recession "cash is king" and we are conserving the Company's advantage.

Timber and wood prices are generally depressed and we are managing Phaunos' assets intensively. In most cases, this means cutting costs and delaying harvesting. This avoids depleting valuable forest assets until prices rebound. However, Phaunos is committed to maintaining the highest environmental standards, and we adhere to our previously stated standards as articulated by the guidelines set out in the Sustainable Forestry Initiative and, wherever possible and practicable, certify the lands under Forest Stewardship Council ("FSC") guidelines.

## REPORT OF THE INVESTMENT MANAGER (continued)

### Investments

As at 31 December 2008, the Group had committed to the following amounts to projects totalling approximately US\$659.6 million in aggregate:

1. US\$30 million to Greenwood Tree Farm, a partnership for investment in the north-western United States, which has acquired four plantations, totalling 35,000 acres of hybrid poplar tree farm in Washington and Oregon. The tree farms are certified under the stringent forest practices guidelines of the FSC. US\$29.2 million was drawn down as at 31 December 2008
2. US\$10 million to National Timber Partners Plus+, an investment partnership investing in the south-eastern United States designed to realise the “higher-and-better-use” values of timberland properties. US\$7.03 million was drawn down as at 31 December 2008.
3. US\$37.9 million to Aurora Forestal, a joint venture in northern Uruguay with 12,500 hectares planted in mixed-age pine plantations with an on-site sawmill. The tree farms are managed under FSC guidelines. US\$27.7 million was drawn down as at 31 December 2008.
4. US\$6.8 million to Caldrey SA, a new harvesting company designed to provide forestry services to the growing timber management industry in Uruguay. US\$4.9 million was drawn down as at 31 December 2008.
5. US\$5.9 million to a loan to a Netherlands not-for-profit foundation – the Masarang Foundation - which manages sustainable, economic and socially responsible forestry projects in Indonesia. US\$5.9 million was drawn down as at 31 December 2008.
6. US\$9 million to Forest Enterprise doo, a Serbian wood pellet mill operation. The mill facility is under construction and expected to be operational by summer 2009 in time for the winter heating season. US\$8.1 million was drawn down as at 31 December 2008.
7. US\$30 million to Pradera Roja, a wholly-owned company in Uruguay formed to buy land and develop new eucalyptus plantations. Over 6,100 hectares on four properties have been acquired with more in the pipeline and planting continues on the properties. US\$14 million was drawn down as at 31 December 2008.
8. US\$150 million to Eucateca, a new company formed to start new teak and eucalyptus plantations in Mato Grosso, Brazil. Over 10,800 hectares on five properties have been acquired, two for teak and three for eucalyptus, with many more properties in the pipeline. US\$47.6 million was drawn down as at 31 December 2008.

## REPORT OF THE INVESTMENT MANAGER (continued)

9. US\$200 million to Green China Forestry, a company formed to acquire existing poplar plantations, and establish new plantations, in China. The ownership and banking structures have been established and the pipeline is robust although many properties have been rejected to date. US\$4.3 million was drawn down as at 31 December 2008.
10. US\$100 million to Romfor Timber SRL, a new company established to hold investments in mature Romanian forestland. US\$0.8 million was drawn down as at 31 December 2008.
11. US\$ 36.3 million to Phaunos Norge SA, a wholly owned company which holds Phaunos' investment in a Norwegian company with extensive forestry assets in East Africa. US\$36.3 million was drawn down as at 31 December 2008.

Since 31 December 2008, the Group has added the following commitments:

- An additional US\$6.4 million has been committed to Greenwood Tree Farm to provide working capital. We have delayed harvesting mature wood from these plantations because of depressed timber markets, not wanting to sell high quality wood at too-low prices; thus, the projected revenues projected have been pushed out and further investment was requested. We still believe in the original premise of the investment, and are well disposed to commit additional capital. None of this additional capital has been drawn down to date.
- US\$50 million has been committed to Balfor Timber, a new, wholly-owned company established to hold investments in mature timberland in the Baltic countries. In consequence, we have reduced the Company's original commitment to Romfor Timber by US\$50m to fund this commitment. We consider that attractive opportunities in the Baltics will offer strong returns over time, and also enhance diversification of the Eastern European portfolio. US\$.03 million has been drawn down as at the 31 March 2009.

We have formed an extended network of professionals internationally to manage the Group's assets. In addition, the investments made by the Group are creating new jobs internationally in some of the markets in the world where they are most needed. Employing appropriate technology in rural settings, the Group can maximize the cost/benefit impact on its projects, and this can often mean adding jobs instead of capital equipment. The jobs the Group creates tend to be in rural locations and this allows people to live in their traditional homes and find work locally without abandoning their villages for jobs in the city.

## REPORT OF THE INVESTMENT MANAGER (continued)

To date, Phaunos has created almost 1,000 jobs internationally. When fully invested, Phaunos will create many more thousands of jobs. Phaunos' people – the Investment Manager's Timber Team, our in-country partners and professionals and our forestry field workers – look forward to continuing the process of building and managing a very valuable asset: Phaunos Timber Fund.

FourWinds Capital Management

29 April 2009

## REPORT OF THE DIRECTORS

The Directors present their report and audited financial statements for the year ended 31 December 2008.

### **Principal Activity and Business Review**

The principal activity of the Company is to provide its shareholders with attractive long term total returns through a diversified global portfolio of timberland and timber-related investments.

A description of the activities of the Company and its wholly owned subsidiaries (together the "Group") during the year is given in the Report of the Investment Manager on pages 13-16.

### **Status**

Phaunos Timber Fund Limited is an Authorised Closed-ended investment company, incorporated in Guernsey on 28 September 2006, with an unlimited life. The Company has two classes of shares in issue; US Dollar denominated Ordinary Shares and C Shares. The Company has raised a total of US\$557.1 million (before expenses) through several placings of Ordinary Shares and C Shares.

### **Share Issues and Repurchases**

The Company's authorised share capital is represented by an unlimited number of Ordinary Shares of no par value and 1,600,000,000 C Shares of no par value.

Initially the Company raised approximately US\$115 million through a placing of 115,150,000 Ordinary Shares at a price of US\$1 each on 20 December 2006. Subsequently, US\$370 million was raised in June 2007 through a placing of 355,769,230 Ordinary Shares at a placing price of US\$1.04 per share. These shares began trading on 5 June 2007. In July 2008, the Company raised a further US\$33 million through a placing of 31,480,376 Ordinary Shares at a price of US\$1.05 each. Trading in these shares commenced on 11 July 2008.

Through the first tranche of its placing of unlisted C Shares at US\$1.00 per share, the Company raised US\$18.5 million in October 2008. Under the second tranche of this placing, a further US\$20.37 million was raised in December 2008. During the fourth quarter of 2008, the Company acquired, by way of on market purchases, 1.34 million of its own Ordinary Shares to hold in treasury at a total cost of just over US\$987,000.

## REPORT OF THE DIRECTORS (continued)

The issued share capital of the Company as at 31 December 2008 was 501,064,606 Ordinary Shares and 38,870,000 C Shares

Originally listed on AIM and listed and traded on CISX, the Ordinary Shares of the Company were delisted from AIM and admitted to listing on the Official List of the UK Listing Authority and to trading on the Main Market of the London Stock Exchange on 10 July 2008.

The C Shares are not listed. Those currently in issue will convert to Ordinary Shares by reference to a conversion ratio determined by reference to the respective NAVs of the Ordinary Shares and the C Shares on a date which is on or before 31 December 2009, with actual conversion occurring shortly thereafter.

The Company has authority to buy back up to 14.99 per cent. of its Ordinary Shares which has been partially utilised in making the share repurchases referred to above and which expires at the conclusion of the next Annual General Meeting of the Company. The Company is seeking renewal of this authority at the 2009 Annual General Meeting again in respect of 14.99 per cent. of the Ordinary Shares in issue at the time of the 2009 Annual General Meeting. Accordingly, a resolution giving the Directors the authority to purchase up to 14.99 per cent. of the Ordinary Shares in issue will be proposed at the forthcoming Annual General Meeting.

### **Investment Objective and Investment Policy**

The investment objective and policy of the Company are as stated on page 2.

### **Results**

The results for the year are set out in the Income Statement on page 34.

### **Dividends and Dividend Policy**

The Board has considered the payment of a dividend for the year ended 31 December 2008 and has concluded that, in line with statements made in the Company's prospectus, dividends will only be paid once the Company is fully invested.

## REPORT OF THE DIRECTORS (continued)

The Directors do not expect to declare any dividends until the Group has generated significant profits. Any dividends declared may reflect capital profits to the extent that net income profits are not earned in respect of the relevant year. Dividends, if any, are expected to be paid in US Dollars.

### **Financing Strategy**

The Company's authorised share capital is such that either further issues of new Ordinary Shares or C Shares or re-issues of Ordinary Shares held in treasury can be made. Subject to prevailing market conditions, the Board may decide to make one or more further issues or re-issues of Ordinary Shares or further issues of C Shares for cash from time to time. Any further issues of new Ordinary Shares or re-issues of Ordinary Shares held in treasury will rank pari passu with Ordinary Shares in issue.

There are no provisions within the Guernsey (Companies) Law, 2008 or the Company's Articles of Incorporation providing pre-emption rights for existing shareholders on the allotment of equity securities for cash or on the re-issue of equity securities out of treasury.

Unless authorised by shareholders, the Company will not issue further Ordinary Shares or re-issue Ordinary Shares out of treasury for cash at a price below the prevailing NAV per Share unless they are first offered pro rata to existing shareholders.

The Directors do not intend to borrow, save for short-term liquidity, working capital requirements, to facilitate the Company's over-commitment policy and to fund share buybacks. However, if the Directors deem it prudent, the Group may borrow for longer term purposes. In any event the Company's power to borrow is limited to 25 per cent. of the NAV of the Company.

### **Shareholder Information**

The NAV of the Company (and hence the NAV per Ordinary Share and NAV per C Share) is calculated in US Dollars at the end of each financial year based upon information supplied by a variety of sources including third party local managers, as described below. The NAV is the value of all assets of the Company less the liabilities to creditors (including the provisions for such liabilities and net assets attributable to C shareholders) of the Company determined in accordance with the valuation guidelines adopted by the Directors from time to time.

## REPORT OF THE DIRECTORS (continued)

Under current valuation guidelines adopted by the Directors, such values are determined in accordance with the applicable accounting standards.

If the Directors consider that any of the above bases of valuations are inappropriate in any particular case, or generally, they may, with the agreement of the Auditors, adopt such other valuation procedures as they consider is reasonable in the circumstances.

All valuations of the Group's portfolio are made, in part, on valuation information provided by the third party managers of investments in the portfolio. Although the Investment Manager will evaluate all such information and data the Investment Manager is generally not in a position to confirm the completeness, genuineness or accuracy of such information or data. In addition, the financial reports typically provided to the Investment Manager are provided only on a half yearly basis and generally are issued two to three months after the respective valuation dates.

The Administrator will notify the LSE and CISX (by way of an RIS announcement) of the NAV per Ordinary Share and the NAV per C Share as soon as practicable after calculation at the end of each financial year.

Any suspension in the calculation of the NAV of the Company, to the extent required under the Articles of Incorporation of the Company or by the rules of CISX and/or the Listing, Disclosure or Transparency Rules (as the case may be) will be notified by the Administrator to the LSE, CISX and/or the public (via an RIS announcement) as soon as practicable after any such suspension occurs.

## REPORT OF THE DIRECTORS (continued)

### **Directors and their Interests**

The Directors' details are given on pages 6-7.

Directors' interests in Ordinary Shares as at 31 December 2008 are as set out below. None of the Directors had any interests in C Shares as at this date.

Director	Ordinary Shares	Percentage of issued Ordinary Shares
Keith Oates (Chairman)*	200,000	0.040
John Le Prevost (resigned 30/01/09)	0	0.000
Sarah Evans (appointed 30/01/09)	0	0.000
Liane Luke	0	0.000
Peter Niven	30,000	0.006
Kimberly Tara**	275,000	0.055

\*75,000 shares which formed part of the Chairman's 2008 remuneration were vested on the 31 December 2008.

\*\* Kimberly Tara's interest in 275,000 Ordinary Shares is in respect of Ordinary Shares owned by FourWinds Capital Management, the Investment Manager, of which Kimberly Tara is a shareholder and a director.

None of the Directors has, or has had, during the year, an interest in any transaction which is, or was, unusual in its nature or conditions, or significant to the business of the Group or which has been effected by the Group during the year, except for the interests in the Investment Manager of Kimberly Tara (by virtue of her shareholding in and directorship of the Investment Manager) and Liane Luke (by virtue of her employment by the Investment Manager), and therefore in the Management Agreement (details of which can be found in note 28).

### **Directors' Remuneration**

From 1 July 2008, the Chairman receives a fee of GBP70,000 per annum. Each of the other Directors receive a fee of GBP25,000 per annum with the exception of Kimberly Tara and Liane Luke who do not receive fees and Peter Niven who receives additional sums of GBP5,000 for his Chairmanship of the both the Audit and Management Committees making

## REPORT OF THE DIRECTORS (continued)

a total fee of GBP35,000 per annum. No commissions or performance related payments will be made to the Directors by the Group.

The aggregate remuneration and benefits in kind of the Directors in respect of the year ending on 31 December 2009 which will be payable out of the assets of the Group is not expected to exceed GBP200,000.

### **Net Asset Value**

The NAV of the Ordinary Shares, including retained earnings, as at 31 December 2008 was US\$0.99 per share. The NAV of the C Shares, including retained earnings, as at 31 December 2008 was US\$0.97 per share.

### **Corporate Governance**

Guernsey does not have its own corporate governance code and, as a Guernsey incorporated company, the Company is not required to comply with the Combined Code on Corporate Governance issued by the Financial Reporting Council (the 'Combined Code'). However, it is the Company's policy to comply with best practice on good corporate governance that is applicable to investment companies. The Board has therefore considered the principles and recommendations of the AIC's Code of Corporate Governance (the 'AIC Code') by reference to the AIC Corporate Governance Guide for Investment Companies (the 'AIC Guide'). The AIC Code, as explained by the AIC Guide, addresses all the principles set out in Section 1 of the Combined Code, as well as setting out additional principles and recommendations on issues specific to investment companies.

The Board considers that it is appropriate to report against the principles and recommendations of the AIC Code, and by reference to the AIC Guide (which incorporates the Combined Code).

The Company has essentially complied throughout the year with the recommendations of the AIC Code and the relevant provisions of the Combined Code. Since all the Directors are non-executive, in accordance with the AIC Code and the preamble to the Combined Code, the provisions of the Combined Code on the role of the chief executive and, except in so far as they apply to non-executive Directors, on Directors' remuneration, are not relevant to the Company, and are not reported on further.

## REPORT OF THE DIRECTORS (continued)

The Board meets at least four times a year and between these formal meetings there is regular contact with the Company Secretary and the Investment Manager. The Directors are kept fully informed of investment and financial controls and other matters that are relevant to the business of the Group and which should be brought to their attention. The Directors have access, where necessary to the furtherance of their duties, to professional advice at the expense of the Company.

The Board has a breadth of experience relevant to the Group and the Directors believe that any changes to the Board's composition can be managed without undue disruption. With any new Director appointed to the Board, consideration will be given as to whether an induction process is appropriate. The AIC Code and the AIC Guide are both available at [www.theaic.co.uk](http://www.theaic.co.uk)

### **Board Responsibilities**

The Board comprises five non-executive Directors, three of whom are independent. The Board meets quarterly to consider the affairs of the Group in a prescribed and structured manner. Biographies of the Directors appear on pages 6 and 7, demonstrating the wide range of skills and experience they bring to the Board.

The Board has formalised arrangements under which Directors, in the furtherance of their duties, may take independent professional advice at the Company's expense. The Directors have access to the advice and services of the Company Secretary through its appointed representatives who are responsible to the Board for ensuring that Board procedures are followed and that applicable rules and regulations are complied with.

To enable the Board to function effectively and allow Directors to discharge their responsibilities, full and timely access is given to all relevant information.

Under the Company's Articles of Incorporation, one third of the Board is subject to retirement by rotation each year, such that all Directors are required to submit themselves for re-appointment at least every three years. Being a newly appointed Director, at the forthcoming Annual General Meeting, Mrs Sarah Evans will retire and, being eligible, offers herself for re-appointment. Directors who have served for nine years or more will be subject to annual re-appointment. Pursuant to the Listing Rules, both Kimberly Tara and Liane Luke are required to retire from office at each Annual General Meeting of the Company and may offer themselves for re-appointment at each such meeting.

## REPORT OF THE DIRECTORS (continued)

### **Changes to Guernsey Company Law**

On 1 July 2008, the Companies (Guernsey) Law, 1994 was superseded by the Companies (Guernsey) Law, 2008. The Directors have adopted the provisions of the Companies (Guernsey) Law, 2008 in preparing the financial statements.

### **Audit Committee**

The Audit Committee comprises Peter Niven (Chairman), Sarah Evans and Keith Oates. (John Le Prevost was a member of this Committee until his resignation from the Board on 30 January 2009).

The function of the Audit Committee is to ensure that the Group maintains high standards of integrity, financial reporting and internal controls. The Audit Committee examines the effectiveness of the Group's internal control systems, the Annual and Interim Reports and the Financial Statements, the Auditors' remuneration and engagement, as well as the Auditors' independence and any non-audit services provided by them.

The Audit Committee receives information from the Administrator and the external Auditors as to the objectivity of their audit and their independence. The terms of reference of the Audit Committee are available on request from the Company Secretary.

### **Management Committee**

The Management Committee comprises Peter Niven (Chairman), Sarah Evans and Keith Oates. (John Le Prevost was a member of this committee until his resignation from the Board on 30 January 2009).

The function of the Management Committee is:

- to ensure that the terms of engagement with all the Company's service providers are operating satisfactorily so as to ensure the safe and accurate management and administration of the Company's affairs and business and that they are competitive and reasonable for the shareholders and to make appropriate recommendations to the Board; and

## REPORT OF THE DIRECTORS (continued)

- to ensure that the Company complies to the best of its ability with applicable laws and regulations and adheres to the tenet of generally accepted codes of conduct.

In addition, the chairmanship of the above committees and each Director's performance will be reviewed annually by the Chairman and the performance of the Chairman will be assessed by the remaining Directors.

Directors' attendance at board meetings during the year:

<b>Director</b>	<b>Quarterly Board Meetings</b>	<b>Ad-hoc Board Meetings</b>	<b>Audit Committee</b>	<b>Management Committee</b>
Keith Oates	4	6	2	1
Peter Niven	4	10	2	1
Kimberley Tara	3	6	N/A	N/A
Liane Luke	4	8	N/A	N/A
John Le Prevost	4	10	2	0

### **Internal Controls**

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness.

The Board confirms that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group. This process has been in place for the year under review and up to the date of approval of this Annual Report and Financial Statements, and is reviewed by the Board on an ongoing basis.

The Board has reviewed the effectiveness of the system of internal control; in particular, it has reviewed and updated the process for identifying and evaluating the significant risks affecting the Group and the policies by which these risks are managed.

## REPORT OF THE DIRECTORS (continued)

The internal control systems are designed to meet the Group's particular needs and the risks to which it is exposed. Accordingly, the internal control systems are designed to manage rather than eliminate the risk of failure to achieve business objectives and by their nature can only provide reasonable and not absolute assurance against misstatement and loss.

The Group does not have an internal audit department. All the Group's management and administration functions are delegated to independent third parties and it is therefore felt that there is no need for the Group to have an internal audit facility. However, this matter is reviewed periodically by the Board.

### **Investment Manager**

FourWinds Capital Management was appointed as Investment Manager of the Company on 13 December 2006. The Directors have reviewed the performance of the Investment Manager and are satisfied that the continued appointment of the Investment Manager on the terms agreed is in the best interests of the shareholders and the Company.

### **Dialogue with Shareholders**

All shareholders in the Company have the right to receive notice of, and attend, the Annual General Meeting during which the Board and the Investment Manager are available to discuss issues affecting the Company.

The Directors are always available to enter into dialogue with shareholders and the Company believes such communication to be important.

### **Annual General Meeting**

**The following information, which is to be discussed at the forthcoming Annual General Meeting of the Company, is important and requires your immediate attention. If you are in any doubt about the action you should take you should seek advice from your stockbroker, bank manager, solicitor, accountant or other financial adviser, authorised under the UK Financial Services and Markets Act 2000 (as amended). If you have sold or transferred all of your shares in the Company, you should pass this document, together with all accompanying documents, to the purchaser or transferee or to the person through whom the sale or transfer was effected for transmission to the purchaser or transferee.**

## REPORT OF THE DIRECTORS (continued)

Resolutions relating to the following items of special business will be proposed at the forthcoming Annual General Meeting of the Company. The Directors recommend that shareholders vote in favour of the resolutions which are, in the Directors' opinion, in the best interests of shareholders as a whole.

### **Resolution 8 - Authority to buy back shares**

The resolution to be proposed will seek to renew the authority granted to Directors enabling the Company to purchase its own Ordinary Shares. The Directors will consider repurchasing Ordinary Shares in the market if they believe it to be in shareholders' interests and as a means of addressing any imbalance between the supply of, and demand for, Ordinary Shares, to increase the NAV per share and to assist in maintaining a narrow discount to NAV per share in relation to the price at which the Ordinary Shares may be trading.

Purchases of Ordinary Shares will only be made through the market for cash at prices below the prevailing NAV per share. Under the Listing Rules of the Financial Services Authority the maximum price which can be paid by the Company for a share shall not be more than the higher of (i) 5 percent above the average of the mid-market values of the Ordinary Shares for the five business days immediately preceding the date of purchase, and (ii) the higher of the last independent trade and the highest current independent bid for the Ordinary Shares on the trading venue where the purchase is carried out. The Directors are seeking authority to purchase up to 14.99 per cent of the issued Ordinary Share capital of the Company at the date the resolution is passed. At the date of the publication of the notice of Annual General Meeting that represented 75,109,584 Ordinary Shares. The authority granted by the resolution will expire at the conclusion of the next Annual General Meeting of the Company or, if earlier, 14 months from the date of passing of the resolution.

The timing of any purchases by the Company pursuant to the authority will be decided by the Directors. Any Ordinary Shares bought back may be held in treasury (up to a maximum of 10 percent of the issued share capital) or be subsequently cancelled by the Company. The Company currently holds 1,335,000 Ordinary Shares in treasury, being approximately 0.26 percent of its issued Ordinary Share capital.

## REPORT OF THE DIRECTORS (continued)

### **Resolution 9 - Authority to make tender offers**

The resolution to be proposed will seek to renew the authority granted to the Directors enabling the Company to purchase its own shares pursuant to a tender offer for up to 25 percent of the issued Ordinary Shares of the Company as referred to and on such terms set out in the Prospectus issued by the Company on 5 June 2008. The Directors will consider making such a tender offer from time to time if they believe it to be in shareholders' interests and as a means of addressing any imbalance between supply of, and demand for, shares, to increase the NAV per share and to assist in maintaining a narrow discount to NAV per share in relation to the price at which the shares may be trading.

The Directors are seeking authority to make tender offers for a maximum number of Ordinary Shares up to 25 per cent. of the issued ordinary share capital. Any such tender offer will be at a maximum price (less expenses) per share below the prevailing NAV. The minimum price (exclusive of expenses) which may be paid for an Ordinary Share pursuant to a tender offer under the authority is US\$0.01. The authority granted by the resolution will expire at the conclusion of the next Annual General Meeting of the Company or, if earlier, 14 months from the date of passing of the resolution.

The timing of any purchases by the Company pursuant to a tender offer made under the authority will be decided by the Directors. Any shares bought back may be held in treasury (up to a maximum of 10 percent of the issued share capital) or be subsequently cancelled by the Company. The Company currently holds 1,335,000 Ordinary Shares in treasury, being approximately 0.26 percent of its issued ordinary share capital.

### **Resolution 10 Amendment to the Articles of Incorporation of the Company**

The resolution to be proposed will seek to amend the Articles of Incorporation of the Company in order to provide that:

- 1) each shareholder is deemed to have agreed to accept communication from the Company by electronic means unless such shareholder notifies the Company otherwise and any such notice to the Company must be in writing, signed by the shareholder and delivered to the registered office of the Company or such other place as the Board directs; and

## REPORT OF THE DIRECTORS (continued)

- 2) the holders of dematerialised shares can vote those shares using CREST Electronic Proxy Voting Service.

The full terms of the proposed amendments to the Articles of Incorporation will be available for inspection from the date of posting of this document until the close of the Annual General Meeting at the offices of Herbert Smith LLP, Exchange House, Primrose Street, London, EC2A 2HS and at the place of the Annual General Meeting for at least 15 minutes before and during the meeting.

### **Going Concern**

The Group's business activities, together with the factors likely to affect its future development, performance and position, are set out in Report of the Investment Manager on pages 13 to 16. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in this report. In addition, Note 26 to the financial statements includes the Group's objectives, policies and processes for managing its capital, its financial risk management objectives, details of its financial instruments and hedging activities and its exposures to credit risk and liquidity risk.

The Group has considerable financial resources and no external borrowings. As a consequence, the Directors believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook.

After making enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue to adopt the going concern basis in preparing the annual report and financial statements.

### **Auditors**

Ernst & Young LLP have expressed their willingness to continue in office as Auditors. A resolution proposing their re-appointment will be submitted at the forthcoming Annual General Meeting.

## REPORT OF THE DIRECTORS (continued)

### **Statement of Directors' Responsibilities**

The Directors are required to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Group as at the end of the financial year and of the profit or loss for that year. In preparing those financial statements, the Directors are required to:

1. select suitable accounting policies and apply them consistently;
2. make judgements and estimates that are reasonable and prudent;
3. state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and:
4. prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

As far as each of the Directors is aware, there is no relevant audit information of which the Company's Auditors are unaware and each Director has taken all reasonable steps he / she ought to have taken as a Director to make himself / herself aware of any relevant audit information and to establish that the Company's Auditors are aware of that information

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time, the financial position of the Group and to enable them to ensure that the financial statements have been properly prepared in accordance with the Companies (Guernsey) Law, 2008. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

### **Responsibility Statement**

To the best of the knowledge of the Directors:

The financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss and comply with International Financial Reporting Standards.

## REPORT OF THE DIRECTORS (continued)

The Chairman's Statement and Report of the Investment Manager includes a fair review of the development performance of the business, a description of the principal risks and uncertainties that it faces for the next year

By order of the Board

Keith Oates  
Chairman  
29 April 2009

Peter Niven  
Director

## REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF PHAUNOS TIMBER FUND LIMITED

We have audited the Consolidated financial statements for the year ended 31 December 2008 which comprise the Consolidated Income Statement, Consolidated Balance Sheet, Consolidated Statement of Changes in Equity, Consolidated Cash Flow Statement and the related notes 1 to 29. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with Section 262 of the Companies (Guernsey) Law, 2008. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of Directors and auditors**

The Directors are responsible for the preparation of the financial statements in accordance with applicable Guernsey law and International Financial Reporting Standards as adopted by the European Union, as set out in the Statement of Director's Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies (Guernsey) Law, 2008. We also report to you if, in our opinion, the Group has not kept proper accounting records, if the Group's financial statements are not in agreement with the accounting records, or if we have not received all the information and explanations we require for our audit.

We read other information contained in the financial statements and consider whether it is consistent with the audited financial statements. The other information comprises About the Group, Investment Objective and Policy, Directors, Investment Manager, Administrator and Company Secretary, the Chairman's Statement, the Report of the Investment Manager, Report of the Directors, Shareholder Information and Directors and Service Providers.

## REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF PHAUNOS TIMBER FUND LIMITED (continued)

We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examinations, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

### **Opinion**

In our opinion the financial statements give a true and fair view, in accordance with International Financial Reporting Standards as adopted by the European Union, of the state of the Group's affairs as at 31 December 2008 and of its loss for the year then ended and have been properly prepared in accordance with the Companies (Guernsey) Law, 2008.

Ernst & Young LLP

Guernsey, Channel Islands

29 April 2009

The financial statements are published on websites maintained by the Company's Investment Manager, FourWinds Capital Management.

The maintenance and integrity of these websites are the responsibility of Phaunos Timber Fund Limited; the work carried out by the Auditors does not involve consideration of these matters and, accordingly, the Auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in Guernsey governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

CONSOLIDATED INCOME STATEMENT  
For the year ended 31 December 2008

	Note	Year ended 31 Dec 2008 USD	28 Sep 2006 to 31 Dec 2007 USD
Net (losses) / gains on financial assets designated as at fair value through profit or loss	14	(4,770,410)	89,282
Operating income	4	<u>15,035,793</u>	<u>15,351,262</u>
Total income		10,265,383	15,440,544
Operating expenses	5	<u>(17,283,409)</u>	<u>(5,820,489)</u>
Net operating (loss) / income before taxation		(7,018,026)	9,620,055
Taxation on ordinary activities	6	<u>528,445</u>	<u>-</u>
Net (loss) / gain for the year / period attributable to shareholders		<u>(6,489,581)</u>	<u>9,620,055</u>
<b>Attributable to:</b>			
Equity holders of the parent		(6,479,759)	9,620,055
Minority interest		(9,822)	-
Net (loss) / gain for the year / period attributable to shareholders		<u>(6,489,581)</u>	<u>9,620,055</u>
		<b>Cents</b>	<b>Cents</b>
Earnings per share for the year / period – Basic and Diluted	8	(1.34)	3.54

In arriving at the results for the financial year, all amounts above relate to continuing operations.

The notes on pages 38 to 73 form an integral part of these financial statements.

CONSOLIDATED BALANCE SHEET  
as at 31 December 2008

	Note	31 Dec 2008 USD	31 Dec 2007 USD
<b>NON-CURRENT ASSETS</b>			
Financial assets designated as at fair value through profit or loss	14	99,486,532	50,197,810
Intangible assets	9	1,334	2,087
Plant and equipment	10	8,069,878	121,263
Land	11	22,641,096	-
Biological assets	12	1,248,861	-
Deferred income tax	19	510,286	-
		<u>131,957,987</u>	<u>50,321,160</u>
<b>CURRENT ASSETS</b>			
Financial assets designated as at fair value through profit or loss	14	210,198,318	-
Inventories and work in progress		1,386,089	-
Receivables	16	9,742,065	2,602,669
Cash and cash equivalents	15	186,074,469	425,863,895
		<u>407,400,941</u>	<u>428,466,564</u>
<b>TOTAL ASSETS</b>		<u>539,358,928</u>	<u>487,787,724</u>
<b>CURRENT LIABILITIES</b>			
Payables – due within one year	17	6,572,242	188,092
Net assets attributable to C Share class	18	37,791,963	-
<b>TOTAL LIABILITIES</b>		<u>44,364,205</u>	<u>188,092</u>
<b>EQUITY</b>			
Share capital	20	-	-
Share premium	22	390,546,882	358,560,982
Retained earnings	23	3,140,296	9,620,055
Distributable reserves	24	110,418,595	110,418,595
Translation reserve		(8,126,442)	-
Purchase of own shares	21	(987,436)	-
Minority interest		2,828	-
<b>TOTAL EQUITY</b>		<u>494,994,723</u>	<u>478,599,632</u>
<b>TOTAL EQUITY AND LIABILITIES</b>		<u>539,358,928</u>	<u>478,787,724</u>
<b>SHARES IN ISSUE</b>		501,064,606	470,919,230
<b>NAV PER SHARE</b>		<b>USD</b> 0.99	<b>USD</b> 1.02

The financial statements were approved by the Board of Directors on 29 April 2009 and are signed on its behalf:

Keith Oates  
Director

Peter Niven  
Director

The notes on pages 38 to 73 form an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS  
for the year ended 31 December 2008

	Note	Year ended 31 Dec 2008 USD	28 Sep 2006 to 31 Dec 2007 USD
<b>Operating activities</b>			
Net (loss) / gain for the year / period attributable to shareholders		(6,489,581)	9,620,055
Add: Net losses / (gains) on financial assets designated as at fair value through profit or loss		4,770,410	(89,282)
Less: Interest income		(10,209,652)	(15,216,801)
Less: Investment income		(420,866)	(134,461)
Add: Depreciation and amortisation		298,377	-
Add: Income tax expense		(496,360)	-
Less: Increase in biological assets and inventories		(2,839,172)	-
Add: Increase in payables		3,826,280	188,092
Less: Increase in receivables excluding accrued income		(8,933,018)	(995,627)
<b>Net cash outflow from operating activities before income</b>		<u>(20,493,582)</u>	<u>(6,628,024)</u>
Interest received		11,486,977	13,609,759
Investment income received		420,866	134,461
<b>Net cash (outflow) / inflow from operating activities</b>		<u>(8,585,739)</u>	<u>7,116,196</u>
<b>Investing activities</b>			
Purchase of financial assets		(314,222,606)	(50,108,528)
Disposals of financial assets		49,965,156	-
Purchase of intangible assets		-	(2,087)
Purchase of land, property, plant and equipment		(29,966,935)	(121,263)
<b>Net cash outflow from investing activities</b>		<u>(294,224,385)</u>	<u>(50,231,878)</u>
<b>Financing activities</b>			
Proceeds of issue of Ordinary Shares		33,054,394	485,150,000
Proceeds of issue of C Shares		38,870,000	-
Costs of issue of Ordinary Shares		(1,068,494)	(161,170,423)
Costs of issue of C Shares		(1,079,313)	-
Repurchase of shares		(987,436)	-
<b>Net cash inflow from financing activities</b>		<u>68,789,151</u>	<u>468,979,577</u>
<b>Cash and cash equivalents at beginning of year / period</b>		425,863,895	-
(Decrease) / Increase in cash and cash equivalents		(234,020,973)	425,863,895
Effect of foreign exchange rate changes		(5,768,453)	-
<b>Cash and cash equivalents at end of year / period</b>	15	<u>186,074,469</u>	<u>425,863,895</u>

The notes on pages 38 to 73 form an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY  
for the year ended 31 December 2008

	Year ended 31 Dec 2008 USD	28 Sep 2006 to 31 Dec 2007 USD
Opening balance	478,599,632	-
Issue of Ordinary Shares	33,054,394	485,150,000
Share issue costs	(1,068,494)	(16,170,423)
Purchase of own Ordinary Shares	(987,436)	-
	<hr/> 30,998,464	<hr/> 468,979,577
Net (loss) / gain for the year / period attributable to shareholders	(6,479,759)	9,620,055
Translation reserve	(8,126,442)	-
	<hr/> (14,606,201)	<hr/> 9,620,055
Minority interest	2,828	-
	<hr/> 2,828	<hr/> -
Closing balance	<hr/> <hr/> 494,994,723	<hr/> <hr/> 478,599,632

The notes on pages 38 to 73 form an integral part of these financial statements.

Notes to the Financial Statements  
for the year ended 31 December 2008

**1 ACCOUNTING POLICIES**

**(a) Basis of Preparation**

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and applicable Guernsey law and on an historical cost basis except for the measurement at fair value of certain financial instruments.

The consolidated financial statements are presented in US Dollars because that is the currency of the primary economic environment in which the Group operates.

The Group comprises the Company and entities controlled by the Company (its subsidiaries).

The consolidated financial statements are prepared to the nearest US\$1.

Comparative figures for 2007 are for the period 28 September 2006 to 31 December 2007

The following Standards and Interpretations issued by the International Accounting Standards Board and the International Financial Reporting Interpretations Committee that are expected to affect the Group have been issued but not yet adopted by the Group:

IFRS 2 (revised 2008) *Share-based Payment* effective for annual periods on or after 1 January 2009.

IFRS 3 (revised 2008) *Business Combinations* effective for annual periods beginning on or after 1 July 2009.

IFRS 8 *Operating Segments* effective for annual periods beginning on or after 1 January 2009.

IAS 1 (revised 2007) *Presentation of financial statements* effective for annual periods beginning on or after 1 January 2009.

IAS 23 (revised 2008) *Borrowing Costs* effective for annual periods beginning on or after 1 January 2009.

IAS 27 (revised 2008) *Consolidated and Separate Financial Statements* effective for annual periods beginning on or after 1 July 2009.

Amendments to IAS 32 and IAS 1 *Puttable Financial Instruments* effective for annual periods beginning on or after 1 January 2009.

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**1 ACCOUNTING POLICIES (continued)**

**(a) Basis of Preparation (continued)**

IFRS 1 and IAS 27 *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* effective for annual periods beginning on or after 1 January 2009.

IAS 39 *Eligible Hedged Items* effective for annual periods beginning on or after 1 January 2009.

IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments Disclosures – Reclassification of Financial Assets (Amendments) and Reclassification of Financial Assets: Effective Date and Transition* effective for annual periods beginning on or after 1 July 2008.

IFRS 7 *Financial Instruments: Disclosures about Financial Instruments* effective for annual periods beginning on or after 1 January 2009.

The Directors have considered the above and are of the opinion that the above Standards and Interpretations are not expected to have an impact on the Group's financial statements except for the presentation of additional disclosures and changes to the presentation of components of the financial statements. These items will be applied in the first financial period for which they are required.

Other Standards or Interpretations have been issued but are not expected to affect the Group.

**(b) Basis of consolidation**

The consolidated financial statements of the Group incorporate the financial statements of the Company and its subsidiaries made up to 31 December 2008. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. All inter-group transactions, balances, income and expenses are eliminated on consolidation.

**1 ACCOUNTING POLICIES (continued)**

**(c) Foreign currency translation**

The consolidated financial statements are presented in US Dollars, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded at the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the Income Statement.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising (where material) are classified as equity and recognised in the Group's foreign currency translation reserve. Such translation differences are recognised as income or expenses in the period in which the operation is disposed of.

**(d) Operating Income**

Interest income is accounted for on an accruals basis. Interest income relates only to interest on bank balances and money market deposits. Distributions are recognised when an entitlement to the dividend is established. Income from the sale of services is recognised upon performance of those services or the transfer of risk to the customer.

**1 ACCOUNTING POLICIES (continued)**

**(e) Taxation**

The Company has been granted exemption from Guernsey Income Tax under the Income Tax (Exempt Bodies) (Guernsey) Ordinance, 1989, and is charged an annual fee of GBP600.

Deferred income taxes are calculated using the liability method on temporary differences. Deferred tax is generally provided on the difference between the carrying amounts of assets and liabilities and their tax bases. Deferred tax is, however, neither provided on the initial recognition of goodwill, nor on the initial recognition of an asset or liability unless the related transaction is a business combination or affects tax or accounting profit.

Deferred tax assets and liabilities are calculated, without discounting, at tax rates that are expected to apply to their respective period of realisation, provided they are enacted or substantively enacted at the balance sheet date. Deferred tax liabilities are always provided for in full. Deferred tax assets are recognised to the extent that it is probable that they will be able to be offset against future taxable income.

The Company and its subsidiaries base their assessment of future taxable income on their latest approved budget forecasts, which are adjusted for significant non-taxable income and expenses and specific limits to the use of any unused tax loss or credit.

If a positive forecast of taxable income indicates the probable use of a deferred tax asset, that deferred tax asset is usually recognised in full. The recognition of deferred tax assets that are subject to certain legal or economic limits or uncertainties is assessed individually by the Group based on the specific facts and circumstances.

Changes in deferred tax assets or liabilities are recognised as a component of tax expenses in the income statement, except where they relate to items that are charged or credited directly to equity in which case the related deferred tax is also charged or credited directly to equity.

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**1 ACCOUNTING POLICIES (continued)**

**(f) Expenses**

All expenses are accounted for on an accruals basis.

**(g) Share issue costs**

The Company's shares have no fixed redemption date. Therefore the costs are written off through the statement of changes in equity.

**(h) Financial assets designated as at fair value through profit or loss**

All investments are designated as at fair value through profit or loss. Investments are initially recognised on the date of purchase at fair value. Transaction costs associated with an investment are recognised immediately in the Income Statement as an expense.

Designation of the investments in this way is consistent with the Company's documented risk management policy and investment strategy and information about the investments is provided to the Board of Directors on this basis.

After initial recognition, investments are measured at fair value, with unrealised gains and losses on investments and impairment of investments recognised in the Income Statement. Investments are derecognised on sale. Gains and losses on the sale of investments will be recognised in the Income Statement.

**(i) Intangible assets**

Intangible assets include acquired software used in administration. Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and install specific software. These items are amortised over 3 years.

Costs associated with maintaining computer software, i.e. expenditure relating to patches and other minor updates as well as their installation, are expensed as incurred.

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**1 ACCOUNTING POLICIES (continued)**

**(j) Plant and equipment**

Equipment, fittings and furniture are carried at acquisition cost less subsequent depreciation and impairment losses.

Depreciation is calculated on a straight line basis so as to write down the cost to estimated residual value over the following periods:

Land improvements	10 years
Machines and Vehicles	5 to 10 years
Computers	3 years
Other equipment	3 to 4 years

**(k) Land**

Land held for use in production or administration is stated at acquisition cost. As no finite useful life for land can be determined, related carrying amounts are not depreciated.

**(l) Biological assets**

Biological assets are considered at their cost value. This treatment applies to all newly established plantations and is in line with IAS 41. IAS41 allows for the deferral of a fair valuation if there has been little biological transformation which the Group have defined as 3 years in faster growing regions. IAS 41.24 states that "Cost may sometimes approximate fair value, particularly when, either little biological transformation has taken place since initial cost incurrence (for example, for fruit tree seedlings planted immediately prior to the end of a reporting period), or the impact of the biological transformation on price is not expected to be material (for example, for the initial growth in a 30 year pine plantation production cycle)."

**1 ACCOUNTING POLICIES (continued)**

**(m) Impairment of tangible and intangible assets**

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered any impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specified to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

**1 ACCOUNTING POLICIES (continued)**

**(n) Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost comprises the cost of direct materials and, where applicable, the cost of direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

**(o) Cash and cash equivalents**

Cash and cash equivalents are carried at cost. For the purposes of the Statement of Cash Flows, cash and cash equivalents consist of cash at bank and investments in money market funds.

**(p) Joint ventures**

The Group's joint ventures have been designated as at fair value through profit or loss.

**(q) Other provisions, contingent liabilities and contingent assets**

Other provisions are recognised when present obligations will probably lead to an outflow of economic resources from the entity and they can be estimated reliably. Timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive commitment that has resulted from past events, for example, product warranties granted, legal disputes or onerous contracts. Restructuring provisions are recognised only if a detailed formal plan for the restructuring has been developed and implemented, or management has at least announced the plan's main features to those affected by it. Provisions are not recognised for future operating losses.

**1 ACCOUNTING POLICIES (continued)**

**(q) Other provisions, contingent liabilities and contingent assets (continued)**

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the balance sheet date, including the risks and uncertainties associated with the present obligation. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Long term provisions are discounted to their present values, where the time value of money is material.

Any reimbursement that the Group can be virtually certain to collect from a third party with respect to the obligation is recognised as a separate asset. However, this asset may not exceed the amount of the related provision. All provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate of the Group's management.

In those cases where the possible outflow of economic resource as a result of present obligations is considered improbable or remote, no liability is recognised.

Probable inflows of economic benefits to the Group that do not yet meet the recognition criteria of an asset are considered contingent assets.

**(r) Share-based payments**

The Group has applied the requirements of IFRS 2 *Share-based Payment*.

Certain Group entities issue equity-settled share-based payments to certain directors. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest.

**1 ACCOUNTING POLICIES (continued)**

**(r) Share-based payments (continued)**

Subject to certain conditions, Caldrey SA, a subsidiary of the Company, has agreed to make equity-settled share-based payments to Fanerey SA in respect of services undertaken on behalf of the Group by Fanerey SA. The share-based payments will be in the form of Ordinary Shares of Caldrey SA and the maximum payments will total 50% of the share capital of Caldrey SA.

**(s) Net assets attributable to C Share class**

During the year the Company has issued C Shares which can be converted into Ordinary Shares at a date yet to be determined. Therefore, under IAS 32, these shares are classified as liabilities and are shown in the accounts at their amortised cost. As no investments have yet been made with the proceeds of the C Share issue, the fair value of the C Shares is considered to equal the amount held in the C Share bank account.

**2 CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION  
UNCERTAINTY**

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

**(a) Fair value of financial instruments**

The Directors use their judgement in selecting an appropriate valuation technique for financial instruments not quoted in an active market. For investments which have been recently acquired the directors consider the fair value to be equal to cost. The investments in National Timber Partner Timbers Fund LP and the 5 year EMTN ("Euro Medium-Term Note") linked to Timber Assets of the Masarang Foundation (the "Masarang EMTN") have been recorded at carrying value as this is considered to be a reasonable approximation of fair value. Other investments are carried at fair value based on the performance of the underlying investments. Fair values have been calculated based on the latest available published financial information of the underlying investments. Such information contains regularly updated fair values of the underlying investments.

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**3 SEGMENTAL ANALYSIS**

**Geographic segments**

The Group's operations are located in the US, South America, Asia and Europe. The following is an analysis of various items analysed by geographical area in which the assets are located.

2008	USA	South America	Asia	Europe	Unallocated	2008 Total
	USD	USD	USD	USD	USD	USD
Net losses on financial assets designated as at fair value through profit or loss	(1,691,104)	(2,738,000)	(341,306)	-	-	(4,770,410)
Operating income	265,888	1,299,912	22	39,334	13,430,637	15,035,793
Net operating (loss)/income before taxation	(1,425,353)	(4,986,448)	(2,307,291)	(381,742)	2,082,808	(7,018,026)
Total equity	-	-	-	-	494,994,723	494,994,723
Total assets	244,416,710	24,877,360	5,588,400	34,228,491	230,247,967	539,358,928
Plant, equipment and intangible assets expenditure	-	32,997,949	-	-	-	32,997,949
2007	USA	South America	Asia	Europe	Unallocated	2007 Total
	USD	USD	USD	USD	USD	USD
Net gains on financial assets designated as at fair value through profit or loss	(3,388)	-	92,670	-	-	89,282
Operating income	-	-	-	-	15,351,262	15,351,262
Net operating income before taxation	-	-	-	-	9,620,055	9,620,055
Total equity	-	-	-	-	478,599,632	478,599,632
Total assets	28,279,810	19,123,350	2,918,000	-	428,466,564	478,787,724
Plant, equipment and intangible assets expenditure	-	123,350	-	-	-	123,350

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**4 OPERATING INCOME**

	<b>31 Dec 2008</b>	<b>31 Dec 2007</b>
	<b>USD</b>	<b>USD</b>
Investment income	420,866	134,461
Bank interest	10,209,652	15,216,801
Income from sales of services	863,473	-
Foreign exchange revaluations	3,503,603	-
Sundry income	38,199	-
	<hr/>	<hr/>
	<b>15,035,793</b>	<b>15,351,262</b>
	<hr/> <hr/>	<hr/> <hr/>

**5 OPERATING EXPENSES**

	<b>31 Dec 2008</b>	<b>31 Dec 2007</b>
	<b>USD</b>	<b>USD</b>
Investment Manager's fees	8,971,876	4,835,483
Directors' remuneration	261,826	267,017
Directors' expenses	2,637	4,432
Directors' & Officers' Insurance (Phaunos Timber Fund Limited)	26,452	40,487
Directors' & Officers' Insurance (Phaunos US Inc)	127,480	58,648
Cost of sales	1,117,994	-
Employee compensation and benefits	216,699	66,293
Employee training	34,136	6,000
Motor and travel expenses	42,425	-
Repairs	41,293	-
Insurance	8,018	-
Audit fees	289,444	81,786
Regulatory fees	45,794	15,952
Administrator's fees	118,908	95,658
Registration fees	18,816	24,181
Nominated Advisor fees	44,400	99,881
Legal and professional fees	2,181,913	101,441
Transaction costs and acquisition of investments	2,490,167	-
Commissions paid	162,391	-
Foreign exchange revaluations	-	17,916
Rentals	69,807	6,621
Depreciation	298,377	-
Other taxes	348,783	56,800
Other operating expenses	363,773	41,893
	<hr/>	<hr/>
	<b>17,283,409</b>	<b>5,820,489</b>
	<hr/> <hr/>	<hr/> <hr/>

**6 TAX**

	<b>31 Dec 2008</b>	<b>31 Dec 2007</b>
	<b>USD</b>	<b>USD</b>
Deferred tax	549,004	-
Current tax	(20,559)	-
	<hr/>	<hr/>
	<b>528,445</b>	<b>-</b>
	<hr/> <hr/>	<hr/> <hr/>

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**6 TAX (continued)**

All tax charges for the year relate to continuing operations. Taxation for jurisdictions outside those of the Group is calculated at the rates prevailing in the respective jurisdictions.

	<b>31 Dec 2008 USD</b>	<b>31 Dec 2007 USD</b>
(Loss) / profit before taxation	(7,537,211)	9,620,055
Tax at the Guernsey corporation tax rate of 0%	-	-
Effects of different tax rates of subsidiaries operating in other jurisdictions	528,445	-
Tax credit and effective tax rate for the period	<b>6.74%</b>	-

**7 DIRECTORS' REMUNERATION**

Each Director of the Company receives a fee of GBP25,000 per annum from the Company, except for the Chairman, who receives GBP70,000 per annum. Peter Niven also receives additional sums of GBP5,000 for his Chairmanship of the Audit Committee and GBP5,000 for his Chairmanship for the Management Committee. Liane Luke and Kimberley Tara do not receive a Director's fee. On 31 December 2008, a further amount of USD75,000 was received by the Chairman in the form of shares.

	<b>31 Dec 2008 USD</b>	<b>31 Dec 2007 USD</b>
Fees	186,826	192,017
Share-based awards	75,000	75,000
	<b>261,826</b>	<b>267,017</b>

**8 EARNINGS PER SHARE**

Earnings per Ordinary Share is based on the net loss for the year attributable to shareholders of USD6,489,581 (2007: USD9,620,055 gain for the period) and on 485,808,820 (2007: 271,719,465) Ordinary Shares, being the weighted average number of Ordinary Shares in issue during the year. There are no dilutive instruments and therefore basic and diluted earnings per share are identical.

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**9 INTANGIBLE ASSETS**

	31 Dec 2008 USD	31 Dec 2007 USD
<b>Cost</b>		
Cost at 1 January 2008	2,087	2,087
Disposals	-	-
Cost at 31 December 2008	<u>2,087</u>	<u>2,087</u>
<b>Amortisation</b>		
Amortisation at 1 January 2008	-	-
Charge for the period	753	-
Amortisation at 31 December 2008	<u>753</u>	<u>-</u>
<b>Net book value</b>		
At 31 December 2008	<u>1,334</u>	<u>2,087</u>

**10 PLANT AND EQUIPMENT**

	31 Dec 2008 USD	31 Dec 2007 USD
<b>Cost</b>		
Cost at 1 January 2008	121,263	-
Additions	8,246,239	121,263
Cost at 31 December 2008	<u>8,367,502</u>	<u>121,263</u>
<b>Depreciation</b>		
Depreciation at 1 January 2008	-	-
Charge for the period	297,624	-
Depreciation at 31 December 2008	<u>297,624</u>	<u>-</u>
<b>Net book value</b>		
At 31 December 2008	<u>8,069,878</u>	<u>121,263</u>

**11 LAND**

	31 Dec 2008 USD	31 Dec 2007 USD
<b>Cost</b>		
Cost at 1 January 2008	-	-
Additions	24,751,710	-
Exchange differences	(2,110,614)	-
Cost at 31 December 2008	<u>22,641,096</u>	<u>-</u>

In accordance with the Group's accounting policy land is not depreciated

<b>Net book value</b>		
At 31 December 2008	<u>22,641,096</u>	<u>-</u>

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**12 BIOLOGICAL ASSETS**

Biological Assets are held by Pradera Roja and consist of Eucalyptus plantations in Uruguay for both the fibre and sawn wood markets. Eucalyptus is typically grown on a seven year rotation for fibre or energy or a fifteen to twenty-two year rotation for sawtimber. Uruguay is one of the key timber markets in Latin America where timber exports grew 32% in 2007, reaching USD243 million.

**13 INVESTMENTS IN SUBSIDIARIES**

Investments in subsidiaries consist of investments in the following wholly-owned companies:

<b>Company</b>	<b>Place of Incorporation</b>
Caldrey SA	Uruguay
Cottage International Group Limited	British Virgin Islands
Eucateca SA	Brazil
Exclusive Technologies Limited	British Virgin Islands
Forest Enterprise BV	Netherlands
Forest Enterprise DOO	Serbia
Green China Forestry Company Limited	Hong Kong
Hamar Holding Limited	British Virgin Islands
Nora Timber Cyprus Limited	Cyprus
Nortimber BV	Netherlands
Oxford Financial Investments Limited	British Virgin Islands
Phaunos Brazil Investimentos Florestais LTDA	Brazil
Phaunos China Limited	Hong Kong
Phaunos Norge AS	Norway
Phaunos US Incorporated	USA
Pradera Roja SA	Uruguay
Romfor Timber (Cyprus) Limited	Cyprus
Romfor Timber BV	Netherlands
SC Romfor Timber SRL	Romania
South Hampton International Limited	British Virgin Islands
Tura Holding Limited	British Virgin Islands
Wood NRG Limited	Cyprus

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**14 INVESTMENTS**

<b>FINANCIAL ASSETS DESIGNATED AS AT FAIR VALUE THROUGH PROFIT OR LOSS</b>	<b>31 Dec 2008 USD</b>	<b>31 Dec 2007 USD</b>
Opening portfolio cost	50,108,528	-
Additions at cost	314,222,606	50,108,528
Disposals at cost	(49,928,195)	-
Closing portfolio cost	314,402,939	50,108,528
Unrealised appreciation on valuation brought forward	(3,388)	-
Unrealised depreciation on valuation for the year	(4,373,395)	(3,388)
Unrealised foreign exchange movement brought forward	92,670	-
Unrealised foreign exchange movement for the year	(433,976)	92,670
Unrealised (depreciation) / appreciation and foreign exchange movement on valuation carried forward	(4,718,089)	89,282
Closing valuation	309,684,850	50,197,810
Non-current assets	99,486,532	50,197,810
Current assets	210,198,318	-
	309,684,850	50,197,810
Unrealised (depreciation) / appreciation and foreign exchange movement on valuation for the year	(4,807,371)	89,282
Realised gain on disposal of investments	36,961	-
Net (losses) / gains on financial assets designated as at fair value through profit or loss	(4,770,410)	89,282

The nature of the investments designated at fair value through profit or loss is as follows:

**Non-current**

GreenWood Tree Fund LP	Timber operation
Balerio – Aurora Forestal	Joint venture
EMTN linked to Timber Assets of the Masarang Foundation	Loan
National Timber Partners Timber Fund LP	Investment in limited partnership
Green Resources AS (Norway)	Loan and investment in equity

**Current**

US Treasury Bills 22/1/09	Financial instrument
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The investment in Green Resources AS (Norway) includes a convertible loan from Phaunos Norge AS to Green Resources AS of NOK67, 510,000. Phaunos Norge AS may exercise its conversion rights in part or in full at the conversion price of NOK33 per share at any time within the conversion period, being from 4 December 2008 until 30 November 2010.

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**14 INVESTMENTS (continued)**

Should Phaunos Norge AS choose not to exercise its conversion rights, the loan shall be repaid in one amount on the expiry, dated 28 February 2011.

**15 CASH AND CASH EQUIVALENTS**

	<b>31 Dec 2008 USD</b>	<b>31 Dec 2007 USD</b>
Cash at bank	159,021,140	3,964,046
Money market funds	27,053,329	421,899,849
	<u>186,074,469</u>	<u>425,863,895</u>

In the Directors' opinion the risk of changes in market value of the money market fund is insignificant.

**16 RECEIVABLES**

	<b>31 Dec 2008 USD</b>	<b>31 Dec 2007 USD</b>
Trade receivables	570,678	-
Prepayments	2,916,499	884,545
Accrued income	329,717	1,607,042
Taxation	79,107	-
Sundry receivables	5,846,064	111,082
	<u>9,742,065</u>	<u>2,602,669</u>

**17 PAYABLES**

(amounts falling due within one year)

	<b>31 Dec 2008 USD</b>	<b>31 Dec 2007 USD</b>
Trade payables	2,970,796	-
Accrued audit fees	107,566	61,046
Accrued administrator fees	7,887	19,664
Accrued registration fees	1,949	1,985
Other accrued expenses	325,307	7,742
Sundry payables	3,158,737	97,655
	<u>6,572,242</u>	<u>188,092</u>

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**18 NET ASSETS ATTRIBUTABLE TO C SHARE CLASS**

	31 Dec 2008 USD	31 Dec 2007 USD
Net assets attributable to C Share class	<u>37,791,963</u>	-
Net asset value per C Share	<u>0.97</u>	-

The issue of C Shares took place as follows:

Date of issue	Number of shares	Price per share USD	Amount received USD
9 October 2008	18,500,000	1.00	18,500,000
22 December 2008	<u>20,370,000</u>	1.00	<u>20,370,000</u>
	<u>38,870,000</u>		<u>38,870,000</u>

**Reconciliation of carrying amount:**

Issue proceeds	38,870,000
Issue costs	(1,079,313)
Income in relation to C Share class	1,285
Expenses in relation to C Share class	<u>(9)</u>
Net assets attributable to C Share class	<u>37,791,963</u>
Net asset value per C Share	<u>0.97</u>

The C Shares will be converted into Ordinary Shares at a rate based on the NAV of the respective share classes on a date to be determined, but no later than 31 December 2009, as set out in the Company's prospectus dated 5 June 2008, which can be found on the Company's website, [www.phaunostimber.com](http://www.phaunostimber.com). The actual date of conversion will take place after the respective NAVs have been calculated.

**19 DEFERRED TAX**

Temporary differences as at 31 December 2008 include:	Carrying Value	Tax Value	Temporary difference	Tax rate	Deferred tax
Property, plant and equipment	2,509,048	2,009,111	(499,937)	25%	(124,984)
Intangible assets	1,333	1,476	143	25%	36
Other financial assets	20,000	16,465	(3,535)	25%	(884)
Tax losses available to be carried forward		1,347,207	1,347,207	25%	336,802
Tax losses available to be carried forward		2,993,160	2,993,160	10%	<u>299,316</u>
Deferred tax asset					<u>510,286</u>

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**20 SHARE CAPITAL**

**Authorised, issued and fully paid**

	<b>31 Dec 2008 USD</b>	<b>31 Dec 2007 USD</b>
Unlimited Ordinary Shares of no par value	-	-

The issues of Ordinary Shares took place as follows:

<b>Date of issue</b>	<b>Number of shares</b>	<b>Price per share USD</b>	<b>Amount received USD</b>
20 December 2006	115,150,000	1.00	115,150,000
5 June 2007	355,769,230	1.04	370,000,000
	<hr/>		<hr/>
As at 31 December 2007	470,919,230		485,150,000
<b>Purchase of own Ordinary Shares held in treasury</b>			
10 July 2008	31,480,376	1.05	33,054,396
21 November 2008	(140,000)	0.70	(98,000)
24 November 2008	(250,000)	0.70	(175,000)
25 November 2008	(160,000)	0.71	(113,600)
26 November 2008	(10,000)	0.73	(7,300)
1 December 2008	(275,000)	0.77	(210,375)
2 December 2008	(150,000)	0.78	(116,250)
3 December 2008	(100,000)	0.79	(78,500)
4 December 2008	(25,000)	0.80	(20,000)
5 December 2008	(225,000)	0.79	(177,750)
	<hr/>		<hr/>
As at 31 December 2008	<u>501,064,606</u>		<u>517,207,621</u>

The holders of the Ordinary shares and C shares will, under general law, be entitled to participate in any surplus assets in a winding-up only in proportion to their shareholdings in the appropriate class.

As detailed above and in note 21, the Company purchased 1,335,000 of its own Ordinary Shares during the year.

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**21 PURCHASE OF OWN SHARES**

	<b>31 Dec 2008 USD</b>
Treasury Shares reserve as at 1 January 2008	-
Purchased during the year	987,436
	<hr/>
Treasury Shares reserve as at 31 December 2008	<u>987,436</u>

The Treasury Shares reserve represents 1,335,000 Ordinary Shares purchased in the market at various prices per share ranging from USD0.70 to USD0.80 and held by the Company in treasury. These shares may be re-issued or cancelled.

At the Annual General Meeting of the Company held on 23 May 2008, it was resolved that the Company be authorised to make market purchases of shares, provided that the number of shares purchased does not exceed 14.99% of the number of Ordinary Shares in issue on the date the resolution was passed. The number of shares in issue at the date the resolution was passed was 470,919,230. The number of shares held in treasury by the Company at the year end represents 0.28% of the Ordinary Shares in issue at the date the resolution was passed.

The Company's authority to make purchases of its own issued Ordinary Shares will expire at the conclusion of each Annual General Meeting of the Company. A renewal of such authority to make purchases of Ordinary Shares will be sought from shareholders at each Annual General Meeting of the Company. Under such authority, the Directors only intend to purchase shares where they believe such purchases will result in an increase in the NAV per share and will assist in narrowing any discount to the NAV per share at which the shares trade. When Ordinary Shares trade at a substantial discount to NAV per share and do not coincide with trading volumes in the market, the Directors feel that it is appropriate to exercise such authority.

Notes to the Financial Statements (continued)  
for the year ended 31 December 2008

**22 SHARE PREMIUM**

	<b>31 Dec 2008 USD</b>
Share premium as at 28 September 2006	-
Share premium on initial raising 20 December 2006 (Ordinary Shares)	115,150,000
Share premium on second raising 5 June 2007 (Ordinary Shares)	370,000,000
Less: Share issue costs	(16,170,423)
Transfer to distributable reserves	(110,418,595)
	<hr/>
Share premium as at 31 December 2007	358,560,982
Share premium on further issue 10 July 2008 (Ordinary Shares)	33,054,394
Less: Share issue costs	(1,068,494)
	<hr/>
Share premium	<u>390,546,882</u>

**23 RETAINED EARNINGS**

	<b>31 Dec 2008 USD</b>	<b>31 Dec 2007 USD</b>
Retained earnings as at 1 January 2008	9,620,055	-
Net (loss) / gain for the year / period attributable to shareholders	(6,479,759)	9,620,055
	<hr/>	<hr/>
Retained earnings as at 31 December 2008	<u>3,140,296</u>	<u>9,620,055</u>

**24 DISTRIBUTABLE RESERVES**

	<b>31 Dec 2008 USD</b>	<b>31 Dec 2007 USD</b>
Distributable reserves as at 1 January 2008	110,418,595	-
Transferred from share premium	-	110,418,595
	<hr/>	<hr/>
Distributable reserves as at 31 December 2008	<u>110,418,595</u>	<u>110,418,595</u>

The above distributable reserves relate only to the Ordinary Share class.

The Company has passed a special resolution reducing the amount standing to the credit of the share premium account on the initial raising to USD nil, and transferring the balance to a distributable reserve. In accordance with the Companies (Guernsey) Law, 1994 (as amended) (the "Companies Law"), the Directors applied to the Royal Court in Guernsey for an order confirming such reduction of the share premium account. The distributable reserve created on cancellation is available as distributable profits to be used for all purposes permitted by the Companies Law, including the buy back of Ordinary Shares and the payment of dividends.

**25 FINANCIAL INSTRUMENTS**

The Group's main financial instruments comprise:

- (a) Cash and cash equivalents that arise directly from the Group's operations;
- (b) Investments in unlisted entities;
- (c) Net assets attributable to C Share class (financial liabilities); and
- (d) Investments in US Treasury Bills.

**26 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES**

The main risks arising from the Group's financial instruments are market price risk, liquidity risk, interest rate risk, credit risk and foreign exchange risk. The Board regularly reviews and agrees policies for managing each of these risks and these are summarised below:

**(a) Market Price Risk**

Market price risk arises mainly from uncertainty about future prices of financial instruments held. It represents the potential loss the Group might suffer through holding market positions in the face of price movements. The Investment Manager actively monitors market prices and reports to the Board as to the appropriateness of the investments held.

There is also a further risk due to the small number of large investments made by the Group. Such a concentration of investments subjects the Group to increased exposure to significant declines in the value of one investment. The Investment Manager actively monitors the appropriateness of such investments held and reports to the Board on the same.

**26 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)**

**(a) Market Price Risk (continued)**

It is the intention of the Directors, subject to market conditions, for the Group to be substantially invested (i.e. 80-85 per cent) or committed in accordance with its investment policy at all times, although the Investment Manager may exercise its discretion to hold cash or cash equivalent instruments. Pending such investment the Group's net funds are invested in fixed income investments (including but not limited to bank deposits, bonds or government issued treasury securities) for the purpose of protecting the capital value of the Group's cash assets.

Details of the Group's Investment Objective and Policy are given on page 2.

*Physical risks associated with timber*

Timberland is subject to a number of natural forces that can damage or destroy growing trees. These include weather events (tornados, hurricanes, ice and snow storms, frost), insects and diseases, and fire. While some trees might be destroyed during one of these events (particularly tornados), most of these events will leave dead standing trees or leave live trees that are damaged and take a year or two to recover. This is likely to adversely affect the Group's operating and financial condition. However, much of the killed merchantable timber is salvable after such events, so some value can be recovered.

*Economic risks associated with timber*

The Group's operating revenues depend on the prevailing market prices for timber and wood products. Decreases in demand or increases of supply in those products may reduce prices, which may reduce the Group's revenues and the value of its timber.

The demand for timber is a derived demand, based on the demand for products such as paper and paperboard, lumber, panels and energy. Changes in the demand for those products will affect the demand for timber and the Group's revenues. The demand for paper and paperboard (and through them the demand for pulpwood) is related to the general level of economic activity. Low economic growth rates may lead to a lessening of demand for pulpwood and lower prices.

**26 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)**

**(a) Market Price Risk (continued)**

The demand for lumber and panels (and through it the demand for sawlogs, veneer logs and pulpwood used in manufacturing panels) is related to construction and remodelling activity. A reduction in such activity may lead to a lessening of demand for logs. The demand for energy (and through it the demand for logging and mill residues, chips and fuelwood) is related to the general level of economic activity and the price of oil. Decreases in oil prices may lead to a decrease in demand for wood-based energy.

*Political risks associated with timber*

Changes in laws related to forest management and environmental legislation may adversely affect the Group's ability to harvest timber as planned. Regulations might require the Group to reduce harvesting or set aside some land for active timber management or restrict the movement of logs across political boundaries. Such regulatory changes might reduce the volume of timber that can be harvested from Group lands and reduce revenues.

*Risk concentrations*

Management measures the geographical and species concentrations of the Group's investment portfolio. The risk exposures of the investment portfolio, excluding the US Treasury Bills, which represent 67.9% of the portfolio, are:

	<b>31 Dec 2008</b> <b>% of total</b> <b>investments</b>	<b>31 Dec 2007</b> <b>% of total</b> <b>investments</b>
<i>Geographic analysis</i>		
USA	11.1	56.3
South America	8.0	37.9
Europe	11.2	-
Asia	1.8	5.8
<hr/>		
<i>Species analysis</i>		
Financial instruments	1.7	5.7
Timber related projects	2.5	-
Eucalyptus	5.0	-
Teak	0.6	7.7
Poplar	9.1	48.7
Pine	13.2	37.9
<hr/>		

**26 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)**

**(a) Market Price Risk (continued)**

*Price sensitivity*

The following details the sensitivity of the Group's investment portfolio, excluding the US Treasury Bills and Masarang EMTN, to a 5% increase and decrease in the market prices, with 5% being the sensitivity rate used when reporting price risk internally to key management personnel and representing management's assessment of the possible change in market prices.

At 31 December 2008, if market prices had been 5% higher with all the other variables held constant, the net result attributable to shareholders for the year would have been USD4,694,907 (2007: USD2,363,991) greater, due to the increase in the fair value of financial assets designated as at fair value through profit or loss. This would represent an increase in total assets of 0.87% (2007: 0.49%).

If market prices had been 5% lower with all the other variables held constant, the net result attributable to shareholders for the year would have been USD4,694,907 (2007: USD2,363,991) lower, due to the decrease in the fair value of financial assets designated as at fair value through profit or loss. This would represent a decrease in total assets of 0.87% (2007: 0.49%).

**(b) Liquidity Risk**

Liquidity risk is the risk that the Group will encounter difficulty in realising assets or otherwise raising funds to meet financial commitments.

Since not all of the Group's investments will be income generating the Group retains a proportion of its liquid assets in cash or near-cash investments for working capital purposes.

The following illustrates the maturity analysis of the Group's financial assets and liabilities as at the year end:

## 26 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

### (b) Liquidity Risk (continued)

	Due on demand	Due <3 months	Due between 3 and 12 months	Due >5 Years	Total
	USD	USD	USD	USD	USD
<b>Assets</b>					
Investments designated as at fair value	-	210,198,318	-	99,486,532	309,684,850
Trade and other receivables	-	-	9,742,065	-	9,742,065
Cash and cash equivalents	186,074,469	-	-	-	186,074,469
<b>Total assets</b>	<b>186,074,469</b>	<b>210,198,318</b>	<b>9,742,065</b>	<b>99,486,532</b>	<b>505,501,384</b>
<b>Liabilities</b>					
Trade and other payables	-	-	6,572,242	-	6,572,242
<b>Total liabilities</b>	<b>-</b>	<b>-</b>	<b>6,472,242</b>	<b>-</b>	<b>6,572,242</b>

Net assets attributable to the C Share Class have been excluded from the analysis as the maturity of the C Shares and subsequent conversion to Ordinary Shares will have no impact on the Group's liquidity.

At the year end, the Company has made a further commitment totalling USD50.0 million into a new venture. The Company has also made further commitments to provide funding of around USD425.6 million into investments existing at 31 December 2008. The Company is intending to raise further funding from share issues in order to meet the commitments noted above. There is a potential liquidity risk to the Company if such further funding is not obtained.

### (c) Interest Rate Risk

The Company holds cash in a money market fund, the return on which is subject to fluctuations in market interest rates.

The weighted average effective interest rate for cash and bank balances as at 31 December 2008 was 3.34% (2007: 5.22%).

The Masarang EMTN earns interest at a fixed rate of 12% per annum. The convertible loan investment in Green Resources AS earns interest at a fixed rate of 12% per annum. None of the other assets or liabilities of the Group attract or incur interest.

**26 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)**

**(c) Interest Rate Risk (continued)**

*Interest rate sensitivity*

If interest rates had been 25 basis points higher and all other variables were held constant, the Group's net assets attributable to shareholders as at 31 December 2008 would have increased by approximately USD465,200 or 0.09% (2007: USD1,064,700 or 0.22%) of total assets, due to an increase in the amount of interest receivable on the bank balances.

If interest rates had been 25 basis points lower and all other variables were held constant, the Group's net assets attributable to shareholders as at 31 December 2008 would have decreased by approximately USD465,200 or 0.09% (2007: USD1,064,700 or 0.22%) of total assets due to a decrease in the amount of interest receivable on the bank balances.

It is not possible to quantify the potential interest rate sensitivity regarding the investments in the Masarang EMTN and Phaunos Norge that contain fixed interest rate items. However it is not thought that this would represent a material amount given the value of these investments in relation to the Group as a whole.

**(d) Credit Risk**

There is a credit risk relating to the Group's investments in joint ventures and other non-wholly owned operations, where the Group has limited control over its investment. There is a further credit risk (although extremely remote) relating to the significant amount invested in the Royal Bank of Scotland Global Treasury Fund ("the GTF"), and the risk of the GTF not honouring the full amount. The Board attempts to minimise such risk by ensuring that due diligence is undertaken prior to any investment and by obtaining regular performance information regarding these investments from the Investment Manager. It also monitors credit ratings to ensure that cash and bank balances are maintained with an institution holding at least an Aa1 credit rating. The gross credit exposure to the Group arising from the above items is shown in notes 14 and 15.

**26 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)**

**(d) Credit Risk (continued)**

The Company has entered into a 5 year zero coupon note with a maturity rate of 12% compounded annually (the "Masarang.EMNT"). Under the terms of a term sheet dated 4 September 2007, entered into between the Company and Masarang Foundation, the Masarang Foundation has pledged 300 hectares of Cempaka and Wasian plantation on the Masarang Foundation property in the North Sulawesi Province of Indonesia as security against the Masarang EMTN. However, no independent valuation is available for this security. The gross credit exposure to the Group under the Masarang EMTN was USD5,588,400 as at the end year end.

The Company has also invested in a convertible loan to Green Resources AS as disclosed in note 14. Should Phaunos Norge AS choose not to exercise its conversion rights, the loan is repayable in full on 28 February 2011. There is a risk that Green Resources AS may be unable to fulfil its obligations to repay the outstanding loan amount or accrued interest. In the event of any such default, Phaunos Norge AS would be entitled to convert the loan principle and accrued interest into shares in Green Resources AS priced at NOK15 per share or may, at its discretion take every measure necessary to recover the loan and all other amounts under the Loan Agreement in accordance with Norwegian law. Under these circumstances, the loan shall have the same rank and priority as the existing ordinary debt of Green Resources AS .

The Group has receivable balances from many sources at the year end. These have been reviewed for credit quality and it has been confirmed that there are no bad debts or items that are past due but not impaired.

**26 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)**

**(e) Foreign Exchange Risk**

The Group undertakes certain transactions denominated in foreign currencies. Hence exposures to exchange rate fluctuations arise. Exchange rate exposures are managed by minimising the amount of foreign currency held at any one time.

The carrying amounts of the Group's foreign currency denominated monetary assets (bank balances) at 31 December 2008 are as follows:

	<b>31 Dec 2008</b>	<b>31 Dec 2007</b>
	<b>USD</b>	<b>USD</b>
GBP	4,895	7,686
Euro	80,767,321	2,825,330
Brazilian Reals	26,659,681	-
Norwegian Krone	50,898	-
	<hr/> <hr/>	<hr/> <hr/>

*Foreign exchange sensitivity*

The Group's exposure to the Euro is mainly through holding the Masarang EMTN and the significant amount of Euro currency invested in the Royal Bank of Scotland Global Treasury Fund.

If USD against the Euro rate had been 5% higher and all other variables were held constant, the Group's net assets attributable to shareholders as at 31 December 2008 would have increased by approximately USD4,317,786 (2007: USD287,167) due to an increase in the value of the Masarang EMTN and the translation of the Euro currency invested in the Royal Bank of Scotland Global Treasury Fund.

If USD against the Euro rate had been 5% lower and all other variables were held constant, the Group's net assets attributable to shareholders as at 31 December 2008 would have decreased by approximately USD4,317,786 (2007: USD287,167) due to a decrease in the value of the Masarang EMTN and the translation of the Euro currency invested in the Royal Bank of Scotland Global Treasury Fund.

The Group's exposure to the Brazilian Real is mainly due to the significant amount of Brazilian currency invested in Itau Bank short term investment accounts.

**26 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)**

**(e) Foreign Exchange Risk (continued)**

If USD rates against the Brazilian Real had been 5% higher and all other variables were held constant, the Group's net assets attributable to shareholders as at 31 December 2008 would have increased by approximately USD1,332,984 (2007: USD Nil) due to the translation of the Brazilian Real currency.

If USD rates against the Euro had been 5% lower and all other variables were held constant, the Group's net assets attributable to shareholders as at 31 December 2008 would have decreased by approximately USD1,332,984 (2007: USD Nil) due to the translation of the Brazilian Real currency.

**(f) Capital Management**

The investment objective of the Company is to provide shareholders with attractive long term returns, expected to be in the form of capital appreciation but with some income, through a diversified portfolio of timberland and timber-related investments.

Details of the Company's Investment Objective and Policy are given on page 2 of these audited financial statements.

Pursuant to the Company's original prospectus, dividends will only be considered once the Company is fully invested. The Directors do not expect to declare any dividends until the Group has generated significant profits. Any dividends declared may reflect capital profits to the extent that net income profits are not earned in respect of the relevant year. Dividends, if any, are expected to be paid in US Dollars.

As the Company's Ordinary Shares are traded on the LSE, the Ordinary Shares may trade at a discount to their net asset value per share on occasion. However, in structuring the Company, the Directors have given detailed consideration to the discount risk and how this may be managed.

**26 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)**

**(f) Capital Management (continued)**

Upon Admission on 11 June 2008, the Directors were granted authority to buy back up to 14.99 per cent of the Ordinary Shares in issue following Admission. The Company's authority to make purchases of its own issued Ordinary Shares will expire at the conclusion of the next following Annual General Meeting. A renewal of such authority to make purchases of Ordinary Shares will be sought from shareholders at each Annual General Meeting of the Company. The timing of any purchases will be decided by the Board.

The Directors intend that purchases will only be made pursuant to this authority through the market, for cash, at prices below the prevailing net asset value per share where the Directors believe such purchases will result in an increase in the net asset value per share of the remaining Ordinary Shares and to assist in narrowing any discount to net asset value per share at which the Ordinary Shares may trade.

Any Ordinary Shares bought back by the Company will either be held by the Company in treasury (and which may be re-issued) or forthwith be cancelled.

As at the year end, the Company has purchased 1,335,000 Ordinary Shares during the year, at various prices per share ranging from USD0.70 to USD0.80 as detailed in note 21. These shares are held by the Company in treasury.

Following approval of the Court in Guernsey, the Company resolved to cancel the amount standing to the credit of its share premium account following Admission. The amount released on cancellation has been credited as a distributable reserve in the books of account and may be used by the Company for the purpose of funding purchases of its Ordinary Shares as described above and for the payment of dividends.

**26 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)**

**(f) Capital Management (continued)**

The Company's authorised share capital is such that either further issues of new Ordinary Shares or re-issues of Ordinary Shares held in treasury can be made. Subject to prevailing market conditions, the Board may decide to make one or more further such issues or re-issues of Ordinary Shares for cash from time to time. Any further issues of new Ordinary Shares or re-issues of Ordinary Shares held in treasury will rank pari passu with Ordinary Shares in issue.

There are no provisions of the Companies (Guernsey) Law, 2008 or the Articles of Incorporation of the Company providing pre-emption rights for existing shareholders on the allotment of equity securities for cash or on the re-issue of equity securities out of treasury.

As at the year end, the Company has issued 38,870,000 C Shares which can be converted into Ordinary Shares as detailed in note 18.

Unless authorised by shareholders, the Company will not issue further Ordinary Shares or re-issue Ordinary Shares out of treasury for cash at a price below the prevailing net asset value per share unless they are first offered pro rata to existing shareholders.

The Group monitors capital on the basis of the carrying amount of equity as presented on the fact of the balance sheet. Capital for the reporting periods under review is summarised as follows:

	<b>31 Dec 2008</b>	<b>31 Dec 2007</b>
	<b>USD</b>	<b>USD</b>
Share premium	390,546,882	358,560,982
Retained earnings	3,140,296	9,620,055
Distributable reserves	110,418,595	110,418,595
Translation reserve	(8,126,442)	-
Purchase of own shares	(987,436)	-
	<hr/>	<hr/>
Total	<u>494,991,895</u>	<u>478,599,632</u>

**26 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)**

**(f) Capital Management (continued)**

The Group is not subject to externally imposed capital requirements.

**27 CAPITAL COMMITMENTS**

At the year end, the Group has made a further commitment totalling USD50.0 million into a new venture. This investment will be made in Eastern Europe.

At the year end the Group has also made further commitments to provide additional funding of around USD425.6 million into existing investments. As at the date of this report, USD52.4 million of these commitments have been fulfilled by the Group. The remaining commitments are open-ended, carry no due date and are paid when the funding is required.

**28 RELATED PARTIES**

During the year under review, Anson Fund Managers Limited was the Company's Administrator and Secretary, Anson Registrars Limited was the Company's Registrar, Transfer Agent and Paying Agent and Anson Administration (UK) Limited was the UK Transfer Agent. During the year under review, John Le Prevost was a director of Anson Fund Managers Limited, Anson Registrars Limited and Anson Administration (UK) Limited. USD137,724 (2007: USD119,839) of costs were incurred by the Company with these related parties in the year, of which USD9,836 (2007: USD21,649) was due to these related parties as at 31 December 2008.

FourWinds Capital Management is the Company's Investment Manager. Liane Luke is a senior consultant to the FourWinds Capital Management group. Kimberly Tara is also a director and shareholder of Fourwinds Capital Management. USD7,836,061 (2007: USD4,835,483) of costs were incurred by the Company with this related party in the year, of which USD nil (2007: USD nil) was due to this related party as at 31 December 2008.

**28 RELATED PARTIES (continued)**

Under the terms of the Investment Management Agreement, the Manager is entitled to receive a base fee together with reimbursement of reasonable expenses incurred by it in the performance of its duties. The base fee will be equal to 0.375 per cent. per quarter of the NAV of the Company, calculated quarterly and payable in advance, using an implied straight-line increase in NAV of 10 per cent. per annum on a basis which increases 2.5 per cent. per quarter. As the quarterly calculation is based on an estimated NAV, following the calculation of the audited NAV at the end of each financial period, the base fee payable over such financial period will be recalculated and any deficiency will be payable by the Company to the Investment Manager. To the extent that such post-audit recalculation demonstrates that an excess fee has been paid, any such amount will be deducted from the payment due in respect of subsequent periods, up until the amount equal to the excess has been repaid.

In addition, the Investment Manager is entitled to a performance fee if the net asset value per share at the end of each Performance Period exceeds the Performance Hurdle for such financial period as defined in the Company's prospectus.

Under the terms of the Investment Management Agreement, FourWinds Capital Management will continue as the Company's Investment Manager unless the agreement is terminated by either party giving to the other not less than 36 months' notice. Such notice cannot be given earlier than the seventh anniversary of the initial admission, that being 20 December 2013. The Investment Manager Agreement may be terminated with immediate effect in such circumstances as the liquidation of either the Company, the Investment Manager or FourWinds Capital Management, or a material breach of its obligations by the Investment Manager not remedied within 28 days of receiving notice of such breach.

Directors' remuneration is disclosed in Note 7.

**28 RELATED PARTIES (continued)**

There are no other key management personnel other than the Directors.

The Company has an agreement with Fanerey, the Manager of Caldrey SA (Note 13), under which up to 50% of Caldrey SA's shares will be transferred to the Manager based on performance over an extended period.

**29 EVENTS AFTER THE BALANCE SHEET DATE**

There have been no events since the Balance Sheet date requiring disclosure that have not already been disclosed in the financial statements.

SCHEDULE OF INVESTMENTS AS AT 31 DECEMBER 2008

<b>NAME OF INVESTMENT</b>	<b>NATURE OF INVESTMENT</b>	<b>VALUATION USD</b>	<b>TOTAL NET ASSETS %</b>
Greenwood Tree Farm Fund	Timber operation	26,982,975	5.44%
Balerio – Aurora Forestal	Timber operation	24,877,360	5.02%
5 Year EMTN linked to Timber Assets of the Masarang Foundation	Loan	5,588,400	1.14%
National Timber Partners Timber Fund LP	Financial instrument	7,235,417	1.47%
Forest Enterprise BV	Timber operation	-	0.00%
Pradera Roja SA	Timber operation	-	0.00%
Romfor Timber BV	Timber operation	-	0.00%
Eucateca SA	Timber operation	-	0.00%
Green China Forestry Company Limited	Timber operation	-	0.00%
Green Resources AS (Norway)	Loan and investment in equity	34,228,491	6.90%
US Treasury Bills 22/1/09	Financial instrument	210,198,318	42.35%
		<u>309,756,850</u>	<u>62.45%</u>

SCHEDULE OF INVESTMENTS AS AT 31 DECEMBER 2007

<b>NAME OF INVESTMENT</b>	<b>NATURE OF INVESTMENT</b>	<b>VALUATION US\$</b>	<b>TOTAL NET ASSETS %</b>
Greenwood Tree Farm Fund	Timber operation	24,428,572	5.10%
Balerio – Aurora Forestal	Timber operation	19,000,000	3.97%
5 Year EMTN linked to Timber Assets of the Masarang Foundation	Loan	2,918,000	0.61%
National Timber Partners Timber Fund LP	Financial instrument	3,851,238	0.80%
Forest Enterprise BV	Timber operation	-	0.00%
Pradera Roja	Timber operation	-	0.00%
Romfor Timber	Timber operation	-	0.00%
Caldrey SA	Timber operation	-	0.00%
Eucateca SA	Timber operation	-	0.00%
Green China Forestry Company Limited	Timber operation	-	0.00%
Green Resources AS (Norway)	Loan and investment in equity	-	0.00%
US Treasury Bills 22/1/09	Financial instrument	-	0.00%
		<u>50,197,810</u>	<u>10.50%</u>

## SHAREHOLDER INFORMATION

The Ordinary Shares are traded on the LSE Main Market and CISX. The Ordinary Shares may be dealt in directly through a stockbroker or professional adviser acting on an investor's behalf. The buying and selling of Ordinary Shares may be settled through CREST.

The ISIN, SEDOL and the LSE mnemonic of the Ordinary Shares are:

ISIN	SEDOL	LSE mnemonic
GG00B1G3RS66	B1G3RS6	PTF

The C Shares are not currently listed or traded on any stock exchange and applications for C Shares must be made through placings of C Shares announced by the Company from time to time.

### **Shareholder Enquiries**

The Company's CREST compliant registrar is, as at the date of publication of these financial statements, Capita Registrars (Guernsey) Limited, who maintains the Company's registers of shareholders. They may be contacted by telephone on +44 (0)1484 600927.

Further information regarding the Company can be found on its website at [www.phaunostimber.com](http://www.phaunostimber.com).

For information about investing in the Company contact [info@fourwindscm.com](mailto:info@fourwindscm.com).

## DIRECTORS AND SERVICE PROVIDERS

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### **Registered Office**

Arnold House  
St Julian's Avenue  
St Peter Port  
Guernsey  
GY1 3NF

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### **Directors**

Keith Oates  
John Le Prevost – Resigned 30/01/09  
Liane Luke  
Peter Niven  
Kimberly Tara  
Sarah Evans – Appointed 30/01/09

### **Corporate Broker**

Shore Capital & Corporate Limited  
Bond Street House  
14 Clifford Street  
London  
England  
W1S 4JU

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### **Sponsor to CISX Listing**

Ozannes  
PO Box 186  
1 Le Marchant Street  
St Peter Port  
Guernsey  
GY1 4HP

### **Auditors**

Ernst & Young LLP  
PO Box 9  
14 New Street  
St Peter Port  
Guernsey  
GY1 4AF

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### **Investment Manager**

FourWinds Capital Management  
Scotia Bank Building  
PO Box 268GT  
George Town  
Grand Cayman  
Cayman Islands

### **Administrator (until 20 February 2009)**

Anson Fund Managers Limited  
Anson Place  
Mill Court  
La Charroterie  
St. Peter Port  
Guernsey GY1 1EJ

### **Administrator (from 20 February 2009)**

HSBC Securities Services (Guernsey) Ltd  
Arnold House  
St. Julian's Avenue  
St Peter Port  
Guernsey  
GY1 3NF

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### **Registrar (until 20 February 2009)**

Anson Registrars Limited  
Anson Place  
Mill Court  
La Charroterie  
St. Peter Port  
Guernsey  
GY1 1EJ

### **Registrar (from 20 February 2009)**

Capita Registrars (Guernsey) Ltd  
Longue Hougue House  
St. Sampson  
Guernsey  
GY2 4JN

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DIRECTORS AND SERVICE PROVIDERS (continued)

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**UK Transfer Agent**

**(Until 20 February 2009)**

Anson Administration (UK) Limited  
3500 Parkway  
Whiteley  
Fareham  
Hampshire  
England  
PO15 7AL

**UK Transfer Agent**

**(from 20 February 2009)**

Capita Registrars Ltd  
The Registry  
34 Beckenham Road  
Beckenham  
Kent  
England  
BR3 4TU

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