Rubicon Annual Shareholders' Meeting – 3 December 2015

Luke Moriarty – CEO's address

Good afternoon ladies and gentlemen.

Let me begin today with a discussion of <u>**ArborGen**</u>**.**

As you know, ArborGen is all about driving a 'step-change' in global forestry productivity, lifting the quality of genetics embedded inside the seedlings being planted.

In order to ensure its progress remains on track, ArborGen breaks this larger goal down into annual **measurable milestones**. Last year we actually published precisely what those **internal targets were for 2015** - let's take a look now to see how ArborGen fared against each of them.

- **Worldwide**, ArborGen wanted to lift volumes 10% and increase revenue 15-20%.

  <u>This was achieved – volumes increased to 309 million, up 17%, as was revenue</u>

- **In the US**, the target was to increase volume by 10%, to in excess of 270 million seedlings, with around 20% of these in advanced genetics.

  <u>These were achieved – 282 million seedlings were produced, up 15% y-o-y</u>

- ArborGen also set the goal of locking up the equivalent of 30% of its US loblolly pine volumes under long-term contracts.

  <u>This was also achieved – a critical milestone that demonstrates the importance of ArborGen to the industry.</u>

- **In Australasia**, the goals were to lift revenue 15-20%, with 85% of volume to be sold as advanced genetics.

  <u>Revenue actually lifted 21%, and the 85% target was also met.</u>

- **In Brazil**, the targets were to sell between 5-10 million eucalyptus seedlings, and sell out the order book for the next year.

  <u>Both of these targets were achieved.</u>

A purpose of these short-term production and sales goals, was also to help ensure ArborGen would be on track for an **EBITDA positive 'run-rate'** (inclusive of the expensing of all research and development costs) as it enters calendar '16. We believe this will be the case, as long as industry replanting levels increase in line with the recovering US housing market, and ArborGen meets its aggressive production ramp-up targets in Brazil.

In our Annual Review we wrote of the current constraints in ArborGen's advanced genetics inventory. While ArborGen forecasts that it will have sufficient advanced product supply to meet demand long-term, in the immediate next few years that will not be the case … with market demand likely outstripping ArborGen's ability to supply.

So, in order **to expand supply,** ArborGen is currently trialling (with initial volumes of MCP and varietal seedlings) **a technology-blend**, of traditional propagation and production methods with ArborGen's advanced biotechnology techniques. The goal here is not only to expand the inventory of advanced genetics, but also **to lower the cost of production** of ArborGen's highest value varietal products. Progress to date has been positive, and over a two year or so period ArborGen should be able to build production to a level more commensurate with market demand for these higher value products. In addition, trials to date indicate that a materially lower cost of production can be achieved from a blended technology approach than is the case under the current pure biotechnology technique.

During the year, ArborGen published the results of a **16-year MCP trial** in Berkley County, in the US. This trial provides a great illustration of what can be achieved with MCP genetics.

- The first conclusion from the data is that 'out of the blocks' the MCP growth rate was ahead of the industry standard OP seedling, and it has continued like that right through the 16 years to today. The comparable performance is shown in this graph by way of the differential gain of MCP over OP.

- The second point from the data is a simple value conclusion – and that is, that even taking into account the much higher cost of the ArborGen MCP seedling, an acre of land planted in MCP more than doubles the land-owner's financial return in NPV[1] terms. In a nutshell that is the ArborGen advanced genetics proposition - you can either pay 16-17 cents for an ArborGen seedling and double your economic return per acre, or instead pay 6 cents for the industry standard seedling and stay where you are. It's just not a tough decision to be honest.

ArborGen is continuing its expansion in Brazil, with an aggressive goal of trebling its production there this next year. In addition, as we have noted previously, ArborGen also continues to investigate a China 'toe in the water'. US-domestic opportunities are also under consideration. These are each fundamental growth initiatives for the company, which ultimately also require funding decisions to be made. But there are always trade-offs in this debate … and we need to be certain that the relationship between strategic growth <u>and</u> funding needs <u>and</u> ultimate value recognition for shareholders is fully understood. Put another way, we do not want to be investing capital today that will not generate a value return for our shareholders within their investment horizon. An internal review is underway at ArborGen to consider this very point, and out of that will come the ArborGen financing strategy. Needless to say, all three partners remain aligned that a **value realisation outcome** for shareholders, sooner rather than later, is the strongly desired outcome.

My Chairman will add some further colour to my ArborGen comments later on in the meeting.

Now let's turn to **<u>Tenon.</u>**

2015 saw Tenon deliver on a series of milestones designed to strengthen its strategic positioning, and to lift its operational and financial performance. These included –

- **Expanding its Syndicated Bank financing facility** – increasing its size to US$75 million, under more favourable borrowing rates, with the elimination of some previously constraining covenants, and with increased flexibility around shareholder payments.

- **The manufacturing upgrade program** at Tenon's world-class clear-wood manufacturing site, in Taupo NZ is nearing completion. This program involves the commissioning of two separate upgrades – the first is designed to increase the recovery of high-value clear wood from each log cut at the sawmill, and the second is designed to convert that additional lumber into Tenon's highest value product – clear boards for sale into Europe and North America. These two projects combined have a capital cost of more than US$7 million, and a forecast annual EBITDA[2] gain of over US$4 million. The first of these projects was commissioned in August, and is now running ahead of target conversions – so we are very happy about that. The second project will be commissioned in February/March, and we believe it will quickly deliver the targeted gains also.

- **New business** was won in the National Home Centre market (with expanded boards and stair parts programs), pro-dealer 'step out' territory growth commenced, and Tenon's position in each of these channels was strengthened.

- **The restructuring of the North American distribution activities was completed.** Management structures were aligned around Tenon's two key customer channels – i.e. the *national home centre activities* which focus on the DIY customer in the remodelling and renovation market, and *pro-dealer activities* which focus on the new home construction market.

- As part of this restructuring a range of **operational improvement initiatives** were completed, that will generate significant gains to Tenon's future earnings and balance sheet. By way of a few examples, these included –

    - The implementation of an **advanced demand planning and forecasting model,** which will optimise inventory and working capital needs … ensuring Tenon is always in-stock, but not over-stocked;

    - A fundamental change in **procurement model and practises**, designed to improve margins as we support Tenon's product and service offering to its customers;

    - A fundamental review Tenon's **logistics model** is currently underway – this review is designed to optimise the performance of Tenon's trucking fleet which travels more than 5 million miles each year across the US, servicing more than 4,500 distinct locations each week;

    - And in April next year Tenon will be **consolidating two Texas warehouses** into a single facility. Shown here in concept form (as it is currently under construction), the facility is 'state of art', purpose built for our needs … and at 370,000 square feet it will be our largest single warehouse location. The consolidation will deliver gains through lower rent and related overheads, improved logistics, and improved customer service and delivery metrics.

- And of course, while all of this has been going on in the background, **the macro-environment for Tenon has continued to improve** – both US housing activity and the NZ dollar are now presenting themselves as tailwinds rather than headwinds. The current NZ:US$ cross rate of around 65 cents is a more comfortable zone – a far cry from the outlier period of an 80 cent dollar that the industry endured for several years. The near term bets are on the US fed raising interest rates and the RBNZ lowering them – one or other, or both, should have a further positive impact on the NZ:US$ for Tenon.

  Offsetting this, of course, is the potential for interest rate rises in the US to slow housing activity and demand in the immediate term – but it is unlikely to be anything other than that – i.e. a slowing of <u>short-term</u> growth. Underlying housing and demographic fundamentals continue to support a <u>longer-term</u> recovery in housing activity towards mid-cycle conditions, and that is the basis on which we are positioning Tenon.

- The operational initiatives Tenon has been focusing on this past year have begun to show through in earnings. Last month Tenon announced its (unaudited) **financial result for the first <u>three</u> months** of the new fiscal 2016 (June) year, which was EBITDA[2] of $6 million (after expensing project costs and FX losses of $1 million). Excluding those costs, at $7 million this result was <u>more than double</u> the previous year's result for the same quarter … and it was equivalent to the result for the entire first <u>six</u> months of last year. So Tenon is now starting to lift its earnings base, and it's fair to say it is operating at a higher 'run rate' than even the first quarter's $6 million EBITDA reflects.

- All of this has begun to be reflected in the **Tenon share price** – as this graph shows. As you can see, there is no doubt that Tenon has materially out-performed all the major global indices – including the NZX50 here in New Zealand, which is very pleasing. However, on a comparable company trading basis, we believe Tenon has been, and still is, materially undervalued.

  Accordingly, the Tenon Board has put in place two **shareholder value initiatives** –

  - The first is the **commencement of dividend payments**, which began this year with the first payment having been made last month. It goes without saying that this dividend flow is very helpful to Rubicon at this juncture, as it assists nicely with our future ArborGen funding commitments.

  - The second Tenon initiative is the undertaking of a **Strategic Review,** which Tenon publicly announced a few months ago. The purpose of this Review is to determine the risk-adjusted path most likely to close the Tenon share price value gap. Obviously, this is a critical process for Tenon … which will also have flow-on value impact to Rubicon shareholders, so we are naturally very interested in the outcome.

And this is probably an appropriate time for me to conclude my remarks for today, and to hand you back to our Chairman, who will pick up the story-line from here.

Thank you for your time today.

[1] This is actually a reference to Bare Land Value (BLV) – BLV is an economic return concept in forestry, and it is is equivalent to the net present value (NPV) of an acre of perpetual forest.

[2] EBITDA refers Earnings before interest, tax, depreciation and amortisations. Although it is a non-GAAP measure, Tenon and Rubicon believes it provides useful information, as it is used internally to evaluate performance and it is also a measure that equity analysts focus on for comparative company performance purposes, as the measure removes distortions caused by the difference in asset age and depreciation policies.