ANNUAL REPORT

12 MONTHS ENDED 30 JUNE 2016

(Released 29 August 2016)

There are forward-looking statements included in this document. As forward-looking statements are predictive in nature, they are subject to a number of risks and uncertainties relating to Tenon, its operations, the markets in which it competes and other factors (some of which are beyond the control of Tenon). As a result of the foregoing, actual results and conditions may differ materially from those expressed or implied by such statements. In particular Tenon's operations and results are significantly influenced by the level of activity in the various sectors of the economies in which it competes, particularly in North America. Fluctuations in industrial output, commercial and residential construction activity, capital availability, housing turnover and pricing, levels of repairs, remodelling and additions to existing homes, new housing starts, relative exchange rates, interest rates, and profitability of customers, can each have a substantial impact on Tenon's results of operations and financial condition. Other risks include competitor product development and demand and pricing and customer concentration risk. Tenon is currently undertaking a Strategic Review, the announcement of which has positively impacted the Tenon share price and closed much of the value-gap that the Board determined warranted the Review taking place. The outcome of the Strategic Review is unknown and uncertain (although a Blue Wolf Capital offer has been announced today in respect of Tenon's North American division), and this could impact (positively or negatively) the Tenon share price moving forward. Grant Samuel is preparing a valuation report for Tenon shareholders, which shows a value range of NZ$3.01 - NZ$3.25 per Tenon share assuming completion of the Blue Wolf offer, however that value is subject to a number of uncertainties and risks beyond the control of Tenon, and it is also pre transaction / wind-up costs. The actual outcome will be determined by the Strategic Review process, which may differ materially from the indicative Grant Samuel valuation. As a result of the foregoing, actual results and conclusions may differ materially from those expressed or implied by such statements.

All references in this document to $ or "dollars" are references to United States dollars unless otherwise stated.

Tenon's financial year is 30 June.

Tenon Highlights - 2016

Shareholder Value Announcements

- **Strategic Review progressing** –

  - Blue Wolf Capital ("Blue Wolf") offer received today for Tenon's North American operations -
    - US$110 million purchase price
    - Implied FY'16[6] EBITDA[5] multiple of 7.3x (adjusted for the LSCFP[8])
    - Offer to go to Tenon shareholders for approval in November
    - Will be combined with large shareholder pro-rata capital return
    - Grant Samuel to prepare independent report for Tenon shareholders
    - All Tenon debt to be repaid on closing

  - Separate Review process in relation to Australasian Clearwood assets continuing

- Tenon final dividend[2] of NZ6.50 cps announced, up 30% on last year's final dividend

- **Circa 50% Total Shareholder Return[9]** (share price gain and dividends paid, adjusted for FX movement) since announcement of Strategic review in August 2015[1]

Financial and Operational

- **Improved operational earnings performance**

  - **Revenue[4] of $430 million, up 9%** (cpp[7] $396 million excl forest/log sales[4])

  - A goodwill write-down of $31 million recorded in relation to Blue Wolf offer along with $3 million of Strategic Review costs expensed, saw a reported **net loss after tax of $(21) million.**

  - **Excluding both those items, net profit after tax more than doubled, to $13 million** (cpp $6 million), and this was after expensing $3 million of restructuring/impairment costs in North America and Australasia (refer EBITDA commentary below).

  - **Gross margin expanded to 26%** (cpp 24% adjusted for forest and log sales)

    Operating Profit lifted 130% to $23 million (cpp $10 million) and **EBITDA[5] doubled to $26 million** (cpp $13 million)**,** prior to the $31 million goodwill write-down noted above in relation to the Blue Wolf offer, $3 million of Strategic Review costs, and $3 million of restructuring/impairment costs

- **Key operational initiatives were completed –**
    - **The two NZ manufacturing capital projects, totalling $7 million, were concluded -**
        - The optimising edger was commissioned in August / September ‘15, the ripline project was commissioned in April / May ’16, and both are achieving targeted benefits
        - Annualised EBITDA benefits projected to exceed $4 million pa
    - **Texas warehouse consolidation completed -**
        - 367,000 sq ft building was completed in Texas in June ‘16
        - Houston and Dallas facilities now consolidated into this new mega-facility
        - Logistics, efficiency and rental gains moving forward
    - **New procurement and forecasting system (Data Profits) now in place**
    - **New business won -**
        - New, and extended, National Home Centre product programmes won (e.g. hardwood boards, commodity boards, etc)
    - **Territories expanded** -
        - Pro-dealer regional expansion implemented (e.g. Louisiana and New York)
- **Balance sheet strengthened –**
    - **Net cash from operating activities lifted materially, to $35 million** (cpp $2 million)
    - **Closing debt (net of cash balances) reduced by $22 million, to $36 million** (cpp $58 million), reflecting -
        - Cash flow from operations, less –
            - $3 million expenditure on the completion of the NZ manufacturing projects, and $2 million in other capex (e.g. IT-related spend in NA distribution activities)
            - $5 million in shareholder dividend payments
            - $3 million in financing costs

Outlook

- **US housing market to continue to improve**
- **NZ$:US$ cross rate forecast to decline again from current levels as the year advances**
- **Operational initiatives put in place in FY’16 to be reflected in FY’17 earnings**
- **EBITDA[5] and Net Earnings targeted to improve[3] further**

12 Months' Highlights – 30 June 2016

Shareholder Letter

Dear Shareholder,

<u>2016 Performance</u>

The old adage that *"the better the company's operating performance, the less that needs to be said"* certainly applies to Tenon's fiscal 2016 operational performance. Accordingly, we are able to keep the operational overview section of our annual letter to you quite brief.

2016 was a strong performance year for us – not only in terms of financial results, but also in terms of setting the platform for future growth. In no particular order –

- We completed our two large **capital upgrade projects at Taupo**, to their combined budget and commissioning timelines. The technology implicit in these projects now provides us with greater 'cut' flexibility, improves recovery of higher value grades and through-put efficiencies, and offers us improved responsiveness to changes in market demand, by product type. The $4 million pa additional EBITDA[5] that should flow from these two projects will also be a strong positive for next year's earnings.

- We continued to **grow our distribution footprint in the US**, expanding territories and launching new product programmes.

- In June, we completed the **consolidation of our two Texas warehouses** into one mega-facility in Dallas. This new purpose built 367,500 sq ft facility will allow us to better serve our customers in the region, whilst reducing our cost base moving forward through rent and logistics savings.

- We implemented a new **demand planning / procurement system** in our North American distribution operations. The targeted benefits include better inventory management and increased sales across any given 12 month period. While we are still in the "bedding down" phase of the implementation, we believe by the end of the current calendar year the majority of the on-going operational benefits from this system will be in place.

- We did incur restructuring/impairment costs in FY'16 (e.g. $2 million in relation to our Australian operations, given Woolworths decision to close its Australian Masters home improvement chain, and $1 million in relation to the Texas warehouse consolidation), however these were fully expensed in the period and we believe that having them behind us will be a positive for us moving into FY'17.

- **Operating profit lifted 130% and our EBITDA[5] doubled** (excluding project costs, goodwill write-down relating to the Blue Wolf offer (refer detailed discussion below), and restructuring / impairment costs noted above).

- We generated $35 million in net cash from operating activities in the period – a strong improvement on the $2 million generated in the cpp, which helped us reduce our net debt to $36 million at balance date (cpp $58 million).

- Last August we announced the commencement of dividend payments, and we paid our first dividend of NZ5.0 cps (in November) in respect of the financial year ended 30 June 2015, and then in April 2016 we made a further payment of NZ5.75 cps in respect of the interim fiscal 2016 period. Today we are now **announcing a final dividend in respect of our fiscal 2016 year, of NZ6.50 cps. This final dividend represents a 30% increase on last year's final dividend**, and is the second successive increase in our dividend rate. This dividend will be paid on 16th September 2016, to Tenon shareholders on the share register as at 5pm, 12th September 2016.

Strategic Review

In August last year we announced that the Board had determined to undertake a Strategic Review of the Company to help determine the most appropriate risk-adjusted value path forward for Shareholders, in order to close the perceived value-gap that was evident in the share trading price at that time. The Board appointed Deutsche Bank and Deutsche Craigs to assist us in that endeavour, and soon after – in October last year – we announced that we had received expressions of interests in Tenon that required us to run a sales process, as one of the key value alternatives open to us to close the value gap.

Much has happened since then. For a start, our earnings profile has begun to prove out as we had projected, with EBITDA[5] doubling in FY'16 y-o-y. Our cash generation has also strengthened materially, with the Company repaying $22 million of its net debt balance in this last fiscal year alone. And our share price has increased significantly. When we announced the Strategic Review last year, we had not begun to pay dividends, the NZ$:US$ FX cross rate was under 65 cents, and the Tenon share price was around NZ$2.00. As at the time of writing this report, the cross rate was over 72 cents, we had announced three dividends over the past 12 months totalling NZ17.25 cps, and the Tenon share price was over NZ$2.50. Adjusting for dividends paid and FX rate movements, the total return to Tenon shareholders since the Strategic Review announcement in August last year (i.e. the past 12 months) has been circa 50%, so we have been very pleased with the return over this period, and particularly with the closing of much of the value gap that has occurred since the announcement of the Review.

The sales process that Deutsche has run determined that there were distinct buyer classes for each of our North American distribution operations and our NZ manufacturing activities, and that in order to optimise value for shareholders separate review processes should be run in respect of these two asset classes. Today we have received a signed offer from Blue Wolf (a North American Private Equity firm operating in the forest and wood products arena) to acquire our North American operations only, for US$110 million – our large New Zealand manufacturing and sales operations fall completely outside of this offer *(please refer attached disclosure which gives further detail of the transaction terms)*. The offer price reflects a 7.3x multiple on our North American division's FY'16 last 12 months' EBITDA[5] (adjusted for the Lowe's supply chain financing programme, which had a balance of $20 million at 30 June '16). We have taken a $31 million goodwill write-down in our 30 June financial statements in order to align the carrying value of our North American assets with the Blue Wolf offer price, and this is disclosed on the face of the Income Statement. It is important to understand that our assets have always been accounted for under IFRS at their "value-in-use" (i.e. their value to Tenon under our continued ownership and control, through the cycle), which you will understand can be quite different from a purchase offer received at any point in time, particularly in early cyclical recovery. Accordingly, while we may have aligned our carrying values with Blue Wolf's offer price, we do not believe this write-down should in any way cloud your judgement as to the strength of the underlying operational performance of Tenon's North American operations in FY'16, or its prospects in FY'17 and beyond.

In this respect we have engaged Grant Samuel to produce an independent report on the proposal for shareholders, to help you assess whether you wish to vote in favour of the Blue Wolf offer, as ultimately it is shareholders who will decide rather than the Tenon Board. **The Board believes it is very important that you have the opportunity to vote on this proposal, and the Tenon Board is unanimously recommending the offer to Tenon shareholders. Approval of the Blue Wolf Offer and completion of the deal would see all of Tenon's debt repaid, and a large (exact amount yet to be finalised) pro-rata cash capital return made to all Tenon shareholders.**

As noted above, Tenon would still maintain its large high-value clearwood manufacturing and sales operation in New Zealand (itself subject to the on-going Review), which in FY'16 reported revenue of circa US$90 million (including Australia). To help you with your overall consideration, Grant Samuel will be assessing the value of Tenon as a whole, inclusive of the New Zealand assets, as part of their valuation report for shareholders. Grant Samuel has yet to complete its final Report, but has confirmed to the Tenon Board today that the Blue Wolf offer is within its assessment of the valuation range for our North American operations, of $108.1 - $129.5 million. Grant Samuel has also provided an indicative value range for the Company as a whole, of NZ$3.01 - NZ$3.25 per share assuming the Blue Wolf offer proceeds, using current exchange rates, inclusive of the value of the NZ manufacturing operations not subject to the Blue Wolf offer, and pre transaction / wind-up costs. Of course, you will realise this is a valuation report only, and not a 'realised value' or 'promise', as the outcome will ultimately be determined by the conclusion of the Company's Strategic Review process later this year. As soon as we have the final Grant Samuel report we will be distributing it to all shareholders, along with the necessary shareholder meeting notice materials, which will outline all relevant details in relation to the Blue Wolf offer. Our expectation is that we will be holding a shareholder meeting to address the Blue Wolf offer, together with the court-approved capital return proposal, in November this year.

If shareholders elect not to proceed with the Blue Wolf offer, we have determined that, from a strategic perspective, we will still continue with the NZ manufacturing Strategic Review process to see where that leads, and we will also continue to run the Company for value as we did in fiscal '16. In that scenario, the Board's intent would also be to re-leverage the Company to market levels and simultaneously return a sizeable amount of capital to shareholders. We believe that in the absence of a sales outcome, the return of capital to shareholders at this point in the Company's life remains the best use of the surplus cash being generated today (in the absence of any obvious acquisition target).

Finally, on behalf of Board and management I would like to thank all our stakeholders for their continued support – as always, it is very much appreciated.

Sincerely,

Luke Moriarty (on behalf of the Board)
Chairman
29 August, 2016

Footnotes –

[1] This is for the period from 28 August '15 through to the writing of this report, adjusting for the November and April dividends.

[2] Imputation credits will not be attached to the dividend, due to Tenon's current non-tax paying position in New Zealand.

[3] Future actual earnings, cash flow, net debt and dividend payment outcomes will be dependent upon continued US housing market recovery, interest rates, NZ$:US$ cross rate, and the Strategic Review (amongst other drivers, many of which are beyond Tenon's control). In particular, the guidance noted herein assumes no adverse changes in either macro-market conditions, and assumes a NZ$:US$ cross rate level similar to that which prevailed in FY'16.

[4] Revenue historically includes the sale of logs at the NZ (Taupo) manufacturing site under back-to-back forest stumpage arrangements. As planned, these arrangements terminated during our FY'15 fiscal year. Whilst additive to revenue, these log sales were carried out at zero margin and did not contribute to Net Earnings. The log sales number included in revenue in FY '15 was $6 million. Revenue also includes the sale of residual forest assets (from time to time) that the Group holds. The revenue from the sale of forests in FY'15 was $4 million. Revenue excluding both forest and back-to-back stumpage sales was $396 million for FY'15. There was no revenue in FY16 relating to either of these items.

[5] EBITDA (i.e. Earnings before Interest, Taxation, Depreciation and Amortisations) is a non-GAAP earnings figure that equity analysts tend to focus on for comparable company performance, because that number removes distortions caused by differences in asset ages, depreciation policies, and debt:equity structures. Refer also to Note 1 of our 30 June 2016 Condensed Financial Statements. Tenon's EBITDA is calculated as Net Profit after Taxation of -$21 million (cpp $6 million), plus Tax Expense of $4 million (cpp $nil), plus Financing Costs of $3 million (cpp $4 million), plus depreciation and amortisations of $3 million (cpp $3 million). We incurred restructuring/impairment costs of $3 million in the period, Strategic Review costs of $3 million, and a goodwill write-off in relation to he Blue Wolf offer of $31 million (cpp $nil), meaning that EBITDA pre these costs was $26 million (cpp $13 million).

[6] Tenon's fiscal year is 30 June, so FY'16 refers to the 12 months ending 30 June 2016.

[7] cpp refers to the corresponding prior period – i.e. the comparable 12-month period to 30 June 2015 (i.e. FY'15).

[8] LSCFP refers to the Lowe's supply chain financing programme, which had a balance of $20 million at 30 June 2016.

[9] Adjusting for share price, FX movements, and dividends.

SUMMARY OF KEY BLUE WOLF CAPITAL TRANSACTION TERMS

1. **Business being disposed of:** Tenon's North American manufacturing, marketing and distribution business, through the sale of 100% of the shares in its US holding company, NACS USA Inc. in a debt-free, cash-free transaction.

2. **Consideration:** US$110,000,000 payable in cash. The purchase price is subject to an adjustment payment / receipt for variance (beyond an agreed +/- US$3 million no-adjustment band), against a set target level of net working capital for the sale business on closing. Tenon will be responsible for some non-material transaction-related costs.

3. **Key conditions:** The sale is subject to the satisfaction or waiver of certain conditions, including -
   - Tenon Limited shareholder approval for the purposes of NZX Main Board Listing Rule 9.1;
   - US antitrust approval; and
   - there having been no material adverse change in sale business between signing and closing.

4. **Potential termination events:** Either party may terminate the transaction if -
   - the sale does not close by 31 December 2016; or
   - Tenon Limited shareholders do not approve the sale for the purposes of NZX Main Board Listing Rule 9.1; or
   - there is a permanent injunction or other restraint against the sale.

   The purchaser can also terminate the transaction if -
   - the Tenon Board withdraws its recommendation of the sale; or
   - Tenon wilfully and materially breaches its obligations in relation to non-solicitation of alternative transactions.

   Tenon may terminate the transaction if it is entering into an alternative transaction as a result of the Tenon Board determining that it is required to do so in order to comply with its fiduciary duties.

   Tenon must pay a termination fee of US$3.3 million if -
   - it terminates the Sale and Purchase Agreement in order to enter into an alternative transaction; or
   - the purchaser terminates the Sale and Purchase Agreement because the Tenon Board has withdrawn its recommendation of the sale; or
   - Tenon has received a public proposal for an alternative transaction, and subsequent to receipt the sale transaction is terminated by either party because of a Tenon shareholder vote against the sale or because 31 December 2016 has passed, and within 12 months after termination Tenon enters into an agreement for or consummates the alternative transaction.

   Tenon must reimburse the purchaser's costs and expenses in an amount of up to US$1.1 million if Tenon shareholders vote against the sale, which reimbursement would be credited against any termination fee paid by Tenon. The purchaser must pay Tenon a termination fee of US$3.3 million if all conditions to the sale have been satisfied but the purchaser fails to close the sale, including as a result of a failure to obtain its debt financing. This commitment is supported by a guarantee from BW Capital Fund III.

5. **Representations and warranties:** The Sale and Purchase Agreement contains a comprehensive set of representations and warranties concerning the sale business. However, the purchaser's sole recourse for breaches of those representations and warranties (other than "fundamental representations") or for tax issues is against an insurance policy to be obtained by the purchaser at its cost. The "fundamental representations" relate to matters such as standing and power of seller and NACS USA Inc. and to title to the shares being sold.

6. **Post closing:** Tenon is subject to several post-closing covenants, including -
   - an agreement not to do business directly with Lowe's; and
   - an agreement not to hire employees of the North American business

   although, Tenon's remaining Clearwood manufacturing and sales business (which will have a 5-year exclusive supply agreement with NACS Inc upon transaction closing) is not constrained in its ability to otherwise carrying out business as it has in the past.