

Forest Enterprises Australia Limited

ASX: FEA

For disclosures see back page under “Important Information”.

Report Date: 4 June 2009

Rating: Short Term – Hold
Medium Term – Buy

PRODUCT FEATURES

Name	Forest Enterprises Australia Limited
Structure	Listed Company
Share Price	\$0.15 (1 June 2009)
Target Return	See body of report
Dividend	Annual Average 1.81 cps.
Key Businesses	Forestry, forest products, managed forestry investments
Location	Plantations: TAS, NSW, QLD. Timber Mill and woodchip export facilities: Bell Bay, TAS.
Liquidity	Low turn over relative to market

Key Financial Indicators – Year end June 2008

GICS Sector	Materials. ASX code: FEA
Market Capitalisation	\$60.8m (1 June 2009)
Discount to NTA	79%
EPS	\$0.104
DPS	\$0.025
Gearing	40%
Net Profit after Tax	\$42.3m



SUMMARY

Organisation

Forest Enterprises Australia Limited (FEA) was established in 1985 and was listed on the Australian Securities Exchange in June 2000. FEA is headquartered in Launceston, Tasmania.

FEA Plantations Limited (FEA Plantations), is a fully owned subsidiary of FEA and has offered a new managed forestry investment every year since 1993 with plantations located in Tasmania, New South Wales, Queensland and Northern Territory. FEA Plantations is now Australia’s largest capital raising forestry manager with respect to investment inflow.

FEA has diversified its business over the last eight years into sawmilling and final product branding and sales. In addition, FEA has 50% ownership of SmartFibre Pty Ltd (SmartFibre) which undertakes the woodchip processing and exporting.

Directors and Staff

FEA and its subsidiaries directly employ approximately 200 people. There are five directors on the board of FEA, one executive and four Non-executives. As a group, the directors and staff have extensive experience in the forestry industry. They are capable in number and skill sets.

Key Businesses

FEA’s primary business since its establishment has been the raising of funds for plantation establishment through managed forestry investments, which remains a crucial business representing approximately 50% of revenue.

FEA Plantations has also established the FEA Timberlands Fund which invests in the land upon which future plantations will be grown. This is part of the strategy to develop a substantial independent private plantation forest resource.

As part of its business integration, FEA has made significant investment in sawlog processing and sales from its modern facility in Bell Bay, Tasmania. Bell Bay processes internally and externally sourced timber which is marketed under FEA’s brands. FEA’s SmartFibre business exports woodfibre to established customers in Japan. SmartFibre and the sale of EcoAsh and BassPine products contribute 48% of FEA’s revenue.

Forest Enterprises Australia Limited

Summary Assessment

Uncertainty over the profile of FEA's MIS sales in the short term prevails. Variations to our sales estimate of \$60m in 2009 will have a material impact on earnings over the next two years. We expect forestry to continue to be supported by investors and a recovery in this source of revenue for FEA over 2010 and 2011.

Growth in demand for forestry products processed at Bell Bay is expected to continue and partially offset lower MIS revenue in 2009 and 2011.

The company is well managed and has an active capital management program to enable it to capitalise on opportunities arising out the sector disruption in the medium term.

Earnings forecasts include:

Financial Year	2009	2010	2011
EPS Forecasts (cps)	0.4	1.6	4.6
PER Forecasts	34.4	9.1	3.3

At a current share price of \$0.15 we rate FEA as a Hold for the short term and Buy over the medium term (> 1 year).

Key rating considerations

Strengths and opportunities

- Improved market share for managed forestry investment sales following the collapse of Timbercorp and Great Southern.
- Strong track record plantation growth rate performance.
- Growth and strong branding of timber businesses such as sawmilling and woodchip exporting.
- Significant pipeline of timber supply.
- Growth of internal land bank for future plantations.
- Improving efficiency of sawmilling operations from state of the art facility in Bell Bay.
- Relatively low level of debt not due until 2011.
- Selling surplus land assets and loan book to reduce debt.
- Growing global demand for timber and proximity to emerging Asia.
- FEA could potentially play a role in industry consolidation.

Weaknesses and threats

- A short term downturn in the forestry managed investment industry is expected following several collapses.
 - Risk of regulatory change to the tax deductibility of managed forestry investments which would result in the collapse of the industry and a major source of revenue for FEA. However, the proportion of revenue from the Forest Products segment is planned to increase.
 - A continued slump in residential construction.
-

Forest Enterprises Australia Limited

TABLE OF CONTENTS

RATING DEFINITIONS	3
OVERVIEW.....	4
ORGANISATION	4
DIRECTORS AND STAFF	4
FORESTRY MIS SECTOR POTENTIAL	7
CORPORATE STRATEGY AND EXECUTION	8
RISK MANAGEMENT AND COMPLIANCE.....	10
LIQUIDITY AND CONCENTRATION OF OWNERSHIP	11
SOURCES OF INFORMATION.....	13
REPORT EXPIRY DATE.....	13
INTERSUISSE CONTACT	13
IMPORTANT INFORMATION.....	14

RATING DEFINITIONS

Atchison Consultants' ratings are multi-factor, encompassing: ownership and organisation, staff, investment objective and process, governance and compliance, fees and other costs and performance. We use the same rating factors in analysing unlisted and listed property funds; however, our rating assessment terms and descriptions differ.

Speculative Buy – The company's ability to generate returns for shareholders is subject to uncertainty as a result of organisation, operating and/or market factors. However, it is significantly underpriced and this includes by reference to fundamental asset values. The company is in a sector with strong growth potential and/or has a particularly strong market advantage over its competition.

Buy – The company is sound in all or most respects with a clear strategy and resources to make profits. It has a clear strategy and it should perform well relative to its competitors. The company must be underpriced relative to its market and/or have good prospect to increase its profit per share relative to its competitors.

Hold – The company is fairly priced in its market.

Sell – The company is no longer fairly priced in its market and/or is expected to lose its ability to outperform in its market.

Forest Enterprises Australia Limited

OVERVIEW

FEA established its first managed forestry investment in 1993 and has offered a new investment every year since - the first of which was clearfall harvested in 2008 and delivered a pre-tax return of 13.3% p.a.

Since its listing in 2000, FEA has diversified its business into sawmilling and final product branding and sales, as well as woodchip exporting. In 2008, FEA completed construction of a modern sawmilling facility in Bell Bay, Tasmania. The facility incurred unexpected costs at start up partly due to a compressed construction timetable, but is now cash flow positive. The original site, worth \$30-\$40m, was purchased by FEA in 2007 for \$10.9m from Carter Holt Harvey as a fibreboard plant.



The future of FEA's managed forestry investment business will depend on investor reaction to tax effective schemes and continued regulatory support. Returns on managed investments and timber products will benefit from the eventual economic recovery and FEA is placed well to emerge with a greater share of the market.

ORGANISATION

Forest Enterprises Australia Limited (FEA) was established by Tony Cannon in 1985 and listed on the Australian Securities Exchange in June 2000. FEA established its first eucalyptus plantations in Tasmania in 1987 and is headquartered in Launceston, Tasmania.

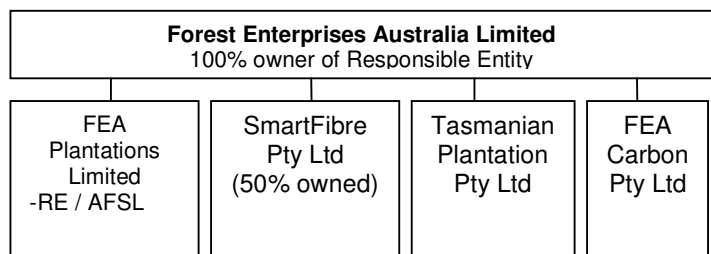
FEA Plantations Limited (FEA Plantations), a fully owned subsidiary of FEA, established its first managed forestry investment in 1993 and has commenced a new MIS every year since. In addition to expanding its plantation estate in Tasmania, FEA Plantations has plantations extending into mainland Australia in New South Wales, Queensland and with its current managed investment offering in the Northern Territory. Following the collapse of Timbercorp and Great Southern, FEA has become Australia's largest

capital raising forestry manager with respect to investment inflow.

FEA Plantations has engaged FEA to perform the management services such as establishing and maintaining the plantations under a head management agreement. Tasmanian Plantation Pty Ltd is the land owning entity.

In response to the often changing regulatory environment in the agricultural managed investment industry, over the last eight years FEA has diversified its business into sawmilling and final product branding and sales, as well as woodchip exporting. FEA has 50% ownership of SmartFibre which undertakes the woodchip processing and exports. FEA Carbon has been established to explore carbon trading possibilities. The organisational structure is shown in Chart 1 below.

Chart 1: Organisational Structure



DIRECTORS AND STAFF

FEA and its subsidiaries directly employ approximately 200 people. There are five directors on the board of FEA, one executive and four non-executives.

William Edwards is a practicing solicitor and has extensive legal knowledge and experience. He was admitted as a practitioner of the Supreme Court of Tasmania in 1993 and has been a partner in Launceston law firms since 1999. He specialises in commercial law and, in particular, estate planning, company law and property trusts. Will has years of legal experience in relation to the timber industry including acting for and advising landowners, mill owners, logging contractors, public companies and other persons and companies involved in the industry.

Tony Cannon is a professional forester with over 25 years experience and is a founding director of FEA. He has supervised and managed a plantation program for Boral Timber Tasmania Limited for a period of 11 years, covering all facets of plantation management and establishment. Since commencing FEA, he has been responsible for land acquisition, plantation establishment, development and general consultancy services to the forest industry.

Forest Enterprises Australia Limited

Table 1: Directors and Key Forestry Staff

Name	Position	Years with FEA	Experience in the forestry sector (years)
William Edwards	Chairman	7	15
Anthony (Tony) Cannon	Executive Director	24	33
Andrew White	CEO	6	>20
Michael Williams	Non-Executive Director	13	12
Desmond King	Non-Executive Director	7	>50
Vincent Erasmus	Non-Executive Director	2	>20
Fergus Leicester	CFO	4	15
Kristen McPhail	General Manager – Sales and Marketing	4	22
Chris Barnes	General Manager - Plantations	2	15
Ken Last	General Manager – FEA Sawmill	1	37
Andrew Wye	General Manager – SmartFibre	5	>20
Mike O'Shea	General Manager – Business Development (Forestry)	5	>30
Doug Massey	General Manager – Strategic Development	3	>10

Andrew White has had over 20 years experience in the forestry industry and has held a number of senior management roles with major Tasmanian forestry companies. These include Gunns Limited, Boral Timber Tasmania and Wesfarmers/Bunnings. Since joining FEA in 2003 as CEO, Andrew has commenced implementation of the processes to achieve a vertically integrated forestry and forest products company through innovation and technology.

Michael Williams is a registered tax agent, liquidator and auditor and has been a partner of Camerons Accountants and Advisers since 1987. He is also a certified financial planner and is an authorised representative of Professional Investment Services Pty Ltd. Michael has been a Director of FEA since 1996.

Desmond King was formerly the CEO of Private Forests Tasmania, a government statutory body, and held that position for 7 years. Private Forests Tasmania was established to specifically promote, foster and assist the private forest sector to sustainably manage native forests and encourage the expansion of plantations. Des has worked in the forestry industry for over fifty years in a range of roles encompassing logging, saw milling, wholesale and industry development.

Vince Erasmus is a qualified forester. He was appointed CEO of ITC Ltd in 2006. Vince has two decades of experience in senior management positions in the South African timber industry and extensive experience in the management of plantations as well as broad experience in the solid

wood processing. Vince has had extensive exposure in maximising forest product yields and returns though investment in and the management of various processing options ranging from sawmilling, veneer and plywood production through to the production of fibre based panels.

Fergus Leicester has 15 years experience in financial and commercial roles within the timber industry, including senior financial management roles at Boral Timber and Gunns Ltd. Fergus joined FEA in 2005 and his responsibilities include capital management, corporate governance, compliance, risk management, information systems, strategic planning, financial analysis and corporate administration.

Kristen McPhail has over 20 years marketing experience in the financial services industry. Kristen was a practicing Certified Financial Planner prior to being Chairman of the award-winning Financial Planning Association's 1994 and 1998 National Conventions in Perth and Cairns. Kristen entered the agribusiness industry with Norgard Clohessy Equity in 1999 as the highly-visible focal point for their marketing and business development, resulting in the company winning the No. 1 position in the BRW FAST 100 survey in 2000. In 2001, Kristen was a WA finalist in the Telstra Business Women's Awards and joined Sylvatech in 2003 as National Marketing Manager. Having joined FEA in 2005, Kristen is responsible for sales and distribution of our Managed Investment Schemes.

Forest Enterprises Australia Limited

Chris Barnes has 8 years experience in managing eucalypt and pine forestry plantations and 5 years experience with agronomy and weed science. Previously the plantation manager for Gunns Ltd, Chris joined FEA in 2007 and is responsible for managing plantation establishment and maintenance programs. Chris is also responsible for ensuring FEA's land acquisition program secures high quality land that supports future plantation growth requirements. Chris is also responsible for adhering to quality guidelines set down for plantations.

Ken Last is responsible for the sawmill at Bell Bay. Ken has worked in the sawmilling industry for the past 30 years. During that time he has held the position of Managing Director at Kauri Timber Company Ltd and Neville Smith Timber Industries Pty Ltd. Ken has served on industry associations in Tasmania and Victoria and until recently was active in industry research and development having served on the executive committee of the Forest and Wood Products Research and Development Corporation for six years.

Andrew Wye is a professional forester with over 20 years experience in a range of operational and senior management roles within the forest industry in Tasmania and New Zealand. Andrew joined FEA in 2004 and manages the SmartFibre joint venture between FEA and Elders. Andrew also provides oversight for wood supply for FEA operations in Tasmania and NSW. He is a member of the Institute of Foresters of Australia and is Chair of the Tasmanian Division.



Mike O'Shea has over 30 years experience in forestry, having held a number of senior management roles at Environmental Consulting International, Hazell Bros Group, North Forest Products and Gunns Ltd. Mike joined FEA in 2005 as the General Manager of Forestry Operations. In 2007 Mike was appointed to his current role as General Manager of Business Development (Forestry). Mike is responsible for the development and implementation of a sawn timber and wood fibre processing capacity within NSW and

Queensland and the development of new forestry and forest products. Mike will also have a significant involvement with emerging carbon credit markets.

Doug Massey joined FEA two years ago working out of the FEA Tokyo office in Japan with the joint venture company SmartFibre marketing Woodchips to overseas customers. Previously Doug worked with Daio Paper Corporation for seven years as a specialist strategy and procurement adviser, also based in Tokyo. Doug has a unique skill set combining the need to speak Japanese with a knowledge and understanding of the Japanese culture. These attributes combined with a strong practical working knowledge of wood processing, provides Doug with good marketing credentials to operate in the Pacific basin. Now based in Australia, Doug is responsible for developing strategic joint venture projects with trading houses to grow market opportunities for FEA both nationally and internationally.

In our view, the directors and key staff are adequately knowledgeable and experienced in the industry.

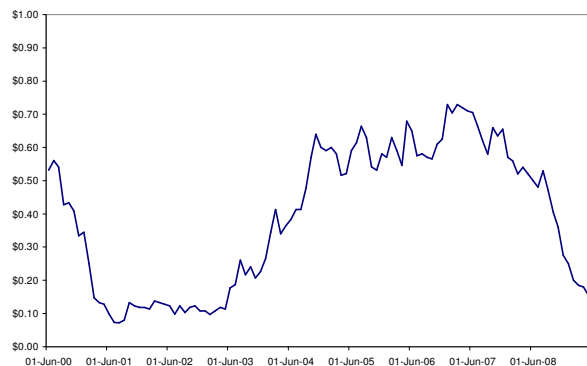
Senior managers of FEA receive a fixed salary plus bonuses linked to performance. FEA has a Remuneration and Nomination Committee to address the remuneration of executives and employees. The Committee meets at least three times per year and comprises three non-executive directors William Edwards, Desmond King and Michael Williams. The Committee recommends to the Board appropriate compensation for non-executive directors which are subject to limits as approved by shareholders.

Track Record

FEA listed on the ASX in June 2000. This was also the time when the company's revenue base was broadened from primarily managed forestry investments to include saw milling and wood chip exports. This post-listing period provides a good indication of management's success in executing this integrated strategy. FEA paid its first dividend in 2005 and has averaged an annual dividend of 1.81 cents per share. Like others in the sector, FEA's share price has fallen significantly since mid-2007. Chart 2 shows FEA's share price history.

Forest Enterprises Australia Limited

Chart 2: Share Price History



FEA's primary business prior to listing was in managed forestry investments and it is still a major contributor to revenue. FEA's managed forestry investments have an average lifespan of approximately 13-14 years including time to harvest and sell the final timber product. The 1993 and 1994 managed forestry projects have reached maturity and either have, or will soon be, harvested. Project 1993 delivered a pre-tax return of 13.3% p.a. and a post-tax return of 7.3% p.a. at the top marginal tax rate. Project 1994 is projected to deliver a pre-tax return of 13.0% p.a.

The sawlog recovery from the clearfall harvest of Project 1993 in 2008 was 68%. The sawlog recovery for the 1993 Project as a whole, including thinning, was 48%. The remaining logs are sold as pulp logs. The clearfall harvest of Project 1994 is scheduled to commence during 2009. Five other projects have produced income through thinning harvesting programs.

Capital raised on Project 2009 is expected to be significantly less than previous years due to the collapse of two competitors and resulting bad press and the economic downturn. This is not expected to have a significant effect on 2008/09 financial year revenue due to the method of recognising revenue from establishment costs and strong growth of FEA's forest products business which is currently reliant on external timber supply. The processing of maturing managed forestry investments will ensure steady supply for the sawmill business. Subdued investment in the managed forestry sector will also affect revenues in the 2010/11 financial year.

FORESTRY MIS SECTOR POTENTIAL

The agribusiness sector has been the subject of much media attention in recent months due to the collapse of two large players, Timbercorp and Great Southern (TIM & GSP). This has put into question the viability of others in the sector. However, the circumstances surrounding these collapses are not a reflection of profitability or relevance of managed forestry investment operators.

TIM & GSP were both victims of massive impending debt obligations as a result of poorly managed expansion, declining assets values, economic downturn and drought. The collapse of both companies, while disastrous for investors and growers, will clean out poor management practices from the sector. FEA has a relatively low level of debt resulting from prudent expansion of operations reliant on investor capita and there are product differences from TIM & GSP with respect to up front and subsequent fees.

Drought issues are more prevalent in horticultural products which are more susceptible to failure due to their reliance on, for example, yield from fruit which may not eventuate or be substandard, in comparison to forestry where the survival of the entire plant is all that is required for sales. One or two years of low rainfall are unlikely to have a significant effect of the final product as it is not sold until 10 to 20 years of age.

In this regard, well managed forestry companies dedicate significant resources to ensuring the location of plantations are in optimal areas with respect to rainfall and the selection of each tree species. Risk of low rainfall is the primary concern and the major factor in location decisions for FEA.

Unlike horticultural schemes, focussed managed forestry companies continue to be supported by government policy and suffered little affect from a tax ruling in 2007. The government remains supportive of the forestry sector and this is expected to be the case going forward. Australia has a large import deficit in forestry products and managed forestry investments have contributed significantly to alleviating this gap. They now accounts for more than one third of plantations and over 80% of new plantation establishment.

Demand for forestry products is expected to grow over the coming decade. Australia is well positioned to benefit from the increasing wealth of emerging Asian economies due to short shipping times. Sales to China and India are increasing as their requirements for construction timber expands.

In Australia, access to logging of native forests is becoming more restricted with greater areas of forests being placed in reserves. Although currently below long term averages, the important local residential construction industry is expected to increase its demand for sawn timber as governments attempt to close the massive gap between housing demand and supply. This has recently been exhibited by the effect of the First Home Owners Grant on building approvals.

We are of the view that the managed forestry investment sector will continue to grow over the

Forest Enterprises Australia Limited

long term as it becomes increasingly important for new plantation establishment. Government legislation should remain unchanged in support of this growth as the industry is well placed both domestically and overseas. However, the current economic climate and negative media exposure is likely to result in depressed investment flows in the coming year.

CORPORATE STRATEGY AND EXECUTION

Corporate Strategy

From 1985 to 2000, FEA was primarily focussed on the sale of managed forestry investments which take advantage of the upfront tax deductibility available on such investments. However, since its listing in 2000, FEA has diversified its business into sawmilling and final product branding and sales, as well as woodchip exporting. FEA now participates in the entire product process from plantation to processing to sale with revenue drawn from multiple sources.

FEA has a substantial holding in forest estate on its balance sheet to provide land for its managed forestry investments. This will be supplemented by the Timberlands Fund.

FEA is accumulating its own sustainable private forest estate to ensure a high quality plantation resource to foster the growth of plantation estate, sawmilling and final product sales enterprises.

Managed Investments

Although the company has broadened its business activities since listing, managed forestry investments remain a crucial business representing 51% of revenue for the half year to 31 December 2008.

FEA also established the FEA Timberlands Fund in September 2008 which is an open ended unlisted trust that invests in the land upon which future FEA MIS plantations will be grown. Based on positive rural property fundamentals and the high cash yield of the fund, we expect the response to the Timberlands Fund to be positive. The fund is part of FEA's strategy to develop a high quality substantial independent private plantation forest resource.

FEA Plantations, the RE, aims to maximise returns for managed forestry investors by recovering high value sawlogs at thinning and clearfall instead of using the timber only for cheaper woodchip products.



Revenue from its managed forestry investment division is currently realised in two stages. Establishment fees are realised over the first two years and management fees deferred until harvest when trees are thinned (nine years) and at final clearfall (usually 13 years). FEA may take advantage of reduced competition in the sector to implement an ongoing fee model whereby management fees would be charged throughout the life of the project.

Since its first offering in 1993, FEA has established more than 60,000 hectares of managed forestry investment timber plantations spread over 600 properties under both freehold and leasehold arrangements. FEA owns 94,500 hectares across Tasmania, northern New South Wales, south east Queensland and the Northern Territory. Tree species include eucalyptus (hardwood), radiata pine (softwood) and more recently, African mahogany (hardwood). The forest portfolio is summarised in Table 2. MIS revenue is broken down similarly between the states.

Table 2: Forest Portfolio

	NSW	QLD	TAS	Total
Managed Forestry Investment Area (hectares)	33,350	4,646	22,826	60,822
Plantation Area (%)	55%	8%	37%	100%

The company intends to sell several land assets in southern Tasmania, New South Wales and Queensland. These properties are worth approximately \$53m out of a total of \$300m in freehold land. This land will be leased by FEA under a sale and leaseback arrangement to retain access to the land.

Part of FEA's corporate strategy is to develop a substantial independent private plantation forest resource funded by managed forestry investments to provide feedstock for its processing facilities. This will ensure sufficient timber supply for FEA's brands and SmartFibre regardless of external supply.

Forest Enterprises Australia Limited

Currently timber supply from this source is small but this will increase significantly as plantations mature.

If the managed forestry investment sector were to disappear due to regulatory change and timber supply dried up in, say 15 years, future plantations would require funding from alternative sources. Through the Timberland Fund, FEA is establishing a land bank so finance would be required for establishment and ongoing management costs such as seedlings. This would have to be funded by borrowing, equity raising or a change to annual grower payments to fund forest management costs.

Plantation Process

FEA Plantations has engaged FEA to perform the management services such as establishing and maintaining plantations under a head management agreement. The woodlots are managed by an internal team of professional forestry managers through the process from establishment of plantations to preparation for their eventual sale.



FEA selects land with an annual minimum average rainfall and deep, fertile soils within an appropriate transport distance of a wood processing centre. Species selected for planting are those that have potential to produce high value sawlogs as well as woodchips. Species are matched to appropriate plantation locations and planted at a high density to provide thinning harvests and to encourage straight tree growth. FEA conducts research, development and trials to improve the genetic quality of seedlings to deliver enhanced growth rates.

FEA has a full time forestry maintenance team which monitors the control of pests and weeds and oversees tree nutrition and fertilisation to maximise plantation growth. Plantations are thinned at approximately two-thirds of their planned maturity to provide income to investors and to enable the best performing trees to attain maximum growth before final harvesting.

Sawlog Products

As part of its business integration, FEA has made an investment of \$72m in sawmilling in its Bell Bay, Tasmania facility. This has been largely funded through debt. The original site, worth \$30-\$40m, was purchased as a fibreboard plant by FEA in 2007 for \$10.9m from Carter Holt Harvey. The owner prior to Carter Holt Harvey spent \$220m developing the 85 hectare site. FEA has incorporated technology to ensure the mill maximises the usable timber recovery from sawlogs and has kiln drying capability. Construction of the facility was completed in early 2008 replacing the old mill which was sold for \$3m. The capacity of the mill is currently 500,000 tonnes per year and this can be expanded to one million with only relatively small further investment. FEA is now Tasmania's largest plantation sawmiller and comprises 70% of the structural softwood sawmilling market in Tasmania.

Bell Bay processes both softwood (pine) and hardwood (eucalyptus) which are marketed under FEA's BassPine and EcoAsh brands respectively. It is the only mill in Australia with both softwood and hardwood processing capabilities. A new high value African mahogany product branded Khaya Mahogany has been offered through the current managed forestry investment and is to be grown in the Northern Territory.



Improved saw milling capability has allowed FEA to source timber supply from outside the harvests of its own plantations. The mill currently processes predominantly softwood, 90% of which is purchased externally. FEA has a long term contract with Timberlands Pacific for the supply of softwood which makes up the majority of external supply. As the plantations managed by FEA mature, each year the proportion of processing dedicated to FEA's internal timber production will increase significantly. FEA do not have a sawmill in NSW however plantations in this area are yet to reach maturity. As this approaches FEA may develop a new facility in NSW or purchase an existing sawmill.

Forest Enterprises Australia Limited

FEA has entered into a wood purchase agreement with FEA Plantations in relation to wood harvested from its managed forestry investment plantations. The agreement provides that wood must be purchased at a fair and reasonable price that takes into account the end uses of the wood and the prevailing market for those users. If FEA Plantations does not approve the purchase price, it can seek a higher price from FEA or sell the wood to another buyer. In the case of eucalypt, a floor price is applicable.

FEA has a competitive advantage in its EcoAsh brand where it conducts its in-house ratings of the timber products. This is an expensive procedure to undergo externally for competitors who do not have this capability.

FEA seeks to achieve premium prices for its timber products through product quality, consistency, reputation, branding and environmental certification. The majority of current output is being absorbed by the Tasmanian market.

Together the sale of EcoAsh and BassPine products contributed 48% of FEA's revenue in the six months to 31 December 2008.

Wood Fibre Products

FEA has 50% ownership of SmartFibre, an export wood fibre business, with Elders. The remaining wood left over from the Bell Bay processing facility is used by SmartFibre. The facility was built in 2003 and currently exports hardwood and softwood woodchips for paper and paperboard production to established customers in Japan. During 2007-08, SmartFibre exported over 500,000 tonnes of wood fibre.



Prices for woodchips with customers in Japan are set at the start of each year. FEA has four long term supply contracts. Hardwood prices are quoted in Australian dollars and softwood in US dollars. The softwood price is re-set every six months.

Net profit after tax from FEA's ownership of in SmartFibre for the six months to 31 December 2008

was \$152,000. FEA has pre-emptive rights over Elders' interest in SmartFibre.

Loan Book

In conjunction with the issue of managed forestry investments, FEA has provided finance to investors by borrowing money and re-lending it at a 2-3% premium. Over the last two years, FEA has scaled back its loan book with sales of approximately \$55m to date with more in the pipeline. Sales have been achieved at 100 cents per dollar. The loan book has less than 5% default but higher than banks of around 1%, and low arrears.

Going forward, FEA will provide loan origination services for a fee instead of conducting its own lending directly. FEA will have no exposure to these loans. For the Project 2009, FEA has received preferred finance of \$95m from two third parties. This will reduce FEA's capital requirements for Project 2009.

Debt

FEA's gearing ratio at 31 December 2008 was 40%. Primary corporate debt of \$205m represents 32% of total assets. This facility has a maximum drawdown of \$235m. These debt facilities are with ANZ and the Commonwealth Bank and do not mature until January 2011. There is also a working capital facility of \$10m. FEA is not in breach of any covenants attached to these loans.

FEA is currently undergoing sales of several assets to further strengthen its balance sheet. A portion of the loan book was sold in 2008 for \$13m at 100 cents in the dollar and a further \$6m due to be sold in June 2009. This result was achieved due to the high quality of the FEA loan book. Most of these proceeds have been used to reduce debt while 12.5% is deferred.

Table 3: Debt Pipeline (excluding working capital facility)

Loan	Due	Lender
\$235m	Jan 2011	ANZ, CBA

The intended sales of land assets in southern Tasmania, New South Wales and Queensland, which are valued at approximately \$53m, are expected to be sold at a discount of 5-10% and be applied to debt.

RISK MANAGEMENT AND COMPLIANCE

Risks

- Agribusiness investment sector downturn: After recent collapses of major competitors in the sector, there is a risk that investors will exit the sector under scepticism of the

Forest Enterprises Australia Limited

investment model. We believe that the managed forestry investment industry will continue to be an effective way of establishing a timber resource and that there will be a downturn of only one or two years. Approximately half of FEA's revenue is currently generated from this source. Much of this is from maturing forests and a short term downturn would affect revenue from 2009/10. Collapse of the sector would require FEA to fund plantations from debt or equity raising.

- **Regulatory risk:** The forestry MIS industry is based around tax concessions. If the government were to reduce or remove these concessions the forestry MIS industry would be unlikely to survive. Currently the government remains committed to MIS as a means of timber production and MIS accounts for one third of all plantations nationally. The government must rely heavily on MIS to reach its targeted growth for the national plantation estate.
- **Construction industry:** Domestic timber production sales revenue is heavily reliant on domestic residential construction. This market is well below long term averages but is beginning to grow slowly as the government attempts to boost the supply of housing. The majority of current output from FEA's Bell Bay sawmill is being absorbed by the Tasmanian market and expected growth in output should be met by increasing domestic and overseas demand.
- **Natural disaster and/or climate change:** FEA relies on a growing supply of timber for its sawmill in Bell Bay. Natural disasters or climate change events such as drought may destroy large forested areas which would decrease the revenue from Bell Bay. FEA reduces the risk of these events by planting in areas of high rainfall and matching species to the growing regions most appropriate.
- **Debt:** FEA has a relatively conservative debt profile. Its major borrowings of \$207m are revolving lines of credit with no scheduled principal payments. They are due in 2011. FEA is not currently in breach of any covenants. Land assets have been earmarked for sale and a large proportion of the loan book has been sold to reduce debt. There is a very low risk of loan default.
- **Distributions:** Due to a large portion of its revenue stream being received towards the end of the financial year, FEA has historically declared a final dividend for the financial year ended June. We believe that a significant downturn in the managed forestry investment industry may diminish the dividend paid in June 2009 if revenue from forestry products does not improve.

Compliance

FEA Plantations has adopted a Compliance Plan for each managed forestry investment which is monitored by a Compliance Committee. The Compliance Committee is chaired by one of the independent Board members. Each Compliance Plan is reviewed every six months and is subject to an independent audit each year. To date there have only been minor breaches of procedural matters.

Conflicts of Interest

FEA has a strict conflict of interest policy whereby Directors must notify the Chairman of any interest the Director has in matters discussed by the Board. That Director is not able to be present during that meeting or vote on that matter unless they have obtained approval from the non-interested directors.

LIQUIDITY AND CONCENTRATION OF OWNERSHIP

Shares in FEA are relatively illiquid compared with the broad share market.

Number of shares:	405.3 million
5 day average volume:	360,709 (26/5 to 1/6/2009)
FEA's turnover:	0.09% per day
S&P/ASX200 turnover:	0.33% per day (May)

As shown below, at 31 December 2008, the top 4 shareholders in FEA own 59.4% of its shares.

Unit Holder	%
Elders Ltd	30.8
Perpetual Trustees Australia Ltd	14.6
AW Seymour and Associates	7.6
Renaissance Smaller Companies Pty Ltd	6.4
	59.4

PROSPECTIVE PERFORMANCE

FEA incurred a net loss of \$4.1m in the six months to 31 December 2008. The result was caused by two main factors. Firstly, a late product ruling on Project 2008 meant that FEA could not accept applications until March 2009. Although FEA's revenue is normally skewed towards the second half of the year, revenue from Project 2008 was at a standstill in the first half.

Secondly, higher than expected start up and operating costs and low production volumes at the Bell Bay facility resulted in a loss in forestry products. The facility is now cash flow positive and expected to meet 2009's target of 320,000 tonnes.

Forest Enterprises Australia Limited

The primary factor that will drive the performance of FEA in the short term will be the effect that the collapse of TIM & GSP has on the managed

forestry investment sector. There remains a risk that investors may shun the sector and this source of revenue which is currently contributing about 50% to FEA, is minimal this financial year. The success of companies in this scenario will be determined by the extent of their activities that are not reliant on the managed forestry investment sector.

We are of the view that capital raising in the managed forestry investment sector will suffer over the next one to two years, but that the confidence in the sector, including FEA, will be restored. There are well managed and resourced timber companies that actively minimise the risks that caused the downfall of TIM & GSP. The non-forestry agribusiness sector may not fare as well as it has been the subject of greater regulatory uncertainty.

FEA is exclusively a forestry and forest product company. It is estimated FEA will raise \$60m for Project 2009 which is down from \$115m for Project 2008. Variations to this estimate will have a material impact on earnings.

Activity in the construction industry will also be a major catalyst for profits in the sector. For FEA, this will affect both the price at which it purchases timber from FEA Plantations (i.e. the investor), and the price it can achieve for its value added products from Bell Bay. This has been a negative influence on revenue as domestic building approvals are well below the long term average. However building approvals have grown steadily, albeit slowly over the March quarter and this should continue following the extension of the First Home Buyers Grant and economic recovery.



FEA has responded to the slowing market by moving to strengthen its balance sheet. The sale of loan book, which is a sound strategy and non-core land assets, will be applied to debt which will reduce the drag of interest on performance. The reduction in lending will be a continuing trend that will

strengthen FEA's position. Third party finance for Project 2009 has been provided which may completely satisfy demand.

FEA's expansion will be far less capital intensive going forward as it looks to increase its leasehold portfolio. Leasehold land currently makes up approximately 25% of FEA's total and this is expected to increase to 50%. FEA recently agreed a long term deal in this respect with Forests NSW for the provision of 4,500 hectares of leasehold land.

Based on these factors, we have estimated on average earnings per share over the next three years as illustrated in Table 4.

Table 4: Financial Forecasts

Financial Year	2009 \$m	2010 \$m	2011 \$m
Operating Revenues			
- Forest products	56.0	75.7	95.2
- MIS	113.2	80.6	101.4
- Timberlands Fund	0.1	0.1	0.3
- Total	169.3	156.4	196.8
NPAT	1.8	6.7	18.7
EPS Forecasts (cps)	0.4	1.6	4.6
PER Forecasts	34.4	9.1	3.3

* At current share price of \$0.15 as at 1 June 2009.

At the current share price of \$0.15 as at 1 June 2009 this represents a price/equity ratio of 34.4 for 2009, 9.1 for 2010 and 3.3 for 2011.

FEA is currently trading at a 79% discount to NTA. Property land assets were last independently valued at \$277m at 30 June 2008 and \$303m following a Directors valuation at 31 December 2008. Given the volume of land assets expected to be put on the market following the collapse of TIM and GSP, FEA's portfolio may be revalued downwards at 30 June 2009 by 5-10%. Table 5 shows the effect that these revaluations would have on the discount to NTA.

Table 5: Discount to NTA

NTA	Land Asset Revaluation		
	0%	- 5%	- 10%
Total Assets	\$634m	\$619m	\$603m
NTA	\$296m	\$281m	\$266m
NTA per Share	\$0.73	\$0.69	\$0.66
Share Price Discount to NTA*	79%	78%	77%

* Based on \$0.15 share price at 1 June 2009

Table 5 shows that possible land asset devaluations of up to 10% would not have a significant effect on FEA's discount to NTA.

Forest Enterprises Australia Limited

SOURCES OF INFORMATION

In addition to a site visit and manager interview, the following sources of information have been relied upon in preparing this report:

- Forest Enterprises Australia Limited – FEA Half Year Results – 27 February 2009
- Forest Enterprises Australia Limited – Forest Enterprises Australia and Forests NSW Media Release – 4 May 2009
- Forest Enterprises Australia Limited – Letter to Shareholders – 7 May 2009
- Forest Enterprises Australia Limited – Profit guidance for the half year ended 31 December 2008 – 6 February 2009
- Forest Enterprises Australia Limited – Statement by Andrew White, CEO of FEA in relation to the Bell Bay sawmill – 12 March 2009
- Forest Enterprises Australia Limited – Senior Management Podcast FAQ's – 27 May 2009
- Forest Enterprises Australia Limited – At A Glance Corporate Fact Sheet
- Forest Enterprises Australia Limited – Fact Sheet No. 4 – May 2009
- Forest Enterprises Australia Limited – Corporate Governance Statement
- FEA Plantations Limited – Project 2009 Product Disclosure Statement – 7 May 2009
- www.fealtd.com
- Australian Plantation Products and Paper Industry Council Media Release – “MIS Forestry Continues to Grow Australia’s Timber Resource” – 24 April 2009.

REPORT EXPIRY DATE

Date Report Prepared: 4 June 2009

Report Expiry Date: The Atchison Consultants report is a point in time assessment and expires after 6 months or if there are any material changes in relation to the information contained in this report or any disclosure or offer document issued in relation to this offer. Atchison Consultants reserves the right change its opinion, rating and/or withdraw the report at any time on reasonable grounds.

Report Prepared By: Lee Hughes

Report Authorised By: Ken Atchison

INTERSUISSE CONTACT

If you wish to discuss this report further, and/or be kept up to date with future reports please contact:

Luke Robinson
Intersuisse Ltd
Toll Free: 1800 653 258
Direct: (03) 9618 8210
Email: lrobinson@intersuisse.com.au

Our services include asset allocation, sector analysis, stock selections and portfolio management for individuals, trustees of superannuation funds and family trusts and institutions

Forest Enterprises Australia Limited

IMPORTANT INFORMATION

Confidential

This document is for the confidential use of the recipients only and is not to be reproduced without the authority of Intersuisse Limited.

Disclaimer

The persons involved in or responsible for the preparation and publication of this report believe that the information herein has been obtained from reliable sources and that any estimates, opinions, conclusions or recommendations are reasonably held at the time of compilation. No warranty is made as to the accuracy of the information in this document and, to the maximum extent permitted by law, Intersuisse Limited and its related entities, including PhillipCapital Pty Ltd, their respective directors and officers disclaim all liability for any loss or damage which may be suffered by any recipient through relying on anything contained or omitted from this document.

General Advice

The content is of a general nature and is based on a consideration of the securities alone, and as such is conditional and must not be relied upon without advice from a securities adviser as to the appropriateness to you given your individual investment objectives, financial situation and particular needs. Whilst this document is based on information and assessments that are current at the date of publication, Intersuisse has no obligation to provide revised assessments in the event of changed circumstances.

Disclosure

Intersuisse Limited, and its related company, Phillip Capital Pty Ltd, (together "Intersuisse") seek to do business with companies it researches and may receive fees for their services. Intersuisse, their directors and associates disclose that some of them may hold securities in the Forest Enterprises Australia. Intersuisse receives commission from dealing in securities. As a result, investors should be aware that Intersuisse may have a conflict of interest that could affect the objectivity of this report.

TAG Asset Consulting Group Pty Ltd (ABN 58 097 703 047), trading as Atchison Consultants, is the holder of Australian Financial Services Licence Number 230846 and has been commissioned by Intersuisse to produce this report. Apart from the fee received for this report, Atchison Consultants has no direct or indirect interest in the success or otherwise of this investment. Atchison Consultants' Financial Services Guide has been provided to Intersuisse Limited.