



The Manager
Companies Announcements Office
Australian Securities Exchange

2 August 2017

Dear Sir/Madam,

Managing Director's interview with Alan Kohler

Please find attached a transcript of an interview between the Company's Managing Director, John Sergeant, and financial journalist Alan Kohler for *The Constant Investor*.

The interview was conducted on 19 July 2017 and has now been made available by Mr Kohler. An audio recording of the interview is available on the website www.constantinvestor.com.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "V Allinson", with a horizontal line extending to the right.

Ms Vicky Allinson
Company Secretary

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A wharf and wood chips turning an island timber company into a global player

A wharf and wood chips turning an island timber company into a global player

[Alan Kohler](#) July 31, 2017 [CEO Interviews](#)



- **Kangaroo Island Plantation Timbers has the most productive forestry land in Australia**
- **The company is building a deep water wharf – Smith Bay Wharf – to get their products to customers**
- **When dealing with timber – look at growth rates over margins**
- **KIPT is transitioning to a 100 per cent woodchip business**

[Mitch Taylor](#) picked Kangaroo Island Plantation Timbers as [one of his three stock picks](#) and he is still a fan. At the helm is CEO is John Sergeant who started as an investor, then joined the board and now leads the company.

The biggest coup for KIPT is the approval to build a wharf which will allow their products to be sent to their customers in China and Japan. Plus, they have the cash on hand to pay for this capital investment. John says they will be able to recoup some of the cost from the wharf by allowing cruise ships to dock.

Within two years the company will be 100 per cent woodchip based and the going rate is AUD\$100 FOB per green tonne.

John Sergeant tells Alan Kohler they are looking to roll-up the private plantations on the island and he's not worried about the paperless office because there will always be a need for disposable nappies.

Perhaps we could just start with a bit of history of the company. How old is it and how did it start?

Well, it started in 2001 and it was like every other timber company in Australia, in that it made its money primarily by promoting tax driven investment schemes, and unlike all the others it's still here today.

Who started it? Was it started by tax scheme promoters?

That's exactly right. Alan, I like to think of it as the Steven Bradbury of Australian forestry, in that everyone else has fallen over and we have sailed serenely on. We now have, you know, the company's been recapitalised and we've wound up all the schemes and so on, and we've profited from the folly of others by picking up investments from other collapsed forestry schemes so that we now have a whole lot of land that we own and a whole lot of trees we own. It's a very, very simple company.

What accounts for the company sailing serenely on, as you put it?

Not doing silly things, really. I mean Gunns, Willmott, Viento, Treecorp, TimberCorp... I mean Australia is littered with the carcasses of timber companies that got carried away with the idea of selling schemes and forgot about forestry. We are just a forestry company. We own land, we plant trees in that land and we try to make the trees grow well and we try to sell them at a profit, and that is the real challenge that we have at the moment.

How long have you been with the company, were you with it at the start?

I've been an investor in the company for about six years, Alan. So, not from the start. And I've been on the board for about four, and CEO for about two. So, there you are.

That's right. So okay, so you started as an investor, then a director, then CEO?

Yes, it's a strange progression and I'm not a forester, and perhaps that's one of the reasons why KPT is still here and poised to do well I think, is because it hasn't been taken over by the sort of madness that gripped the forestry industry in the last decade. None of us are foresters, we're more investors in the way we look at the company.

What is your background, John?

You'd be horrified to know. I have a background in biological sciences and psychology. So, nothing in life has equipped me to run a forestry company and no one should buy the shares of KPT on the strength of my CV.

Oh it sounds perfect John, you sound absolutely eminently qualified.

No, not at all. The trick with our company, Alan, is that although we have land and we have trees and actually we have the most productive forestry land in Australia. Our difficulty is getting the trees off Kangaroo Island and into the hands of our customers in Japan and China. And most of my time is spent working with the South Australian Government to develop a deep water wharf on Kangaroo Island over which we can export this resource.

Well we might as well talk about that now. You're proposing to build what's called the Smith Bay Wharf. Recently the environmental guidelines were released. Do those guidelines suggest to you that the thing is now possible?

More than possible. I think it's overwhelmingly likely now. I mean obviously people in my position do tend to say things like that, Alan, but the South Australian Government does not have a history of saying no to projects – to developments that have been designated as a state significant development, which this has. So, we were really pleased with the EIS guidelines, they tell us exactly what we need to do in order to get the project approved. And as luck would have it – actually, not luck, good planning – we have already done all of the scientific studies we need to do in order to complete that EIS.

So, from here on in it should be relatively smooth and I hope a relatively rapid path to get the thing approved, and it's fully financed which is again a little unusual in these sorts of things.

What do you mean, fully financed?

That all the money needed to build the wharf is already in place. So, we're really just waiting on development consent to...

Do you mean you have the cash in the bank?

We have the bank ready to provide the cash, Alan.

How much will it cost?

It will cost \$25-30 million and we have a facility for up to \$30 million. Banks are happy to invest in infrastructure with a, you know, with a guaranteed customer locked in, which is of course what we are. We know we need to move hundreds of thousands of tonnes over that wharf every year, so it's a fairly bankable proposition.

Can you explain to us the benefit of the wharf, the Smith Bay Wharf, to the company?

Well, I'll do more than that. The benefit to the company is that it enables us to get our timber off the island more cheaply than by the alternate route, which is barging it off the island and which involves a lot of double handling. So, it maximises our operating profit to have that wharf in place. But they're also enormous benefits to the South Australian community because Kangaroo Island is the – the premier calls it the arrow head of South Australian tourism, it's the place in South Australia that people want to visit. And at the moment the cruise ship cannot dock there. So, putting in that facility is a great thing for the island.

It allows cruise ships to dock then.

Indeed it does. At the moment the cruise ships do visit in mid-Summer and try to get their passengers ashore in small boats. But if the weather is choppy, they just sail right on past. So, it should be a huge thing for Kangaroo Island tourism because it should enable year-round cruise ship visits.

What will be the return on investment of the \$25-30 million you'll spend on that wharf?

The real answer, Alan, is that we don't know. We know what it's worth to us as a timber business but in all our forecasting we don't make any projections about income from other uses and there will be a lot of other uses as things move on...

What's the ROI just off your own use?

Well that's not something we've made public, but I would say this, that we sacrifice a third of our operating profit by using an alternate means.

Which is how much?

That's roughly about – it's worth about \$7 million a year to the company to have that wharf in place and you can – you're a very clever man, Alan, you would have already worked out that...

I'm calling it 25%.

Ah, yes, that's a very good approximation, yep.

Right, okay, well that's good. And that's to start with, that's without charging the cruise ships. What other products could be exported from Kangaroo Island off using your wharf?

I'm more excited about imports, and again this is not – we are a timber company and we've survived by sticking to our knitting. So, other people are going to make money I think by bringing fertiliser and diesel onto the island. The island is a huge consumer of diesel because everyone relies on diesel generation for power. It is connected to the grid but it's not a very good connection and there's not a lot of electricity on the island.

So, it uses huge amounts of diesel, it uses large amounts of fertiliser. Like the rest of South Australia it has old soils that need nutrients added and then there's potential for exporting grains. A lot of the island's grain already goes to Japan and if we have a big ship sailing up to Japan it's not a difficult matter to put a few containers of grain on the deck. So, there'll be plenty of other uses, but from our point of view our philosophy is build it and they will come. It's a good investment based on timber, that's the basis on which we'll do it and then everything else is a bonus.

And you will own 100% of that wharf?

My word, we will, yep. That's – that's – if you're a commodities exporter it doesn't – it's not very good to be beholden to someone else to get your products to market.

Now, you're shipping logs aren't you, they're not milled?

We would be shipping pine logs and eucalypt woodchips. So, about 20% of the resource is pine and that needs to go as logs, so it can be turned into sawn timber and the rest is high quality Eucalyptus Globulus, which is used to make fine papers, viscose, rayon, disposable nappies, that sort of thing. All of it.

But you're not wood chipping them on the island are you, or are you?

We chip them infield, so they get chipped as they are harvested.

Oh, right.

Because it's very easy – that's just for logistical reasons, Alan. It's very easy to handle and move woodchip, you know, you can pump it. Whereas, moving logs around is a bit trickier. So, our plan in the long term is to harvest all the pine that's on the island and replace it with eucalypts so that we can be a 100% woodchip operation. And I should add, it's all – it's all plantation, none of it's native forest and it's all FSC certified.

Do I assume therefore that the wood-chipping business is a better margin than in logs?

It's not so much the margin, it's just that the growth rates are better with eucalypts. We get growth rates on Eucalyptus Globulus, or Tassie Blue Gum, that are 25% better than the best mainland plantations on Kangaroo Island. The main reason is because there's not much summer evaporation, it being an island. So, eucalypts do so well that even though pines do well as well, it's better to switch them over to eucalypts just from a productivity point of view. The actual margins are pretty similar, it's just a – it's a question of maximising land productivity.

When do you think you'll become a 100% woodchip business?

Within about two and a half years I'd anticipate. So, really the pine is more of a legacy issue. We'll clear it away, we'll replace it with eucalypts and then, you know, we'll make a single product.

And what's the sort of arrangement for selling the woodchips, do you do it on contract or is there a spot price that you sell it at?

Yeah, it's a good – that's a very good question. We have an MOU with Mitsui to, the Japanese trading house, to sell all our woodchips and indeed our pine logs. It's a very opaque market and that's something that should deter investors who are looking at our company, I think. It's like Uranium, the vast majority of woodchips are sold on five year contracts for volume with annual price negotiation. Now, there is a spot market but the spot market accounts for a tiny fraction of globally traded woodchip. Almost all of it is on long term contract and there's a reason. The reason is – it's the way iron ore used to be.

The reason is because a pulp mill is such a huge piece of kit and so expensive, like a nuclear reactor, that the first thing pulp mill owners want to do is lock in supply and then they worry about price. So, exactly like people who own a nuclear reactor worry about getting their uranium first and then what they pay for it second. So, the spot market which people can observe is just odds and ends left over after – after the contracted amounts have been traded.

How much do you get for the woodchips?

Typically, we'd get in excess of AUD\$100 FOB per green tonne. So, that's – that's the number we work with. In all our models we assume a good deal less than that because we like to be conservative. But that's – that's the current going rate.

And you're selling a fair bit of water in that too I suppose, aren't you, if it's green?

That's right. I mean you pay money to move moisture around the globe. So, I mean one of the tricks in the business is try and reduce the moisture, you know, infield. You know, dry out the logs before you chip them. But because we only get paid for the dry content which typically is around 52-54% off the green tonne.

What do you think the best way for an investor to think about your company is? Is it as a resource? You've got this many trees and they're worth this much money. Or should it be seen as a producer of an inventory called trees or woodchips...

I think there's – there's...

...and you produce this much – this much of it per year and you get this much dollars per tonne?

I reckon there's three ways of looking at it and it just depends upon the mindset of the investor. Some people, and in every other English speaking country in the world, Alan, long term investors have about 4 or 5% of their portfolio in timberland. So, it's just an asset class that, you know, the Yale Endowment or the Pension Fund of British Columbia or any long term North American or European investor has about, you know, a 20th of their money in this uncorrelated asset class. So, that's how some people look at it. If you want that exposure to that asset class on the ASX, it's us. We're the only one.

The other way to look at that is simply as a, as you say, as a producer and to look at its through-put and its ability to generate free cash. We anticipate generating free cash with a wharf in place of \$15-20 million per annum sustainably. But the other way to look at it is as an owner of a piece of monopoly infrastructure and, you know, to assess the company on that basis. And for that reason the company's structured such that all the timber assets are in one entity and the wharf asset is another, is in another and when the wharf is up and going we'll report those sectors separately so people can look at the two parts of the company and form their own view. Does that answer your question?

It does. You say that it's uncorrelated. I guess that's a sort of, you know, almost conventional wisdom of timber, but isn't it correlated, and particularly your business, correlated to paper?

No, not so much and I'll explain why. Global paper consumption is going down by about 1% a year, okay? But paper consumption in our region, the markets we supply, is going up. So, Europe and US and indeed Australia is falling while North Asia is growing. But you've got to remember what we're producing. We're producing something called dissolvable pulp which is basically cellulose. There's no other good way of producing cellulose and it's used for things like disposable nappies, rayon and viscose. So, it's a high end fibre product. It's a mistake to think of timber as merely going into paper and packaging. It's – it's – the best quality timber goes into a wide variety of end uses for any consumer.

But would you – are you saying you would still have a business if the paperless office did actually arrive? You know, it never has arrived despite all the predictions that it would. But if it did arrive would you still have a business?

I've seen huge research documents predicting the paperless office, all of them printed – I'm being a little facetious here. I think global paper demand will continue to fall, it has to, Alan. The thing is that the markets – in the markets we supply it's still rising, eventually it will fall. But I can't see demand for things like disposable nappies going down any time soon as, you know, as more and more middle class people emerge in the markets Australia supplies. And I should say, Alan, that the Asia-Pacific market and the Atlantic market for woodchips are two different markets.

The commodity is so bulky and so cheap that it's very difficult to move supply from one market to the other. Really the only country that can supply both is South Africa. So, there's not much – there's not much movement between that slowing market in the Atlantic and our growing market in the Asia-Pacific.

You say that it's \$15-20 million cash sustainable – sustainably. What do you mean by that? Do you mean just that's an ongoing thing, you just plant the trees, they grow and, you know, for as far the eye can see that's the sort of cash that you'll earn?

Yes, it's – it's like a magic pudding. It's not like a normal resources commodity company where the resource gradually exhausts and the average grade of what remains falls over time. In fact, timber is the exact opposite. Not only do we harvest at the rate that we're growing, so that, you know, the standing timber volume remains constant through the life of the company, but also we harvest the worst stuff first. So, the average quality of what remains actually rises. An example of that is harvesting the pine first. Every time we harvest a pine plantation and replace it with a Eucalyptus Globulus one we're actually increasing the value of our inventory because we're replacing a better performing – a poor – a relatively poorly performing tree with a better performing one and obviously there's a limit.

You're also increasing the area of your plantations. You recently purchased or are buying, in the process of buying Forestry Investment Trust Estate, 19 hectares of which 10 hectares is planted.

There's thousands of hectares, I should say.

I'm sorry, yeah not – 19,000 hectares. So, there's another 9,000 hectares, is that another 9,000 hectares that you can plant in addition to the 10 that's already planted?

No it's not, Alan. Kangaroo Island is a pretty special place. It's like Australia's Galapagos and a lot of the land that we own is covered in remnant native vegetation and we have no plans to clear that and I don't – you know, we wouldn't be given consent to do so even if we asked. For example, our company, you know, owns at least 5,000 hectares of native vegetation that's habitat to the glossy black cockatoo, which only exists on Kangaroo Island. You know, so, we don't have any plans to expand our plantation footprint, other than by planting on land that is already cleared, and we have a little bit of that as well. But just to correct one thing you said, we have – we've completed that acquisition.

Yeah right, okay.

We now own – we own an area of forestry land that would cover Adelaide, to put that in perspective.

There are also a number of private plantations on the island. Do you think you'll be in the position at some point to roll them up, to consolidate them?

We're in discussions with all 12 private growers with a view to doing exactly that, and on favourable terms I might add. You know, we operate on an island. You know, squeezing those people will not be good karma for our company, we have to deal with them fairly, give them a good exit and you know, ideally make them shareholders and supporters of our company and then we're in the process of doing that.

And so, at the end of that process and having bought the estate that you've just bought, how much land will you end up having planted or could you end up having planted?

I think where we'll end up is with about 20,000 hectares planted. We can squeeze a lot more planted area out of our current estate without clearing any native vegetation. And that'll do us, I mean we'd be happy to be effectively an annuities stock, you know, backed by a huge tangible asset, you know, of land and standard – standing timber and spitting off a very, very predictable dividend stream, that's our ambition.

And what proportion...

My ambition is to be – is to be boring, Alan. I want this to be a boring company.

And what – what proportion of your cash flow do you think you will dispatch as dividend?

We're targeting 60% but we may well be able to better that. Forestry is certainly capital intensive but that capital's already deployed. So, the sustaining capex for forestry which is basically replanting and fencing and so on, is relatively low. So, you know, it should generate a lot of cash. And the other thing of course is the world woodchip market, despite dire predictions about paperless offices, is actually increasing. There's a real shortage of supply because so much of demand has been satisfied from native forest logging and those native forests in a lot of places in the world are now gone. So, the whole industry is divided into plantations, which means scarcity and price rises. So, it's a good time for us. Forestry has been through a terrible, terrible period but it's coming out of it now.

Well, I've enjoyed talking to you, John. Thanks very much.

Well, I've enjoyed talking to you, Alan. Thank you for your interest and they were very good questions.

Great, thank you and all the best for the future.

Thank you, thank you, we'll stay in touch no doubt.

We will.