

Submission: Public Hearing to the Inquiry into the Triabunna Woodchip Mill and Future Development Opportunities for the Triabunna Region

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Preamble

After following the initial coverage of the initial submissions into the sale of the Triabunna woodchip facility, I have reviewed my decision not to participate and provide the following submission. The document provides the data, and decision-making processes Gunns undertook in the sale of Triabunna. I expect this will be valuable information and provide further insights.

Events Leading to the Transaction

During the second half of calendar year 2010, Gunns Limited made very public its decision to exit from its involvement in the native forest sector. This included all of its activities on the mainland and Tasmania.

The decision was a response, not only to the stark evidence of the decline in the market for native forest woodchips, but to recognition that a plantation fibre sourced pulp mill was the best chance of a viable future for the company.

This decision to exit the native forest sector was taken for the following reasons:

1. Gunns continued involvement in the sector would limit access to both debt and equity capital for the company.
2. That the volume trends for the consumption of sawn hardwood in Australia had been in decline for the past 4 decades (Australian consumption in 1971 was 2,724,000m³, with a population on 12.7 million moving to 913,000m³ in 2009 with a population on 21.3 million, an 80% decline in annual per capita consumption), with the trend not at its end point and that the financial returns that the business provided had fallen below acceptable levels. Plantation grown sawn fiber was replacing native hardwood in the structural and low value markets, while glass, metals and stone were eroding the decorative markets.
3. That the highly priced Japanese woodchip market was moving to higher quality plantation fibre, lower priced Asian fibre and was insisting on FSC (Forest Stewardship Council) certified product.
4. That to underwrite the significant investment that the Company had made in the hardwood plantations in Tasmania and provide a sustainable long term forest products business. The development of the Bell Bay Pulp Mill would be an essential component of this strategy.

Gunns had, arguably, the best understanding of the domestic and international markets for Australian native forest products, and the implications on product demand from the conflict that had engulfed the industry. This understanding

helped form the decision to focus on the plantation sector of the industry and the development of domestic processing for these products.

Gunns also believed that such an exit was seen as not only allowing Gunns to achieve its business objectives, but also allow for the industry to reestablish itself for the future, without the conflicts that had followed Gunns.

Gunns' intention was made public, with specific discussions with the major stakeholders, being Government, employees, suppliers and unions. These discussions were part of broader discussions within the industry that led to the negotiations between the industry and the environmental movement.

Gunns reaffirmed its commitment to an exit from the Tasmanian Native Forest sector at its 2010 Annual General Meeting in November 2010, where a specific undertaking was given by Gunns to allow the consolidation of Gunns Tasmanian Native Forest interests, provided that Gunns shareholders, employees and contractors were to be adequately compensated for this decision.

It should be noted that Gunns was specifically excluded from being part of the negotiations on the Tasmanian Forest Agreement, other than where Gunns was directly impacted around the exit provisions. Gunns was not one of the parties that became known as the "signatories to the IGA".

Triabunna Sale Process

Triabunna Woodchip facility had one major contract customer since the 1970s, being Nippon Paper. This supply arrangement was supported by a contract that was due to expire in December 2010.

During 2010 the Gunns sales team worked with Nippon seeking to achieve a change in position. Unfortunately this was not achieved, as Nippon's preference for supply to its Japanese facilities was for FSC certified, plantation fibre at more competitive prices than had been historically achieved.

In the first quarter of 2011, the Triabunna woodchip facility was closed and all the employees were given their notice of redundancy.

Gunns embarked on a sale process for the facility and invited industry participants to review an information pack on the facility and make a commercial offer. From this process three offers were received:

1. An industry group whose offer was highly conditional and incomplete, with a value range between \$0m and \$5m.
2. The Triabunna Investments offer of \$10m, without conditions.
3. Fibre Plus (Tas) Pty Ltd and RD O'Connor and B O'Connor (Aprin Pty Ltd) with an offer of \$16m. This group will be the O'Connor transaction for this report.

During the month of May Gunns negotiated with O'Connor to conclude an agreement. During these negotiations Gunns made it clear that such a transaction was to be concluded by 30 June 2011. In early June 2011, O'Connor and Gunns entered into an agreement for the sale of the Triabunna facility, with the date for settlement being 29 June 2011.

The contract for sale was not subject to any finance provisions, but did include specific details around transitional arrangement and the need for Gunns to undertake maintenance works prior to the sale.

O'Connor represented in this agreement to Gunns that funding was not an impediment to settlement by the 29 June 2011. Only when O'Connor failed to settle the transaction on the agreed settlement date, did it become apparent that the equity component of the investment was not significant and that the debt funding had not been committed.

Gunns completed its required maintenance works, at significant financial cost, and was in a position to settle this transaction on the agreed settlement date.

On the 29 June 2011, O'Connor advised Gunns that they were not in a position to settle the transaction. Indeed, no money was deposited in Gunns' bank accounts to settle the agreement.

On further inquiry it was learnt that O'Connor was seeking to fund the transaction by way of a loan of \$10m and a funding arrangement of \$6m from the Tasmanian State Regional Development Authority. Such arrangements were preliminary and incomplete.

It is beyond doubt, that had O'Connor on the 29 June 2011 complied with the Agreement of Sale, as they had contracted, Gunns would have settled.

But this failure left Gunns to review what options it had. It was communicated to O'Connor that Gunns was still keen to complete the transaction, but O'Connor needed to supply proof that they had the ability to do this. During this period Gunns continued to seek to understand O'Connor's ability to raise the finance and complete the transaction. Early in July 2011 O'Connor's solicitor advised Gunns that the contract was "at an end".

Once O'Connor's position became clear, Gunns commenced negotiation with Triabunna Investments, that had the next highest bid and with the least number of conditions. This was and would be considered normal commercial process in the conduct of any sale.

Not to complete this transaction, as outlined, would have been a breach of the fiduciary duty. By law officers of a company must act in the best interest of the owners of the business.

In the discussions with Triabunna Investments, it was Gunns that insisted that should Triabunna Investments be successful in the purchase that they make the

facility available to the industry as a woodchip export facility. Triabunna Investments agreed with this, on the condition that it would only be made available for wood that was procured from areas covered in the Tasmanian Forest Agreement.

On the conclusion of the negotiations with Triabunna Investments, Gunns was at a decision point. Accept the negotiated contract that was on offer from Triabunna Investments, which was now unconditional and with known counter parties, with the capacity to complete, or hold out for O'Connor to achieve funding.

We knew that Triabunna Investments would not accept delaying tactics and would most likely remove the offer if this were the case.

The judgment had to be made on O'Connor's ability to arrange the necessary finance to complete a contract, noting that O'Connor's solicitor had informed Gunns in July 2011, that the contract is "at an end". These considerations included:

1. The commitment status of the loan funding being sought. There was uncertainty as to due diligence and completion requirements.
2. The approval requirements for the TDA loan were unknown. This process could also have been potentially subject to political risk.
3. What would the continual delay in this process mean to our stated exit from the native forest sector and our ability to gain financial partner support for the Bell Bay Pulp Mill?

The Gunns decision was to conclude the agreement with Triabunna Investments, given that the industry had many months to purchase the facility and had either chosen not to or had not been able to financially conclude a transaction. Gunns had however provided for them the opportunity to maintain the facility.

Gunns, the Environmental Non Government Organisations (ENGO) and the Triabunna Woodchip Facility.

During the negotiation between Gunns and Triabunna Investments regarding the sale of the Triabunna Woodchip facility, there were no discussions with any of the ENGO's that linked or inferred an arrangement around the Bell Bay Pulp Mill.

Gunns view of the Triabunna transaction was that it was to be judged on the financial merits of each of the offers and there was never any intent or required need to link the transaction to the Bell Bay Pulp Mill.

On separate occasions, Gunns did seek to negotiate with the ENGO movement around the Bell Bay Pulp Mill and the certification of its plantation estate across Australia.

Given the history of the Gunns and the increasing awareness of corporate governance and social responsibilities, engagement with ENGO's was a necessary

part of doing business. We entered into such discussions in ‘good faith’ and with sound intentions. Gunns believed that the development of a plantation based pulp mill in Bell Bay would provide the necessary economic balance to what Gunns predicted would be the sharp fall in demand for native forest product. However to achieve this the general community needed to trust Gunns beyond what it traditionally had.

Discussions did take place with the ENGO movement around Gunns’ involvement in the exit from native forests and seeking to provide for the Bell Bay Pulp Mill in the Tasmanian Forest Agreement. Unfortunately this was not achieved, however as previously noted Gunns was not a signatory to this agreement and the outcome was between the parties that signed it.

As a result of these discussions with the ENGO movement and other groups, Gunns did make a number of changes to its business practices. These included:

1. A commitment to using only plantation grown fiber in the Bell Bay Pulp Mill, should it be built.
2. An elimination of the use of 1080 poisons in Tasmania for the reduction of browsing animals in the plantations.
3. Modification to the use of fire in hazard reduction in order to reduce the level of smoke emissions from plantations.
4. Chemical usage and notification processes.
5. Improved engagement with community groups.
6. A move to Elemental Chlorine Free (ECF) production technology in the proposed Bell Bay Pulp Mill.

Unfortunately these improvements and Gunns’ exit from the Native Forest business did not result in the external support of the new plantation business strategy of the company by the ENGOs.

Events Since the Triabunna Sale

The markets for native forest woodchip have not improved, with customers increasingly purchasing more competitive Asian grown plantation hardwood and Australian plantation hardwood.

New and more modern pulp mills in the world have moved or are moving to a supply requirement that more characterizes plantation fibre due to its consistent characteristics and higher pulp yields. This linked to the high Australian dollar and the abundant availability of quality fibre has repositioned the native forest fibre for some time to come. To be clear, there is no viable market for native forest fibre, and Gunns was at the forefront of the Tasmanian industry’s exposure to a fundamental market change.

Tasmania is not the only area affected by this transition, with Boral closing its Newcastle facility and Nippon closing its Eden facility.

There also remains an abundance of plantation grown eucalyptus woodchips for sale. According to the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARE) Australia's plantation log supply 2010 – 2054; published in May 2012, the following volumes will be available for exports.

Year	2010 – 2014	2015 – 2019	2020 - 2024
Volume tonnes	9,763,000	12,571,000	13,499,000

Exports of hardwood woodchips, supplied from both plantations and from native forests in the calendar years 2012 and 2013 were 3,342,000 bone-dry tonnes (in green tonnes, as above 6,684,000 approximately) and 3,526,000 bone-dry tonnes (in green tonnes, as above 7,052,000 approximately) respectively.

The requirement to harvest these plantations will directly impact on the price and access that native forest woodchips will have to international markets in the coming decade.

Conclusion

I believe that Gunns actively sought to provide the traditional native timber industry an improved opportunity through its withdrawal, to pursue a future that would have provided new opportunities for economic activity in Tasmania. This was an opportunity that could not be realized should Gunns have remained engaged in the native forest industry.

Gunns actively and publicly provided the industry and Government the trends that were affecting the traditional markets for woodchips and for sawn timber, contributing to the economic challenges that faced the industry. Those parties' inability to act or recognize these issues should be the focus of any review, not a private legal commercial transaction between entities.

With the exit from Triabunna, Gunns conducted a transparent and commercial sales process. The industry was given every opportunity to purchase the assets and when they chose not to, it was Gunns who provided the industry with the opportunity to have continued access to the facility.

As I have said, an orderly and transparent sale to whatever market existed was our obligation as directors of Gunns Limited. Gunns was not in a position to spoil its only market in favour of a bidder that had failed to meet its commitment as a preferred bidder already.

Personal Note

I have worked in the Timber Industry much of my working life and during that time the industry and markets have changed enormously. The customer has moved from timber furniture to metal and glass, the competition has grown, and become more sophisticated with Australian Eucalypts being grown faster and more productively in other parts of the world. The demand for native forest has declined dramatically, the increased requirement for plantation pulp has grown

exponentially. The voice of the green movement is a powerful and a relevant force not to be underestimated or ignored.

Times have changed and are continuing to change rapidly for the timber industry. We cannot live in the past about how things were done or what markets we had historically. The industry needs significant funding to re-equip itself for the future, funding that will only be available if the future industry is economically sustainable and has the broad support of the community.

This will be a future that does not have the export of native forest wood chip as its major product or one that is reliant on Government subsidies to survive.

The market is sending a clear and sustained message it just has to be heard. I hope this inquiry helps this to happen.

Gregory L'Estrange