



ASX Release

Monday, 22 February 2010

Gunns' strategic review to reshape the company

- **First half profit impacted by rising dollar and Asian downturn**
- **Outlook improved for second half**

Integrated forestry company Gunns Limited (ASX: GNS) today reported a net profit after tax (NPAT) for the six months to 31 December 2009 year of \$0.4 million, following the downturn in Asian markets and a rising Australian dollar.

Earnings before interest and tax (EBIT) for the half was \$4.8 million with operational EBIT at \$7.8 million, an 88 per cent decline on the prior corresponding period. Group revenue for the period was \$325.9 million, down 24 per cent. No interim dividend was declared.

Chairman John Gay said trading conditions had been extremely difficult in the company's key markets throughout the 2009 calendar year and had caused the depressed earnings for the reported period. A decline in managed investment scheme sales due to the collapse of several operators also impacted profits in the period. Recent improvement in key markets is expected to result in an improved second-half result and dividend distribution.

"With the changing conditions in key markets and industry opportunities which have arisen, we have undertaken a comprehensive strategic review to reshape the company to realise value in the group's assets and participate in growth opportunities," he said.

"This includes a corporate restructure to create a separate investment vehicle to facilitate direct investment in our significant plantation forestry estate, more appropriately valuing these assets and allowing us to expand it through further consolidation of hardwood plantation assets across Australia."

“This vehicle will also allow Gunns to maximise its investment in the Bell Bay Pulp Mill. ”

“We will also provide a more compelling investment structure to assist in closing the financing arrangements for the Bell Bay Mill. The mill is critical to maximising the value of our Australian forest resource, allowing Gunns to take a substantial proportion of this resource out of the relatively low-value and limited base of the commodity woodchip export market and add significant value to an export resource.”

“Gunns will also build on the merged Gunns, Auspine and ITC sawmilling operations and participate in future consolidation opportunities.”

“These steps, which follow a comprehensive strategic review of the group, will substantially improve the company's strategic position in forestry, fibre and timber processing for the future.”

OPERATIONS

The strengthening Australian dollar impacted on competitiveness in the Asian market and the traditional export woodchip market to Japan was affected by reduced demand due to the global financial crisis.

“Many of our customers operated at reduced output levels during the period under review, and this situation continues,” Mr Gay said.

“While the Chinese market is growing, pricing remains highly competitive due to the strength of the Australian dollar and short-term surpluses of low-priced competing products.”

Wood fibre revenue decreased to \$140.6 million, down 38 per cent, with earnings decreasing to \$6.9 million. This result is a direct reflection of the trading conditions experienced during the period. Management has retained a strong focus on cost control implementing programs to reduce fixed costs, to allow efficient operations in an environment of reduced volumes.

Timber Products revenue decreased two per cent to \$127.7 million with earnings increasing to \$5.5 million. Trading conditions gradually improved through the half, a trend which has continued in the current calendar year. The hardwood timber business of ITC Timber Pty Ltd was acquired in December 2009 for \$88.5 million.

This acquisition provides highly complementary milling and processing operations in Victoria, which is a strategically important location for Gunns. It has created a business with significant scale and a distribution footprint across Australia and South East Asia.

The business is expected to deliver an annualised EBIT of approximately \$20 million when all synergies are realised. These savings will be achieved through operational consolidation, optimisation of product between facilities and a reduction in overhead costs. Working capital investment in the combined business will be significantly reduced, with a targeted inventory reduction of \$30 million over 18 months. Integration costs are expected to be about \$4 million.

The Tasmanian merchandising business recorded a significant increase in turnover and earnings following completion of the redevelopment of our major Launceston retail operation in September 2009. The construction business experienced a relatively weak first half but has an improved outlook for the second half as a result of contracts secured. Sales volume and earnings for the cool climate wine business were improved notwithstanding the strength of the Australian dollar which lead to reduced export sales

Earnings from the managed investment business were down \$7.8 million from the prior year. The result reflects the low level of sales achieved following the collapse of a number of major MIS operators late in the 2009 financial year and the resultant reluctance by investors to participate in this market segment. As a result minimal plantation development activity was undertaken in the period.

Earnings per share (EPS) for the half decreased by 6.6 cents to (0.4) cents.

Operating cash inflow of \$19.3 million for the half compares to an operating cash outflow in the prior year first half of \$4.5 million.

BELL BAY PULP MILL PROJECT

Gunns is currently negotiating with several new purely financial investors as potential equity partners in the Bell Bay Pulp Mill. They would join Swedish forest products cooperative Södra, with whom negotiations continue as a potential industry-based equity partner.

“Gunns has appointed a financial adviser to bring the equity investment round to a close,” Mr Gay said.

“The project is being held in a ready status to allow us to immediately commence construction on financial close.”

“As previously announced, the mill will operate on 100 per cent plantation fibre from the commencement of operations.”

“We are also committed that the wood supply to the mill be Forest Stewardship Council (FSC) accredited.”

“This will be the most environmentally advanced Pulp Mill in the world and will move Gunns from an exporter of commoditised hardwood chips to a value-added processor with direct entry to the Asian pulp market.”

“The recent market for export woodchips has reinforced the merits of the mill – in a period where wood fibre value has remained static in real terms pulp value has increased significantly with a strong outlook.”

“We believe that the investment merits of the Pulp Mill project will be enhanced by providing potential investors with the ability to invest in both the Pulp Mill and the underlying forest resource.”

STRATEGIC REVIEW

Mr Gay said the company had conducted a strategic review following the downturn in key markets.

“The landscape for the Gunns business and the broader forest industry has changed significantly as a direct result of the global financial crisis,” he said.

“The market for our core product – hardwood wood fibre – has been impacted by a prolonged downturn.”

“At the same time significant opportunities for growth and consolidation across the forest products sector have arisen – notably in plantation management and sawmill operations.”

“Gunns has more than \$1 billion invested in forest assets – land and trees. This value is not recognised in the company’s current capitalisation.”

“Recognising these issues, the Board has undertaken a strategic review of the group’s operations and structure.”

“We intend to restructure the group to:

- Establish an investment vehicle to facilitate direct investment in our plantation forestry assets. This vehicle will more appropriately value Gunns forestry assets and will provide a vehicle for the expansion of this asset base through the further consolidation of hardwood plantation assets across Australia. This vehicle will also allow Gunns to maximise its investment in the Bell Bay Pulp Mill.
- Provide a more compelling investment structure to assist in closing the financing arrangements for the Bell Bay Pulp Mill. The mill is critical to maximising the value of our Australian forest resource, taking a substantial proportion of this resource out of the relatively low value and limited base of the commodity woodchip export market.
- Establish a stand-alone timber processing business to build on the merged Gunns, Auspine and ITC operations and participate in future consolidation opportunities.

“Advisors have been appointed to fast track this restructure, which although complex, should deliver significant shareholder value if executed in a timely manner.”

"Of critical importance is achieving financial close in relation to the Pulp Mill. The Board acknowledges that this uncertainty must be removed. A market update in respect to the progress of the restructuring initiatives will be provided in late April 2010."

GREAT SOUTHERN PROJECTS

Gunns Plantations Ltd (GPL) recently received approval to be appointed as the Responsible Entity (RE) for a number of Great Southern pulpwood Managed Investment Schemes.

Great Southern's hardwood pulpwood resources (located in the Green Triangle region of South Australia, in south west Western Australia and in Tasmania) represent one of Australia's largest hardwood plantation estates. These estates are strategically important to the Bell Bay Pulp Mill project.

OUTLOOK

Market conditions for the wood fibre business are expected to remain weak although a gradual improvement is expected through the course of the 2010 calendar year. The relative value of the Australian dollar will remain a critical factor in the competitiveness of supply into the growing Asian markets.

Earnings from Gunns' role as a manager of the Great Southern forestry projects will progressively increase through the 2010 year.

Domestic construction continues to show signs of improvement and demand for timber products has improved in the current half, with a general price increase achieved for most products from 1 February 2010. The Timber Products business will show further improvement from the integration of the ITC business which will be completed by 30 June 2010.

The MIS market has changed significantly over the past year with an outlook that remains uncertain. The company expects to provide guidance in respect of its activity in this sector in the course of the next month.

The company expects significant earnings improvement and the re-instatement of a dividend payment in the second half. An important factor in the recovery will be the outcome of woodchip price negotiations for the 2010 calendar year and the impact on both price and volume of supply. Further guidance on the full year outlook will be provided on completion of these negotiations.

Contact

Media: Matthew Horan 0403 934 958