

The Manager
Companies Announcements Office
Australian Securities Exchange

24 October 2018

Dear Sir/Madam,

Quarterly letter to shareholders

Please find attached a copy of the latest in a series of letters that the Managing Director of the Company addresses to its shareholders following the end of each quarter.

The letter is intended to provide background information on the Company's activities and highlight the progress that has been made, while providing some insight into the Board's rationale for the Company's actions and its plans.

Yours sincerely,



Ms Vicky Allinson
Company Secretary

Quarterly Letter

September Quarter 2018

Dear Shareholder,

The public exhibition of the Environmental Impact Statement (EIS) for the Kangaroo Island Seaport at Smith Bay will, I expect, begin very soon. There will be plenty to say about the development at that time and I do not propose to spend much of this letter discussing the approval process or the contents of the EIS. I only wish to make two points.

The first is that the EIS is one of the most comprehensive, thorough and well-supported documents that I have read. Every statement is underpinned by evidence and the various authors (there were many) have been careful to be balanced and dispassionate in their discussion of the environmental, economic and social impacts that the development will generate. It is a credit to the team at Environmental Projects, an Adelaide-based firm that can hold its own against the global firms that tend to dominate the EIS space.

Environmental Projects has been well supported by a wide study team of scientists, engineers and subject-matter specialists.

The second point is that, notwithstanding the quality of the EIS, and the fact that this is an excellent project for the State and the Island, we live in a democracy and should expect some level of opposition. Every transformative project leads to unfounded fears and engenders some resistance to change. That is to be expected. We must also expect some opponents to spread misinformation, and this has indeed occurred. I expect that the facts in the EIS will come as a relief to people who have been alarmed by some of this rumour-mongering – some of it deliberately mischievous.

In addition, there are of course some people who will be negatively affected: perhaps because their water views will be altered, or because they will experience increased vehicle noise, or disturbance from forestry operations. Where these impacts can be avoided, mitigated or offset, we will seek to do this ... and we will listen to everyone's concerns, whether well-founded or otherwise, and do our best to respond empathetically, with evidence and, where possible, with action.



And it needs to be remembered that even that icon of Kangaroo Island tourism, the magnificent Southern Ocean Lodge (pictured), met with fierce local opposition before its eventual approval. Kangaroo Island is a special place, and Islanders care very deeply about it. Some are rightly suspicious of outsiders with big plans. We are lucky to have on our board Shauna Black, a long time KI resident who

ensures that the good of her community is always to the fore in our deliberations. And there are a great many people in the KI community who realise that we love the Island too, and who are right behind us, eager for the trees to be harvested and keen to see the economic and population growth that will flow once that wharf is approved.

So, it is a very good EIS. Even so, expect a certain amount of criticism, misinformation and negativity... and expect your Company to continue to act in a way that respects the views of the community.

However, the main topic I wish to address this quarter is the future of the KI Seaport itself. In my March 2018 letter, I foreshadowed this topic. So, let's step forward in time and imagine that the facility has been built and that timber is being exported from Kangaroo Island at long last. There are a few issues that your board needs to resolve between now and then, and I want to share some of our thinking.

Who should operate the KI Seaport?

This is not a simple question. There are various functions involved in operating a port and they do not all have to be done by the same entity. Let's start with the whole business of getting cargo onto vessels. We already expect that Mitsui will operate ship-loading for woodchip vessels, using equipment that is subject to a BOOT arrangement¹. However, we also know that we will need to load logs. Logs require marshalling, scaling (measuring and sorting into different grades) and loading onto ships. There are various specialist operators who can undertake this difficult task. As other cargoes begin to use the port, there will also need to be an operator in place to handle the import and export of, for example, containerised freight.

These are not issues unique to the KI Seaport. Every port in the world has arrangements in place for each of the freight tasks that it manages, often with multiple providers. In our case, some aspects will be best performed directly by KPT and some will need to be tendered out to specialists. The process of finalising these landside arrangements and generating competitive tension can be managed during the construction period.

Then there is the marine side of port operations, arranging everything that an incoming vessel needs, making vessels aware of the requirements of the facility and of tide and weather conditions. Pilotage, tugs, mooring arrangements and vessel traffic control fall into this category, along with compliance with national border protection legislation, biosecurity protocols and South Australian regulation of harbors² and navigation.

This set of tasks requires a specialist in such matters, and it will not surprise anyone to learn that we are in discussions with an experienced port operator, which already manages

¹ BOOT is Build, Own, Operate and Transfer. For more details see the ASX release dated 17 September.

² In South Australia, "harbor" is spelled in what we would now recognise as an American fashion. This applies in all official documents and in place names, like Victor Harbor. Funnily enough, this seems to be the only word to which this convention applies. Colour, favour and their cousins are aligned with the rest of Australia.

several other ports in Australia. Of course, there are quite a few potential providers, and there is some scope to transition over time to internal control of some of these functions, or to appoint more than one operator for different aspects of marine operations.

What about the use of the facility by others?

As we have said from the start, and as government has required, we are building a multi-user facility, and doing so in a way that we hope will benefit non-timber users. Let's start, though, with timber. We expect that all the Island's timber will pass over the KI Seaport in due course. We will set a usage charge applying per tonne of timber, that covers operating and capital costs and provides a fair rate of return. So, timber will pay for the wharf.

We reserve the right to exercise some control over harvest scheduling, and thereby integrate non-KPT timber into the overall wood-flow, but this would only be to the extent necessary to ensure reasonably stable employment levels for harvest and haulage contractors and predictable levels of supply to our pulp mill and sawmill customers. We also reserve the right to have a preferential charging regime for "foundation timber customers" – those who, like KPT itself, commit their volume in advance and fit in with the overall harvest schedule. Our expectation is that all independent tree growers will elect to be foundation customers. This would mean that all timber on the Island (KPT's included) pays the same port usage charge.³

But what about other non-timber users? We have committed to the State Government and to the KI Council that we will make the facility available to non-timber users without requiring these users to make a contribution to the capital cost of the facility. The charge for importing containerised freight, for example, will be based only on the recovery of capital and operating costs attributable to that freight task. We expect to make a reasonable margin from non-timber freight, and we want our vessels to have berthing priority, but we do not expect non-timber users to pay for the facility itself. In this way, we can show government that we are building and operating the KI Seaport as a piece of public infrastructure. We are happy to have ESCOSA⁴ appointed to ensure that we honour this commitment.

So, for the 300 or so days a year when there is no timber vessel at the wharf, we have the potential to accommodate third party users at prices they will find attractive. Indeed, if they are happy to pay our demurrage (as cruise ships typically are) we do not mind moving a timber vessel off the berth to accommodate them.

How will we grow and develop third party business?

First, let me make it clear that the economics of the KI Seaport do not depend on attracting

³ Of course, we still need to work with independent tree growers to ensure that they get a good financial outcome. There will be an optimal time of harvest for any given plantation and we need to be scheduling reasonably close to that optimum. In fact, we want to ensure that these people do so well financially, and find the whole process so easy, that they are motivated to work with us to plant another timber crop immediately!

⁴ The Essential Services Commission of South Australia

non-timber users. Moreover, some activities may require additional government consent. However, we should be looking to attract as much usage as possible, both to maximise the benefits of ownership and to maximise the benefits to the community of having this freight option available. Part of the equation is to have attractive pricing, but the other part is having the correct incentives in place. We need to structure our arrangements with landside and marine side operators such that each benefits from increased usage. Already, Mitsui, our partner in woodchip handling (and so much else) is looking at whether nearby stranded timber assets on the mainland might be exported via the KI Seaport. If the right logistical solution can be found to bring timber from the Fleurieu Peninsula (which grows great trees) directly to Smith Bay, then the increased throughput will benefit both Mitsui and KPT. It's early days yet, of course, and this would only ever be a marginal addition to the big volumes of timber growing on the Island. However, one day, we may see a growing timber industry on the Fleurieu, exporting through Kangaroo Island.

There will be other such opportunities. Containerised freight is an obvious one and there is no limit on the range of items that can be moved on and off the Island in this fashion. However, we are also very interested in another bulk commodity: hay. There is potential for the relatively dry parts⁵ of Kangaroo Island to produce hay for export. Hay is a bit like timber. It too is a bulky, low-density product, even when compressed. There is a strong market for hay in North Asia and the Middle East (and in drought-affected parts of Australia from time to time) but land transport costs are high on a per tonne basis. Accordingly, just like timber, hay production for export is only economically attractive if one is near a deep-water port. There are some very astute and well-organised farmers on Kangaroo Island. They will be thinking about the risks and returns for hay crops on land currently used for other crops or intensive grazing, or perhaps integrating larger areas and longer periods of lucerne production into their existing crop rotation cycle. We look forward to working with the AgKI group to explore this possibility, as well as the potential for containerisation of farm inputs and of KI-grown grains and pulses.

Although it is not a matter directly addressed in the draft EIS, we have said from the outset that the KI Seaport has been designed to be suitable for cruise ships to dock. Some minor modifications may be needed, of course. For example, while they sit high in the water and would not require additional dredging, cruise ships tend to be very long and some may require an additional mooring point to be established to the west, to secure the ship's bowline. Some people in the cruise ship industry with whom we have spoken have been very enthusiastic about being able to dock at Kangaroo Island. However, it remains to be seen whether this happens or not. While the current practice of transferring passengers by tender boat to Penneshaw is unsatisfactory in poor weather, and Penneshaw is a very long way from the Island's places of outstanding natural beauty, at least there are things to do in

⁵ The relatively high rainfall parts of the Island will do better growing tree crops. In fact, EconSearch estimates that trees will be three times as profitable as grazing, and generate more employment, on land with over 600mm rainfall.

Penneshaw itself. There is precious little with which to amuse oneself at Smith Bay, other than a bit of bushwalking. At least there are plenty of Kangaroos to see! And there may be potential to add some grape vines and perhaps the associated products that KI produces.

Perhaps the biggest potential is not from the cruise ships that currently visit Kangaroo Island, despite the challenges, but from those that do not. We will work at developing this business and time will tell if we are successful.

From time to time, there will be a need to bring some oversize cargo to Kangaroo Island. At the moment, every water tank on the Island, every prefabricated roof truss and every piece of heavy machinery is no bigger than would fit on a semi-trailer, because that has been the limitation imposed by the Sealink vehicular ferries. We expect that there will be occasions when “big things” are needed and the KI Seaport is the only means of getting them onto the island. Some of the materials handling infrastructure and larger forestry equipment will be among the first such consignments.

Before we leave the question of additional uses, I should point out that the pontoon has a ramp at the south eastern end that is 12m wide, enabling roll-on roll-off vessels (like some of those operated by Sealink, pictured) to load and unload trucks at Smith Bay should there be a need. This ramp could also be used for barges and transhippers. Lest there be any doubt, KPT has no intention of competing with either Sealink or new entrant KI Connect in the domestic passenger business. We have no plans to build all the infrastructure that is needed to manage domestic passengers ... and Smith Bay itself is hardly where one would choose to arrive or depart if travelling to the mainland.



Of course, while all the potential additional uses discussed above are interesting and some are worth pursuing, the most important way to maximise the investment return on the KI Seaport is to increase the volume of timber grown and harvested on Kangaroo Island. That, we expect, will be the main source of additional usage, once the shackles are released from the timber industry on Kangaroo Island and once landowners have the incentive and the ability to plant trees if they decide it is the highest and best use of their land.

What sort of company do we want to be?

Our Company initially listed on the ASX in 1999, eventually winding up its MIS schemes and adopting the name Kangaroo Island Plantation Timbers in 2013, at a time when the only assets of any value were (as the names suggests) wholly-owned timber plantations on Kangaroo Island. For the last five years, the name has been descriptive and accurate. It remains so. Soon, however, we will also be the owner of a port: a single berth port but a

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port nevertheless. That will make us an infrastructure company, although I doubt that another name change will be warranted.

The Board's intention is to retain ownership of the port for the medium term at least. Plenty of commodities exporting companies have seen their profits eroded by port charges, and we would not want to put our timber assets completely at the mercy of a future port operator. However, after we have been using the port for a few years ourselves and have explored the opportunities for additional usage, we may be in a position to establish a long term take or pay agreement covering our timber, in which we lock in reasonable port charges for the long term, in return for guaranteed volumes over the same period. There will be a right time for a transaction such as this, when infrastructure is flavour of the month and we have a good sense of what ownership is worth to us.

For the time being, we have only taken two actions in pursuit of this eventuality: we run all port-related activity through a 100% subsidiary, KI Seaport Pty Ltd, which holds all Smith Bay land and which will operate as a separate business; and we have worked out a charging regime under which KI Seaport will bill our timber-owning subsidiary for use of the port.

Typically, ports around Australia are owned by a combination of dedicated port operators and industry super funds, sometimes in conjunction with or intermediated through infrastructure investment funds. Ultimately, it will probably be some similar combination that owns the KI Seaport. However, no one can say when this will be or what the size of the financial benefit to KPT will be, although we are confident that the port will be worth more than the cost of building it. We will, however, account for it at cost until we have a good reason to do otherwise.

I do hope to be able to share good news soon about our progress through the final stages of the approval process.

With best wishes and thanks,



John Sergeant
Managing Director

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