

CITY FORESTS LIMITED

CITY FORESTS LIMITED

**ANNUAL REPORT
FOR THE YEAR
ENDED
30 JUNE 2012**

CITY FORESTS LIMITED

CONTENTS

	Page
Company Particulars	3
Directors' Report	4 - 10
Information on Directors	11 - 12
Trend Statement	13
Financial Statements	14 - 17
Statement of Cashflows	18 - 19
Notes to the Financial Statements	20 - 54
Appendix:	
Statement of Service Performance	55 - 56

CITY FORESTS LIMITED

COMPANY PARTICULARS

As at 30 June 2012

DIRECTORS

R D Liddell (Chairman) - B.Com., C.A. (P.P.), A.C.I.S., A.F.Inst.D.
P R Hudson (Deputy Chairman) - J.P., B.Com., C.A. (Retired 31.3.12)
M O Coburn - F.N.Z.I.M., A.F.Inst.D. (Deputy Chairman as at 1.4.12)
N G Evans - N.Z.C.E., D.B.A., M.Inst.D.
S J McLauchlan – B Com, F.C.A.(P.P.), A.F.Inst.D.

CHIEF EXECUTIVE OFFICER

Grant Dodson – B.For.Sci, M.N.Z.I.F., M.Inst.D.

REGISTERED OFFICE

31 Stafford Street
Dunedin
New Zealand

BANKERS

Westpac Banking Corporation

SOLICITORS

Gallaway Cook Allan

FINANCIAL ADVISERS

Deloitte

AUDITOR

Audit New Zealand on behalf of the Controller and Auditor General

CITY FORESTS LIMITED

DIRECTORS' REPORT

For the Year Ended 30 June 2012

The Directors of City Forests Limited are pleased to present their report on the activities of the Company for the year ended 30 June 2012.

Principal Activities of the Company

This report covers the financial year 1 July 2011 to 30 June 2012.

The principal activities of the Company are the growing, harvesting, processing and marketing of forest products from plantations it owns. The products are sold both in the domestic and export markets. It is also involved in the processing of chips from forest residues for the export trade through an associate company, Otago Chipmill Limited.

Results for the Year Ended 30 June 2012

	\$000
Operating Surplus before Income Tax and Impairment	5,518
Less Income Tax	641
Less Impairment	3,000
Net Surplus for the Year	<u>1,877</u>

State of Affairs

The Directors are satisfied with the results achieved by the Company, having regard to the more difficult trading conditions experienced during the year, and believe that the state of affairs of the Company is satisfactory.

Dividends

The Directors declared and paid a fully imputed dividend of \$1,100,000 in December 2011 and a final un-imputed dividend of \$1,100,000 in June 2012.

Donations

There have been donations made of \$5,832 during the year.

Changes in Accounting Policies

There have been no changes in accounting policy.

Reserves

The following net transfers have been made to or from reserves:

	\$'000
To Forestry Reserve	2,522
To Retained Earnings	(2,845)
To Hedging Reserve	(1,072)
To Land Revaluation Reserve	(505)

CITY FORESTS LIMITED

DIRECTORS' REPORT Cont'd/... **For the Year Ended 30 June 2012**

Review of Operations

This review of operations and the accompanying financial reports cover the 1 July 2011 to 30 June 2012 financial year.

During the year the company has operated in a climate of lacklustre operational returns for the forest industry driven by the European financial crisis, continued sluggish economic activity in the United States and below average growth across the Asia-Pacific region. This has been felt most at the Milburn Wood Processing Plant whilst returns from domestic and export log sales although satisfactory have not been at the high levels seen last financial year. The Company continues to be active in the carbon market and has completed a number of pre-contracted sales of Carbon Credits or NZU's to emitters under the New Zealand Emissions Trading Scheme. This combination of log and carbon revenues has delivered a satisfactory financial performance for the company given the difficult trading environment. Cash flows from these operating activities have funded \$2.2 million in shareholder dividends, reinvestment in the forest asset through planting and silviculture operations and provided for a modest reduction the company's debt levels.

Export log volumes to our principal South Korean customers have been steady during the year. The key profitability drivers of market price, exchange rate and shipping costs, although variable, have been at levels that provide returns from harvesting at approximately long term average levels. Domestic log sales have been strong during the year as domestic customers seek additional volumes to achieve improved economies of scale. The company has introduced a log stumpage tender program to take advantage of this demand and the first tender has been successfully completed with harvesting under way by the successful party.

The Milburn Processing Plant has once again faced difficult market conditions for timber products. As a result the Company made a strategic decision to exit wood processing and a process was conducted with a number of interested parties concluding in a lease of the facility to Craigpine Timber Limited. This lease is associated with a log supply agreement. As a result of these arrangements additional logs will be processed in New Zealand, the facility will remain open and be operated by a large scale timber processor and the Company will no longer be exposed to financial risk from this operation. As part of this process the book value of the site assets has been reduced to reflect fair value taking into account future cash flows.

During the year the market price of carbon reduced significantly driven by excess supply of cheap carbon credits from Europe. The company is in the fortunate position to have pre-contracted sales at favourable prices and achieved revenue of approximately \$1.6m from carbon trading under the New Zealand Emissions Trading Scheme during the period. In addition the company has contracted a number of NZU sales for the coming financial year.

Change in value of the forest asset value has once again been a significant contributor to the Company's financial performance. The discounted cash flow valuation is impacted by a number of factors including production costs, market prices, forest harvest, forest growth, carbon valuation and discount rate interacting to deliver a gain of \$3.50 m. This year following independent advice the company reduced the discount rate applied to value the Company's forests from 7.5% to 7%. This had a positive impact on the valuation.

CITY FORESTS LIMITED

DIRECTORS' REPORT Cont'd/... For the Year Ended 30 June 2012

Forest replanting and tending operations have continued to add value to the forest asset. This year has been a particularly large planting year with the company restocking 732ha of harvest areas awaiting replanting. No new land acquisitions have occurred during the year.

Management is focused on delivering strong returns to our shareholder and has positioned the company in terms of production, logistical and international marketing capacity as well as carbon trading ability, to take advantage of the opportunities available to the forest industry.

Developments

The exit from Milburn wood processing operations, lease of the facility to Craigpine Timber Limited in conjunction with a log supply agreement and the introduction of a log stumpage tender program are the main achievements for the year.

Forest Valuation

The value of the Company's forests increased from \$100.3m at 30 June 2011 to \$103.5m at 30 June 2012. This net \$3.2m increase was attributable to a combination of factors, primarily;

- Positive forest growth and maturity in the forest asset, offset by harvesting removals.
- An increase in certain forest yield assumptions following reconciliation increasing the value.
- Recent market price decreases negatively impacting the 5 year rolling average price and forest value.
- Operational savings in harvesting and forest access costs increasing the forest value.
- The reduction of "Post 1989" forest carbon value for the remainder of "Kyoto Commitment Period One" under the New Zealand Emissions Trading Scheme, by the value of sales completed in the financial year.
- A reduction in the discount rate applied from 7.5% to 7% increasing the forest value.

Sustainable Forest Management

The Company continues to demonstrate its commitment to responsible and sustainable management of its forest estates. During the year an audit of its management practices to the Forest Stewardship Council Certification Standard was completed successfully.

Change of Directors

Mr Paul Hudson resigned from the Board in March 2012. The Company acknowledges the substantial contribution made by Mr Hudson during his twelve year tenure as a Director. Mr Michael Coburn was appointed Deputy Chairman following Mr Paul Hudson's resignation.

CITY FORESTS LIMITED

DIRECTORS' REPORT Cont'd/... For the Year Ended 30 June 2012

Outlook

The outlook for the coming financial year is to deliver a strong financial result driven by solid export and domestic log sales that have been partially underpinned by foreign exchange hedging, fixed price domestic log stumpage tender sales and fixed price international shipping. The company will also realise substantial revenues from pre-contracted carbon sales at favourable pricing. The net result of these activities is the forecast provision of \$4.4m of dividends to the shareholder, including a special \$2m dividend from carbon sales, and a substantial reduction in net debt.

Looking to the longer term future we are optimistic that City Forests and the New Zealand Forest Industry have entered a period of generally more favourable returns in international log markets. This is driven by strong demand for wood products and other commodities by China and other Asian economies experiencing substantial economic growth. As experienced in the last 12 months it is expected that economic volatility will cause these returns to remain cyclic in nature throughout each financial year.

This period of opportunity coincides with the Company's annual harvest reaching long term sustainable levels of approximately 270,000 m³ per annum. The Company is well placed with a mature, harvest ready forest and proven export capability to make the most of the Asian economic boom.

Carbon trading will continue to be a contributor to company performance over the next 10 years and provide financial recognition of the company's wider positive environmental impact.

The Company's approximately 4000 ha of "Post 1989" forest will deliver annual carbon returns until the value of the sustainable minimum quantity of carbon stored in the "Post 1989" tree crop has been realised. By following this conservative strategy "Post 1989" forest estate carbon liabilities at harvest will be substantially avoided. The final allocation of "Pre-1990" carbon credits will occur in 2013.

The combination of improved harvest returns and carbon sales revenue is forecast to deliver solid profits and positive cashflow, a reduction in net debt and an increasing and regular series of dividends to our shareholder over the course of the Company's ten year plan.

Social and Environmental Contributions [Triple Bottom Line]

City Forests Limited has continued its Forest Stewardship Council Certification during the year and is making steady progress on improving its knowledge and management of a number of environmental and cultural issues within its forest estate. This includes work in progress identifying rare, threatened or endangered flora and fauna.

The community continues to benefit from the significant network of walking and cycle tracks, picnic areas and other public amenities maintained by City Forests Limited. The Company continues to encourage the public use of its forests in a controlled fashion with numerous recreational activities occurring during the year.

CITY FORESTS LIMITED

DIRECTORS' REPORT Cont'd/... **For the Year Ended 30 June 2012**

Our financial contribution to the community has been modest and a number of minor donations totalling \$5,832 have been made to various community groups and charities. In addition non cash donations of firewood have been made to some clubs and charities.

During the year the Company's forests stored carbon balance increased by approximately 6,735 tonnes of Carbon or 24,692 tonnes of CO₂, when compared to 30 June 2011. Approximately 4,463 tonnes of carbon were emitted from operations giving a net carbon positive footprint for the year of 2,272 tonnes of Carbon or 8,330 tonnes CO₂.

Of the total stored carbon in the Company's forests, the net proportion attributable to the Company's Kyoto forests (planted post 1989) was an annual increase of approximately 25,823 tonnes of carbon or 94,685 tonnes of CO₂ based on our registered post 1989 forest area and MAF Carbon lookup tables.

Financial Statements

The audited financial statements for the year ended 30 June 2012 are attached to this report.

Directors' Interests in Contracts

Refer to Directors' Declarations of Interest section on pages 11 to 12 and the Related Parties Transactions note 31.

Auditors

The Controller and Auditor General have contracted the audit to Audit New Zealand. Auditor's remuneration is set out in Note 5 on page 30.

Employee Remuneration

The number of employees with total remuneration exceeding \$100,000 per annum is detailed in the following table in \$10,000 remuneration brackets.

Table 1; Employee Remuneration and Other Benefits, \$000

	120 - 130	130 - 140	140 - 150	150 - 160	250 - 260
Number of Employees	1	1	1	1	1

CITY FORESTS LIMITED

DIRECTORS' REPORT Cont'd/... For the Year Ended 30 June 2012

Information on the Directors of City Forests Limited

Director	Responsibilities	Remuneration \$000	
		2012	2011
Ross D Liddell	Chairman, Remunerations Sub Committee	37	36
Paul R Hudson	Deputy Chairman, Remunerations Sub Committee. (Retired March 2012)	18	23
Norman G Evans	Non-Executive Director	21	21
Michael O Coburn	Non-Executive Director, Deputy Chairman from April 2012	21	21
Stuart J McLauchlan	Non-Executive Director	21	21

Directors' Insurance

As provided in the Company's Constitution, City Forests Limited has arranged policies of Directors' Liability Insurance, which together with a deed of indemnity, ensure that the Directors will incur no monetary loss as a result of actions undertaken by them as Directors provided that they operate within the law.

Directors' Benefits

No Director of City Forests Limited has, since the end of the previous financial year, received or become entitled to receive a benefit other than a benefit included in the total remuneration received or due and receivable by the Directors shown in the financial statements.

There were no notices from Directors of the Company requesting to use Company information received in their capacity as Directors which would not otherwise have been available to them.

Staff

The Directors record their appreciation of the professional and positive way that both staff and contractors have carried out their duties during the year. The Company is very fortunate to have a small but dedicated team ably led by Grant Dodson, the Company's Chief Executive Officer.

CITY FORESTS LIMITED


DIRECTORS' REPORT Cont'd/... **For the Year Ended 30 June 2011**

Events Subsequent to Balance Date


No significant events have occurred subsequent to balance date.

On behalf of the Board of Directors:

R D Liddell
Chairman


Date 28/8/12

M O Coburn
Deputy Chairman


Date

CITY FORESTS LIMITED

Information on the Directors of City Forests Limited

Director & Qualifications

Declarations of Interest

Ross D Liddell (Chairman)

B.Com., C.A. (P.P.), A.C.I.S., A.F.Inst.D.

Chairman, Browns Barkly Limited
Chairman, Dunedin City Treasury Limited
Chairman, James Maurice Properties Limited
Chairman, Palmer & Son Limited
Chairman, Palmers Mechanical Limited
Chairman, Palmer M H Limited
Chairman, Viblock Limited
Chairman, Victory Lime 2000 Limited
Deputy Chairman, Aurora Energy Limited
Deputy Chairman, *DELTA* Utility Services Limited
Director, AB Lime Limited
Director, Blackhead Quarries Limited
(Retired 31st October 2011)
Director, Hunterfields Investments Limited
Director, McMahon Investments Limited

Date appointed November 2000

Paul R Hudson (Deputy Chairman)

J.P., B.Com., C.A.

Director, Aurora Energy Limited
(Retired 31 March 2012)
Director, *DELTA* Utility Services Limited
(Retired 31 March 2012)
Councillor, Dunedin City Council

Date appointed November 2000

Retired 31st March 2012

Michael O Coburn (Non-Executive Director)

F.N.Z.I.M., A.F.Inst.D.

Director, Arthur Barnett Limited
Director, Lake Hayes Estate Limited
Director, New Zealand Land Fund Limited
Director, Aurora Energy Limited
Director, *DELTA* Utility Services Limited
Director, *DELTA* Investments Limited
Director, Jack Tewa Foundation
Director, New Zealand Aquifer Limited
Shareholder (via a trust), Locations Realty Queenstown Limited

Date appointed September 2003

Appointed as Deputy Chairman 1st April 2012

CITY FORESTS LIMITED

Director & Qualifications

Declarations of Interest

Norman G Evans (Non-Executive Director)

N.Z.C.E., D.B.A., M.Inst.D.

Chairman, Enabling Pty Limited (Aus)
Director, Enabling NZ Limited
(Retired September 2011)
Director, Dunedin Transport Limited
(Retired November 2011)
Director, Aurora Energy Limited
Director, *DELTA* Utility Services Limited
Director, Halo Investment Management Limited
Director, Halo Fund No 1 Limited
Director, Lifetime Health Diary Limited

Date appointed July 2005

Stuart J McLauchlan (Non-Executive Director)

B Com, F.C.A. (P.P.), A.F.Inst.D.

Director, Cargill Hotel 2002 Limited
Director, Dunedin Casinos Limited
Director, Scenic Circle Hotels and Subsidiaries
Director, Otago & Southland Employers Association
Chairman, Dunedin International Airport Limited
Director, AD Instruments Pty Limited
Chairman, NZ Sports Hall of Fame
Pro Chancellor, University of Otago
Partner, GS McLauchlan & Co
Director, Aurora Energy Limited
Director, *DELTA* Utility Services Limited
Director, University of Otago Foundation Studies
Limited
Chairman, Scott Technology Limited
Director, Lund South Limited
Director, South Canterbury Subsidiaries
Chairman, Pharmac
Director, X Rock Automation Pty Limited
Director, USC Investment Limited
Director, *DELTA* Investments Limited
Chairman, UDC Finance Limited
Director, HTS 110 Limited
Director, Roxdale Foods Limited

Date appointed June 2007

CITY FORESTS LIMITED

TREND STATEMENT

	Year Ended 30 Jun 12 \$'000	Year Ended 30 Jun 11 \$'000	Year Ended 30 Jun 10 \$'000	Year Ended 30 Jun 09 \$'000	Year Ended 30 Jun 08 \$'000
<u>FINANCIAL PERFORMANCE</u>					
Domestic Revenue	8,652	6,503	6,263	5,397	5,520
Export Revenue	30,869	35,451	33,255	23,685	16,898
Other Revenue	2,703	3,912	2,118	1,491	2,257
New Zealand Carbon Credits	2,316	6,850	3,264	-	-
Gain in fair value of forestry asset	3,503	738	6,174	3,311	5,638
Total Revenue	48,043	53,454	51,074	33,884	30,313
Percentage Increase (Annualised)	(10.1%)	4.7%	50.7%	11.8%	(9.3%)
Inventory Movement	(820)	695	(182)	(138)	677
Total Expenses	41,705	42,867	41,577	33,716	28,773
Percentage Increase	(2.7%)	3.1%	23.3%	17.2%	(3.5%)
Operating Surplus before Taxation and Impairment Charges	5,518	11,282	9,315	30	2,217
Impairment Charges	3,000	-	-	-	-
Income Tax	641	1,748	2,201	(335)	795
Surplus after Income Tax and Impairment Charges	1,877	9,534	7,114	365	1,422
Share of Retained Surplus in Associate Company	-	-	-	-	-
Total Surplus after Taxation	1,877	9,534	7,114	365	1,422
<u>SHAREHOLDERS' FUNDS</u>					
Shareholders Funds	81,938	83,838	75,961	70,869	71,917
Operating Cash flow	5,130	13,266	5,397	2,091	(1,990)
Dividends Paid - Normal	2,200	2,000	1,850	1,850	1,850
Value of Forest	103,528	100,335	99,840	94,035	90,614
Surplus after tax to shareholders funds	2.29%	11.93%	9.40%	0.52%	1.98%
Proprietorship Ratio	56.10%	56.69%	51.32%	51.14%	53.56%
Net Forest Revaluation	2,522	531	4,322	2,318	3,777
Net Land Revaluation	(505)	(10)	-	162	605
<u>FOREST STATISTICS</u> (whole no's)					
Forest harvested (m ³)	266,281	263,530	241,961	210,803	179,678
Volume traded (m ³)	27,151	20,564	22,397	16,103	17,131
Forest planted (ha)	732	811	349	589	321
Total forest (ha)	16,129	16,011	15,997	16,044	16,119
Forest purchased (ha)	-	-	-	-	-

CITY FORESTS LTD

Statement of Comprehensive Income For the Year Ended 30 June 2012

	Note	Year to 30 June 2012 S'000	Year to 30 June 2011 S'000
Revenue	3	42,127	49,123
Financial income	4	2,413	3,593
Gain/(loss) in fair value of forestry asset	27	3,503	738
Total revenue		48,043	53,454
Inventory movement		(820)	695
<i>Less expenses</i>			
Contractors		15,404	15,318
Depreciation and amortisation expense		705	736
Directors fees		118	122
Employee expenses		2,752	2,811
Financial expenses	6	1,563	1,732
Impairment of wood processing assets		3,000	-
Raw materials and consumables used		4,441	5,633
Other expenses	5	16,722	16,515
Total expenses		44,705	42,867
Profit before tax		2,518	11,282
Income tax expense	9	(641)	(1,748)
Net Profit for the Year		1,877	9,534
Other comprehensive income			
Gains/(loss) on cash flow hedges taken to equity		(1,489)	490
Tax effect of cash flow hedges taken to equity		417	(137)
Increase/(decrease) in land revaluation		(505)	(10)
Other comprehensive income for the year		(1,577)	343
Total Comprehensive Income for the Year		300	9,877

The accompanying notes and accounting policies form an integral part of these audited financial statements.

CITY FORESTS LTD

Statement of Changes in Equity

For the Year Ended 30 June 2012

		Year to 30 June 2012 \$'000	Year to 30 June 2011 \$'000
	Note		
Equity at beginning of year		83,838	75,961
Total comprehensive income for the year		300	9,877
Distribution to owners			
Dividends	8	(2,200)	(2,000)
Equity at end of year		81,938	83,838

The accompanying notes and accounting policies form an integral part of these audited financial statements.

CITY FORESTS LTD

Balance Sheet

As at 30 June 2012

	Note	As at 30 June 2012 \$'000	As at 30 June 2011 \$'000
Equity			
Share Capital	10	25,691	25,691
Forestry reserve	11	40,927	38,405
Land revaluation reserve	11	14,970	15,475
Hedging reserve	11	(228)	844
Retained earnings	12	578	3,423
Total Equity		81,938	83,838
Current Liabilities			
Trade and other payables	13	2,147	2,999
Other current liabilities	15	1,303	959
Employee Provisions	16	163	245
Derivative financial instruments	14	1,695	1,151
Current portion of term borrowings	17	5,419	3,867
Provision for taxation		29	37
Total current liabilities		10,756	9,258
Non-Current Liabilities			
Derivative financial instruments	14	2	-
Term borrowings	17	27,987	29,579
Other liabilities	15	320	320
Deferred tax liability	18	25,028	24,872
Employee provisions	16	20	26
Total non-current liabilities		53,357	54,797
Total Liabilities		64,113	64,055
TOTAL EQUITY PLUS LIABILITIES		146,051	147,893

The accompanying notes and accounting policies form an integral part of these audited financial statements.

CITY FORESTS LTD

Balance Sheet Cont'd/....

As at 30 June 2012

		As at 30 June 2012 \$'000	As at 30 June 2011 \$'000
	Note		
Current Assets			
Cash and cash equivalents	21	1,011	909
Trade and other receivables	22	5,032	4,016
Derivative financial instruments	14	812	975
Inventories	24	1,375	2,195
Prepayments		51	181
Other current assets	23	69	547
Intangibles - New Zealand carbon credits	29	552	366
Total current assets		8,902	9,189
Non-Current Assets			
Derivative financial instruments	14	560	1,349
Property, plant and equipment	28	32,737	36,687
Forestry assets	27	103,528	100,335
Investments in equity accounted investees	25	308	308
Investments	25	1	1
Intangibles – computer software	26	15	24
Total non-current assets		137,149	138,704
TOTAL ASSETS		146,051	147,893

For and on behalf of the Board of Directors

R D Liddell
Chairman



Date 28/8/12

M O Coburn
Deputy Chairman



Date

The accompanying notes and accounting policies form an integral part of these audited financial statements.

CITY FORESTS LTD

Statement of Cash Flows For the Year Ended 30 June 2012

		Year to 30 June 2012 S'000	Year to 30 June 2011 S'000
	Note		
Cash Flows from Operating Activities			
<i>Cash was provided from</i>			
Receipts from customers		40,867	53,116
Interest received		6	4
Dividends from other investments		175	-
Effect of exchange rate changes		2,225	3,570
		<u>43,273</u>	<u>56,690</u>
<i>Cash was disbursed to</i>			
Payments to suppliers and employees		36,763	40,085
Interest paid		1,304	1,533
Income Tax		76	1,207
Subvention payments		-	599
		<u>38,143</u>	<u>43,424</u>
Net Cash Inflows/(Outflows) from Operating Activities	30	5,130	13,266
Cash Flows from Investing Activities			
<i>Cash was provided from</i>			
Sale of property, plant and equipment		77	105
		<u>77</u>	<u>105</u>
<i>Cash was disbursed to</i>			
Purchase of property, plant and equipment		298	1,132
Purchase of Forest Assets – Cost of bush		1,810	2,063
		<u>2,108</u>	<u>3,195</u>
Net Cash Inflows/(Outflows) from Investing Activities		(2,031)	(3,090)

The accompanying notes and accounting policies form an integral part of these audited financial statements.

CITY FORESTS LTD

Statement of Cash Flows Cont'd/.... For the Year Ended 30 June 2012

	Year to 30 June 2012 S'000	Year to 30 June 2011 S'000
Cash Flows from Financing Activities		
<i>Cash was provided from</i>		
Proceeds from borrowings	8,776	8,699
	<u>8,776</u>	<u>8,699</u>
<i>Cash was disbursed to</i>		
Repayment of borrowings	9,573	16,123
Dividends paid	2,200	2,000
	<u>11,773</u>	<u>18,123</u>
Net Cash Inflows / (Outflows) from Financing Activities	<u>(2,997)</u>	<u>(9,424)</u>
Net Increase / (Decrease) in Cash Held	102	752
Cash and short term deposits at the beginning of the year	<u>909</u>	<u>157</u>
CASH AND SHORT TERM DEPOSITS AT THE END OF THE YEAR	<u>1,011</u>	<u>909</u>
Composition of Cash		
Cash and short term deposits	<u>1,011</u>	<u>909</u>

The accompanying notes and accounting policies form an integral part of these audited financial statements.

CITY FORESTS LTD

Notes to the Financial Statements

For the Year Ended 30 June 2012

1. REPORTING ENTITY

City Forests Limited is a Council Controlled Trading Organisation as defined in the Local Government Act 2002. The company, incorporated in New Zealand under the Companies Act 1993, is a wholly owned subsidiary by Dunedin City Holdings Limited. Dunedin City Holdings Limited is wholly owned by Dunedin City Council.

The registered address of the company is 31 Stafford Street, Dunedin.

City Forests Limited is a profit orientated entity.

The financial statements have been prepared in accordance with the requirements of, the Local Government Act 2002, the Companies Act 1993 and the Financial Reporting Act 1993.

These financial statements are presented in New Zealand dollars because that is the currency of the primary economic environment in which the company operates.

2. SIGNIFICANT ACCOUNTING POLICIES

Statement of Compliance

The annual financial statements have been prepared in accordance with NZ GAAP. They comply with New Zealand Equivalents to International Financial Reporting Standards (IFRS), and other applicable Financial Reporting Standards, as appropriate for profit orientated entities.

The financial statements were authorised for issue by the directors on 28th August 2012.

Basis of Accounting

The financial statements have been prepared on the historical cost basis, except for the revaluation of certain property, plant and equipment, biological assets, derivative financial instruments, financial instruments classified as available for sale and financial instruments held for trading.

The accounting policies set out below have been applied consistently to all years in these financial statements.

Associate Entities

The company has used deemed cost for the value of the shares held in Otago Chipmill Limited.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

Revenue Recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts and GST.

Revenue from services rendered is recognised when it is probable that the economic benefits associated with the transaction will flow to the entity. The stage of completion at balance date is assessed based on the value of services performed to date as a percentage of the total services to be performed.

Sales of goods are recognised when significant risks and rewards of owning the goods are transferred to the buyer, when the revenue can be measured reliably and when management effectively ceases involvement or control.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Company As Lessor

Amounts due from lessees under finance leases are recorded as receivables at the amount of the company's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the company's net investment outstanding in respect of the leases.

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease.

The Company As Lessee

Assets held under finance leases are recognised as assets of the company at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability.

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

Foreign Currencies

The financial statements of the company are presented in the currency of the primary economic environment in which the company operates (its functional currency). For the purpose of the financial statements the results and financial position of the company are expressed in New Zealand dollars, which is the functional currency of the company.

Transactions in currencies other than New Zealand dollars are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are translated at the rates prevailing on the balance sheet date. The company does not hold non-monetary assets and liabilities denominated in foreign currencies.

In order to hedge its exposure to certain foreign exchange risks, the company may enter into forward contracts and options (see below for details of the company's accounting policies in respect of such derivative financial instruments).

Borrowing Costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in the income statement in the year in which they are incurred, with the exception of the Ministry of Forestry loans.

Government Loans

Forestry term liabilities are Ministry of Agriculture and Forestry Repayable Loans. Interest is calculated annually on the repayable loans. The company is repaying these loans over a 10 year period commencing 1st January 2012.

Employee Entitlements

Entitlements to salary and wages and annual leave are recognised when they accrue to employees. This includes the estimated liability for salaries and wages and annual leave as a result of services rendered by employees up to balance date at current rates of pay.

Entitlements to long service leave and retirement gratuities are calculated on an actuarial basis and are based on the reasonable likelihood that they will be earned by employees and paid by the company.

The company recognises a liability for sick leave to the extent that absences in the coming year are expected to be greater than the sick leave entitlements earned in the coming year. The calculation is based on the value of excess sick leave taken within the previous twelve months.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

Good and Service Tax (GST)

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except for receivables and payables which are recognised inclusive of GST.

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The company's liability for current tax is calculated using tax rates that have been enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Property, Plant and Equipment

Property plant and equipment are those assets held by the company for the purpose of carrying on its business activities on an ongoing basis.

All property, plant and equipment, apart from forestry land, are stated at cost less any subsequent accumulated depreciation and any accumulated impairment losses.

There is no property, plant and equipment whose title is restricted or pledged as security.

Forestry land is stated at its revalued amount, being the fair value at the date of revaluation, determined from market-based evidence by appraisal undertaken by Quotable Value.

Self constructed assets include the direct cost of construction to the extent that they relate to bringing the fixed assets to the location and condition for their intended service.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

Property, Plant and Equipment Cont'd/....

Revaluations of forestry land are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date.

Any revaluation increase is credited to the appropriate revaluation reserve, except to the extent that it reverses a revaluation decrease previously recognised as an expense, in which case the increase is credited to the income statement to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of such land is charged as an expense to the extent that it exceeds the balance, if any, held in the revaluation reserve relating to a previous revaluation of that asset.

Depreciation is charged so as to write off the cost or valuation of assets, other than land, forestry land, properties under construction and capital work in progress, on the straight-line basis or diminishing value basis. Rates used have been calculated to allocate the assets cost or valuation less estimated residual value over their estimated remaining useful lives.

Depreciation of these assets commences when the assets are ready for their intended use.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets, or where shorter, over the term of the relevant lease.

Depreciation rates and methods used are as follows:

	<u>Rate</u>	<u>Method</u>
• Freehold Buildings	2% - 3%	Straight Line
• Roads	5% - 24%	Diminishing Value
• Bridges	2% - 2.4%	Diminishing Value
• Plant and Equipment	6% - 80.4%	Diminishing Value
• Fences	10% - 13%	Diminishing Value
• Motor vehicles	9.6% - 36%	Diminishing Value
• Office equipment	10% - 60%	Diminishing Value

Derecognition

Forestry assets and property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset.

Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year the item is derecognised.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

Forests

The fair value of the forest, exclusive of the forest land, is determined at each reporting date. Fair value is equivalent to the NZIF Forest Valuation Standards definition of market value. Fair value is determined using the discounted cash flow methodology and in using this method, financing costs and replanting costs are excluded. The method first determines the current market value of the collective forest and land resource, with land then subtracted at its current market value to provide the value of the forest asset.

The valuation takes into account changes in price over the accounting period through a graduated current to five year average price curve as well as the quantity of trees harvested and the growth that has occurred in the forest. Any change in forest valuation is recorded in the income statement.

Research and Development Expenditure

Expenditure on research activities is recognised as an expense in the year in which it is incurred.

Impairment of assets excluding goodwill

At each balance sheet date, the company reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset or cash-generating unit is estimated to be less than its carrying amount, the carrying amount of the asset or cash-generating unit is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately, unless the relevant asset or cash-generating unit is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease to the extent of any previous revaluation increase for that asset or cash generating unit that remains in the revaluation reserve. Any additional impairment is immediately transferred to the statement of comprehensive income.

Where an impairment loss subsequently reverses, the carrying amount of the asset or cash-generating unit is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset or cash-generating unit in prior years. A reversal of an impairment loss is recognised as income immediately.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

Inventories

Inventories reported in the balance sheet include:

- Log inventories
Valued at net realisable value less estimated point of sale costs.
- Wood processing inventories
Products which as a result of processing are valued at lower of cost or net realisable value.
- Other inventory
Valued at the lower of cost and net realisable value.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, deposits held at call with banks, other short term highly liquid investments with original maturities of three months or less and bank overdrafts.

Financial Instruments

Financial assets and financial liabilities are recognised on the company's balance sheet when the company becomes a party to the contractual provisions of the instrument.

Trade and other receivables

Trade and other receivables are subsequently measured at amortised cost using the effective interest method. Gains and losses when the asset is impaired are derecognised or recognised in the Income Statement.

Investments

Investments are recognised and derecognised on a trade date where a purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at cost, including transaction costs.

Investments in debt and equity securities

Investments in debt and equity securities are financial instruments classified as held for trading and are measured at fair value at balance date. Any resultant gains or losses are recognised in the income statement for the year.

Trade and other payables

Trade and other payables are initially measured at fair value and subsequently measured at amortised cost using the effective interest method.

Trade and other receivables

Trade and other receivables are initially measured at fair value and subsequently measured at amortised cost less any allowances for estimated irrecoverable amounts.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

Borrowings

Borrowings are initially recorded net of directly attributable transaction costs and are measured at subsequent reporting dates at amortised cost. Finance charges, premiums payable on settlement or redemption and direct costs are accounted for on an accrual basis to the Income Statement using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the year in which they arise.

Financial Liability and Equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the company after deducting all of its liabilities.

Derivative financial instruments and hedge accounting

The company's activities expose it primarily to the financial risks of changes in foreign currency exchange rates, interest rates and commodity prices. The company uses foreign exchange forward contracts, foreign exchange options and interest rate swap contracts to hedge these exposures.

The company does not use derivative financial instruments for speculative purposes. However, derivatives that do not qualify for hedge accounting, under the specific NZ IFRS rules, are accounted for as trading instruments with fair value gains/losses being taken directly to the income statement.

The use of financial derivatives is governed by the company's policy approved by the board of directors. The policies provide written principles on the use of financial derivatives.

Derivative financial instruments are recognised at fair value on the date that the derivative is entered into and are subsequently remeasured to their fair value. The fair value on initial recognition is the transaction price. Subsequently fair values are based on independent bid prices quoted in active markets as provided to us by our banker counter parties.

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity and the ineffective portion is recognised immediately in the statement of comprehensive income. If the cash flow hedge of a firm commitment or forecasted transaction results in the recognition of an asset or a liability, then, at the time the asset or liability is recognised, the associated gains or losses on the derivative that had previously been recognised in equity are included in the initial measurement of the asset or liability. For hedges that do not result in the recognition of an asset or a liability, amounts deferred in equity are recognised in the statement of comprehensive income in the same year in which the hedged item affects net profit or loss.

For an effective hedge of an exposure to changes in the fair value, the hedged item is adjusted for changes in fair value attributable to the risk being hedged with the corresponding entry in the income statement. Gains or losses from re-measuring the derivative, or for non-derivatives the foreign currency component of its carrying amount, are recognised in the statement of comprehensive income.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... **For the Year Ended 30 June 2012**

Derivative financial instruments and hedge accounting Cont'd/....

The fair value of a hedging derivative is classified as a non current asset or liability if the remaining maturity of the hedge relationship is more than twelve months and as a current liability if the remaining maturity of the hedge relationship is less than twelve months.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the statement of comprehensive income as they arise. Derivatives not designated for effective hedge relationship are classified as current assets or liabilities.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the statement of comprehensive income for the year.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not carried at fair value with unrealised gains or losses reported in the statement of comprehensive income.

Carbon credits

Emissions units held are treated as intangible assets, and initially recorded at fair value.

- Fair value is cost in the case of purchased units
- Fair value is initial market value in the case of government granted units
- Emissions unit fair value is marked to market (revalued) annually at 30 June subsequent to initial recognition and annually thereafter
- The difference between initial fair value or previous annual revaluation and disposal or revaluation value of the units is treated as revenue if positive or expense if negative
- Emissions obligations are recognized as a current or future liability depending on the legislated liability period
- Emissions Liability is recorded at the market value of emissions units at the end of the period
- Increases in emissions liabilities at 30 June are treated as expenses and reductions are treated as revenue

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

Standards and Interpretations effective in the current period

Those with disclosure impact:

The impact of the adoption of the following Standards and Amendments has been to expand the disclosures provided in these financial statements:

The following are the new or revised Standards or Interpretations in issue that are not yet required to be adopted by entities preparing financial statements for periods ending on 30th June 2012.

Standard/Interpretation	Effective for annual reporting periods beginning on or after	Expected to be initially applied in the financial year ending
Amendments to NZ IAS 12 'Income Taxes' – Deferred Tax:		
Recovery of Underlying Assets	1 January 2012	30 June 2013
Amendments to NZ IAS 1 'Presentation of Financial Statements'		
– Presentation of Items of Other Comprehensive Income	1 July 2012	30 June 2013
NZ IFRS 11 'Joint Arrangements' (refer Note 1)	1 January 2013	30 June 2014
NZ IFRS 12 'Disclosure of Interests in Other Entities' (refer Note 1)	1 January 2013	30 June 2014
NZ IFRS 13 'Fair Value Measurement' (refer Note 1)	1 January 2013	30 June 2014
NZ IAS 27 'Separate Financial Statements' (revised 2011) (refer Note 1)	1 January 2013	30 June 2014
NZ IAS 28 'Investments in Associates and Joint Ventures' (revised 2011) (refer Note 1)	1 January 2013	30 June 2014
Amendments to NZ IFRS 7 'Financial Instruments : Disclosures'		
– Offsetting Financial Assets and Financial Liabilities (refer Note 1)	1 January 2013	30 June 2014
Improvements to IFRS: 2009 – 2011 cycle	1 January 2013	30 June 2014
Amendments to NZ IAS 32 'Financial Instruments: Presentation'		
– Offsetting Financial Assets and Financial Liabilities (refer Note 1)	1 January 2014	30 June 2015
NZ IFRS 9 'Financial Instruments'	1 January 2015	30 June 2016
Revised NZ IFRS 9 'Financial Instruments' (2010) (refer Note 2)	1 January 2015	30 June 2016
Amendments to NZ IFRS 9 and NZ IFRS 7 Mandatory Effective Date and Transition Disclosures	1 January 2015	30 June 2016

Note 1 – Applicable to Profit Oriented Entities only

Note 2 – The revised NZ IFRS 9 adds guidance on the classification and measurement of financial liabilities and derecognition of financial instruments. The effective date is the same as the previous version of NZ IFRS 9, with earlier adoption permitted.

Those with no impact:

Other standards adopted during the year have not led to any changes in the company's accounting policies with measurement or recognition having impact on the periods as presented in these financial statements.

Provisions

A provision is recognised in the balance sheet when the company has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

Intangible Assets

Intangible assets acquired separately are reported at cost less accumulated amortisation. Amortisation is charged on a diminishing value basis over their estimated useful lives.

Statement of Cashflows

The statement of cashflows is prepared exclusive of GST, which is consistent with the method used in the Income Statement.

Changes in accounting policies

There have been no changes in accounting policies.

	As at 30 June 2012 \$'000	As at 30 June 2011 \$'000
3. OPERATING REVENUE		
Sales revenue	39,729	42,157
New Zealand carbon credits	2,316	6,850
Gain on sale of property, plant and equipment	15	58
Other revenue	67	58
	<u>42,127</u>	<u>49,123</u>
4. FINANCIAL INCOME		
Interest on other investments	6	3
Dividends / bonus issue	175	-
Effect of exchange rate changes	2,226	3,570
Movement in commodities	6	20
	<u>2,413</u>	<u>3,593</u>
No interest is earned on impaired or restricted assets		
5. OTHER EXPENSES		
Audit fees - for audit of financial statements	33	31
Donations	7	4
Loss on sale of property, plant and equipment	-	4
Rental expense on operating leases	52	50
Research expenditure	87	94
Cost of bush applied	2,878	3,025
Shipping costs	9,867	11,056
Other expenses	3,798	2,251
	<u>16,722</u>	<u>16,515</u>

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

	As at 30 June 2012 S'000	As at 30 June 2011 S'000
6. FINANCIAL EXPENSES		
Interest - related parties	1,300	1,502
Facility fees – related parties	263	230
Total financial expenses	<u>1,563</u>	<u>1,732</u>
7. EARNINGS PER SHARE		
Basic earnings per share is calculated by dividing the net surplus/(deficit) attributable to the shareholder of the company by the weighted average number of ordinary shares on issue during the year	7.31c	37.11c
Number of shares		
Weighted average number of ordinary shares	25,690,522	25,690,522

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

8. DIVIDENDS

	As at 30 June 2012 \$'000	As at 30 June 2011 \$'000
The following dividends were paid by the company:		
Interim dividend - \$0.0428 per share	1,100	1,000
Final dividend - \$0.0428 per share	1,100	1,000
	<u>2,200</u>	<u>2,000</u>

9. INCOME TAX

Net profit/loss for the year	2,518	11,282
Profit before income tax	<u>2,518</u>	<u>11,282</u>
 Tax thereon at 28% (2011 30%)	 705	 3,385
<i>Plus / (less) the Tax Effect of Differences</i>		
Income not assessable for taxation	-	(1,519)
Expenditure not deductible for taxation	2	2
Under / (over) tax provision in prior years	(17)	(73)
Effect on deferred tax balances due to change in company income tax rate	-	(47)
Fully imputed dividends	(49)	-
 Tax effect of differences	 <u>(64)</u>	 <u>(1,637)</u>
 Tax expense	 <u>641</u>	 <u>1,748</u>
 Effective tax rate	 25.5%	 15.49%
<i>Represented by</i>		
Current tax provision	132	1,164
Deferred tax provision	526	657
Under / (over) tax provision in prior years	(17)	(73)
	<u>641</u>	<u>1,748</u>
 Income tax - Imputation Credit Account		
Balance at the beginning of the year	776	37
Credits attached to dividends received	75	10
Taxation payments made	78	1,205
Credits attached to dividends paid	(890)	(476)
	<u>39</u>	<u>776</u>

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

9. INCOME TAX Cont'd/....

Tax Rate

The tax rate used in the above calculation is the corporate tax rate of 28% payable by New Zealand corporate entities on taxable profits under New Zealand law.

	As at 30 June 2012 \$'000	As at 30 June 2011 \$'000
10. EQUITY - Share Capital		
Issued Capital	25,691	25,691
The company has issued 25,690,522 ordinary shares and these are fully paid. Fully paid ordinary shares carry 1 vote per share and carry the right to dividends and pro rata share of net assets on winding up of the company.		
11. RESERVES		
Forestry Reserve		
Balance at beginning of the year	38,405	36,822
Transfer from retained earnings	2,522	1,583
Balance at the end of the year	40,927	38,405
Hedging Reserve		
Balance at beginning of the year	844	491
Gain/(loss) in fair value movement in derivatives	(1,072)	353
Balance at the end of the year	(228)	844
Land Revaluation Reserve		
Balance at beginning of the year	15,475	15,485
Forestry land revaluations	(505)	(10)
Balance at the end of the year	14,970	15,475

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of the cash flow hedging instruments relating to interest payments and foreign exchange transactions that have not yet occurred.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

11. RESERVES Cont'd/....

The forestry reserve arises with the revaluation of the forestry assets which is put to the income statement. There is a transfer between retained earnings and the forestry reserve of the revaluation net of deferred taxation.

	As at 30 June 2012 \$'000	As at 30 June 2011 \$'000
12. RETAINED EARNINGS		
Balance at the beginning of the year	3,423	(2,528)
Net profit/(loss) for the year	1,877	9,534
Dividend distributions	(2,200)	(2,000)
Transfer to forestry reserve	(2,522)	(1,583)
Balance at the end of the year	578	3,423

13. TRADE AND OTHER PAYABLES

Trade payables	2,147	2,999
	2,147	2,999

The amounts due to customers under construction contracts at 30 June 2012 were \$nil (2011: \$nil).

The directors consider that the carrying amount of trade payables approximates their fair value.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

14. FINANCIAL INSTRUMENTS

	As at 30 June 2012 \$'000	As at 30 June 2011 \$'000
<u>Financial Assets</u>		
Trade and other receivables	5,032	4,016
Derivative financial instruments	1,372	2,324
	<u>6,404</u>	<u>6,340</u>
<i>Analysed as:</i>		
Current	5,844	4,991
Non-Current	560	1,349
	<u>6,404</u>	<u>6,340</u>
<u>Financial Liabilities</u>		
Trade and other payables	2,147	2,999
Derivative financial instruments	1,697	1,151
Borrowings	33,406	33,446
	<u>37,250</u>	<u>37,596</u>
<i>Analysed as:</i>		
Current	9,261	8,017
Non-Current	27,989	29,579
	<u>37,250</u>	<u>37,596</u>

Currency derivatives

Currency Risk

The company manages risk associated with exchange rate fluctuations through the use of currency derivatives to hedge significant future export sales. The foreign exchange policy of City Forests Limited allows foreign exchange forward contracts and options in the management of its exchange rate exposures. The instruments purchased are only against the currency in which the exports are sold.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

14. FINANCIAL INSTRUMENTS Cont'd/....

At balance sheet date, the total notional amount of outstanding forward foreign exchange contracts to which City Forests Limited is committed are as follows:

Outstanding Contracts	Average exchange rate 2012	Foreign currency 2012 FC'000	Contract value 2012 NZD'000	Fair value 2012 NZD'000	Fair value 2011 NZD'000
Cashflow hedges					
Sell USD					
Current	0.720	7,050	9,792	778	975
Non current	0.724	8,800	12,152	558	1,336
Buy USD					
Current	0.839	400	477	30	(49)
Non current	-	-	-	-	-
Sell AUD					
Current	0.776	250	322	4	(11)
Non current	-	-	-	-	13
				1,370	2,264

<u>2012</u>	<1 yr	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	5 yrs	Total
<u>Financial Assets</u>							
Trade and other receivables	5,032	-	-	-	-	-	5,032
Derivative financial instruments	812	508	52	-	-	-	1,372
	5,844	508	52	-	-	-	6,404
<u>Financial Liabilities</u>							
Trade and other payables	2,147	-	-	-	-	-	2,147
Derivative financial instruments	1,695	2	-	-	-	-	1,697
Borrowings	5,419	1,022	1,593	1,639	1,230	22,503	33,406
	9,261	1,024	1,593	1,639	1,230	22,503	37,250
<u>2011</u>	<1 yr	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	5 yrs	Total
<u>Financial Assets</u>							
Trade and other receivables	4,016	-	-	-	-	-	4,016
Derivative financial instruments	975	1,069	280	-	-	-	2,324
	4,991	1,069	280	-	-	-	6,340
<u>Financial Liabilities</u>							
Trade and other payables	2,999	-	-	-	-	-	2,999
Derivative financial instruments	1,151	-	-	-	-	-	1,151
Borrowings	3,867	12,001	5,713	4,233	3,698	3,934	33,446
	8,017	12,001	5,713	4,233	3,698	3,934	37,596

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

14. FINANCIAL INSTRUMENTS Cont'd/....

Interest Rate Swaps

Credit and Interest Rate Risk

The company uses interest rate swaps to manage its exposure to interest rate movements on its multi-option facility borrowings by swapping a proportion of those borrowings from floating rates to fixed rates. The treasury policy recommends that the level of the fixed interest hedge should be limited to a series of ranges within set debt time periods.

The interest rate agreements are held with independent and high credit quality financial institutions in accordance with group credit policy. The credit risk is limited because the counterparties are banks with high credit ratings assigned by international credit rating agencies. The carrying amount of financial assets recorded in the financial statements represents the company's maximum exposure to credit risk.

The notional principal outstanding with regard to the interest rate swaps is:

	As at 30 June 2012 \$'000	As at 30 June 2011 \$'000
Maturing in less than one year	3,000	-
Maturing between one and five years	10,000	11,000
Maturing after five years	5,000	10,000
	<u>18,000</u>	<u>21,000</u>

Liquidity Risk

Liquidity risk represents the company's ability to meet its contractual obligations. The company evaluates its liquidity requirements on an ongoing basis. In general the company generates sufficient cash flows from its operating activities to meet its obligations arising from its financial liabilities and has credit lines in place to cover potential shortfalls.

Credit Risk

The company's credit risk is primarily attributable to its trade receivables. The amounts presented in the balance sheet are net of allowances for doubtful debts.

The company has no significant concentration of credit risk, with exposure spread over a large number of counterparties and customers.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

14. FINANCIAL INSTRUMENTS Cont'd/....

Sensitivity Analysis

Based on historic movements and volatilities the following movements are reasonably possible over a twelve month period:

- Proportional foreign exchange rate movement of -10% (depreciation of NZD) and a +10% (appreciation of the NZD) against the USD, from the year end rate of .7993 and against the AUD from the year end rate of .7932.
- A parallel shift of +1% / -1% in the NZD market interest rate from the year end 90 day BBBR of 2.43%.

Should these movements occur, the impact on profit and loss and equity for each category of financial instrument held at balance date is presented below. The movements are illustrative only.

	Carrying amount \$'000	Interest rate		Foreign exchange	
		-100bp	+100bp	-10%	+10%
	Profit	Equity Profit	Equity Profit	Equity Profit	Equity Profit
<u>Financial Assets</u>					
<u>Derivatives</u>					
Currency Hedges – Buy USD	517	-	-	(57)	47
Currency Hedges – Sell USD	19,830	-	-	2,203	(1,803)
Currency Hedges – Sell AUD	315	-	-	35	(28)
Other Financial Assets	5,773	-	-	407	(333)
<u>Financial Liabilities</u>					
Interest rate swaps	18,000	(580)	558	-	-
Total increase/(decrease)		(580)	558	2,588	(2,117)

1. Cash and cash equivalents include deposits at call which are floating interest rates. Sensitivity to a 1% movement in rates is \$nil.
2. Accounts receivable within City Forests Limited include \$1,811 of USD and \$520 of AUD denominated receivables at year-end.
3. Derivatives subject to the hedge accounting regime are managed by the company to be 100% effective and thus there is no sensitivity to equity change in either interest rates or exchange rates.
4. Borrowings are subject to an interest rate hedging policy. Sensitivity to any movement in the interest rate is limited to the effect on the amount of floating rate debt that exceeds the amount of the fixed rate hedge.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

Fair value of financial instruments

Fair value measurements recognised in the statement of financial position

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 Fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 Fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 Fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	2012			
	Level 1	Level 2	Level 3	Total
	NZ \$'000	NZ \$'000	NZ \$'000	NZ \$'000
Financial assets				
Derivative financial assets	-	1,372	-	1,372
New Zealand carbon credits	552	-	-	552
	<u>552</u>	<u>1,372</u>		<u>1,924</u>
Financial liabilities				
Derivative financial liabilities	-	-	-	-
	<u>-</u>	<u>1,697</u>	<u>-</u>	<u>1,697</u>
	-	1,697	-	1,697

15. OTHER LIABILITIES

	As at 30 June 2012 \$'000	As at 30 June 2011 \$'000
(i) <u>Current Liabilities</u>		
Other current liabilities	1,303	959
	<u>1,303</u>	<u>959</u>
(ii) <u>Non-Current Liabilities</u>		
Other non-current liabilities -- Ferny Hill land liability	320	320
	<u>320</u>	<u>320</u>

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

	As at 30 June 2012 \$'000	As at 30 June 2011 \$'000
16. EMPLOYEE PROVISIONS		
<u>Current liabilities</u>		
Long service leave	36	44
Annual leave and days in lieu	112	161
Gratuities	15	40
	<u>163</u>	<u>245</u>
<u>Long service leave</u>		
Opening balance	44	36
Increase/(decrease) in provision	(8)	8
Closing balance	<u>36</u>	<u>44</u>
<u>Annual leave and days in-lieu</u>		
Opening balance	161	139
Increase/(decrease) in provision	(49)	22
Closing balance	<u>112</u>	<u>161</u>
<u>Gratuities</u>		
Opening balance	40	-
Increase/(decrease) in provision	(25)	40
Closing balance	<u>15</u>	<u>40</u>
<u>Non-current liabilities</u>		
<u>Gratuities</u>		
Opening balance	26	55
Increase/(decrease) in provision	(6)	(29)
Closing balance	<u>20</u>	<u>26</u>
17. TERM BORROWINGS (secured)		
Dunedin City Treasury loan facility	21,382	21,337
Forestry loans	12,024	12,109
	<u>33,406</u>	<u>33,446</u>

The term borrowings are secured against certain assets and undertakings of City Forests Limited.

The forestry loans are from the Ministry of Agriculture and Forestry. They are fixed rate loans secured by registered first mortgage over certain land assets and are covered by repayment insurance. Each loan is associated with an individual stand of trees and is repayable by equal quarterly repayments over the next 10 years commencing January 2012. The interest capitalised for the year ended 30 June 2012 was \$758 (2011 \$718).

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

17. TERM BORROWINGS (secured) Cont'd/...

The repayment period on the term borrowings is as follows:

	As at 30 June 2012 \$'000	As at 30 June 2011 \$'000
Less than one year	5,419	3,867
Repayable between one to two years	1,022	12,001
Repayable between two to three years	1,593	5,713
Repayable between three to four years	1,639	4,232
Repayable between four to five years	1,230	3,698
Repayable later than five years	22,503	3,935
	<u>33,406</u>	<u>33,446</u>

The weighted average interest rate for the Dunedin City Treasury Limited loan facility, ranged between 4.00 and 7.52% (2011 4.00 – 7.52%).

The weighted average interest rates for the forestry loans is 6.217%, (2011: between 4.5% and 6.5%).

Directors estimate the fair value of the group's borrowings, by discounting their future cash flows at the market rate, to be as follows:

Multi-option note facility	21,382	21,336
Forestry loans	11,718	11,532

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

18. DEFERRED TAX LIABILITIES AND ASSETS

	2012 \$'000	2012 \$'000	2012 \$'000	2012 \$'000	2012 \$'000	2012 \$'000
	Opening Balance Sheet	Charged To Equity	Charged to Income	Closing Balance Sheet Assets	Liabilities	Net
Property, plant and equipment	1,076	-	(849)	-	227	227
Employee provisions	(79)	-	7	72	-	(72)
Forest	14,935	-	981	-	15,916	15,916
Capitalised forestry costs	8,557	-	337	-	8,894	8,894
Other investments	-	-	-	-	-	-
Revaluations of foreign exchange contracts	634	(250)	-	-	384	384
Revaluations of interest rate swaps	(305)	(167)	-	472	-	(472)
Other	54	-	97	-	151	151
Balance at the end of the year	24,872	(417)	573	544	25,572	25,028

	2011 \$'000	2011 \$'000	2011 \$'000	2011 \$'000	2011 \$'000	2011 \$'000
Property, plant and equipment	1,056	-	20	-	1,076	1,076
Employee provisions	(94)	-	15	(79)	-	(79)
Forest	14,729	-	206	-	14,935	14,935
Capitalised forestry costs	8,196	-	361	-	8,557	8,557
Other investments	-	-	-	-	-	-
Revaluations of foreign exchange contracts	435	199	-	-	634	634
Revaluations of interest rate swaps	(242)	(63)	-	(305)	-	(305)
Other	80	-	(26)	-	54	54
Balance at the end of the year	24,160	136	576	(384)	25,256	24,872

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

19. CAPITAL EXPENDITURE COMMITMENTS

	As at 30 June 2012 \$'000	As at 30 June 2011 \$'000
Plant and Equipment	-	-

20. LEASE COMMITMENTS

(i) Minimum operating lease commitments

Payable within one year	77	38
Payable between one to five years	114	14
Payable later than five years	3	-
	<u>194</u>	<u>52</u>

(ii) Minimum finance lease payments

Payable within one year	-	-
Payable between one to five years	-	-
Payable later than five years	-	-
	<u>-</u>	<u>-</u>

Building lease term is for 6 years commencing December 2005 with four 3 year rights of renewal.

21. CASH AND CASH EQUIVALENTS

Cash and cash equivalents	<u>1,011</u>	<u>909</u>
---------------------------	--------------	------------

Cash and short-term deposits comprise cash held by the company and short-term bank deposits with an original maturity of three months or less.

22. TRADE AND OTHER RECEIVABLES

Trade receivables	5,030	3,895
Due from related Parties - Otago Chipmill Limited	2	121
	<u>5,032</u>	<u>4,016</u>

The Directors consider that the carrying amount of the trade and other receivables approximates their fair value.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

23. OTHER CURRENT ASSETS

	As at 30 June 2012 S'000	As at 30 June 2011 S'000
Goods and services tax	69	547
	<u>69</u>	<u>547</u>

24. INVENTORIES

Raw materials and stores	354	598
Finished goods	1,021	1,597
	<u>1,375</u>	<u>2,195</u>

25. INVESTMENTS

Non-Current Investments

Shares and units in other companies and funds	1	1
Shares and advance in Otago Chipmill Ltd	308	308
	<u>309</u>	<u>309</u>

Otago Chipmill Balance Sheet

Total assets	1,352	1,780
Total liabilities	93	201
Net assets	<u>1,259</u>	<u>1,579</u>

No contingent liabilities have arisen with the investment in the Otago Chipmill Limited

Full revenue/surplus/deficit of associate – 49.9% of this reflects City Forests share.

Revenue	2,429	1,914
Profit before income tax	161	555
Income tax	73	104
Profit after income tax	<u>88</u>	<u>451</u>

26. INTANGIBLE ASSETS

Computer software

Balance at the beginning of the year	24	29
Plus purchases	7	17
Less amortisation expenses	(16)	(22)
	<u>15</u>	<u>24</u>

The amortisation expense has been included in the line 'depreciation and amortisation expense' in the income statement.

The following useful lives are used in the calculation of amortisation

Software - 2-3 yrs

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

27. FORESTRY ASSETS

	As at 30 June 2012 \$'000	As at 30 June 2011 \$'000
Balance at the beginning of the year	100,335	99,840
Add Costs capitalised in establishing forests during the year	2,568	2,782
Increase in forest from acquisition	-	-
Forest revaluation	3,503	738
Less Log sales	(2,878)	(3,025)
	<u>103,528</u>	<u>100,335</u>
Gains/(losses) arising from changes in fair value less point of sale costs;		
attributable to physical changes	364	(1,975)
attributable to price changes	2,828	2,470

The directors of City Forests Limited revalue its forestry assets annually.

The valuation methodology used establishes the fair value of the collective forest and land resource and then subtracts the value of the forestry land at \$25,113,800 value (see note 28). The NZ IFRS valuation rules require that the value is calculated under the assumption that a stand will not be replanted once felled irrespective of the sustainable forest policy of the directors. The change in the value of the forest from year to year is reflected in the Income Statement.

Fair value requires calculating the present value of expected net cash flows using a post-tax discount rate. This discount rate used by the company is 7.0%.

At 30 June 2012 the company owned stands of trees on 16,129 hectares of a total land holding of 19,987 hectares. During the year the company harvested approx. 266,281 m3 of logs from its forests.

City Forests Limited is exposed to financial risks associated with USD log price and the USD and AUD sawn timber prices. This risk is managed through its financial management policy described within note 14, Financial Instruments. City Forests Limited is a long-term forestry investor that expects log prices to fluctuate within a commodity cycle. It is not possible to hedge against 100% of the price cycle but the company does manage harvest volumes to minimise the impact of the commodity price cycle over the longer term.

The valuer of the forestry asset was an employee of the company who has a Bachelor of Forestry Science with Honours, a Post Graduate Certificate in Executive Management and is a member of the New Zealand Institute of Forestry. He has the appropriate knowledge and the skills to complete the valuation.

A peer review of the valuation process and key inputs was conducted by Chandler Fraser Keating. The peer review was completed with regard to a summary of market transactions at arms length terms and current market conditions. The valuation assumptions include all direct costs and revenues.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

28. PROPERTY, PLANT AND EQUIPMENT

	Land Other Valuation	Forest Land Valuation	Building Cost	Roads Bridges Cost	Plant Equipment Cost	Sub-Total
2012	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Cost or Valuation						
Balance at beginning of year	1,089	25,524	1,913	6,218	7,304	42,048
Increase through acquisition	-	-	-	-	-	-
Purchases/revaluation	(95)	(410)	-	131	57	(317)
Disposals	-	-	-	-	(2)	(2)
Transfer to property intended for sale	-	-	-	-	-	-
Reclassified as intangibles	-	-	-	-	-	-
Balance at end of year	994	25,114	1,913	6,349	7,359	41,729
Accumulated depreciation						
Balance at beginning of year	-	-	264	3,104	2,456	5,824
Depreciation	-	-	45	164	354	563
Impairment	110	-	726	-	2,103	2,939
Disposals	-	-	-	-	-	-
Transfer to property intended for sale	-	-	-	-	-	-
	110	-	1,035	3,268	4,913	9,326
Balance at end of year	884	25,114	878	3,081	2,446	32,403
Comprising - Cost	-	-	878	3,081	2,446	6,405
Valuation	884	25,114	-	-	-	25,998

The land valuations were obtained from Quotable Valuation which is the valuation company used by the relevant city and district councils. The revaluation of the land for the year ended 30 June 2012 was (\$505). All other asset classes are shown at cost.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

28. PROPERTY, PLANT AND EQUIPMENT Cont'd/....

		Motor Vehicles	Office Equipment	
	Sub-Total	Cost	Cost	Total
2012 Cont'd/....	\$'000	\$'000	\$'000	\$'000
Cost or Valuation				
Balance at beginning of year	42,048	940	384	43,372
Increase through acquisition	-	-	-	-
Purchases/ revaluation	(317)	92	11	(187)
Disposals	(2)	(149)	-	(151)
Transfer to property held for sale	-	-	-	-
Reclassified as intangibles	-	-	(8)	(8)
Balance at end of year	41,729	883	387	43,026
Accumulated depreciation				
Balance at beginning of year	5,824	534	328	6,686
Reclassified as intangibles	-	-	-	-
Depreciation	563	105	21	689
Impairment	2,939	56	5	3,000
Disposals	-	(114)	-	(113)
Transfer to property held for sale	-	-	-	-
	9,326	583	354	10,262
Balance at end of year	32,403	301	33	32,737
Comprising - Cost	6,405	301	33	6,739
Valuation	25,998	-	-	25,998

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

28. PROPERTY, PLANT AND EQUIPMENT Cont'd/....

	Land Other Valuation	Forest Land Valuation	Buildings Cost	Roads Bridges Cost	Plant Equipment Cost	Sub-Total
2011	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Cost or Valuation						
Balance at beginning of year	1,089	25,534	1,863	5,552	7,055	41,093
Increase through acquisition	-	-	-	-	-	-
Purchases/revaluation	-	(10)	50	666	259	965
Disposals	-	-	-	-	(10)	(10)
Transfer to property intended for sale	-	-	-	-	-	-
Reclassified as intangibles	-	-	-	-	-	-
Balance at end of year	1,089	25,524	1,913	6,218	7,304	42,048
Accumulated depreciation						
Balance at beginning of year	-	-	218	2,957	2,096	5,271
Depreciation	-	-	46	147	362	555
Impairment	-	-	-	-	-	-
Disposals	-	-	-	-	(3)	(3)
Transfer to property intended for sale	-	-	-	-	-	-
	-	-	264	3,104	2,455	5,823
Balance at end of year	1,089	25,534	1,645	2,595	4,959	35,822
Comprising - Cost	-	-	1,649	3,114	4,849	9,612
Valuation	1,089	25,524	-	-	-	26,613

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

28. PROPERTY, PLANT AND EQUIPMENT Cont'd/....

		Motor Vehicles	Office Equipment	Total
2011 Cont'd/....	Sub-Total \$'000	Cost \$'000	Cost \$'000	\$'000
Cost or Valuation				
Balance at beginning of year	41,093	1,173	361	42,627
Increase through acquisition	-	-	-	-
Purchases/ revaluation	965	154	24	1,143
Disposals	(10)	(387)	(1)	(398)
Transfer to property held for sale	-	-	-	-
Reclassified as intangibles	-	-	-	-
Balance at end of year	42,048	940	384	43,372
Accumulated depreciation				
Balance at beginning of year	5,271	725	301	6,297
Reclassified as intangibles	-	-	-	-
Depreciation	555	131	27	713
Impairment	-	-	-	-
Disposals	(3)	(322)	-	(325)
Transfer to property held for sale	-	-	-	-
	5,823	534	328	6,685
Balance at end of year	36,225	406	56	36,687
Comprising - Cost	9,612	406	56	10,074
Valuation	26,613	-	-	26,613

29. NEW ZEALAND CARBON CREDITS

The New Zealand Emissions Trading Scheme was enacted under the Climate Change Response Amendment Act 2008 and was made into law on 26th September 2008.

A forest owner with forests established after 31st December 1989, under the Act, may opt to join the Emissions Trading Scheme. Post-89 forests will earn carbon credits (NZU's) from 1st January 2008 and these may be traded within New Zealand or converted into Assigned Amount Units (AAU's) and sold internationally. City Forests Limited completed registration of the Post-89 forests under the Emissions Trading Scheme in January 2010. These forests have been sequestering carbon under the scheme since 1st January 2008. Subsequent to our Post-89 registration, the New Zealand Government has allocated City Forests Limited a total of 344,613 Post-89 derived NZU's, being the carbon sequestered by these forests during the 2008 to 2011 calendar years. In 2012 80,000 Post-89 NZU's (2011 91,487) have been sold to emitters with New Zealand interests.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

As at 30th June 2012, 81,176 units were unsold (2011 19,991). Under the accrual principle, the unsold credits have been valued based on the current market prices and recognised in the financial statements. The value has been carried in the financial statements as follows:

	As at 30 June 2012 S'000	As at 30 June 2011 S'000
New Zealand carbon credits	552	366

30. RECONCILIATION OF NET SURPLUS FOR THE YEAR TO CASHFLOWS FROM OPERATING ACTIVITIES

	As at 30 June 2012 S'000	As at 30 June 2011 S'000
Net gain/(loss) for the year	1,877	9,534
<i>Items Not Involving Cash Flows</i>		
Depreciation and loss on sale	705	740
Depletion of forest	2,878	3,025
Deferred tax	574	594
Depreciation recovered/capital gains	(15)	(58)
Forestry revaluation	(3,503)	(737)
Impairment of fixed assets	3,000	-
Other non-cash items		
<i>Impact of Changes in Working Capital Items</i>		
(Increase)/Decrease in accounts receivable	(1,040)	3,510
(Increase)/Decrease in inventories	820	(696)
(Increase)/Decrease in prepayments	130	(85)
(Increase)/Decrease in tax refund due	(8)	(651)
Increase/(Decrease) in accounts payable	(531)	(1,613)
Increase/(Decrease) in other current liabilities	(56)	42
Increase/(Decrease) in current assets	299	(339)
Net cash inflows/(outflows) from operating activities	5,130	13,266

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

31. RELATED PARTY TRANSACTIONS

Amounts receivable from and payable to related parties at balance date are disclosed in notes, 13, 22 and 17.

Transactions with Dunedin City Council Group

City Forests Limited undertakes transactions with Dunedin City Council and other Dunedin City Council controlled entities on an arms length commercial basis. The company purchased goods and services and traded with Dunedin City Council in respect of the following transactions:

	As at 30 June 2012 S'000	As at 30 June 2011 S'000
Sales of services to the Dunedin City Council:		
Contracting services	-	37
	-	37
Purchases of goods and services from the Dunedin City Council:		
Rates and property rentals	11	11
Administration and office services	2	1
Other	105	5
	118	17
Payable to Dunedin City Council as at balance date	-	-
Payable to Delta Utility Services Limited	69	138
Payable to Dunedin City Holdings Limited	14	14
Subvention payments:		
Citibus Limited	-	281
Taieri Gorge Railway Limited	-	33
Dunedin Venues Management Limited	-	285
	-	599
Loan from Dunedin City Treasury Limited as at balance date	21,382	21,336
Loans received during the year	8,776	8,699
Loans paid during the year	8,730	16,123
Interest due to Dunedin City Treasury Limited as at balance date	150	154
Interest paid during the year	1,300	1,502
Other payments including facility fees	263	231
Purchases of goods and services from Delta	756	874

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

31. RELATED PARTY TRANSACTIONS Cont'd/....

Transactions with Associate Companies

The company also conducted the following commercial transactions with associate companies:

	Year ended 30 June 2012 \$'000	Year ended 30 June 2011 \$'000
Sales of goods and services to associate companies:		
Forest products sold to Otago Chipmill Limited	783	478
Management fees received from Otago Chipmill Limited	25	25
Purchases of goods and services from associate companies	1	1
At year end the following amounts were owed to and from the Associated Company:		
Receivable from associate companies	2	121

No related party debts have been written off or forgiven during the year and no provision has been required for impairment of any receivables to related parties.

Transactions with companies in which directors have an interest;

- During the course of the year:

Mr R D Liddell had related party interests with the following organisations during the year.

Chairman, Palmers Mechanical Limited		
Plant Maintenance	5	16
Chairman, Dunedin City Treasury Limited		
Interest on Loan	1,300	1,502
Facility Fees	263	231
Director, Blackhead Quarries Limited		
Purchase of Roading Materials	103	267

Mr S J McLauchlan had related party interests with the following organisations during the year.

Director, Otago & Southland Employers Association		
Subscriptions	1	1
Pro Chancellor, University of Otago		
Purchase of Services	1	10

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

31. RELATED PARTY TRANSACTIONS Cont'd/....

The Directors of City Forests Limited sat on the Boards of the following organisations during the year. Details of the type and value of services purchased from each organisation during the financial year covered by this report are as follows.

	Year ended 30 June 2012 \$'000	Year ended 30 June 2011 \$'000
Director, Dunedin City Holdings Limited		
Management Services	50	50
Dividends	2,200	2,000
Director, Delta Utility Services Limited		
Roading & Earthmoving Services	756	874

At year end the following amounts were owed to and from the Companies in which Directors have an interest:

Payable to:		
Blackhead Quarries Limited	30	29
Palmers Mechanical	2	-
University of Otago	-	11

Compensation of key management personnel

The remuneration of directors and other members of key management during the year was:

Salaries and Short-term benefits	929	899
Post-Employment benefit	-	97
	929	996

The remuneration of directors is agreed annually by the Dunedin City Council in accordance with the policies that it sets from time to time. The remuneration of management is determined on the recommendation of the board committee having regard to the performance of individuals and market trends.

CITY FORESTS LIMITED

Notes to the Financial Statements Cont'd/.... For the Year Ended 30 June 2012

32. STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

A number of accounting standards have been issued but as they are not yet compulsory they have not been applied to this set of accounts. The standard to be applied to future financial statements is NZIFRS 9. NZ IAS39 is being replaced through three phases: phase 1 classification and measurement; phase 2 impairment methodology and phase 3 hedge accounting. The new standard is required to be adopted for the year ended 31st December 2013.

City Forests Limited

STATEMENT OF SERVICE PERFORMANCE

For the Year Ended 30 June 2012

The principal activities of the Company are the growing, harvesting, processing and marketing of forest products from plantations it owns.

<u>Performance Targets</u>	<u>Achievement</u>
1a. A comprehensive review of the Company's long term strategic plan will have been completed with a particular focus on investigations into opportunities for increased profitability through wood process innovation and greater control over marketing and distribution.	The Company's long term strategic plan has been reviewed as part of the annual budget process. A significant change has occurred with the exit from Wood Processing and the addition of a log tender program.
1b. Opportunities for expanding the Company's scale will have been investigated.	The Company has increased its annual harvest levels to long term sustainable levels. We have introduced a log stumpage tender program during the period. Production thinning has been carried out delivering additional mid rotation revenues.
1c. Opportunities for balancing the Company's exposure to United States Dollar revenues taking into account market and product margin factors will have been implemented.	<p>The Company maintains a significant USD foreign exchange forward cover position in line with Company policy.</p> <p>The exit from Wood Processing and subsequent increase in domestic log sales and the log stumpage tender program have increased NZD revenues.</p>
2a. Strategic Plan for the Wood Processing Facility at Milburn will be completed.	Strategic review of our wood processing operation concluded with an exit strategy from the operation which has been successfully implemented. The company retains the assets as landlord.
3a. The marketing strategy and plan will be updated.	A Sales and Marketing plan is in place and has been reported in the board papers. A number of new and significant log customers have been developed during the year. Log stumpage tender program implemented. Additional rental returns from the lease of underperforming company assets have been secured during the year.
3b. No single customer will have received more than 30% of the Company's annual harvest by volume.	Our largest customer in South Korea, Sun Chang Corporation received 20.2% of the Company's annual harvest volume.
3c. Revenues from lumber sales will be at least 30% of total sales.	This has not been achieved. Revenue from lumber sales was 20.8% of total wood fibre sales. (excluding Carbon)
3d. Lumber from the Company's wood processing plant will be sold into at least two markets.	Lumber sales have occurred to USA, China, Taiwan, Vietnam, Australia, New Zealand.

City Forests Limited

	<u>Performance Targets</u>	<u>Achievement</u>
3e.	The company will maximise financial opportunities from the sales of Carbon stored in the company forests.	The Company has completed significant Carbon sale transactions during the period. The Company has been the first to establish carbon measurement sample plots.
4a.	Contracted monthly log delivery requirements for customers will be met within plus or minus ten percent 80% of the time.	On an annualised basis all customers received their contracted volumes within plus or minus 10%. Variations were by mutual agreement.
5a.	The annual harvest from the forest estate will be at least 200,000m ³ .	The annual harvest from the CFL forest estate was 266,281m ³ .
5b.	An annual forest health report will have been completed by 30 th June 2011.	An annual forest health report was completed in September 2011.
6a.	At least 600ha of the Company's forests will have been pruned and thinned.	1433 ha of the Company's forest was pruned and thinned.
7a.	At least one new forest management technique will be introduced as a result of research findings.	Forest plantings of selected clone seedling trials have been established across a range of sites. Production thinning has been successfully adopted as a management technique delivering additional mid rotation revenues. Forest spatial information system has been significantly upgraded.
8a.	Forest Stewardship Council Certification will be maintained.	Forest Stewardship Council Certification was maintained following audit in the last quarter of 2011.
8b.	Lost time accident rates for staff and contractors will be reduced to a maximum 40 lost time injuries per 1,000,000 hours.	Lost time accident rates for staff and contractors was 26.1 lost time injuries per 1,000,000 hours. (25.1 in 2011)
8c.	All forests will have current forest management plans which identify social and environmental, as well as economic outputs.	The company has a comprehensive forest management plan that has been externally audited as part of the FSC certification process. This covers all forest areas.
9a.	The Company will have in place an environmental management system which will include procedures for sustainability monitoring.	An environmental management system is in place with on-going monitoring of environmental values.
9b.	The Company will prepare and report on a carbon budget.	The Company has prepared and reported on a carbon budget in the annual accounts.
10a.	Every staff member will have a training plan in place. Contractors in the areas of silviculture and harvesting will have a training plan in place for their employees.	Forest staff members are working towards achieving Personal Development Plans. Other training provided as necessary. Contractors are required to have a training plan for their employees.
10b.	Each harvesting crew will have a trained "log maker".	Each harvesting crew had a trained log maker in place during the year.
10c.	There will be "nil" instances of non-compliance with the Company's EEO policy.	There were no instances of non-compliance with the Company's EEO policy.
11a.	All the Company's forest management plans will have a section allocated to Recreation and Educational use of the forests.	The Company's forest management plans have sections allocated to recreation and education.