



Annual Report 2017



ENVIRONMENTAL

\$6.0M

\$4.5 million
projected

HEALTH & SAFETY



7.1



LTIF per 1 million hours worked

326

access permits granted





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www.cityforests.co.nz

DIRECTORS' REPORT

For the year ended 30 June 2017

The Directors of City Forests Limited are pleased to present their report on the activities of the Company for the year ended 30 June 2017.

Principal activities of the Company

This report covers the financial year 1 July 2016 to 30 June 2017.

The principal activities of the Company are the growing, harvesting and marketing of forest products from plantations it owns. The products are sold both in the domestic and export markets.

| Results for the year ended 30 June 2017 | \$000 |
|--|---------------|
| Operating surplus before income tax and impairment | 27,524 |
| Less income tax | 7,420 |
| Net surplus for the year | 20,104 |

State of affairs

The Directors are very pleased with the results achieved by the Company, having regard to the favourable 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 total of \$6,000,000 in dividends during the year made up of:

- > an interim un-imputed dividend of \$1,500,000 in December 2016,
- > a final un-imputed dividend of \$3,000,000 in June 2017,
- > a special un-imputed dividend of \$1,500,000 in June 2017,

ENVIRONMENT

13

water quality monitoring sites

1.8M

tonnes of carbon stored



Health and safety

The Board and Management of the Company is committed to achieving best practice in health and safety performance. Board resources allocated to governance and oversight of this key operational area have been significant during the year.

The Company recorded a Lost Time Injury Frequency (LTIF) of 7.1 lost time injuries per 1 million hours worked (18.2 previous year). One incident – a strained calf muscle – occurred in a silviculture operation during the year and contributed to this LTIF statistic which encompasses all Company staff and contract forest operations employees working on the Company estate.

During the year the Company continued to improve its health and safety systems in accordance with its annual plan. The areas of driver training, pre-operation risk assessment, internal safety audit systems, fatigue management and drug and alcohol testing were specific focus areas for the year.

Donations

There have been cash donations made of \$12,250 during the year.

Changes in accounting policies

There has been no change in accounting policies during the year.

Reserves

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

| | \$'000 |
|-----------------------------|--------|
| To forestry reserve | 6,933 |
| To retained earnings | 7,171 |
| To hedging reserve | 939 |
| To land revaluation reserve | 241 |
| To carbon credit reserve | (470) |

Review of operations

This review of operations and the accompanying financial reports cover the 1 July 2016 to 30 June 2017 financial year.

Directors are pleased to report a record financial performance for City Forest Limited for the year in terms of both operational profit recorded of \$20.1m and dividends paid of \$6.0m. A summary of markets and operational factors contributing to the result is detailed below.

Log export markets

The Company continues to supply both the South Korean and Chinese log markets with regular shipments. This financial year was one of the most stable periods recorded in Asian log markets. Log prices rose steadily throughout the year in the “price setting” China market and these were mirrored in South Korea.

Although log inventories in China reached high levels of 5 million cubic meters following the Chinese New Year Holiday these stocks were quickly utilised by local processors fulfilling high levels of domestic demand. China log inventories have now returned to more manageable levels and demand is expected to remain strong for the foreseeable future.

The cost per cubic meter of international shipping to Asian markets rose from the cyclical low point experienced in the previous financial year to manageable levels in the USD \$17 – USD \$25 range and remained relatively stable about those levels throughout the year.

An oversupply of shipping capacity in a generally flat world commodity market combined with sustained lower fuel costs maintained shipping costs to Asia at approximately half of the Company’s long-term average cost of USD \$38 per cubic meter.

GROWTH

▲ +25%

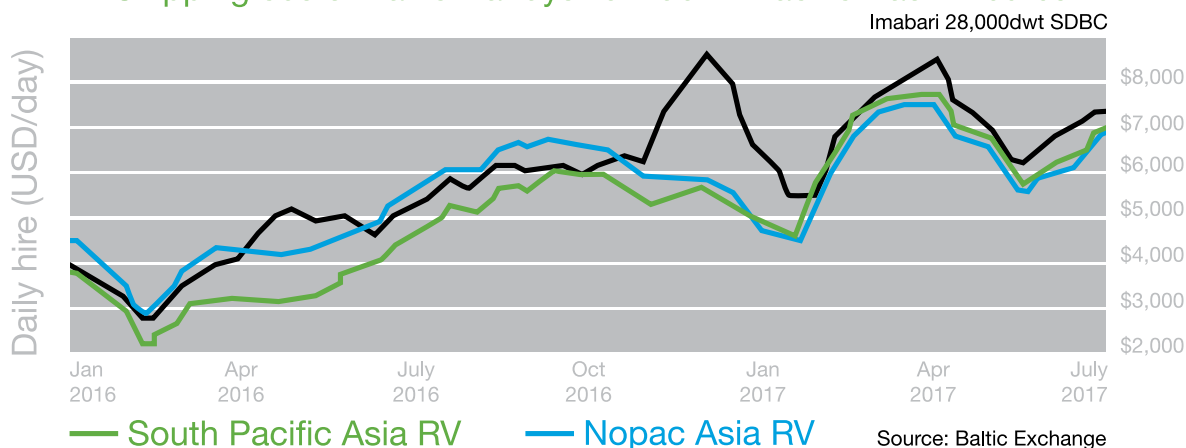
total surplus after tax

▲ +11%

total assets



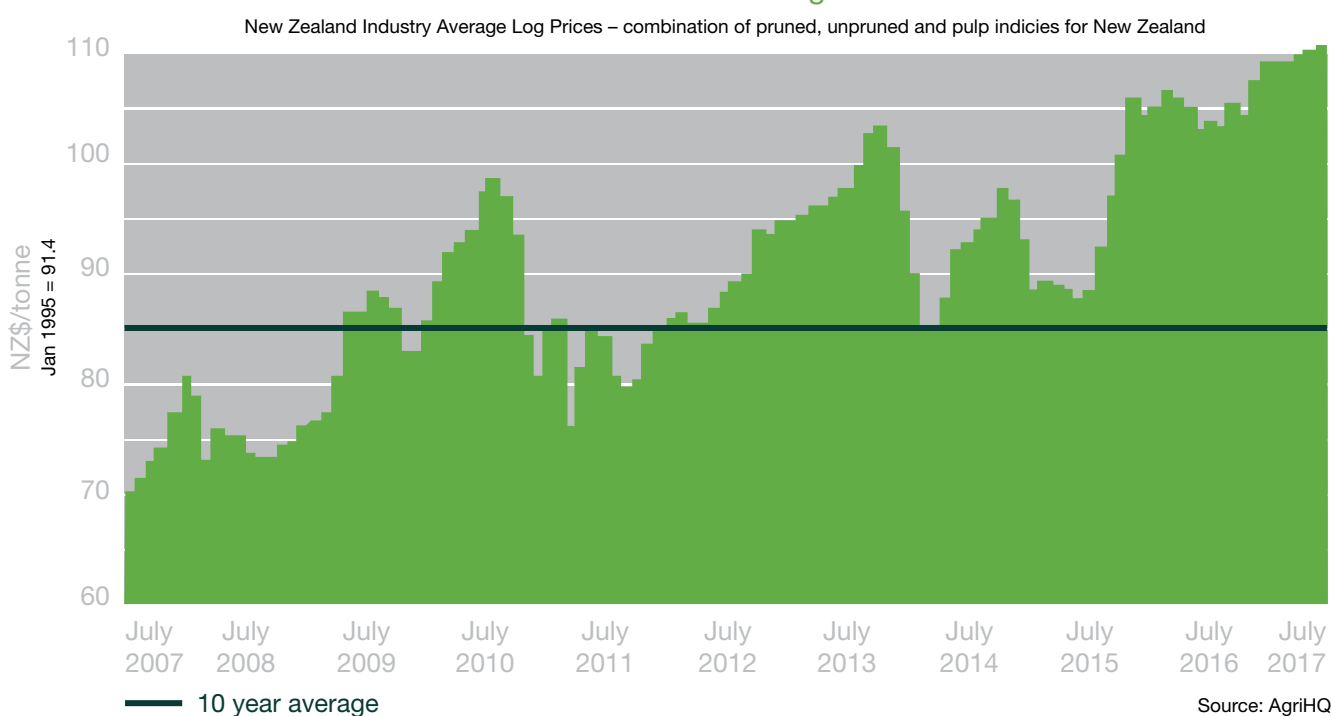
Shipping costs: Baltic Handysize Index – Pacific Basin Routes



During the year the value of the New Zealand Dollar compared to the United States Dollar was comparatively favourable. However, increases in the New Zealand Dollar in the final quarter negatively impacted receipts to a small degree. This was offset by price increases and lower shipping costs.

The combination of slowly increasing log market prices, favourable shipping costs and a lower value New Zealand Dollar when combined, delivered a period of very strong and stable log export returns for New Zealand forest owners.

Ten Year Combined Log Indicator



Foreign exchanging hedging

The Company receives revenue from export log sales in United States Dollars. These are converted to New Zealand Dollars and the applicable exchange rate impacts the Company's New Zealand Dollar returns. The Company hedges a proportion of its foreign exchange risk and the remainder of USD receipts are converted at spot rates.

Foreign exchange risk is managed by a United States Dollar hedging portfolio administered on the Company's behalf by Dunedin City Treasury Limited. The transactions and hedging portfolio are managed in accordance with the Company's Foreign Exchange Policy that is endorsed by the shareholder. The Company was compliant with the foreign exchange policy throughout the year. As described above the year has seen a lower value New Zealand Dollar which has been a significant factor contributing to strong returns from the export log market.

Domestic log market

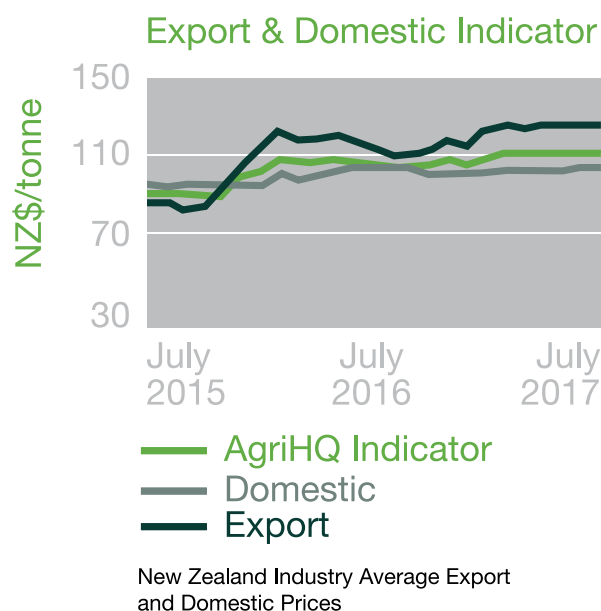
The Company continues to supply domestic mills in Otago and Southland and where possible prioritises supply to domestic mills. Overall 44.3% (45.1% previous year) of log production from the Company's forests was supplied to Domestic customers. Domestic supply is principally limited by production availability of the required domestic log grades and domestic processing capacity.

Most domestic wood processing customers enjoyed a positive year with strong lumber demand from a buoyant New Zealand housing construction market and the lower value of the New Zealand dollar increasing returns from lumber exports.

Prices for logs supplied to domestic customers increased during the year due to competing price pressure from the alternative log export market. Major domestic customers are on a negotiated

three-month log pricing cycle and as such are generally insulated from competing against the rapid swings in log price that can occur both up and down in the log export market.

During the year the Company increased its supply to the upgraded Pan Pac Milburn Mill which increased demand from April 2017.



Bio-energy

The Company continues to supply logs into the Dunedin bio-energy market. Some of this wood is dried and chipped for use in the modern low emission wood energy heat plants installed in a number of Dunedin buildings while a significant proportion continues to be sold into the traditional firewood market. Although the bio-energy market generally utilises lower quality logs not suited for higher uses it is growing in consumption as demand increases for clean energy.

Forest production

The Company had a busy second half of the production year making the most of favourable log markets. The overall cut from the forest estate was 277,201m³. This represents approximately a 3%



A new ROB – Remote Operated Bulldozer – a tether machine used to assist felling machines when working on steep slopes. It is owned and operated by Gamble Forest Harvesting, contracted to City Forests

undercut compared to its long term sustainable cut level. This undercut balances the 4% overcut the previous financial year.

The Company has focused its harvest activity in generally higher productivity stands particularly in the second half of the financial year. This has led to an increase in the supply of higher quality logs. Considering the favourable log pricing experienced during the period the Company has made good returns from high quality forest being harvested.

The Company handled a total volume of 341,656m³ for the year. The 64,455m³ of outside wood represents a steady volume of traded wood for the Company comparable to last financial year. The volume arose principally due to the Company optimising its harvesting capacity. Harvest capacity is shared by third parties who harvest woodlot volume and generally trade the logs through City Forests market channels. The arrangement allows the Company to fully utilise its supply chain contractors without overcutting the forest.

Roading and infrastructure

A roading network of approximately 306km is established in the Company's estate. Fifty-eight kilometres of major roads provide arterial access throughout the estate. Secondary roads, minor roads or tracks are upgraded prior to harvest and are generally kept operational for harvesting the next crop rotation. Regular maintenance is carried out principally by Delta Utility Services Limited, a sister company.

Forest asset operations

The Company continues to re-establish all its production areas as soon as reasonably practical following harvest. The Company is actively working to plant all available productive areas and to plant the best available tree crop on those areas. This involves selecting tree stocks with the best genetic potential to produce a high value tree crop from each site.

The Company is participating in the implementation of the latest forest industry research, funded by the Forest Growers Levy to increase the productivity

of the Company's forest estate. Scientists from the Crown Research Institute Scion have visited Company forests during the year to undertake trials, analyse growth data and provide advice to increase productivity per hectare.

The Company undertakes thinning in all its forests selecting the best trees to grow on to final harvest. As a direct result of the Scion research, thinning regimes have been modified to increase crop productivity. Pruning is carried out on its most productive sites to ensure a continued supply of high quality clear wood logs principally for domestic mills.



The mark of
responsible forestry

Sustainable forest management

The Company continues to demonstrate its commitment to responsible and sustainable management of its forest estates.

The Company has held uninterrupted Forest Stewardship Council (FSC) certification since 2000.

FSC is an independent, non-governmental, not-for-profit organisation established to promote the responsible management of the world's forests. Based in Europe FSC was established in 1993. FSC certification is based on compliance with 10 principals and criteria.

These principals incorporate amongst others indigenous peoples' rights, community relations and worker's rights, benefits from the forest eco-system, environmental impact, rare threatened or endangered flora and fauna management, forest management plans and monitoring and assessment performance.

The full list of principals and criteria can be viewed online at FSC.org

During the year a surveillance audit of Company management practices to the Forest Stewardship Council Certification Standard was completed.

This certification provides key independent verification that the Company strategy to be a sustainable land manager, good corporate and community citizen and a truly environmentally positive organisation is being successfully implemented. The Company's products are sold as FSC-certified.

New land acquisition

During the year the Company purchased the majority of the Clutha District Council forest estate through an open tender process. The blocks of forest are situated close to the Company's existing Tokoiti and Kaitangata forests. The Company also purchased a private forest block adjacent to its Millers Forest.

Overall the Company added 396.9ha to the forest estate and this provides a positive addition to the Company's sustainable cut level. The Company continues with its strategy of modest estate expansion where quality forest or land can be acquired economically in proximity to existing work areas.

Milburn wood processing plant

The Company leased the Milburn wood processing plant to Craigpine Timber Limited during the year. The lease has operated smoothly during the year. However, Craigpine have confirmed they will not renew the lease when it ends on 30 June 2017. The site is currently listed for sale.

Carbon

The Company continues to be a participant in the emissions trading scheme and the Company's forests' store a significant volume of carbon expressed as New Zealand Units (NZU's) each representing one tonne of carbon dioxide.

Carbon Price History – Spot NZU

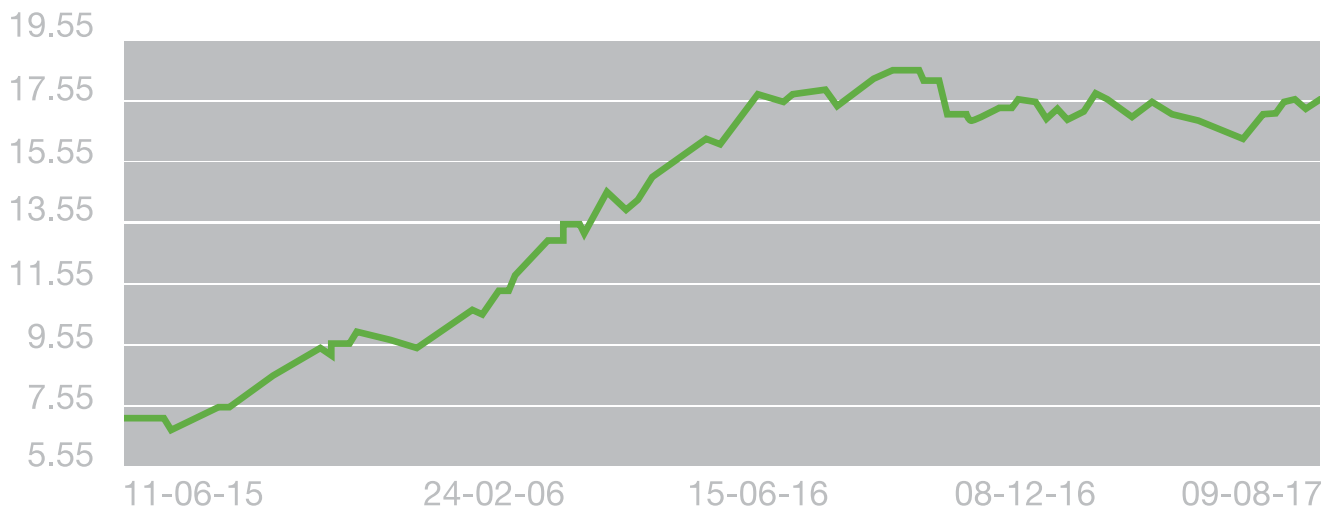


Chart: NZU Price. Source: OM Financial

The Company has received updated Company specific carbon yield tables following re-measurement of the network of sample plots. Once received the tables enabled the Company to file an emissions return during the final quarter and the Company received an allocation of 372,434 NZUs.

The Company has not traded any NZUs during the year. The market price of an NZU has been relatively flat in the \$16 to \$18 range throughout the year.

Carbon is incorporated as a component in the Company's forest valuation and the recognition of NZUs held in the Company's registry account is defined by accounting policy.

Forest valuation

The Company's forests are valued annually on 30 June and increased in value by \$9.629m from the previous year. The main drivers of the valuation increase were increases in five year average log prices, a revision of forecast forest yields to better reflect current forest production and the addition of new forest purchases.

The Company maintains a policy of a conservative but fair valuation of its forest assets. Although this year's value increase is significant it reflects a standard forest valuation approach that is independently audited by a third party, Woodlands Pacific. Key input variables impacting the valuation are benchmarked against industry averages to ensure they meet the conservative but fair value test.

Dividends

The Company has paid a dividend to the shareholder of \$6.0m during the year. This has been increased from the projected \$4.5m due to the favourable trading conditions experienced during the year.

Social and environmental contributions

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 through a permit system with numerous recreational activities

and organised events occurring during the year. Significant military exercises, the Rally of Otago, walking, mountain biking, horse trekking and hunting access are the most notable events.

The Company's financial contribution to the community has continued and a number of cash donations totalling \$12,250 and sponsorships totalling \$25,200 have been made to various organisations, community groups and charities.

Part of this sum is an in kind contribution to the road maintenance costs associated with the Rally of Otago. Non-cash donations of firewood have been made to a number of clubs and charities.

Future strategy

The Company continues to operate in a generally favourable forest products market, although market conditions and subsequent returns are typically variable within the financial year and between years. Operationally, the Company intends to continue to harvest its forests at their long-term sustainable cut level with some variation typically about +/- 10% to adjust for market conditions. Logs will continue to be supplied to a range of domestic and international markets.

Performance improvement in forest productivity and supply chain continues to be a focus of management to ensure returns from the forest estate are maximised in the long term.

The strategy of gradual and modest forest estate expansion continues and the Company plans to invest in economically viable new forest or land purchases that become available within its operational area.

In summary, the 2016 – 2017 year has been favourable in terms of health and safety performance, operations, profit and dividends paid. The directors' focus is to ensure the Company is run on a long-

term sustainable basis and that operational performance improvement and business growth occurs so long-term wealth is grown for the shareholder.

Outlook

The outlook for the 2018 financial year is to deliver a positive result. The underlying operational performance is predicted to be similar to 2017, however this will be dependent on how log markets track throughout the year.

The Company's financial performance is driven by export and domestic log sales and strong customer relationships.

A dividend of \$5 million is forecast for the 2018 year.

Looking to the medium-term future the Company is optimistic that the New Zealand forest industry will continue to generate favourable returns in international and domestic log markets. This is driven by strong demand for wood products domestically and from China and other Asian economies experiencing economic growth. As experienced in the past it is expected that economic volatility will cause these returns to remain cyclic in nature throughout each financial year.

This Company's annual harvest is now at long-term sustainable levels of approximately 285,000 m3 per annum. The Company is well placed with a mature, harvest ready forest and proven export capability to make the most of market opportunities.

Carbon revenues are expected to once again become a contributor to Company performance in the medium term and carbon prices have recovered from 2013 lows. Carbon revenues provide financial recognition of the Company's wider positive environmental impact.



Fire fighting exercises with Company staff, volunteers and various authorities are held on a regular basis to sustain skill levels and preparedness

Change of directors

No changes in directors occurred during the period.

Financial statements

The audited financial statements for the year ended 30 June 2017 are attached to this report.

Directors' interests in contracts

Refer to Directors' Declarations of Interest section on pages 17 to 18 and the Related Parties Transactions note 20.

Auditors

The Controller and Auditor General have contracted the audit to Audit New Zealand. Auditor's remuneration is set out in Note 4.

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.

Number of employees

| | |
|-----------------------|---|
| \$150,000 – \$160,000 | 1 |
| \$170,000 – \$180,000 | 1 |
| \$180,000 – \$190,000 | 1 |
| \$290,000 – \$300,000 | 1 |

Information on the directors of City Forests Limited

| Director and responsibilities | Remuneration \$000 | |
|---|--------------------|------|
| | 2017 | 2016 |
| John F Gallaher | 54 | 53 |
| Non-executive Director (Appointed 1st November 2012) Chairman Remunerations Sub-Committee (Appointed 1st October 2013) | | |
| Tony D Allison | 29 | 28 |
| Non-executive Director (Appointed 1st November 2012) Chairman Audit Committee (Appointed 1st October 2013) | | |

| Director and responsibilities | Remuneration \$000 | |
|---|--------------------|------|
| | 2017 | 2016 |
| Tim J Mepham | 29 | 28 |
| Non-executive Director (Appointed 1st December 2013) | | |
| Michael C Horne | 29 | 28 |
| Non-executive Director (Appointed 9th December 2013) | | |

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 highly skilled and dedicated team ably led by Grant Dodson, the Company's chief executive officer.

Events subsequent to balance date

No significant events have occurred subsequent to balance date.

On behalf of the Board of Directors:

J F Gallaher
Chairman



29 August 2017

T D Allison
Director



29 August 2017



**Maximising
mechanised
harvesting**

COMPANY PARTICULARS

As at 30 June 2017

DIRECTORS

J F Gallaher – A.F.A., F.A.C.A., B Com., CM.Inst.D. (Appointed 1.11.12)

(Appointed Chairman 1st October 2013)

T D Allison – B.Com., B.A., C.A., CM.Inst.D. (Appointed 1.11.12)

T J Mephram – B.Com., C.A., M.Inst.D. (Appointed 1.12.13)

M C Horne – L.L.B., C.A. (P.P.), B.Com., CM.Inst.D. (Appointed 9.12.13)

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



Information on the Directors of City Forests Limited

Director & Qualifications

Declarations of Interest

John Gallaher (Chairman appointed October 2013)

A.F.A., F.A.C.A., B Com., CM.Inst.D

Chairman, Digital Community Trust
 Chairman, Otago Southland Diocesan Board of Management
 Chairman, TracPlus Global Limited
 Chairman, Tui Motu Foundation Inc
 Chairman, United Way NZ Inc
 Chairman, Mercy Hospital Dunedin Limited
 Deputy Chairman, NZCEO Limited
 Deputy Chairman, NZCEO Finance Limited
 Director, CIANZ Inc
 Director, FMO Registry Services Limited
 Director, Fund Managers Otago Limited
 Director, Gamma Investments Limited
 Director, Granwood Holdings Limited
 Director, Grow Dunedin Steering Group
 Director, Heifer Ranching NZ Limited
 Director, Mastah Investments Limited
 Director, OPAL Limited
 Director, Otago Rescue Helicopter Limited
 Director, TracPlus Security Nominees Limited
 Trustee, Otago Rescue Helicopter Trust
 Trustee, William Sheriff Charitable Trust
 Member, FIBA Finance Commission

Date appointed 1st November 2012

Tony Allison (Non-Executive Director)

B.Com., B.A., C.A., CM.Inst.D.

Director, AA Cleaners (Otago) Limited
 Director, Dunedin International Airport Limited
 Director, Smith City Finance Limited
 Director, Smith City (Southern) Limited
 Director, Smith City Properties Limited
 Director, SGG Finance Limited
 Director, Smith City Group Limited

Date appointed 1st November 2012

Mr Tim J Mepham (Non-Executive Director)

C.A., B Com., M.Inst.D.

Deputy Chair, Presbyterian Support Otago
 Treasurer, Yellow Eyed Penguin Trust
 Principal, Rautaki Advisory
 Director, PSO Retirement Villages Limited

Date appointed December 2013

Director & Qualifications

Declarations of Interest

Mr Michael C Horne (Non-Executive Director)

L.L.B., C.A. (P.P.), B Com., CM.Inst.D.

Director, Ettioled Limited
 Director, Best View Limited
 Director, Ellis Fibre Global Limited
 Director, Ellis Fibre NZ Limited
 Director, Escea International Limited
 Director, Escea Limited
 Director, Otago Polytechnic
 Director, Otago Southland Division of the Cancer Society of
 New Zealand
 Director, Palmer & Son Limited
 Director, Palmer MH Limited
 Director, Palmer Mechanical Limited
 Director, Palmer Resources Limited
 Director, PDS (Computer Services) Limited
 Director, Prospectus Nominees
 Director, Prospectus Nominees Services Limited
 Director, Rawhiti Road Investments Limited
 Director, Viblock Limited
 Director, Foodco New Zealand Limited
 Director, Greenbriar Limited
 Director, Southern Rehab Limited
 Trustee, Digital Community Trust
 Trustee, Otago Festival of Arts Trust

Date appointed December 2013



TREND STATEMENT

| | Year Ended 30 Jun 17 \$'000 | Year Ended 30 Jun 16 \$'000 | Year Ended 30 Jun 15 \$'000 | Year Ended 30 Jun 14 \$'000 | Year Ended 30 Jun 13 \$'000 |
|--|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| <u>FINANCIAL PERFORMANCE</u> | | | | | |
| Domestic Revenue | 12,756 | 12,335 | 9,412 | 12,687 | 13,590 |
| Export Revenue | 26,465 | 33,861 | 26,751 | 22,108 | 18,983 |
| Other Revenue | 869 | 656 | 2,228 | 2,385 | 2,652 |
| Total Revenue | 40,090 | 46,852 | 38,391 | 37,180 | 35,225 |
| Percentage Increase | (14.4%) | 22.0% | 3.2% | 5.5% | (16.6%) |
| Inventory Movement | 869 | (224) | (170) | (308) | (479) |
| Total Expenses | 28,857 | 35,341 | 31,072 | 28,216 | 29,514 |
| Percentage Increase | (18.3%) | 13.7% | (10.1%) | (4.4%) | (29.2%) |
| Operating Surplus | 12,102 | 11,287 | 7,149 | 8,656 | 5,232 |
| New Zealand Carbon Credits | 6,182 | 1,462 | - | 2,694 | 6,172 |
| Gain in fair value of forestry asset | 9,629 | 9,524 | 2,515 | 1,571 | 7,046 |
| Write down value of land | (389) | - | - | - | - |
| Impairment Charges | - | - | (80) | 1,500 | - |
| Surplus After Non-Operating Items And Before Taxation | 27,524 | 22,273 | 9,744 | 11,421 | 18,450 |
| Income Tax | 7,420 | 6,252 | 2,702 | 3,130 | 3,836 |
| Total Surplus after Taxation | 20,104 | 16,021 | 7,042 | 8,291 | 14,614 |
| <u>SHAREHOLDERS' FUNDS</u> | | | | | |
| Shareholders Funds | 130,873 | 115,670 | 96,649 | 95,932 | 91,725 |
| Operating Cash flow | 12,200 | 11,787 | 8,734 | 8,278 | 17,263 |
| Dividends Paid - Normal | 4,500 | 4,500 | 4,500 | 2,600 | 2,400 |
| - Special | 1,500 | 2,000 | 500 | 2,500 | 2,000 |
| Value of Forest | 136,333 | 123,802 | 113,629 | 111,093 | 108,589 |
| Surplus after tax to shareholders funds | 15.36% | 13.85% | 7.29% | 8.64% | 15.93% |
| Proprietorship Ratio | 66.00% | 65.12% | 62.53% | 63.34% | 61.89% |
| Net Forest Revaluation | 9,629 | 9,524 | 1,811 | 1,131 | 5,073 |
| Net Land Revaluation | (148) | - | (22) | (102) | - |
| <u>FOREST STATISTICS</u> (whole no's) | | | | | |
| Forest harvested (m ³) | 277,201 | 306,452 | 299,377 | 284,373 | 302,096 |
| Volume traded (m ³) | 64,455 | 71,364 | 18,530 | 2,583 | 1,917 |
| Forest planted (ha) | 579 | 487 | 605 | 602 | 520 |
| Total forest (ha) | 16,795 | 16,469 | 16,315 | 16,326 | 16,114 |
| Forest purchased (ha) | 347 | 156 | - | 204 | - |

Statement of Comprehensive Income

For the Year Ended 30 June 2017

| | Note | Year to 30 June 2017 \$'000 | Year to 30 June 2016 \$'000 |
|--|------|--------------------------------------|--------------------------------------|
| Revenue | 3 | 46,239 | 48,304 |
| Financial income | | 33 | 11 |
| Gain/(loss) in fair value of forestry asset | 15 | 9,629 | 9,524 |
| Total revenue | | 55,901 | 57,839 |
| Inventory movement | | 869 | (224) |
| <i>Less expenses</i> | | | |
| Contractors | | 13,896 | 14,192 |
| Depreciation and amortisation expense | | 375 | 410 |
| Directors fees | | 141 | 137 |
| Employee expenses | | 1,483 | 1,398 |
| Financial expenses | | 853 | 1,235 |
| Other expenses | 4 | 12,498 | 17,970 |
| Total expenses | | 29,246 | 35,342 |
| Profit before tax | | 27,524 | 22,273 |
| Income tax expense | 5 | 7,420 | 6,252 |
| NET PROFIT/(LOSS) AFTER TAX | | 20,104 | 16,021 |
| Other comprehensive income | | | |
| Gains/(loss) on cash flow hedges taken to equity | | 1,304 | 1,971 |
| Tax effect of cash flow hedges taken to equity | | (365) | (552) |
| Increase/(decrease) in land revaluation | | 241 | - |
| Carbon credits revaluation above initial recognition taken to equity | | (586) | 10,832 |
| Tax effect of carbon taken to equity | | 116 | (2,362) |
| Other comprehensive income for the year | | 710 | 9,889 |
| Total Comprehensive Income for the Year | | 20,814 | 25,910 |

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



Statement of Changes in Equity

For the Year Ended 30 June 2017

| | Note | Year to 30 June 2017 \$'000 | Year to 30 June 2016 \$'000 |
|---|-------------|--|--|
| Equity at beginning of year | | <u>116,059</u> | <u>96,649</u> |
| Total comprehensive income for the year | | 20,814 | 25,910 |
| Distribution to owners | | | |
| Dividends | | <u>(6,000)</u> | <u>(6,500)</u> |
| Equity at end of year | | <u>130,873</u> | <u>116,059</u> |

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

Statement of Financial Position

As at 30 June 2017

| | | As at 30 June 2017 \$'000 | As at 30 June 2016 \$'000 |
|--------------------------------------|------|------------------------------------|------------------------------------|
| | Note | | |
| Equity | | | |
| Share Capital | 6 | 25,691 | 25,691 |
| Forestry reserve | 7 | 62,732 | 55,799 |
| Land revaluation reserve | 7 | 15,088 | 14,847 |
| Hedging reserve | 7 | (16) | (955) |
| Carbon credit reserve | 7 | 10,820 | 11,290 |
| Retained earnings | 8 | 16,558 | 9,387 |
| Total Equity | | 130,873 | 116,059 |
| Current Liabilities | | | |
| Trade and other payables | | 3,170 | 3,098 |
| Other current liabilities | | 445 | 293 |
| Employee Provisions | | 125 | 120 |
| Derivative financial instruments | 9 | 40 | 524 |
| Current portion of term borrowings | 10 | 1,686 | 1,686 |
| Provision for taxation | | 1,803 | 2,274 |
| Provision for dividend | | - | 1,000 |
| Subvention payable | | 548 | - |
| Total current liabilities | | 7,817 | 8,995 |
| Non-Current Liabilities | | | |
| Derivative financial instruments | 9 | 525 | 947 |
| Term borrowings | 10 | 18,842 | 16,832 |
| Other liabilities | | 320 | 320 |
| Deferred tax liability | 11 | 39,890 | 34,871 |
| Total non-current liabilities | | 59,577 | 52,970 |
| Total Liabilities | | 67,394 | 61,965 |
| TOTAL EQUITY PLUS LIABILITIES | | 198,267 | 178,024 |

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

Statement of Financial Position Cont'd/....

As at 30 June 2017

| | | As at 30 June 2017 \$'000 | As at 30 June 2016 \$'000 |
|--|------|------------------------------------|------------------------------------|
| | Note | | |
| Current Assets | | | |
| Cash and cash equivalents | | 810 | 302 |
| Trade and other receivables | | 2,909 | 4,162 |
| Derivative financial instruments | 9 | 426 | 69 |
| Inventories – raw materials | | 1,062 | 193 |
| Prepayments | | 426 | 274 |
| GST refund | | 244 | 253 |
| Assets held for sale | 17 | 1,122 | 16 |
| Total current assets | | 6,999 | 5,269 |
| Non-Current Assets | | | |
| Derivative financial instruments | 9 | 118 | 76 |
| Property, plant and equipment | 16 | 31,383 | 31,556 |
| Forestry assets | 15 | 136,333 | 123,802 |
| Investments | | 1 | 1 |
| Intangibles – computer software | | 20 | 32 |
| Intangibles – New Zealand carbon credits | 18 | 23,413 | 17,288 |
| Total non-current assets | | 191,268 | 172,755 |
| TOTAL ASSETS | | 198,267 | 178,024 |

On behalf of the Board of Directors:

J F Gallaher
Chairman



29 August 2017

T D Allison
Director



29 August 2017

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

Statement of Cash Flows

For the Year Ended 30 June 2017

| | | Year to 30 June 2017 \$'000 | Year to 30 June 2016 \$'000 |
|--|-----------|--------------------------------------|--------------------------------------|
| | Note | | |
| Cash Flows from Operating Activities | | | |
| <i>Cash was provided from</i> | | | |
| Receipts from customers | | 41,313 | 46,780 |
| Interest received | | 25 | 11 |
| | | <u>41,338</u> | <u>46,791</u> |
| <i>Cash was disbursed to</i> | | | |
| Payments to suppliers and employees | | 24,649 | 31,871 |
| Interest paid | | 811 | 899 |
| Income tax/subvention | | 3,121 | 1,884 |
| Effect of exchange rate changes | | 9 | 350 |
| Carbon credits purchased | | 548 | - |
| | | <u>29,138</u> | <u>35,004</u> |
| Net Cash Inflows/(Outflows) from Operating Activities | 19 | 12,200 | 11,787 |
| Cash Flows from Investing Activities | | | |
| <i>Cash was provided from</i> | | | |
| Sale of property, plant and equipment | | 105 | 37 |
| | | <u>105</u> | <u>37</u> |
| <i>Cash was disbursed to</i> | | | |
| Purchase of property, plant and equipment | | 1,511 | 1,627 |
| Purchase of Forest Assets – Cost of bush | | 4,950 | 1,753 |
| | | <u>6,461</u> | <u>3,380</u> |
| Net Cash Inflows/(Outflows) from Investing Activities | | <u>(6,356)</u> | <u>(3,343)</u> |

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



Statement of Cash Flows Cont'd/....

For the Year Ended 30 June 2017

| | Year to 30 June 2017 \$'000 | Year to 30 June 2016 \$'000 |
|--|--------------------------------------|--------------------------------------|
| Cash Flows from Financing Activities | | |
| <i>Cash was provided from</i> | | |
| Proceeds from borrowings | 6,410 | 3,790 |
| | <u>6,410</u> | <u>3,790</u> |
| <i>Cash was disbursed to</i> | | |
| Repayment of borrowings | 4,746 | 6,906 |
| Dividends paid | 7,000 | 5,500 |
| | <u>11,746</u> | <u>12,406</u> |
| Net Cash Inflows / (Outflows) from Financing Activities | <u>(5,336)</u> | <u>(8,616)</u> |
| Net Increase / (Decrease) in Cash Held | 508 | (172) |
| Cash and short term deposits at the beginning of the year | <u>302</u> | <u>474</u> |
| CASH AND SHORT TERM DEPOSITS AT THE END OF THE YEAR | <u><u>810</u></u> | <u><u>302</u></u> |
| Composition of Cash | | |
| Cash and short term deposits | <u><u>810</u></u> | <u><u>302</u></u> |

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

Notes to the Financial Statements

For the Year Ended 30 June 2017

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 and the Companies 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. The rounding is in (000)'s.

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 29th August 2017.

Basis of Accounting

The Company is a Tier 1 for-profit entity as defined by the External Reporting Board and has reported in accordance with Tier 1 For-profit Accounting standards. These annual financial statements are general purpose financial reports which have been prepared in accordance with generally accepted accounting practice in New Zealand, and comply with the New Zealand equivalents to the International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards as appropriate for profit entities.

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.

Critical Accounting Estimates and Assumptions

In preparing these financial statements, estimates and assumptions have been made concerning the future. These estimates and assumptions may differ from the subsequent actual results. Estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations or future events that are believed to be reasonable under the circumstances. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Note 15 provides information about the forestry assets and the relevant assumptions in determining the value.

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.

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 statement of comprehensive income via surplus or deficit 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 Primary Industries Repayable Loans. Interest is calculated six monthly 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.

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 statement of comprehensive income via surplus or deficit 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 statement of comprehensive income via surplus or deficit, 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.

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 statement of comprehensive income via other comprehensive income 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 statement of comprehensive income via surplus or deficit in the year the item is derecognised.

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 statement of comprehensive income via surplus or deficit.

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 via surplus or deficit.

Impairment of assets excluding goodwill Cont'd....

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.

Inventories

Inventories reported in the balance sheet include:

- Log inventories
Valued at net realisable value less estimated point of sale costs.
- 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.

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 statement of comprehensive income via surplus or deficit 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, commodity swaps 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 statement of comprehensive income via other comprehensive income.

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 via surplus or deficit. 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 via other 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 statement of comprehensive income via other comprehensive income. 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 via other comprehensive income.

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 via surplus or deficit 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 via surplus or deficit 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 via surplus or deficit.

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 bi-annually thereafter
- Emissions obligations are recognised as a current or future liability depending on the legislated liability period
- The difference between initial fair value or previous annual revaluations and disposal or revaluation value of the units is recognised in other comprehensive income

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:



Standards and Interpretations effective in the current period Cont'd/....

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.

Amendments to NZ IAS 1 – Presentation of 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 2017.

| New Pronouncement | Effective Date |
|---|-----------------|
| New or revised Standards or Interpretations | |
| NZ IFRS 9 <i>Financial Instruments (2014)</i> | 1 January, 2018 |
| NZ IFRS 15 <i>Revenue from Contracts with Customers</i> | 1 January, 2018 |

Adoption of New Revised Standards and Interpretations

No standards have been adopted during the year which have had a material impact on the financial statements. There are no standards in issue but not yet effective which would materially impact the amounts recognised in the financial statements.

Statement of Cashflows

The statement of cashflows is prepared exclusive of GST, which is consistent with the method used in the statement of comprehensive income via surplus or deficit.

'Operating activities' represents all transactions and other events that are not investing or financing activities, and includes receipts and repayments of occupancy advances.

'Investing activities' are those activities relating to the acquisition and disposal of property, plant and equipment.

'Financial activities' are those activities relating to changes in the debt capital structure of the Company.

Changes in accounting policies

There have been no changes in accounting policies.

3. OPERATING REVENUE

| | As at 30 June 2017 \$'000 | As at 30 June 2016 \$'000 |
|---|------------------------------------|------------------------------------|
| Sales revenue | 39,710 | 46,663 |
| New Zealand carbon credits | 6,182 | 1,462 |
| Gain on sale of property, plant and equipment | 38 | 22 |
| Other revenue | 309 | 157 |
| | <u>46,239</u> | <u>48,304</u> |

4. OTHER EXPENSES

| | | |
|--|---------------|---------------|
| Audit fees - for audit of financial statements | 35 | 34 |
| Donations | 12 | 8 |
| Loss on sale of property, plant and equipment | 6 | - |
| Rental expense on operating leases | 53 | 76 |
| Research expenditure | 145 | 192 |
| Cost of bush applied | 2,394 | 1,535 |
| Shipping costs | 4,785 | 6,147 |
| Write down of land value | 389 | - |
| Subvention | 548 | - |
| Other expenses | 4,131 | 9,978 |
| | <u>12,498</u> | <u>17,970</u> |



5. INCOME TAX

| | | |
|---|---------------|---------------|
| Net profit from continued operations | 27,524 | 22,273 |
| Profit before income tax | 27,524 | 22,273 |
| Tax thereon at 28% | 7,707 | 6,236 |
| <i>Plus/(less) the Tax Effect of Differences</i> | | |
| Income not assessable for taxation | (5) | - |
| Expenditure not deductible for taxation | 116 | 10 |
| Under / (over) tax provision in prior years | (3) | 6 |
| Losses utilised from Dunedin Stadium Properties Ltd | (395) | - |
| Tax effect of differences | (287) | 16 |
| Tax expense | 7,420 | 6,252 |
| Tax expense made up as follows: | | |
| Continued operations | 7,420 | 6,252 |
| | 7,420 | 6,252 |
| Effective tax rate | 27.0% | 28.1% |
| <i>Represented by</i> | | |
| Current tax provision | 2,626 | 3,005 |
| Deferred tax provision | 4,797 | 3,241 |
| Under / (over) tax provision in prior years | (3) | 6 |
| | 7,420 | 6,252 |

Imputation credit account

City Forests Limited is a member of an income tax consolidated group and has access to the income tax consolidated group's imputation credit account.

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.

6. EQUITY - Share Capital

Issued Capital

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.

| As at 30 June 2017 \$'000 | As at 30 June 2016 \$'000 |
|------------------------------------|------------------------------------|
|------------------------------------|------------------------------------|

| | |
|--------|--------|
| 25,691 | 25,691 |
|--------|--------|

7. RESERVES

Forestry Reserve

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

| | | |
|---------------------------------------|---------------|---------------|
| Balance at beginning of the year | 55,799 | 48,942 |
| Transfer from retained earnings | 6,933 | 6,857 |
| Balance at the end of the year | 62,732 | 55,799 |

Hedging Reserve

Balance at beginning of the year
Gain/(loss) in fair value movement in derivatives
Balance at the end of the year

| | |
|-------------|--------------|
| (955) | (2,373) |
| 939 | 1,418 |
| (16) | (955) |

Land Revaluation Reserve

Balance at beginning of the year
Forestry land revaluations
Balance at the end of the year

| | |
|---------------|---------------|
| 14,847 | 14,847 |
| 241 | - |
| 15,088 | 14,847 |

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

Carbon Credit Reserve

Balance at beginning of the year
Gain in carbon credits above initial recognition value
Balance at the end of the year

| | |
|---------------|---------------|
| 11,290 | 2,820 |
| (470) | 8,470 |
| 10,820 | 11,290 |

The amount held in the reserve is net of deferred tax where relevant. Any value above initial recognition is held in the Carbon Credit revaluation reserve.



| | As at 30 June 2017 \$'000 | As at 30 June 2016 \$'000 |
|---------------------------------------|------------------------------------|------------------------------------|
| 8. RETAINED EARNINGS | | |
| Balance at the beginning of the year | 9,387 | 6,722 |
| Net profit/(loss) for the year | 20,104 | 16,021 |
| Dividend distributions | (6,000) | (6,500) |
| Transfer to forestry reserve | (6,933) | (6,856) |
| Balance at the end of the year | 16,558 | 9,387 |

9. FINANCIAL INSTRUMENTS

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.

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 2017 | Foreign currency 2017 FC'000 | Contract value 2017 NZD'000 | Fair value 2017 NZD'000 | Fair value 2016 NZD'000 |
|--------------------------|----------------------------------|------------------------------------|-----------------------------------|-------------------------------|-------------------------------|
| Cashflow hedges | | | | | |
| Sell USD | | | | | |
| Current | 0.704 | 7,000 | 9,971 | 385 | (313) |
| Non current | 0.692 | 1,800 | 2,603 | 118 | (8) |
| Buy USD | | | | | |
| Current | - | - | - | - | (5) |
| Non current | - | - | - | - | (48) |
| | | | | 503 | (374) |

| 2017 | <1 yr | 1-2 yrs | 2-3 yrs | 3-4 yrs | 4-5 yrs | 5 yrs | Total |
|----------------------------------|-------|---------|---------|---------|---------|--------|--------|
| Financial Assets | | | | | | | |
| Trade and other receivables | 2,909 | - | - | - | - | - | 2,909 |
| Derivative financial instruments | 426 | 118 | - | - | - | - | 544 |
| | 3,335 | 118 | - | - | - | - | 3,453 |
| Financial Liabilities | | | | | | | |
| Trade and other payables | 3,170 | - | - | - | - | - | 3,170 |
| Derivative financial instruments | 40 | 319 | - | - | 206 | - | 565 |
| Borrowings | 1,686 | 2,454 | 1,686 | 119 | - | 14,583 | 20,528 |
| | 4,896 | 2,773 | 1,686 | 119 | 206 | 14,583 | 24,263 |
| 2016 | | | | | | | |
| Financial Assets | | | | | | | |
| Trade and other receivables | 4,162 | - | - | - | - | - | 4,162 |
| Derivative financial instruments | 69 | 76 | - | - | - | - | 145 |
| | 4,231 | 76 | - | - | - | - | 4,307 |
| Financial Liabilities | | | | | | | |
| Trade and other payables | 3,098 | - | - | - | - | - | 3,098 |
| Derivative financial instruments | 524 | 132 | 536 | - | - | 279 | 1,471 |
| Borrowings | 1,686 | 1,686 | 1,686 | 2,610 | - | 10,849 | 18,517 |
| | 5,308 | 1,818 | 2,222 | 2,610 | - | 11,128 | 23,086 |

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 2017 \$'000 | As at 30 June 2016 \$'000 |
|-------------------------------------|------------------------------------|------------------------------------|
| Maturing in less than one year | - | 5,000 |
| Maturing between one and five years | 8,000 | 5,000 |
| Maturing after five years | - | 3,000 |
| | <u>8,000</u> | <u>13,000</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.

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 .7324 and against the AUD from the year end rate of .9738.
- A parallel shift of +1% / -1% in the NZD market interest rate from the year end 90 day BBBR of 1.98%.

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% |
| | | Equity Profit | Equity Profit | Equity Profit | Equity Profit |
| <u>Financial Assets</u> | | | | | |
| <u>Derivatives</u> | | | | | |
| Currency Hedges – Sell USD | 12,573 | - | - | - | (817) |
| Other Financial Assets | 1,419 | - | - | - | (129) |
| <u>Financial Liabilities</u> | | | | | |
| Interest rate swaps | 8,000 | (199) | 191 | - | - |
| Total increase/(decrease) | | (199) | 191 | - | (1,221) |

1. Accounts receivable within City Forests Limited include \$1.039 million of USD denominated receivables at year end.
2. 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.
3. 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.
4. The carrying value of the derivative has been calculated based on rates on each individual contract.

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). |

| | 2017 | | | |
|----------------------------------|-----------|-----------|-----------|-----------|
| | Level 1 | Level 2 | Level 3 | Total |
| | NZ \$'000 | NZ \$'000 | NZ \$'000 | NZ \$'000 |
| Financial assets | | | | |
| Derivative financial assets | - | 544 | - | 544 |
| New Zealand carbon credits | 23,413 | - | - | 23,414 |
| | 23,413 | 544 | - | 23,958 |
| Financial liabilities | | | | |
| Derivative financial liabilities | - | 565 | - | 565 |
| | - | 565 | - | 565 |

| | 2016 | | | |
|----------------------------------|-----------|-----------|-----------|-----------|
| | Level 1 | Level 2 | Level 3 | Total |
| | NZ \$'000 | NZ \$'000 | NZ \$'000 | NZ \$'000 |
| Financial assets | | | | |
| Derivative financial assets | - | 145 | - | 145 |
| New Zealand carbon credits | 17,288 | - | - | 17,288 |
| | 17,288 | 145 | - | 17,433 |
| Financial liabilities | | | | |
| Derivative financial liabilities | - | 1,471 | - | 1,471 |
| | - | 1,471 | - | 1,471 |

10. TERM BORROWINGS

| | As at 30 June 2017 \$'000 | As at 30 June 2016 \$'000 |
|-------------------------------------|------------------------------------|------------------------------------|
| Dunedin City Treasury loan facility | 15,350 | 12,000 |
| Forestry loans | 5,178 | 6,518 |
| | <u>20,528</u> | <u>18,518</u> |

The forestry loans are from the Ministry of Primary Industries. They are fixed rate loans secured by registered interest 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 10 years commencing January 2012. The interest capitalised for the year ended 30 June 2017 was \$346,277 (2016 \$430,531).

There is no security over the Dunedin City Treasury loan. This is a \$22 m evergreen unsecured facility.

The weighted average interest rate for the Dunedin City Treasury Limited loan facility, ranged between 5.4% and 7.53% (2016 6.083 – 7.53%).

The weighted average interest rates for the forestry loans is 6.09%, (2016 6.09%). There are no covenants on the term borrowings (2016 nil).

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

| | | |
|----------------------------|--------|--------|
| Multi-option note facility | 15,350 | 12,000 |
| Forestry loans | 4,671 | 6,315 |

The repayment period on the term borrowings is as follows:

| | | |
|-------------|---------------|---------------|
| Current | 1,686 | 1,686 |
| Non Current | 18,842 | 16,832 |
| | <u>20,528</u> | <u>18,518</u> |



11. DEFERRED TAX LIABILITIES AND ASSETS

| | 2017 \$'000 | 2017 \$'000 | 2017 \$'000 | 2017 \$'000 | 2017 \$'000 | 2017 \$'000 |
|---|-----------------------------|----------------------|-------------------------|---------------------------------------|----------------|----------------|
| | Opening Balance Sheet | Charged To Equity | Charged to Income | Closing Balance Sheet Assets | Liabilities | Net |
| Property, plant and equipment | (46) | - | 32 | (14) | - | (14) |
| Employee provisions | (54) | - | (1) | (55) | - | (55) |
| Forest | 21,700 | - | 2,696 | - | 24,396 | 24,396 |
| Capitalised forestry costs | 9,861 | - | 317 | - | 10,178 | 10,178 |
| Revaluations of foreign exchange contracts | (104) | 245 | - | - | 141 | 141 |
| Revaluations of interest rate swaps | (266) | 120 | - | (146) | - | (146) |
| Revaluation of carbon credits | 3,773 | (116) | 1,725 | - | 5,382 | 5,382 |
| Other | 7 | - | 1 | - | 8 | 8 |
| Balance at the end of the year | 34,871 | 249 | 4,770 | (215) | 40,105 | 39,890 |

| | 2016 \$'000 | 2016 \$'000 | 2016 \$'000 | 2016 \$'000 | 2016 \$'000 | 2016 \$'000 |
|---|----------------|----------------|----------------|----------------|----------------|----------------|
| Property, plant and equipment | (77) | - | 31 | (46) | - | (46) |
| Employee provisions | (57) | - | 3 | (54) | - | (54) |
| Forest | 19,033 | - | 2,667 | - | 21,700 | 21,700 |
| Capitalised forestry costs | 9,730 | - | 131 | - | 9,861 | 9,861 |
| Revaluations of foreign exchange contracts | (656) | 552 | - | (104) | - | (104) |
| Revaluations of interest rate swaps | (266) | - | - | (266) | - | (266) |
| Revaluations of carbon credits | 1,002 | 2,362 | 409 | - | 3,773 | 3,773 |
| Other | 7 | - | - | - | 7 | 7 |
| Balance at the end of the year | 28,716 | 2,914 | 3,241 | (470) | 35,341 | 34,871 |

12. CAPITAL EXPENDITURE COMMITMENTS

| | |
|---------|---------|
| As at | As at |
| 30 June | 30 June |
| 2017 | 2016 |
| \$'000 | \$'000 |

There are no capital commitments as at 30 June 2017 (2016 \$nil)

13. CONTINGENT ASSETS OR LIABILITIES

There are no contingent assets or liabilities as at 30 June 2017 (2016 \$nil)

14. LEASE COMMITMENTS(i) Minimum operating lease commitments

| | | |
|-----------------------------------|-----------|------------|
| Payable within one year | 37 | 72 |
| Payable between one to five years | - | 36 |
| Payable later than five years | - | - |
| | <u>37</u> | <u>108</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.

15. FORESTRY ASSETS

| | As at 30 June 2017 \$'000 | As at 30 June 2016 \$'000 |
|---|------------------------------------|------------------------------------|
| Balance at the beginning of the year | 123,802 | 113,629 |
| Add Costs capitalised in establishing forests during the year | 2,083 | 1,947 |
| Increase in forest from acquisition | 3,212 | 237 |
| Forest revaluation | 9,629 | 9,524 |
| Less Cost of trees harvested | (2,393) | (1,535) |
| | <u>136,333</u> | <u>123,802</u> |
| Gains/(losses) arising from changes in fair value less point of sale costs; | | |
| attributable to physical changes | (6,054) | 841 |
| attributable to price changes | 18,585 | 9,332 |
| | <u>12,531</u> | <u>10,173</u> |

The Directors of City Forests Limited revalue its forestry assets annually at 30 June.

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 \$27,569,800 value (see note 16). 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 statement of comprehensive income.

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 6.5% (2016 6.5%).

The forestry valuation is subject to a number of assumptions. The ones with the most significant volatility or impact on the valuation are the discount rate applied and log prices adopted. The discount rate adopted was 6.5%; a +/- 50 basis point movement in the discount rate would change the valuation by +\$7.03 mil / -\$6.41 mil. A 10% increase or decrease in assumed log prices would change the valuation by +\$11.59 mil / -\$11.51 mil; (note that these sensitivities are shown are independent and different outcome would result from combined changes in discount and log prices).

At 30 June 2017 the Company owned stands of trees on 16,795 hectares of a total land holding of 20,850 hectares. During the year the Company harvested approx. 277,201 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 9, 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 Woodlands Pacific. The peer review was completed with regard to a summary of market transactions at arms length terms and current market conditions. The peer review confirmed the valuation assumptions include all direct costs and revenues.

16. PROPERTY, PLANT AND EQUIPMENT

| | Land Other Valuation | Forest Land Valuation | Building Cost | Roads Bridges Cost | Plant Equipment Cost | Sub-Total |
|--|----------------------------|-----------------------------|------------------|--------------------------|----------------------------|-----------|
| 2017 | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 |
| Cost or Valuation | | | | | | |
| Balance at beginning of year | 305 | 26,375 | 1,914 | 7,183 | 7,445 | 43,222 |
| Increase through acquisition | - | - | - | - | - | - |
| Purchases/revaluation | (13) | 1,584 | - | 5 | 60 | 1,636 |
| Disposals | (2) | - | (2) | - | (390) | (394) |
| Transfer to assets held for sale | (290) | - | (509) | - | (2,645) | (3,444) |
| Balance at end of year | - | 27,959 | 1,403 | 7,188 | 4,470 | 41,020 |
| Accumulated depreciation/impairment | | | | | | |
| Balance at beginning of year | 30 | - | 1,524 | 3,904 | 6,486 | 11,944 |
| Depreciation | - | - | 16 | 168 | 81 | 265 |
| Impairment | - | 389 | - | - | - | 389 |
| Disposals | - | - | (1) | - | (337) | (338) |
| Transfer to assets held for sale | (30) | - | (260) | - | (2,054) | (2,344) |
| | - | 389 | 1,279 | 4,072 | 4,176 | 9,916 |
| Balance at end of year | - | 27,570 | 124 | 3,116 | 294 | 31,104 |
| Comprising – Cost | - | - | 124 | 3,116 | 294 | 3,534 |
| Valuation | - | 27,570 | - | - | - | 27,570 |

The land valuations were obtained from Quotable Valuation which is the valuation Company used by the relevant city and district councils. The revaluation movement in the land for the year ended 30 June 2017 was \$(148K) (2016 \$nil). All other asset classes are shown at cost.

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

| | | Motor Vehicles | Office Equipment | |
|----------------------------------|---------------|-------------------|---------------------|---------------|
| | Sub-Total | Cost | Cost | Total |
| 2017 Cont'd/.... | \$'000 | \$'000 | \$'000 | \$'000 |
| Cost or Valuation | | | | |
| Balance at beginning of year | 43,222 | 762 | 307 | 44,291 |
| Increase through acquisition | - | - | - | - |
| Purchases/ revaluation | 1,636 | 100 | 18 | 1,754 |
| Disposals | (394) | (47) | (3) | (444) |
| Transfer to assets held for sale | (3,444) | (121) | (83) | (3,648) |
| Balance at end of year | 41,020 | 694 | 239 | 41,953 |
| Accumulated depreciation | | | | |
| Balance at beginning of year | 11,944 | 514 | 277 | 12,735 |
| Depreciation | 265 | 78 | 14 | 357 |
| Impairment | 389 | - | - | 389 |
| Disposals | (338) | (29) | (3) | (370) |
| Transfer to assets held for sale | (2,344) | (115) | (82) | (2,541) |
| | 9,916 | 448 | 206 | 10,570 |
| Balance at end of year | 31,104 | 246 | 33 | 31,383 |
| Comprising – Cost | 3,534 | 246 | 33 | 3,813 |
| Valuation | 27,570 | - | - | 27,570 |

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

| | Land Other Valuation | Forest Land Valuation | Buildings Cost | Roads Bridges Cost | Plant Equipment Cost | Sub-Total |
|----------------------------------|----------------------------|-----------------------------|-------------------|--------------------------|----------------------------|---------------|
| 2016 | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 |
| Cost or Valuation | | | | | | |
| Balance at beginning of year | 320 | 25,574 | 1,913 | 6,712 | 7,440 | 41,959 |
| Increase through acquisition | - | - | - | - | - | - |
| Purchases/revaluation | - | 801 | 1 | 471 | 24 | 1,297 |
| Disposals | - | - | - | - | (4) | (4) |
| Transfer to assets held for sale | (15) | - | - | - | (15) | (30) |
| Reclassified as intangibles | - | - | - | - | - | - |
| Balance at end of year | 305 | 26,375 | 1,914 | 7,183 | 7,445 | 43,222 |
| Accumulated depreciation | | | | | | |
| Balance at beginning of year | 30 | - | 1,508 | 3,730 | 6,414 | 11,682 |
| Depreciation | - | - | 16 | 174 | 90 | 280 |
| Impairment | - | - | - | - | - | - |
| Disposals | - | - | - | - | (4) | (4) |
| Transfer to assets held for sale | - | - | - | - | (14) | (14) |
| | 30 | - | 1,524 | 3,904 | 6,486 | 11,944 |
| Balance at end of year | 275 | 26,375 | 390 | 3,279 | 959 | 31,278 |
| Comprising - Cost | - | 801 | 390 | 3,279 | 959 | 5,429 |
| Valuation | 275 | 25,574 | - | - | - | 25,849 |

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

| | | Motor Vehicles | Office Equipment | |
|------------------------------------|---------------|-------------------|---------------------|---------------|
| | Sub-Total | Cost | Cost | Total |
| 2016 Cont'd/.... | \$'000 | \$'000 | \$'000 | \$'000 |
| Cost or Valuation | | | | |
| Balance at beginning of year | 41,959 | 838 | 302 | 43,099 |
| Increase through acquisition | - | - | - | - |
| Purchases/ revaluation | 1,297 | 104 | 5 | 1,406 |
| Disposals | (4) | (180) | - | (184) |
| Transfer to property held for sale | (30) | - | - | (30) |
| Reclassified as intangibles | - | - | - | - |
| Balance at end of year | 43,222 | 762 | 307 | 44,291 |
| Accumulated depreciation | | | | |
| Balance at beginning of year | 11,682 | 589 | 262 | 12,533 |
| Reclassified as intangibles | - | - | - | - |
| Depreciation | 280 | 89 | 15 | 384 |
| Impairment | - | - | - | - |
| Disposals | (4) | (164) | - | (168) |
| Transfer to property held for sale | (14) | - | - | (14) |
| | 11,944 | 514 | 277 | 12,735 |
| Balance at end of year | 31,278 | 248 | 30 | 31,556 |
| Comprising - Cost | 5,429 | 248 | 30 | 5,707 |
| Valuation | 25,849 | - | - | 25,849 |

17. ASSETS HELD FOR SALE

| | 30 June 2017 \$'000 | 30 June 2016 \$'000 |
|---|------------------------------------|------------------------------------|
| Freehold land held for sale | 275 | 15 |
| Assets relating to property classified as held for sale | 847 | 1 |
| | 1,122 | 16 |

The Company intends to dispose of assets at Milburn which it no longer utilises in the next 12 months. A search is underway for a buyer. No impairment loss was recognised on reclassification of the assets as at 30 June 2017.

The Directors have assessed that the carrying value is a fair value of the assets.

18. 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 2,005,337 Post-89 derived NZU's, being the carbon sequestered by these forests during the 2008 to 2017 calendar years. In 2015 3,086 ERU's were purchased, 2,999 were surrendered later in the year to meet a liability the Company had for carbon credits. There has been no carbon credit sales for the financial year.

The Company purchased 30,967 units during the year.

The carbon credits are assessed as having an indefinite life as they have no expiry date. As the NZUs are an indefinite life intangible asset they are not amortised but are tested for impairment on an annual basis or when indications of impairment exist.

As at 30th June 2017, 1,369,304 units were unsold (2016 965,903). 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 2017 \$'000 | As at 30 June 2016 \$'000 |
|----------------------------|--|--|
| New Zealand carbon credits | 23,413 | 17,288 |

In future years there will be a carbon credit liability against a proportion of the carbon credits sequestered from post-1989 forest areas in accordance with New Zealand Emission Trading Scheme Regulations. A proportion of Carbon sequestered from Post-1989 areas will have to be surrendered to compensate for the carbon liability generated from harvesting those forest areas. The intangible asset represents the value of carbon sequestered to date and can be used to settle carbon credit liability on harvesting.



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

| | As at 30 June 2017 \$'000 | As at 30 June 2016 \$'000 |
|---|------------------------------------|------------------------------------|
| Net gain for the year | 20,104 | 16,021 |
| <i>Items Not Involving Cash Flows</i> | | |
| Depreciation and loss on sale | 381 | 410 |
| Depletion of forest | 2,394 | 1,535 |
| Deferred tax | 4,770 | 3,241 |
| Depreciation recovered/capital gains | (38) | (22) |
| Forestry revaluation | (9,629) | (9,524) |
| Allocation of carbon credits/revaluation carbon credits | (6,164) | (1,462) |
| Write down value of land | 389 | - |
| Subvention accrual | 548 | - |
| Other non-cash items | | |
| <i>Impact of Changes in Working Capital Items</i> | | |
| (Increase)/Decrease in accounts receivable | 1,252 | (166) |
| (Increase)/Decrease in inventories | (869) | 224 |
| (Increase)/Decrease in prepayments | (151) | (92) |
| (Increase)/Decrease in tax refund due | (471) | 1,128 |
| Increase/(Decrease) in accounts payable | 218 | 485 |
| Increase/(Decrease) in other current liabilities | (534) | 9 |
| Net cash inflows/(outflows) from operating activities | 12,200 | 11,787 |

20. RELATED PARTY TRANSACTIONS

Transactions with Dunedin City Council Group

The Company purchased goods and services and traded with Dunedin City Council in respect of the following transactions:

| | As at 30 June 2017 \$'000 | As at 30 June 2016 \$'000 |
|--|------------------------------------|------------------------------------|
| Purchases of goods and services from the Dunedin City Council: | | |
| Rates and property rentals | 9 | 14 |
| Other | 4 | 3 |
| | <u>13</u> | <u>17</u> |
| Dunedin City Holdings Limited | | |
| Managing Services | 50 | 50 |
| Dividends (including provision of \$1m) | 6,000 | 6,500 |
| Delta Utility Services Limited | | |
| Roading & Earthmoving Services | 342 | 230 |
| Payable to Dunedin City Council as at balance date | <u>-</u> | <u>2</u> |
| Payable to Delta Utility Services Limited | <u>34</u> | <u>29</u> |
| Payable to Dunedin City Holdings Limited | <u>-</u> | <u>-</u> |
| Subvention payable: | | |
| Dunedin Stadium Property Limited | <u>548</u> | <u>-</u> |
| | <u>548</u> | <u>-</u> |
| The subvention payments were made for the tax effect of the losses transferred | | |
| Loan from Dunedin City Treasury Limited as at balance date | <u>15,350</u> | <u>12,000</u> |
| Loans received during the year | 6,410 | 3,790 |
| Loans paid during the year | 3,060 | 5,220 |
| Interest due to Dunedin City Treasury Limited as at balance date | 86 | 94 |
| Interest paid during the year | 844 | 885 |
| Interest rebate received | 8 | 11 |
| Net interest | <u>832</u> | <u>874</u> |
| Other payments including facility fees | - | - |



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

| | Year ended 30 June 2017 \$'000 | Year ended 30 June 2016 \$'000 |
|--|---|---|
|--|---|---|

Transactions with companies in which Directors have an interest:

- During the course of the year:

Mr T D Allison had related party interests with the following organisations during the year.

Director, Otago & Southland Employers Association

| | | |
|--------------|---|---|
| Subscription | 1 | 2 |
|--------------|---|---|

Mr M C Horne had related party interests with the following organisations during the year.

Director, Palmers Mechanical Limited.

| | | |
|--|----|---|
| | 21 | 5 |
|--|----|---|

Director, Deloitte

Financial Services/Directorship

| | | |
|--|-----|-----|
| | 144 | 126 |
|--|-----|-----|

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.

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

| | |
|---------------------|----|
| Payable to Deloitte | 10 |
|---------------------|----|

Compensation of key management personnel

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

| | | |
|----------------------------------|------------|------------|
| Salaries and Short-term benefits | 943 | 919 |
| Post-Employment benefit | - | - |
| | <u>943</u> | <u>919</u> |

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.

STATEMENT OF SERVICE PERFORMANCE

For the Year Ended 30 June 2017

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 which meets the objective of a 6% return on shareholders' funds. | Three year average return is 12.1% Strategy day held on 9 th June 2017 involving the Board and Senior Managers. The Company's long term strategic plan has been reviewed and accepted by the shareholder as part of the annual budget and statement of intent process. |
| 1b. Opportunities for expanding the Company's scale will have been investigated. | The strategic plan incorporates a modest forest expansion program. Two new property purchases total 396.9ha occurred during the year and a number of opportunities were investigated. |
| 2a. No single customer will have received more than 30% of the Company's annual harvest by volume. | Our largest customer Craigpine Timber Limited received 10.7% of the Company's annual harvest volume. |
| 2b. The Company will maximise financial opportunities from the sale of Carbon stored in the Company forests. | The Company has monitored Carbon sales price during the period and considered its Carbon Sales policy at board level. No Carbon Sales occurred during the period. |
| 2c. The Company will incorporate Carbon accounting in the strategic plan. | Carbon strategy recognised in Forest Valuation and Strategic 10 year plan. |
| 2d. The Company will balance and track exposure to domestic and export markets | Domestic log sales 44.3% (45.1% last year) |
| 3a. The Company will meet its annual supply commitments to domestic customers. | On an annualised basis all customers received their contracted volumes within plus or minus 10%. Variations were by mutual agreement. |
| 3b. The Company will meet its volume commitments to export shipping and export customer contracts. | All export commitments were met however purchase wood volumes were needed to supplement Company production for some shipments. |
| 4a. The annual harvest from the forest estate will be within 20% of the long term sustainable yield. | The annual harvest from the Company forest estate was 277,201 m ³ including billet wood. This is 97.3% of sustainable yield of 285,000 m ³ . |
| 4b. An annual forest health report will have been completed by 30 th June 2017. | The annual forest health report was completed in January 2017. One disease incursion of Red Needle Cast was discovered in Company forests during the year. From next year our Company forest health report will be superseded by a forest industry wide biosecurity surveillance network. |



| | <u>Performance Targets</u> | <u>Achievement</u> |
|-----|--|---|
| 4c | The annual fire plan will be updated and operational. | Fire plan was completed in September 2016 prior to the start of the fire season. |
| 4d | The Company will actively participate in regional land use planning processes. | The Company actively participated in the Otago Regional Council Plan Change 6a process and the Forestry National Environmental Standard process. |
| 5a. | The Company will have reviewed the best species and silvicultural management plan to apply to annual operational areas. | A comprehensive forest growing performance improvement program was started during the year incorporating input from Scion lead researchers. The percentage of pruned area is 68% |
| 6a. | The Company will participate in Industry Research Consortia. | The Company has paid the Forest Growers Levy and is directly involved through the Forest Owners Association in the allocation of levy research funds. |
| 6b. | At least one new forest management technique will be introduced as a result of research findings. | Forest management plans have been modified to increase site productivity as a result of research results. |
| 6c. | The Company will participate in environmental research to minimise chemical use | Herbicide and cutover over-sowing testing was conducted during the period. |
| 7a | The Company will maintain supply arrangements with Otago and Southland wood processors. | Otago & Southland supply: Pan Pac: 27,023m3 Craigpine: 29,835m3 Niagara: 20,129m3 Dongwha: 12,822m3 Bioenergy: 8,064m3 |
| 7b. | Bioenergy wood supply | |
| 8a. | Lost time accident rates for staff and contractors will be reduced to a maximum 25 lost time injuries per 1,000,000 hours. | Lost time accident rate for staff and contractors was 7.1 lost time injuries per 1,000,000 hours. (18.2 last year) |
| 8b. | Drug & Alcohol Testing | 99 tests were conducted, one positive random test was recorded. |
| 8c. | Forest Stewardship Council Certification will be maintained. | Forest Stewardship Council Certification was maintained following audit in 2016. |
| 8d. | A current forest management plan will be in place which identifies 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. |
| 8e. | The company will work with partners to maintain and enhance RT&E species on and around the Company estate. | Sponsorship of \$5000 was donated to research and conservation of the NZ Falcon. |

| <u>Performance Targets</u> | <u>Achievement</u> |
|--|---|
| 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. This is available on the Company's website and includes water, soil disturbance and reserve biodiversity monitoring. |
| 10a. Every staff member will have a training plan. | Forest staff members have training plans. Other training provided as necessary. Contractors have training plans for their employees. |
| 10b. The Company will engage with its contractors to participate in Modern Apprenticeship programs. | There are currently two modern apprentices employed in Company operations |
| 10c. Each harvesting crew will utilise trained tree fellers, breaker outs and log makers. | Each harvest crew has multiple trained employees for all three listed tasks |
| 10d. 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. Recreation use is monitored through permit issuance. |
| 11b. The Company will maintain a Forest Access Permit system. | 326 permits were issued during the year. |
| 11c. The Company will track and report on the distance of public walking and mountain bike tracks in the Companies forests | The Company has 8.2km of walking tracks and 20.9km of mountain bike tracks on its estate. |
| 12. To contribute to, or assist where possible, with the Dunedin City Council community outcomes (as listed in the Annual Plan). | The Companies financial, sustainability, environmental and recreational achievements compliment the annual plan. No issues of conflict with the plan have been identified. |



| <u>Financial Targets (Statement of Intent)</u> | | | <u>Achievement</u> | |
|--|--------------------------|---------|--------------------------|---------|
| 12a | Profit before income tax | 18,411 | Profit before income tax | 27,524 |
| 12b | Profit after income tax | 13,254 | Profit after income tax | 20,104 |
| 12c | Shareholders equity | 123,650 | Shareholders equity | 130,873 |
| 12d | Normal dividend | 3,000 | Normal dividend | 4,500 |
| 12e | Special dividend | 1,500 | Special dividend | 1,500 |
| 12f | Operating cashflow | 5,454 | Operating cashflow | 12,200 |
| 12g | Capex | 4,630 | Capex | 6,467 |
| 12h | Term debt | 20,507 | Term debt | 20,528 |

AUDIT NEW ZEALAND

Mana Arotake Aotearoa

Independent Auditor's Report

To the readers of City Forests Limited's financial statements and performance information for the year ended 30 June 2017

The Auditor-General is the auditor of City Forests Limited (the company). The Auditor-General has appointed me, Scott Tobin, using the staff and resources of Audit New Zealand, to carry out the audit of the financial statements and performance information of the company on his behalf.

Opinion

We have audited:

- the financial statements of the company on pages 20 to 55, that comprise the statement of financial position as at 30 June 2017, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date and the notes to the financial statements that include accounting policies and other explanatory information; and
- the performance information of the company on pages 56 to 59.

In our opinion:

- the financial statements of the company on pages 20 to 55:
 - present fairly, in all material respects:
 - its financial position as at 30 June 2017; and
 - its financial performance and cash flows for the year then ended; and
 - comply with generally accepted accounting practice in New Zealand in accordance with the New Zealand equivalents to International Financial Reporting Standards.
- the performance information of the company on pages 56 to 59 presents fairly, in all material respects, the company's actual performance compared against the performance targets and other measures by which performance was judged in relation to the company's objectives for the year ended 30 June 2017.

Our audit was completed on 29 August 2017. This is the date at which our opinion is expressed.

The basis for our opinion is explained below. In addition, we outline the responsibilities of the Board of Directors and our responsibilities relating to the financial statements and the performance information, we comment on other information, and we explain our independence.

Basis for opinion

We carried out our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the Professional and Ethical Standards and the International Standards on Auditing (New Zealand) issued by the New Zealand Auditing and Assurance Standards Board. Our responsibilities under those standards are further described in the Responsibilities of the auditor section of our report.

We have fulfilled our responsibilities in accordance with the Auditor-General's Auditing Standards.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of the Board of Directors for the financial statements and the performance information

The Board of Directors is responsible on behalf of the company for preparing financial statements that are fairly presented and that comply with generally accepted accounting practice in New Zealand. The Board of Directors is also responsible for preparing the performance information for the company.

The Board of Directors is responsible for such internal control as it determines is necessary to enable it to prepare financial statements and performance information that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements and the performance information, the Board of Directors is responsible on behalf of the company for assessing the company's ability to continue as a going concern. The Board of Directors is also responsible for disclosing, as applicable, matters related to going concern and using the going concern basis of accounting, unless the Board of Directors intends to liquidate the company or to cease operations, or has no realistic alternative but to do so.

The Board of Directors' responsibilities arise from the Local Government Act 2002.

Responsibilities of the auditor for the audit of the financial statements and the performance information

Our objectives are to obtain reasonable assurance about whether the financial statements and the performance information, as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit carried out in accordance with the Auditor-General's Auditing Standards will always detect a material misstatement when it exists. Misstatements are differences or omissions of amounts or disclosures, and can arise from fraud or error. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of readers, taken on the basis of these financial statements and the performance information.

We did not evaluate the security and controls over the electronic publication of the financial statements and the performance information.

As part of an audit in accordance with the Auditor-General's Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. Also:

- We identify and assess the risks of material misstatement of the financial statements and the performance information, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- We obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control.
- We evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.
- We evaluate the appropriateness of the reported performance information within the company's framework for reporting its performance.
- We conclude on the appropriateness of the use of the going concern basis of accounting by the Board of Directors and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists we are required to draw attention in our auditor's report to the related disclosures in the financial statements and the performance information or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the company to cease to continue as a going concern.
- We evaluate the overall presentation, structure and content of the financial statements and the performance information, including the disclosures, and whether the financial statements and the performance information represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Board of Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Our responsibilities arise from the Public Audit Act 2001.

Other information

The Board of Directors is responsible for the other information. The other information comprises the information included on pages 3 to 19, but does not include the financial statements, and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of audit opinion or assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information. In doing so, we consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on our work, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Independence

We are independent of the company in accordance with the independence requirements of the Auditor-General's Auditing Standards, which incorporate the independence requirements of Professional and Ethical Standard 1 (Revised): Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board.

Other than the audit, we have no relationship with, or interests in, the company.



Scott Tobin
Audit New Zealand
On behalf of the Auditor-General
Dunedin, New Zealand





The most **practical** and
effective method to
fight climate change
is to **plant trees**

