

Rural Managed Investment Schemes in Victoria, Australia: The demise of Timbercorp.

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ABSTRACT

Managed Investment Schemes gained popularity in the last 25 years, particularly in the forestry and horticultural sector. One of the largest players was Timbercorp. The 2008 Annual report reveals it was established in 1987, had net assets of \$595.6m, made a profit of \$44.6million, had 14,615 shareholders, 18,400 grower investors with an investment of \$2 billion, a horticultural estate of 22,000 ha and a forestry estate of 98,000 ha and 63,000 Mgl of High Security water. Their land holdings were mainly in Queensland and Victoria. There were also operations in Western Australia, South Australia, and Tasmania. Crops included softwood plantations (generally Eucalyptus Globulus) Blue Gum for wood chip production, almonds, olives, citrus, avocado, mangoes, table grapes, truss tomatoes and garlic.

The horticultural projects were well managed from a technical point of view. For instance the olive estate of some 6,530 ha produced 27,160 tonnes in 2008, yielding some 4.6 million litres of extra virgin oil.

On 23 April 2009 the Company was placed in voluntary administration, owing \$903m.

This paper provides some background on the Australian almond growing industry, and examines the corporate structure of Timbercorp/grower investors, particularly almond growing, to provide some reasons for the demise of this large Company.

KEYWORDS

Timbercorp. Managed Investment Scheme. Grower Investors. Agricultural crops. Almond growing.

INTRODUCTION

Almonds originated in Central Asia and China. In the 1700's they were brought to America. In the early 1900's perfect growing conditions were found in the central valleys of California. The USA accounts for 37 % of the world's production, at 1.3 million tonnes. There are approximately 450,000 acres in production.

In Australia the industry began in South Australia. The industry has expanded to the Riverland in South Australia, New South Wales/Riverina and along the Murray river in Northern Victoria.

The almond tree requires well drained soils. Waterlogging can cause root rot, and inflict fatal damage. They require regular fertilising and are particularly susceptible to zinc deficiency.

Winters should be mild with no severe spring frosts and warm dry summers. The trees are drought resistant but high returns require irrigation. 850 to 1000mm per year.

Almonds are usually planted on a 6m x 6m grid to give a total of some 250 trees per ha. Varieties of different species need to be planted for cross pollination, and bees also help.

Birds are a large problem at harvest time. Harvest is usually in February and March. Good to excellent yields are 1.5 tonne tonnes per ha. to 2.5 tonnes per ha.

The Australian Industry: Data from the Australian Almond Board 2008.

Almond Plantings:

Almond Life cycle

Source: Almond Board of Australia 2008. P.10,11

Almond Plantings P.4,5

Almond Production P.6

Almond sales P.12

Almond projections P.11

Almond Lifecycle

Dormancy

Almond trees are dormant over the colder winter period, around May to July in Australia.



Blossom

Blossom usually occurs in late July to early August. At the start of blossom in almond orchards, you will often see alternate rows in bloom. This is because almonds are not self-pollinating, so there are always 2-3 varieties interplanted in an orchard. Bees are used to cross-pollinate the blossoms.

Maturing Nuts

During September and October, blossom petals fall and leaves begin to form on the trees. The fuzzy greyish-green fruit starts to form, and grows rapidly in size over spring. The hulls which cover the growing nuts continue to mature and harden.



Almond Lifecycle



Hull Split

The hardened hulls usually start to split over summer, around January and February. Over the next month the splits widen and open further. The almond shell is now visible through the split in the husk, and the nut itself begins to dry out. Eventually, the nut separates from its stem and the hull opens completely.

Harvest

Harvest occurs between February and April, when the kernel is at an acceptable moisture level. Mechanical harvesting requires that orchard floors be clear of large weeds and swept of all foreign material. Shakers are used to vibrate the tree trunk, so that the husks, shells and nuts inside fall to the orchard floor. After drying, they are swept into rows and picked up ready for storage.



Processing

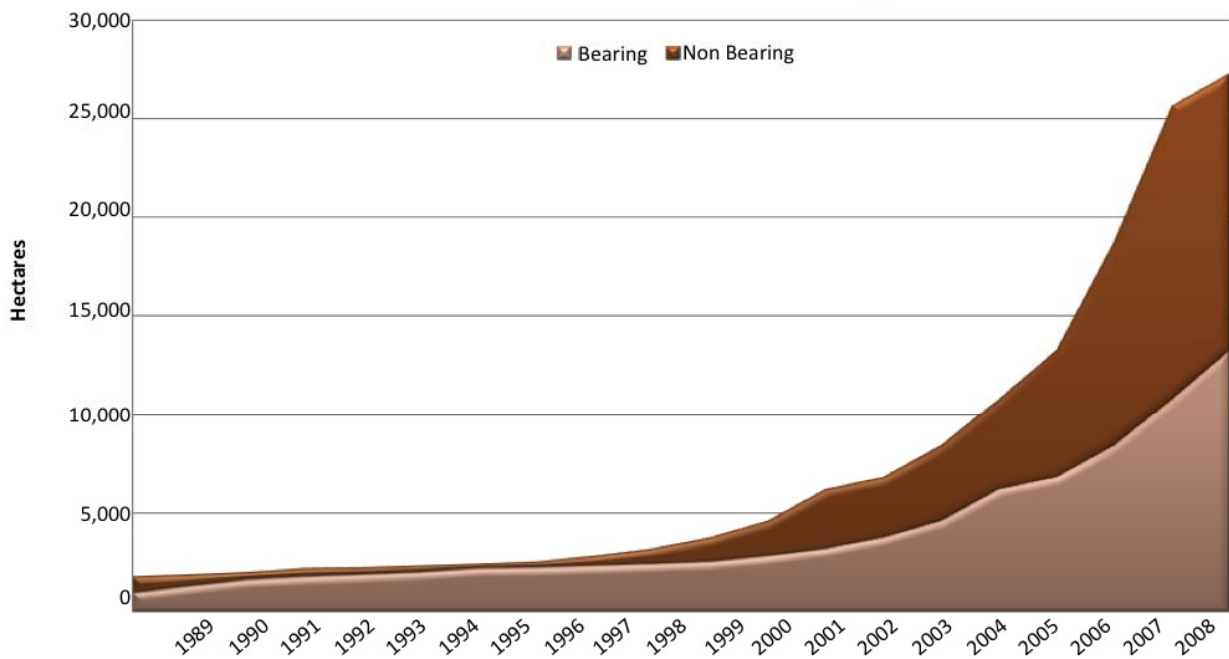
The first step in processing almonds is to remove the hull and shell of the almond. This is known as either hulling and shelling, or cracking.

Almonds can be slivered, sliced, diced, split, left whole or ground (meal/flour) depending on application.

Almond Plantings

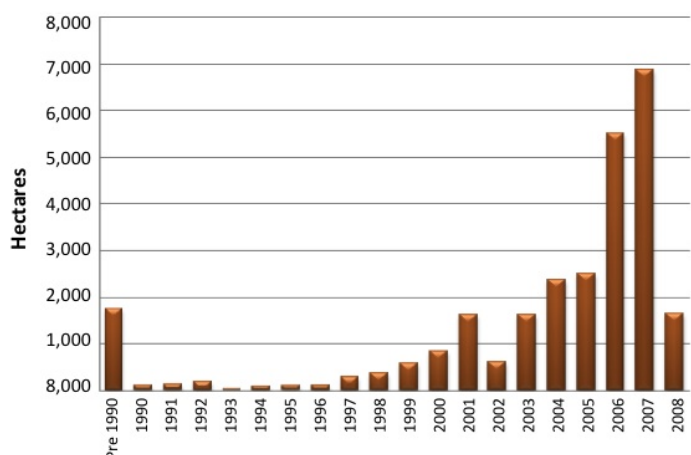
- Australian almond plantings have increased over the past nine years: from 3,750 hectares (9,000 acres) in 1999 to 27,300 hectares (67,500 acres) in 2008.
- Less than 20% of Australian almond plantings have reached full maturity (eight years and older).
- More than half of plantings are non-bearing (less than three years).

Australian Almond Plantings



Australian State	Non-bearing acres
New South Wales (NSW)	76%
Victoria (VIC)	57%
South Australia (SA)	19%

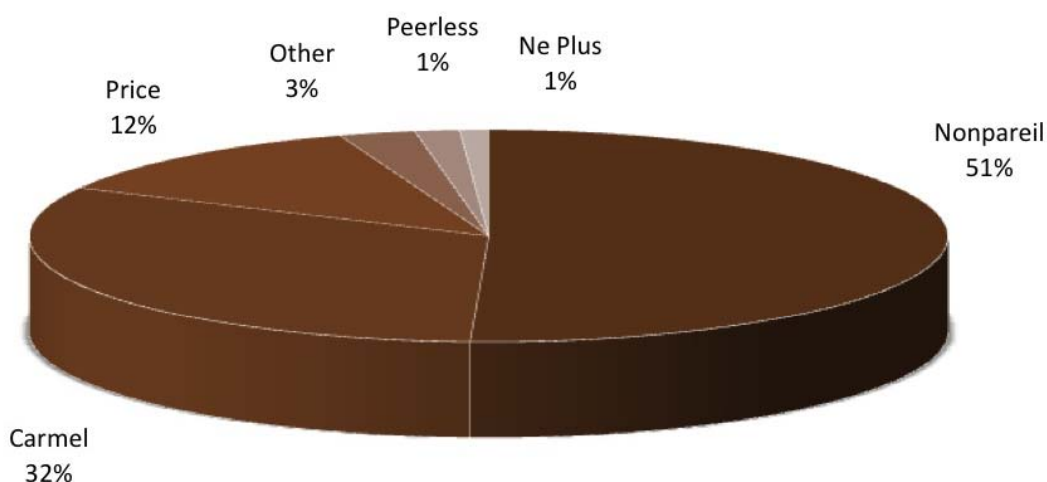
Age of Almond Plantings



Almond Plantings

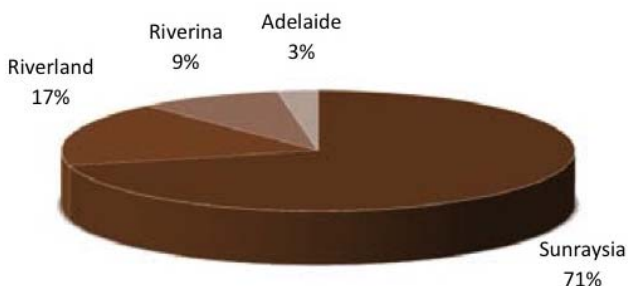
- Nonpareil is currently the dominant variety, with over 50% of plantings.
- Carmel is the most popular pollinator, with 32% of plantings, followed by Price (12%).
- Other pollinators include Ne Plus, Peerless, Mission, Monterey and Fritz.

Almond Plantings by Variety

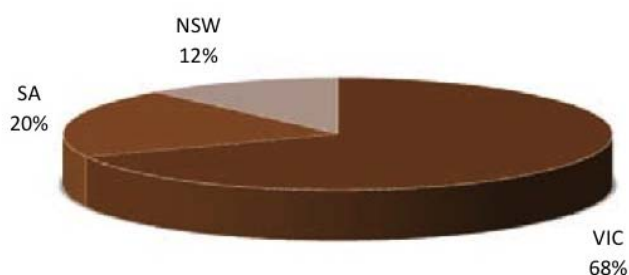


- Sunraysia (Victoria) is the largest Australian almond growing region, with more than 70% of plantings, followed by the Riverland (South Australia) and Riverina (New South Wales).

Almond Plantings by Region

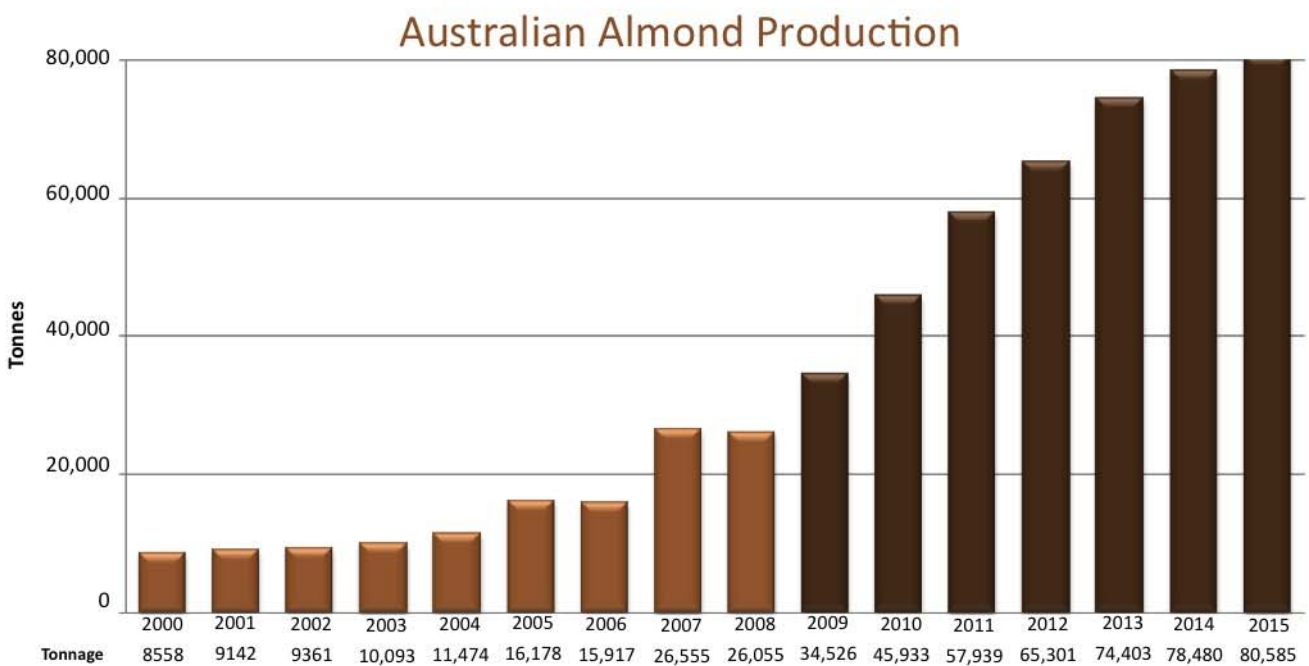


Almond Plantings by State

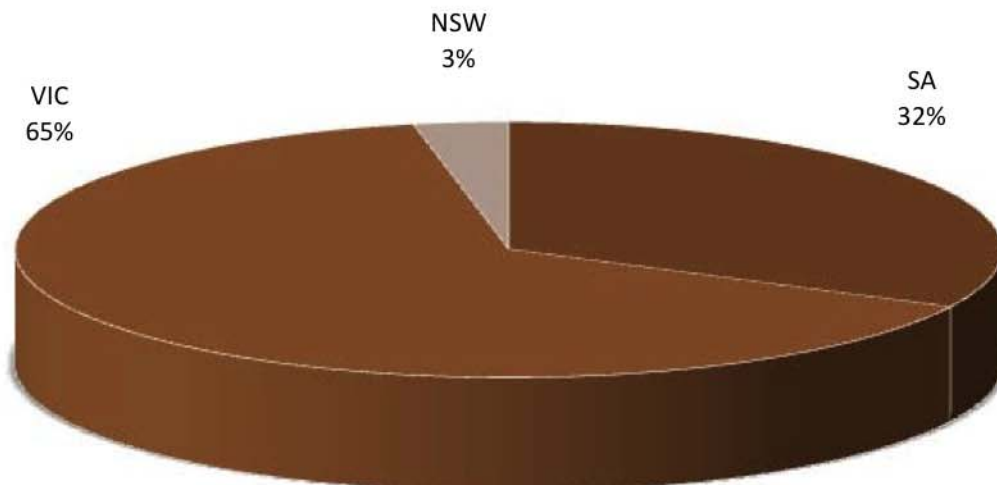


Almond Production

- Australian Almond production in 2008 totalled more than 26,000 tonnes kernel (57.32 million pounds).
- Future production increases will occur as young plantings reach full maturity.
- Based on existing plantings, productive capacity is expected to reach 80,000 tonnes of kernel (176 million pounds) by 2015, a three-fold increase of current production.



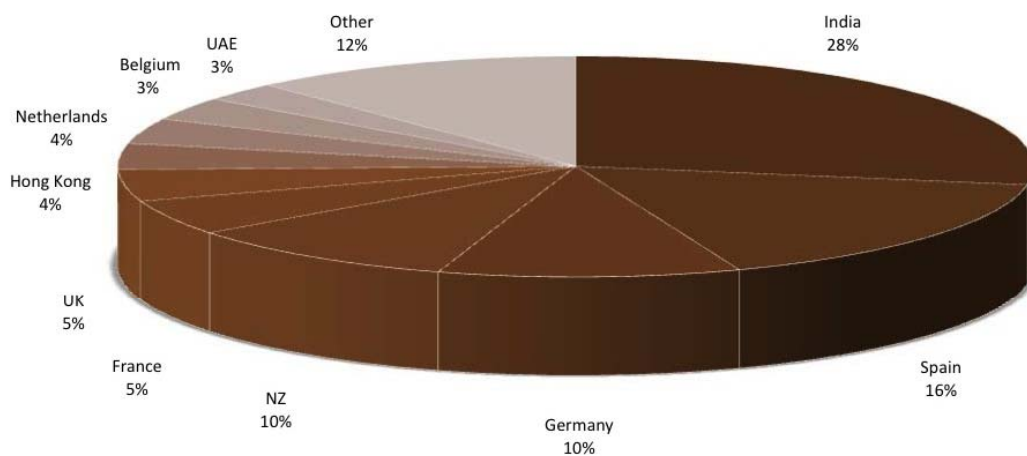
Almond Production by State - 2008



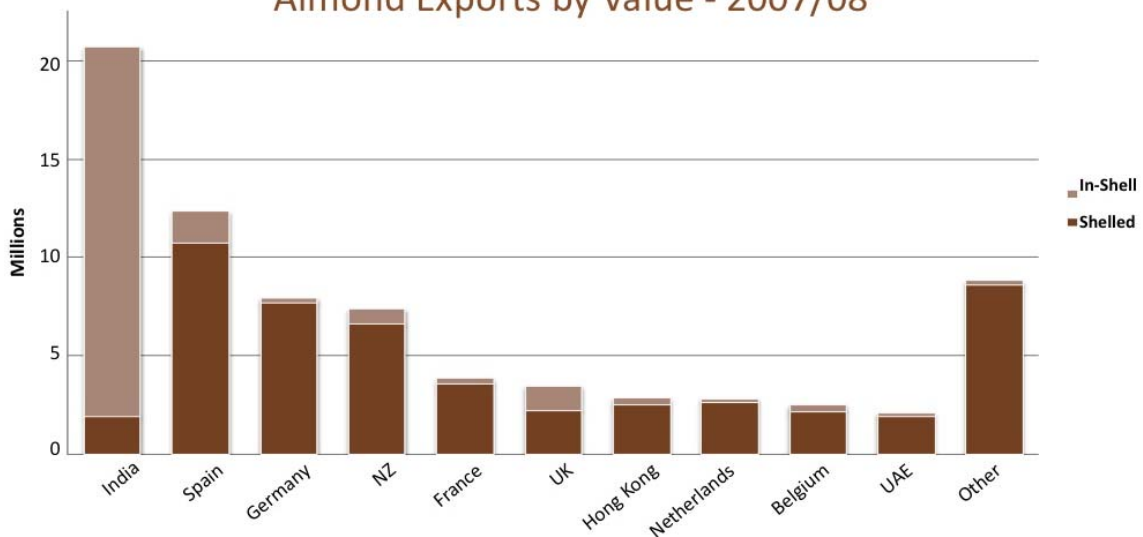
Almond Sales

- Australian almonds are currently exported to more than 40 countries. Exports represented 50% of 2007/08 Australian almond sales.
- In 2007/08 Australia exported \$75 million of almonds: 9,200 tonnes (20.3 million pounds) of kernel and 5,800 tonnes (12.8 million pounds) of in-shell almonds.

Almond Exports by Value - 2007/08



Almond Exports by Value - 2007/08



The overall conclusion from these graphical representations is the large increase in almond plantings in the last 10 years, driven largely by Managed Investment Schemes.

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Literature Review

What is a managed Investment scheme ? It is a structure for collective or pooled investment such as a property trust or equity fund. According to the Financial Review of 17 November 2009, in Australia there are 5,200 schemes that manage some \$113 billion. Agriculture accounts for 3.2% of the total.

The structure operates to collect and distribute funds only and is not a legal entity. The operator must be a public company, and have a financial services licence. The responsible entity (operator) must register the scheme with the Australian Securities and Investment Commission. (ASIC). Whilst ASIC exercises a monitoring role it is not a prudential regulator. For instance, it does not check to ensure that the responsible entity has sufficient funds for operations and working capital. The responsible entity operates the scheme on behalf of investors. Investors in the schemes have no day to day control.

According to ASIC, Managed Investment Schemes cover a wide variety of investments. Examples include: property trusts, agricultural schemes, timeshare investments, international equity trusts and some film schemes.

Investor growers were attracted to Timbercorp agricultural schemes by reasonable product returns from crops and the taxable deductions of their investments. Giving the taxable status some certainty were Product Rulings from the Australian Taxation Office. What is the status of a Product Ruling.?

In Product Ruling No PR 2006/146 a standard answer to this question is given.

“ This product ruling is a public ruling for the purposes of the Tax Administration Act 1953.

A public ruling is the expression of the Commissioners opinion about the way in which a taxation provision applies or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling we must apply the law to you as set out in this ruling.... You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provisions apply to you..”

Of course a favourable tax ruling was a good sales pitch to put before grower investors as it gave the scheme a sound and ongoing taxation basis.

Below this explanation and level of protection in **BOLD TYPE** are the words:

No Guarantee Of Commercial Success.

What is misleading and deceptive conduct under The Trade Practices Act? Waye says that the question of whether or not conduct is misleading or deceptive or likely to mislead or deceive, is to be determined by reference to the class of persons likely to be affected by the conduct. In the words of Gibbs CJ in Parkdale Custom Built Furniture v Puxu Pty Ltd 1982 149 CLR 191 at p.199 he said... “the section must in my opinion be regarded as contemplating the effect of conduct on reasonable members of that class” That is the class of people as average ,not the least or best astute.

Furthermore conduct is deceptive or misleading if it has the capacity or tendency to deceive; intention to mislead or deceive is not required. A corporation may act honestly and reasonably and still be guilty of misleading and deceptive conduct. Prima facie if as a result of the conduct, a person is induced to enter a contract and suffers loss an action to recover will lie. Any contract terms to the contrary are irrelevant.

Silence may constitute misleading and deceptive conduct, where there is a duty to reveal relevant facts.

In Winterton Constructions V Hambros Australia Pty Ltd 1992 39 FCR 97 at p.114 Hill J said” the failure to communicate (relevant matters) may constitute conduct which is misleading or deceptive because the person who ultimately may act to his or her detriment is entitled to infer from the silence that no danger or detriment existed.”

To recover damages an applicant must have relied on the misleading or deceptive conduct.

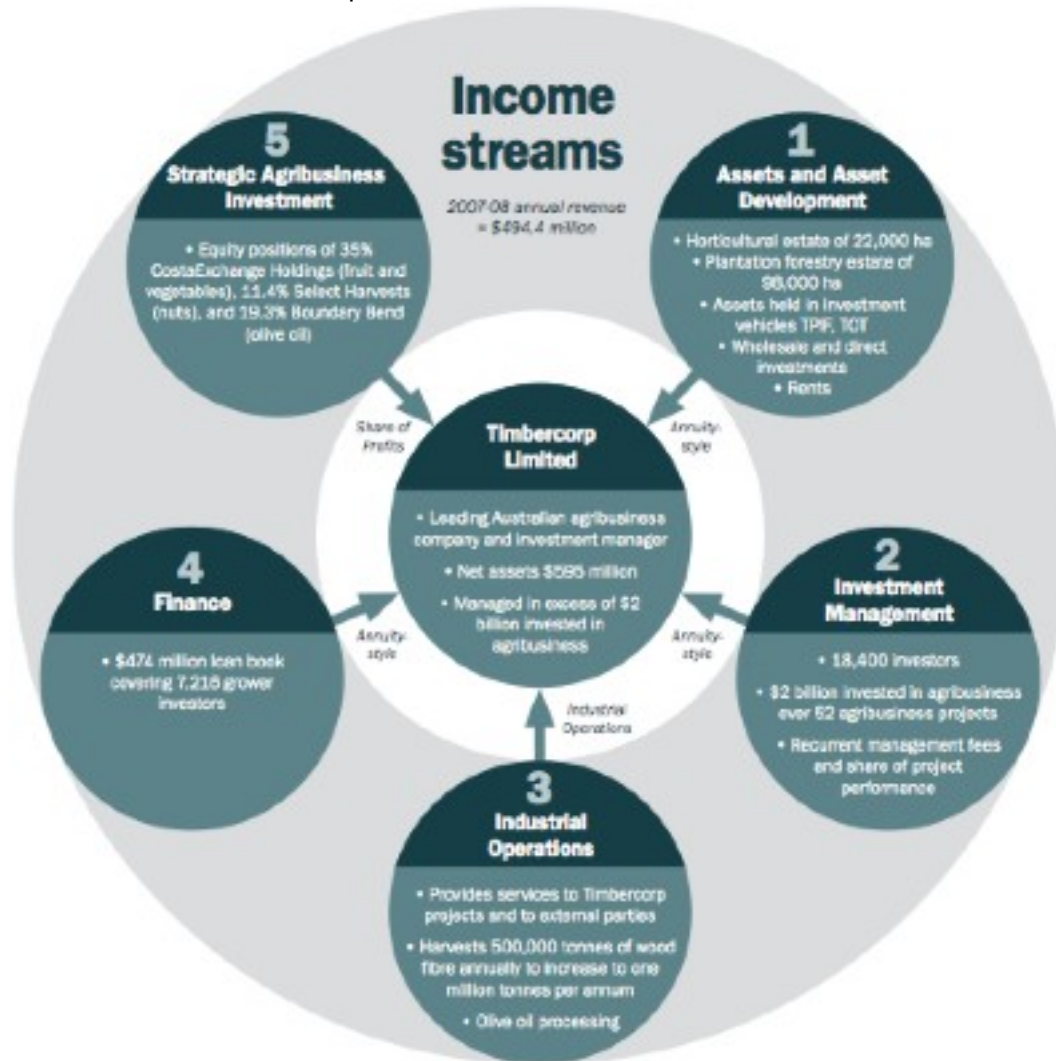
Therefore there must be conduct likely to mislead and deceive whether by false representations or silence or a combination of both and there must be direct reliance on those representations that have led to a loss.

THE CASE STUDY TIMBERCORP AND ALMONDS

SOME GENERAL TIMBERCORP OBSERVATIONS

Timbercorp had a complex corporate structure. When Voluntary Administrators were appointed on 23 April 2009, Timbercorp had 40 subsidiary companies performing a wide range of duties. Some subsidiary companies had joint venture relationships with other independent companies. I can find no documentation to establish if these companies had commercial and proper agreements between them. The various grouping of functions is illustrated

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 in this table in the Annual Report of 2008.

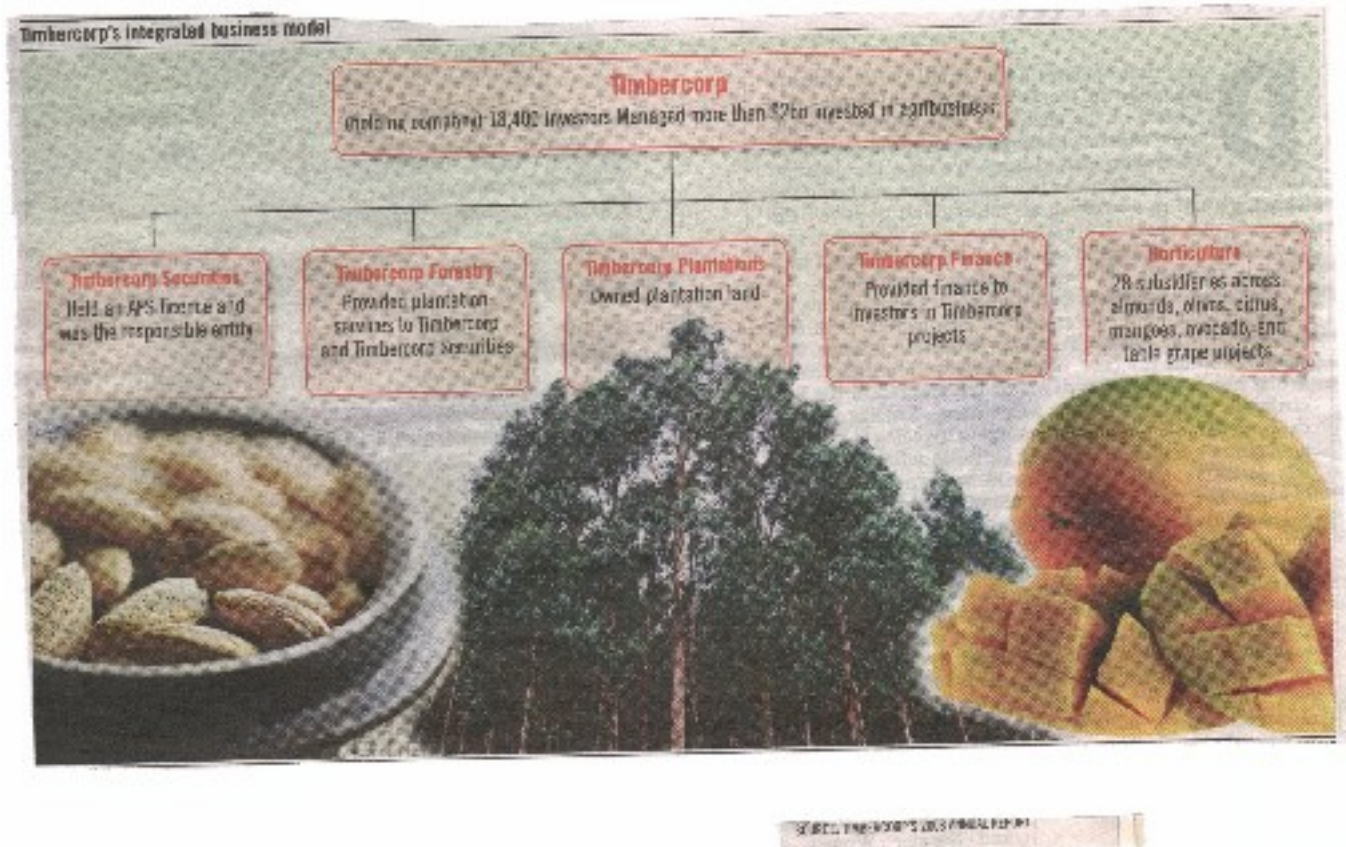


The table is very complex and in my opinion, designed to confuse rather than inform grower investors and advisors.

A more simplified business model is produced here.

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Source: Australian Financial Review. (AFR) 17 November 2009.



Here are some pertinent observations in regard to Timbercorp:

Firstly, Timbercorp paid hefty commissions to financial advisers. These payments may have overridden any expert or independent advice. The 2008 Annual Report reveals over \$70million was paid in commissions. According to Adviser Edge (Investment Analysts) the product commissions were structured as follows:

- 10% of the application monies or 5% plus a 1% trailer for 9 years or
 - 8% of the application monies plus 8% of the fees paid in 2009 and 2010
- Also payable was a half % commission on standard loan finance terms.

These commissions were paid to many advisers with little technical knowledge of the schemes.

The Adviser Edge report failed to benchmark these commissions on a comparable basis to other investment products. Were they reasonable? Consider an investment in Timbercorp of \$400,000. Commission would be \$40,000. For a home of the same value the real estate commission would be \$10,000 to \$12,000. The real estate agent would do a lot more work for his commission.

Secondly, Timbercorp in February 2009 declared a net profit of \$44.6 million, for the 2008 year. On April 23 2009 two months later it went into voluntary liquidation, owing \$903 million. The published accounts hid a worsening tale of ultimate demise. The directors could have been guilty of misleading and deceptive conduct under the Trade Practices Act, for not appearing to disclose the correct financial position of the company at the annual meeting in a clear and simple fashion. By their silence they inferred that the Company could meet their ongoing obligations.

Thirdly, Investments in Timbercorp attracted tax deductibility with the protection of Tax Rulings. One would naturally be drawn to the conclusion that people with very high incomes would invest. This was certainly the case, but you did not need a high income to invest. Timbercorp owned a subsidiary Timber Corp Finance. You could borrow up to 90% of your invoices in an existing Timbercorp investment. The loans were from 2 to 10 years with interest rates of 9.25% for 2 years and 11.25% for 10 years for 2008. This offer received substantial take up from grower investors.

Fourthly, When Timbercorp was put into voluntary administration these Timbercorp Finance loans had a total value of \$477.8 million, involving some 7216 growers. A substantial sum was owed by Timbercorp to the banks. These loans were non recourse which means these loans still have to be paid back, by the grower investors to the liquidator.

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Fifthly On 29 June 2009 a meeting of creditors voted unanimously to wind up the 41 Companies in the Timbercorp group.

The overall current position has had a huge impact on grower investors and rural communities, where supplies were purchased, employment increased and contractors thrived. Consider the following three scenarios:

Case 1. Take the plight of trucking owner Jeremy Van Hoff. Since 2004 he sunk \$720,000 into 5 agricultural projects. The investment was mainly financed by Timbercorp Finance. He scrutinised each Prospectus and obtained independent advice. In September 2008 he received an update for his olive investment. This showed the scheme to be solvent. But it was not. By next April Timbercorp was in liquidation. "I was bewildered and surprised that this was going to go this way." Van Hoff says.

"What the accounts clearly say is that they are able to pay debts when they are due...and we made decisions based on information given to us by Timbercorp." ..AFR November 17 2009.

What Van Hoff did not know was by October Timbercorp probably was in breach of its bank covenants. The 2008 Annual Report reveals that in late 2008 lenders waived certain banking covenants. Page 105 of the annual report in small print says so. Some \$375m was involved. By November 2008 the financial situation had deteriorated, with Timbercorp announcing it would stand out of MIS in 2009 and embark on a sale of the forestry assets to repay debt. (They actually said it was to restructure the Company). This announcement should have rung some alarm bells. The only offers they received were below book value. I suspect the book value may have been higher than market value as the land was purchased at well above market rates. This inflated book value may have been perpetuated in the Annual Accounts. Even armed with the above information what could Mr. Van Hoff do. Not much I suspect.

The above factors were not brought to the attention of investors in a clear and simple manner. This may constitute misleading and deceptive conduct by the Timbercorp directors.

Case 2. Craig Stevens of Robinvale in North Western Victoria, owns a fleet of trucks, purchased with the promise of ongoing work from Timbercorp almonds. Today they sit idle in a yard. "I have had to scale down and put all my drivers off because there is nothing happening....now its just good old me".

Stevens like other business people in Robinvale, and grower investors wonder what went badly wrong to bring a world class company like Timbercorp to its knees. AFR 8 September 2009.

Case 3. Keith Cumming has more than a million blue gum seedlings that are slowly dying, costing him hundreds of thousands of dollars, following the failure of Timbercorp and Great Southern. He owns the Arborline nursery in Hamilton, Western Victoria and supplied seedlings to both companies. He has \$140,000 in unpaid bills from the Companies, his yearly profit gone....AFR 29 September 2009.

ALMOND GROWING

Timbercorp almonds are grown near Robinvale in north western Victoria, adjacent to the Murray river. There are 8096 ha of planted almond trees. The dry climate and red limestone based soils were a good combination for almond growing. Furthermore, the almonds enjoy a 40,825 Mg/L water right. The water rights were acquired when the Victorian Government broke the legal nexus of land and water. Water rights could be transferred from one property to another, thus enabling Timbercorp to build a very large water right for almond growing.

Timbercorp arrived in Robinvale in 2000 and saw cheap land, in the midst of a drought, where generally wheat farmers held the desired land holdings, worth around \$100 per acre. Land owners were offered many multiples of this price and eagerly accepted. In many cases it was their get out of gaol card and retirement income.

A combination of the right climate, well drained soils, the ability to gain a large water right and the availability of cheap land saw a rapid expansion of almond growing. They are growing well.

Grower investors were encouraged to invest due to their 100% tax deductibility of their investment, and the promise of a future income stream from the project. They felt secure with the decision to invest supported by an Australian Tax Office (ATO) Product Ruling. The tax deductibility has now been withdrawn for horticultural projects.

I will examine the relevant documentation for the 2007 Almond project, for post June growers. This involves the ATO Product Ruling, Timber Corp information and an independent assessment of the Project by Advisor Edge.

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For almond growing the responsible entity is Timbercorp Securities Pty. Ltd. An example of the complexity of the scheme is described in the following clauses of the ATO product ruling.

Clause 37..The Project land and water licenses for the project are owned by Almond Land Pty.Ltd(AL) (the lessor) The properties will be leased to Timbercorp Securities Pty.Ltd (TSL)(the lessee).

Clause 39 The grower will enter a sublease with TSL and AL to use and occupy their almondlots for the growing and cultivation of almond trees. An almond lot constitutes some .25 ha (2,500 sqm.) with approximately 62 trees.

Orchard operational management including marketing and processing has been subcontracted to Select Harvests Pty.Ltd.from. Almond Management Pty.Ltd is the project manager. The project term is 23 years.

Basically the ruling gives full tax deductibility to the initial capital cost, ongoing rental and interest on loans.

The annual fees and charges for this scheme were as follows:

Initial capital cost: \$9,000 for an almond lot of 2,500 sqm.

RENTALS:

2008/2009 a fee of \$2,000 (rent and management)

Next 3 years \$ 770 per year

Ongoing rental of \$1610 annually, indexed to inflation.

PLUS

Annual orchard operating costs from 2009 and

Deferred management fees of 7.15% of gross proceeds from the 2010 financial year.

A cursory analysis of these figures is now required. If land at Robinvale was purchased for \$100 to \$500 plus per acre, let us assume an average price of \$300 per acre which equals \$ 750 per ha. The initial capital cost of an almond woodlot was say \$9,000 for .25 ha. This equates to \$36,000 ha. Allowing 5Mgl water per ha (Water right divided by area) @\$2,000 Mgl = \$10,000 ha. That still leaves \$26,000 ha for tree establishment, management, infrastructure development and building construction. Even that analysis is favourable to Timbercorp as the trees were owned by them and they provided water, not the water right over the project life of 23 years. Clearly, Timbercorp had a reversionary interest in the trees, water and land. Clearly there was a big windfall for Timbercorp.The situation was not viable or on a sound commercial footing.The initial capital of the grower investor of some \$9,000 could represent 62 trees @\$120 per tree (= \$7,440) and a land value of \$1,560 per quarter ha or \$6,240 per ha. Clearly these figures appear to be inflated. In most cases the ongoing annual management and land lease fees exceeded the current market value of the land. In addition to these large inflows, the company went into voluntary liquidation owing \$903m. Where was all this money spent?

Adviser Edge provided an independent report in April 2008, albeit instructed by Timbercorp. Their conclusion in the executive summary is " based on the adviser Edge assessment model, the 2007 Timbercorp Almond - late growers has achieved a four star assessment rating. Investors considering participating in the offer should have a moderate risk tolerance, with the project considered a worthwhile addition to a balanced agribusiness portfolio."That advice was, in my opinion based on an incomplete and/or defective analysis of all the facts.

At Page 5. it states" Adviser edge considers Timbercorps Board of Directors to be highly experienced and capable of directing the company in its assigned responsibilities under the offer".Two directors appear to have little direct agricultural or horticultural experience. According to the Annual Report not one director has any formal agricultural or horticulture qualifications. In my opinion the Board was severely lacking in these areas.

The Adviser Edge report does not benchmark or analyse the costs to grower investors. It accepts them as reasonable. I find the report is far from independent, and does not contain a rigorous analysis of the issues that any grower investor needs to know.

On 25 September 2009, the receivers sold 8096 ha of Timbercorp almond orchards at Robinvale for \$128m or \$15,810 ha, on an unencumbered basis, including 40,825 MGL of water rights. My analysis of this transaction is that the land and almond trees had an average value of \$4693 ha or \$1900 per acre or \$42m and \$86m for water rights(40,825 Mgl x \$2,100 Mgl). The sale price of \$15,810 ha should be contrasted with the \$36,000 ha above. Clearly, it was not a viable situation.The purchaser was OLAM an international supply chain manager of agricultural products and ingredients based in Singapore.The purchase represents one third of Australias almonds by acreage. Whilst grower investors were not happy, the offer was the best at the time. The capital return to growers has yet to be decided. There is no evidence to suggest that the sale to Olam International does not represent Market Value.

The \$128m will not satisfy the \$150m owed to the banks. .ANZ has exposure of some \$45m and a bank consortium an exposure of \$105m. The lenders and growers are locked in dispute as to how the proceeds should be split.

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Timbercorp used aggressive marketing campaigns to sell its schemes, backed by glossy so called independent reports. However, the rural almond production was good. In 2007, 27,000 tonnes of almonds were produced.

The financial fundamentals of investment in almond growing were not on a viable basis. The world credit crunch in late 2008 slowed new investment dramatically, and the tax deductibility status is now overturned. Contracted investors became nervous and in some cases stopped paying on going fees, interest and rentals to Timbercorp. This may have left the parent company in a position in early 2009 unable to pay their debts, due to low cash inflows. One obvious question is where did all the grower investor money go? In the case of almonds there was some 8,000 ha with a grower investor entry fee of \$32,000 ha ($\$8,000 \times (.25\text{ha}) \times 4$) meaning \$256m was put into the project, apart from ongoing rent and management fees.

These cash flows and other funds generated largesse. In the AFR of 08 September 2009, there was an interview with a local councillor at Robinvale. He recalls an experience that raised questions about where their money was spent, when Timbercorp were establishing their enterprises." Timbercorp took us on tour; they had their own bus there, a 20 seater, driven by a local person," he says.

"We pulled up on what I thought was a gravel road, but it turned out to be a runway. All of a sudden there was a hell of a noise and I was not prepared to see two aeroplanes meet us."

" They were potential investors from every where. We were taken for a tour of the farms, olives and almonds, then we were taken to the Murray river. A chef was already there with a huge barbecue, white hat and a beautiful table decorated with food and fruit."

" All of this extravagance was bestowed on people who were yet to invest a dollar."

CONCLUSION

In the last 12 months of the life of Timbercorp, there appears to be some evidence for further investigation of potential, misleading and deceptive conduct in regard to management and company directors. This is based on the evidence I have examined. There remain many unanswered questions as to where and how funds were spent. That is, funds of grower investors and the \$903 million, that was owed at the date of Voluntary Administration.

The schemes were set up in a complicated web of different companies. Thus, their affairs were presented in a complicated fashion. The terms of their relationships are not clear. It seems likely that most grower investors would not understand what they were buying. Indeed the Annual Report is very broad. One needs to know all commercial arrangements between the various companies for each scheme.

What is needed is a good forensic accountant to unravel some of the unanswered questions raised here.

Simon A. de Garis FAPI

DECLARATION:

As at 21 December 2009 the Simon A de Garis Trust owned 6,000 shares in Timbercorp.

In late 2009 I wrote to the Managing Director, of Timbercorp, indicating my willingness to do some research, as I firmly believe MIS schemes have a rightful place in agriculture if structured correctly.

Subsequent events at Timbercorp explain why I did not get a response.

My nephew, Mr. Samuel Beaton is a former employee of Timbercorp.

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