

Rubicon Annual Shareholders' Meeting – 3 December 2007

CEO's address

Good morning ladies and gentlemen. It is a pleasure to be with you today, to discuss the performance of Rubicon over the past year.

2007 was a year in which much was achieved in terms of advancing our major investment activities of ArborGen, Horizon2 and Tenon ... but it will probably be remembered most as a year dominated by adverse macro-economic conditions. A stubbornly strong NZ:US exchange rate, negative sentiment in the US housing sector, and the emergence of global credit concerns, each weighed heavily on the Tenon share price during the period ... and this in turn flowed through to Rubicon's own share price.

So, in a year where we made significant advancements in the strategic positioning of each of our investments, it is naturally disappointing that the additional share price value-recognition we achieved in our biotechnology activities was, unfortunately, offset by the impact of the fall in Tenon's share price. As you can see, the net effect of this has been a "flat-ish" Rubicon share price in terms of year-on-year share price performance, albeit with some volatility across the period.

Whilst since its listing, Rubicon has out-performed the NZX50 on a compound annual return basis, we fell short of the market return in the year just past – something we are not happy about. As the green segment of the previous graph showed, this is almost wholly due to the poor performance of Tenon's share price during the period. So let's take **a closer look at Tenon**, to help us understand exactly what has gone on there.

And with Tenon, it is really a story about macro-economic conditions – two factors in particular - the NZ:US exchange rate and the US housing market.

At our last year's ASM the NZ:US exchange rate was around 67 cents, and I remember presenting this slide, which showed forecasters' average 12-month forward currency view. As you can see, the experts' forecast back then was that the exchange rate would weaken throughout 2007 to be below 55 cents by about now. Well, as we all know, this didn't happen – the currency actually went in the other direction, strengthening over the past 12 months to average 73 cents, peaking at over 80 cents, and today it is stubbornly sitting at around 77 cents. There can be no doubt that the strength of the NZ dollar should be of concern to the New Zealand economy. The impact on exporters is obvious from this graph, which shows the share price performance in 2007 of some of New Zealand's better-known export / currency-related stocks – on average they have declined around 30% over the period.

And of course Tenon has not escaped the impact of the strong NZ dollar. This chart shows the clear correlation that exists between the rising NZ dollar and Tenon's share price over 2007 – and even if you choose a shorter time frame – say, the past three months – the correlation is equally obvious.

Of course, Tenon's share price sentiment has been even further affected by **an almost unprecedented decline in the US housing market** – something the NZ export-related stocks on the previous chart have not had to deal with.

The initial slowing in the US housing market occurred in 2006 - after 17 successive Federal Reserve interest rate-rises, which were partially designed to take the top off the housing bubble. However, that was followed this year by a complete collapse of the sub-prime mortgage market and emerging global credit concerns. These events have been very well publicised so I won't go over them again today, other than to say that their impact has been immediate.

The chart behind me shows year-on-year (annualised) new housing data in the US – you can see that the current figure of 1.2 million housing starts is down almost 50% from the 2.3 million starts of only 18 months or so ago. This next chart shows the inventory of existing homes in the US available for sale – up from an historic average of around 4.5 months in inventory to now be over 10.5 months. These fundamental drivers have naturally had an impact on house prices ... as this next graph shows. And all of these factors have combined to not only dry-up the issuance of new sub-prime loans (and hence demand for housing) but also to cause the owners of existing loans to write-off very substantial amounts.

As you can imagine, none of this has been favourable to companies that have exposure to the US housing market. This next graph charts the impact that these events have had over the past 18 months on the share prices of some of the US companies that operate in Tenon's market segment. As you can see, the shares of these companies have fallen between 50-75% ... and Tenon's performance is not dissimilar. Of course, this is actually a creditable performance on Tenon's part, because as we have just discussed Tenon has also been subject to the negative impact of the NZ:US exchange rate that the other stocks on this chart have not. If we were to reverse the [estimated] foreign exchange impact from the chart, the Tenon performance line would look more like this – although still slightly negative, it would clearly have outperformed these market competitors by quite a margin.

And the reason for that is that Tenon has worked very hard over the past 24 months to cement its market positioning as a specialty wood products manufacturer and distributor – a position that gives it more resilient earnings at the bottom of the cycle and stronger margins as the cycle expands again.

During the period, this has seen Tenon:

- Exit entirely from its poor performing AWM investment;
- Increase its ownership in Southwest Mouldings to 75%;
- Acquire 100% of Ornamental Mouldings – a manufacturer and supplier of high-value, ornate mouldings and decorative products;
- Advance the roll-out of its new out-door product, through a nationwide distribution agreement with BlueLinx – BlueLinx is, by far, the largest distributor in the US, with over 11,500 customers;
- Establish a new 5-year US\$100 million bank facility, to support its current and future operational and strategic needs;
- Put in place some initial cost-out initiatives - such as the conversion of the Taupo operating plant to geothermal power; and
- Report a US\$20 million operating earnings result for its June 2007 fiscal year

This restructuring has now put Tenon into an enviable industry position - by key performance metrics such as gross margin and EBITDA margin percentage. Tenon's specialty niche business model affords it a top quartile industry position.

To illustrate this, this next slide takes the same three companies we looked at earlier, and shows their operating earnings for the 12 months to September 2007 (i.e. their last published numbers) as a percentage of their previous 12 months' reported earnings. You can see the impact that the deterioration in the US housing market has had – their earnings are all off significantly – down almost 60% on average. However if we look at Tenon over this period (these are Tenon's last published figures, which are in respect of the June 2007 year) the positive impact of the Ornamental Mouldings acquisition along with the gains Tenon has made from its cost-out initiatives, allowed Tenon to report flat year-on-year earnings – which is a very strong earnings performance in an environment where industry and competitor earnings have been down significantly.

Looking forward, Tenon will continue a strategy of strengthening its market position. This will see Tenon:

- Advance its organic growth opportunities in the outdoor segment – currently represented by its Armourwood and Lifespan products;
- It will continue to develop its One-Company initiatives - which will produce earnings gains in areas such as procurement and back-office efficiencies;
- It will be “opportunistic” with product opportunities outside of the US; and
- It will aggressively pursue its cost-out programme – where Tenon believes there is considerable scope for earnings-improvement.

Effective implementation of this strategy will see Tenon well placed for the longer-term. The positive outlook for its target markets remains unchanged - ageing housing stock, positive household formation statistics, high employment levels, and strong individual net worth data, are all supportive of future success for the Company.

To this point, one of the data series we follow most closely is dollars spent on residential remodeling in the US. This is a critical value driver for Tenon's success – much more so than new housing starts. Over the past decade, annual remodeling expenditure increased at an average rate of 5.9% per annum. Of course this is not the case currently, with calendar 2007 data running at a rate of minus 2.1%, and an expectation that 2008 will be similar. However, beyond 2008, the National Association of Home Builders in the US is anticipating significant per annum growth in remodeling expenditure – as is shown on this slide. As you can imagine, such a trajectory would provide considerable momentum for Tenon's future earnings.

As to the immediate outlook, despite worsening market conditions year-on-year, Tenon's expectation is (assuming current market conditions) that for the six months to December 2007 it will report EBITDA of around US\$9 million – in line with the figure it reported in the previous year. If this can be achieved in the much more challenging market conditions and exchange rate environment that prevail today, then it will be a strong performance for the Company, and one which should satisfy market expectations.

Turning now to our forestry biotechnology activities.

As the year's activities for each of these businesses are discussed in detail in the Annual Report, I won't repeat those achievements for you today. Instead, I thought we could spend our time more usefully if we were to give you some further insight into our most often-asked question - "What might the future value of ArborGen be?"

As you know, ArborGen is all about providing superior-value treestocks targeted to its customers needs. Those customers may want these treestocks for traditional “forestry” end-uses – such as pulp, paper and lumber – or indeed, for non-traditional purposes – such as for use in biofuels applications. So, at any one time, ArborGen must have a full pipeline of products in development to meet these different future market needs. This chart shows just some of the products currently under development at ArborGen, and their commercialisation timeline. We have previously given examples of the potential value that the first two products to market - improved-pulping Eucalyptus and cold-tolerant Eucalyptus - could potentially generate for ArborGen once they were fully distributed into the Brazil and US marketplaces respectively. That exercise surprised most, as the examples [which are of course subject to a number of assumptions and estimates – accordingly the actual outcomes could differ markedly] showed a potential (capitalised) value to ArborGen at full market penetration, from just these two initial products (combined), of more than 750 million US dollars post tax.

Since giving those examples, we have been asked many times to provide further data points, so that the potential offered by ArborGen's other products might also be assessed in a similar manner. So I thought we could do that today - this time by analysing ArborGen's short-rotation loblolly pine product, which is destined for the US market.

So let's begin.

In forestry, the greatest cost is the cost of time – i.e. the time investors need to wait for their trees to grow to maturity, before they can realise a cash return on money that they may have invested several decades earlier. Clearly, if a tree can be made to grow faster, with no degradation in wood quality produced, then that would massively increase value to the forest grower - and of course also to the provider of such a treestock.

In the US, loblolly pine is the predominant pine species. For primarily lumber applications, it typically has a rotation age of around 26 years before it is harvested. ArborGen is currently developing two short-rotation pine products – the first designed to reduce loblolly's rotation age from 26 years to 20, and the second subsequent product is targeting a rotation age of 17 years. Early results indicate ArborGen may already be at this second product level of performance.

Whilst this is of course a significant scientific achievement, for our purposes the real question is - What might the value be of such a product to ArborGen? We can actually quite quickly estimate its potential value if we start with a few assumptions.

[I should say that these are only assumptions - actual outcomes may of course differ].

- First assumption - All other things held constant, a reduction in harvest age to 17 years doubles the net present value of an acre of loblolly pine planting. This value-lift is simply the impact of receiving the revenues from harvesting 9 years earlier, and does not take account of any of the gains on the cost side of the equation, or indeed the significant option value that comes from having access to the harvested land much earlier for either a second rotation or an alternate use.
- Second assumption - A doubling of the net present value of an acre of plantings translates to \$1.20 of additional value per each treestock planted in that acre, as at the time of planting.
- Third assumption - Let's assume ArborGen receives, say, 35% of this additional treestock value created, and the rest goes to the forest grower.

Final assumption - The current US loblolly pine market is 850 million treestocks per annum. Let's assume ArborGen captures only 35% of this market at full adoption of the product.

Now, with those assumptions, the value of one year's worth of sales (at full penetration), of this one ArborGen product, in this one market, can be simply calculated as:

the market size captured, (which in this example is 35% of 850 million treestocks), multiplied by ArborGen's share of the value added, (which here is 35% of 1 dollar and 20 cents), all net of a 35% tax. When you multiply all this out, the potential value accruing to ArborGen annually, would be just over 80 million US dollars, post-tax.

Repeating this level of sales year after year, without any assumed growth in market share, or use of this product in other markets, translates into a value to ArborGen for just this one product of more than 1 billion US dollars post tax. (For those of you wanting to do the numbers, the calculation is simply 80 million + US dollars per annum capitalised at the forest industry's discount rate of 8% after-tax per annum).

[Detailed calculations of this example will be included in an "ArborGen Update December 2007" document, within the "Publications" section of the Rubicon website - www.rubicon-nz.com.]

Clearly this is an extremely large number, for just this one product from ArborGen's total portfolio. Of course, this value does assume successful commercial sales, at a constant 35% market adoption, and a 35% value-sharing rate. And given ArborGen is still many years away from selling short-rotation loblolly as a commercial product, the equity market naturally discounts this prospective value fairly aggressively for both risk and time. However the real point of the example, along with the two Eucalyptus products we have analysed in previous years, is not to be too prescriptive or specific as to individual product trait values, but rather it is to show the "big-picture" value-potential that can be generated by ArborGen's business model. Under the assumptions we have discussed, these three products have a capitalised value-potential at full market penetration approaching US\$2 billion post-tax. And it needs to be remembered that these represent only three of the products in the ArborGen product pipeline that we saw earlier on.

It goes without saying that in order to extract this value, ArborGen must be able to get its products to market in the future. And with that in mind, last month we completed a transaction that saw each of ArborGen's three Partners roll their respective commercial tree operations into ArborGen. This US\$60 million transaction was structured such that each Partner maintained their one-third ownership shareholding in ArborGen. For Rubicon, this required us to first acquire the remaining 50% of Horizon2 from Carter Holt Harvey for \$10 million and to then roll 100% of Horizon 2 into ArborGen.

The benefits to ArborGen that will accrue from this transaction include:

- The creation of an immediate market-scale presence.

ArborGen now has operations in 20 locations, spanning four countries and employing over 185 staff.

It is now the largest global producer of treestocks. The combined businesses acquired, sold in excess of 300 million treestocks last year – representing over a third of the entire pine treestock market in the US South, 15% of the hardwood market in the same geography, 50% of the pine market in New Zealand and 20-25% of the softwood market in Australia.

- ArborGen's product development is significantly advanced as a result of these acquisitions. It now owns outright International Paper's and MeadWestvaco's superior pine and hardwood genetics in the US market, and Horizon2's genetics in the Australasian market ... and it now has over 10,000 Eucalyptus and Pine varieties in trial across four countries in more than 50 locations. This is the most extensive trial database of its type in the world, and a critical competitive advantage in ArborGen's product development and marketing programme.
- In addition to offering immediate cashflow from existing commercial sales, the acquired businesses bring commercial manufacturing and product distribution capability that ArborGen did not previously possess - and which it would otherwise have had to develop at some considerable cost over a very extended period of time;
- But most importantly, through these operations ArborGen now owns the critical channels to market for its first generation varietal and second generation transgenic products.

With this transaction completed, and the operations now being integrated into the existing business, ArborGen is well-placed to meet its future value-potential – which as you know, we believe to be enormous.

The biotechnology revolution that has created so much value for the agricultural industry will, undoubtedly, also occur in forestry in the future. History has shown that the big winner in the agricultural biotech arena has been the first-mover. In forestry-biotechnology, we believe the first-mover and the big winner will be ArborGen.

Thank you Ladies and Gentlemen - that concludes my review for 2007. But before I finish, I would just like to thank each of you for your attendance today, and also for your support over the year. It is very much appreciated.

Thank you.

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