

## TIMBER

### UNUSUAL, SHORT TERM INVESTMENT "OPTION"



**John Brickwood:**

"The structure of the model allows for both buy and sell pricing to be determined at the outset."

#### Would you say investing in Australian Timber differs to that embraced and practiced in other parts of the world - ie managed accounts; medium to long term lay-outs? Why? Peculiarities exhibited by Australian Timber investments

The Australian Timber Investment is fundamentally different to the majority of timber investments worldwide as it focuses on matured, milled timber as opposed to plantation growing of timber. It is a buy/sell arrangement structured to provide investment options and security. Where hardwood timber investments are typically a medium to long-term investment, the Australian Timber Investment offers short-term investment options (as short as 12months), which can then be rolled over. The basis of the investment structure is that as an asset class, it is one whose primary source of return is derived from the increased value of the timber as it dries. The reason timber increases in value is that from the green-sawn planks that eventually become hardwood flooring, the value is determined by the moisture content. During the drying period the timber gets harder and stronger and increases in value by approximately 40%. Through the many businesses that I have consulted, or been involved with, I have found very few, where the value of the stock increases while "sitting on the shelf". Australian hardwood is an exception.

#### Do you face capacity constraints in the context of the amount that can be invested and managed?

The existing model has been in place for the last four years and has a current capacity of AUD10mn. The model is expandable and can be replicated nation-wide as required. Over the next 3-5 years we envisage a holding of AUD100-200mn.

#### What are the different investment vehicles you offer? How and why did the firm choose to employ this route? Would you say it offers superior performance on an annualised; risk/return basis, when compared with managed, long dated stapled down investments in Timberlands? What are the other advantages/benefits that "option related" timber investing offers?

We structured this buy/sell model based on the large amounts of stock required to be held during the drying process of S timber. It provided a perfect medium for investment as the investor holds title of the stock for this period, during which time the timber increases in value.

We offer three different investment options, structured to accommodate different investment requirements.

The first is an option for a 12 month period with the profit paid to the investor at this time and the initial investment re-invested for a further 12month period before the buy-back clause is triggered.

The second option allows for both the initial investment and the profit to be rolled over into a second 12 month period. Under both these scenarios, a 9% return is paid with a 2% bonus which may be paid to the investor for early buy back under favourable drying conditions.

The third option provides for a fixed 12 month period only.

On a risk/return basis, the model offers superior performance when compared to traditional timber investments as, at all times, the asset is secured by title over it and the rate of return is set at the outset. The timber is, at any point, saleable to the market, regardless of the point in the drying process. The value of the timber is not determined by management forces and of course compared with plantation timbers is very liquid - as little as three months notice for an early exit still attracts a 4% pa return on investment.

It holds up well against many traditional asset classes, including stocks, bonds and real estate and because of its unique nature, performs differently from securities or other investments.

#### Valuation is critical to the strategy you pursue - how is this undertaken to ensure

#### transparency for an investor?

The beauty of this model is exactly that - its transparency. From the time the timber is milled, to the time it is dried, it is very simple to determine its value - a call to the local mill or timber merchant will provide the market value. Prices are determined by the wholesale/distributor rate to allow for at least a 30% margin for volatility in the market. The relatively short-term options of the model allow for pricing restructures at a maximum of every 24months. As Australian hardwood is becoming progressively more renowned in both the domestic and international markets, the market value is consistently on the incline. The timber is bought and sold in lineal metres, with shrinkage and recovery determined in the buy (not the sell) price.

#### How do you manage and mitigate the risk posed by the roll over effect, (contango type situations) to optimise performance?

The structure of the model allows for both buy and sell pricing to be determined at the outset. All holding associated costs are incorporated in the purchase price and the buyback price represents only a portion of the increased percentage value throughout both the initial and the rollover period. Subsequent investments invoke a new purchase agreement with the lineal meter price, (and corresponding lineal metres per investment) set accordingly.

#### What other embedded risk does this sort of investing entail?

Risks involved with this investment are primarily physical rather than operational. Insurances are incorporated in the purchase price with optional extra cover. External auditing is undertaken to ensure the quota per purchaser. It is also important to be in a market that is not saturated. Over the next 10 years Australia will only be able to supply 70% of its timber needs, the balance will be imported from other countries. It is true that the buying and selling of timber at a guaranteed return per annum, where the purchaser holds title of the commodity, with flexible options of investment is a little different from the purchase of shares or financial products.

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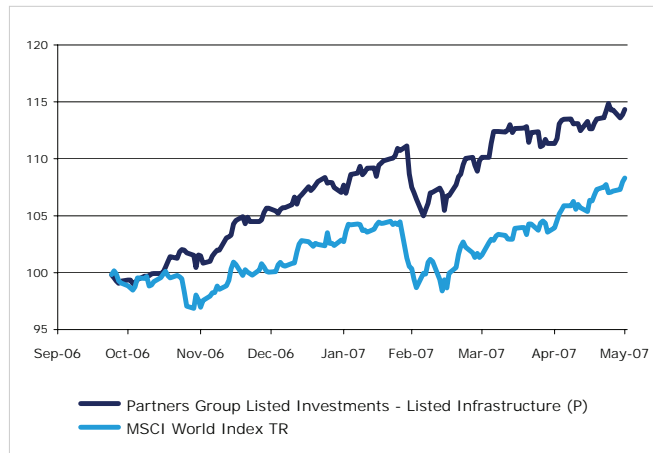
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## LISTED INFRASTRUCTURE



Title: Fund's performance since inception  
Source: Partners Group

## PARTNERS GROUP LISTED INFRASTRUCTURE FUND

**Focus:** Actively managed fund that offers access to "listed core infrastructure" companies

**Strengths:** • Daily liquidity

• "on-the-ground" approach to due diligence

**Weakness:** • Better suited to those with a medium to long term outlook

• Since inception, fund's performance has tended to mimic the course charted by equity investments (not an index hugger - fund aims to deliver superior risk adjusted return)

**Opportunities:** • According to a study published by the OECD\*, the annual world-wide capital requirements for infrastructure projects will amount to EUR 1'000bn until 2030 (\*"Infrastructure to 2030", OECD 2006)

• Excess demand for infrastructure projects versus limited availability of capital

• The lack of capital is increasingly covered by the private sector

**Threats:** • Underlying assets are sensitive to changes in real interest rates (ie an increase in real interest rates may be detrimental to performance, whereas a decrease should be positive)

• Exhibit sensitivity to regulatory and legal issues

### Risk Management

- Major risk at fund level: manager's assessment of the underlying's return is skewed to the downside owing to unpredictable and unforeseen events: regulatory, fraudulence, time lags etc.
- Ability to identify listed infrastructure investment opportunities: ☐☐☐☐☒
- Ability to invest at attractive valuations: ☐☐☐☐☒
  - Universe: typically ltd. to companies with market cap > EUR 100mn and/or avg. daily volume of > EUR 100,000
  - Universe: avg. market cap of approx. EUR 2.7bn and avg. daily volume of EUR 63mn
- Expertise in portfolio construction: ☐☐☐☐☒
  - Correlation amongst fund's underlyings oscillates between a band of: -0.3 to 0.8
- Volatility of returns: ☐☒☐☐☐

☐ Low ☐ Low / Moderate ☐ Moderate ☐ Moderate to High ☒ High

- Leverage risk: None at the portfolio level
  - Owing to the inelastic nature they exhibit (predictable and stable cash flow generation) the underlying's themselves maybe highly leveraged (by up to 90%)
- Currency risk: ☐☐☒☐☐
 (fund does not actively hedge it - rather diffuses the risk posed via broad-based diversification)
- Underlying's performance related risk: ☐☐☒☐☐
 (systematically reduced and managed by conducting on-site assessments, monitoring)
- Regulatory risk: ☐☐☒☐☐
- Underlying's performance assessment skills: ☐☐☒☐☐
 (pursue a conservative outlook)

### Performance Parameters

☒ Low ☐ Low / Moderate ☐ Moderate ☐ Moderate to High ☐ High

- No. of positions in the portfolio: 20-30
- Efficiency in putting investor capital to work: ☒☒☒☒
- Diversification:
  - Geographic: broadly, and well diversified
  - Sector: broad (exception: 24% is allocated toll road related investments owing to their predictable cash flows)
  - Underlying's avg. investment horizon: 3 years
- Liquidity: under normal conditions\*: 91% in one week, 98% in two weeks, 100% in 3 weeks (\*assuming that the fund can only trade 25% of the avg. daily volume of the last 6 months)

- Ability of investment to perform in:
  - Rising markets: outperforms
  - Falling markets: not immune to sudden, unanticipated, sharp, short-lived pull backs
- Most challenging situations for such a fund: averted owing to diversification - but the impact of regulatory, legal, issues could potentially skew performance to the downside
- All inclusive annual expense ratio: 2.3%

### Outlook

- Barriers to entry: labour intensive due-diligence; network, evaluation models
- Outlook on the infrastructure sector: upside potential
- Outlook for Partner's listed infrastructure fund: upside potential
- Threat posed by competition: exists but not detrimental

- Ability to deliver net annual targeted returns over:
  - Next 12 months: realistic
  - Next 3-5 years: high
- Outperformance can be expected when: majority of the assessments, for underlying's performance, held in the portfolio are accurate; markets are stable, real interest rates are stable/declining

### Investment

- Current AuM: EUR58mn
- Targeted AuM: currently unconstrained
- Fund is targeted at: a broad based investor universe
- In order to optimise returns recommended holding period: min 18-24months
- Geographic restriction: apply
- Fund's base currency: EUR

- Fund's complexity for an investor: simple
- Transparency provided: high
- Fund/manager Reg. with: group registered with FSA, publicly listed co. in Switzerland
- Fund Ratings/awards: 2007: Fund Innovation of the year award (Finanzen Euro, a German finance publication)

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## FILM INVESTING

### PERFORMANCE OPTIMISATION

“Our fund’s micro managed, portfolio approach to film and venture partner selection, affords the ability to avoid the potential pitfalls of revenue participation in film projects and the vagaries of excessive fees and charges - thus enhancing the attraction to this form of investment. The use of guarantees rather than immediate funding provides a greater degree of flexibility for the investors.” **David Tucker**



**Film investing: what are the different, and new, sources that could generate revenue streams for an investor?**

New sources of revenue will include: Digital distribution, 3D distribution, video on demand, streaming video, digital television, mobile content delivery, handheld content delivery, plus the associated and proportional increase in tie-ins and ancillary revenue streams, such as: merchandising, product placement, spin-offs and video games. Consequently, there has been a dramatic increase in the upside associated with films, whilst affording the opportunities to significantly reduce the downside risks. Our approach, because of its people and processes, is uniquely placed to capitalise on these changes in the marketplace, to ensure profitability for a portfolio of commercially viable films.

**How important is it to have a box office hit? How much does it, should it, be contributing to overall performance?**

From a performance perspective, a box office hit is nice to have but is not essential, as the market for feature films is changing rapidly and remarkably. With this as backdrop, we believe it is essential to put together a portfolio of venture partnerships directly with the studios and or established production entities. This strategy maximises the benefits from a film investment, whilst minimising the inherent risks. It ensures the correct structure is in place and works best for both the investor and the film industry, to garner this source of alpha.

The “venture partners” for our fund, are drawn solely from the highest echelons of the industry. They are all reputable and well-regarded US-based production companies (some of which are household names), mini-majors and major studios, with established track records.

The production companies are, for the most part, businesses whose talent base and productions are highly sought after by the US studios and world-wide distributors. A box office hit, particularly in the “domestic” market (USA/Canada) is normally the driving force behind a strong worldwide theatrical release. However, in many instances, theatrical performance is increasingly becoming an advert for the DVD, video and ancillary market releases (sound tracks, games, spin off, merchandising etc.). By using this robust and repeatable process to create a diversified portfolio of films, increases the potential to make films that will be successful.

**What performance (net annual) can an investor expect?**

We are targeting a net return of 15% to 25% per annum over the period of investment with a very low correlation to other asset classes. Going back five years, returns from the domestic box office and initial video rental receipts for some of the venture partners that we are intending to use in our fund were analysed. The numbers fall within our range even without including all the ancillary market returns. Although this is not a guarantee for future performance, reputable film makers do continue to generate profitable films.

**Bearing the investor’s interest in mind, what according to you should be an appropriate fee structure?**

The fees should be no different than any other alternative investment - 2% per annum management fee with a 20% performance fee paid at the end of the investment term.

**What are the loopholes and where do you believe an investor should exercise caution?**

The devil is in the detail. The investment returns of each venture will be wholly dependent on the detail of the co-financing and revenue participation arrangements, which historically have not favoured the investor. It is fairly typical to find co-financing/co-production “partners” using complex revenue waterfalls and inequitable fee structures, thereby inhibiting the transparency, accountability and inherent

## FILM INVESTING

### PERFORMANCE OPTIMISATION

profitability of the individual projects and the overall slate.

For example, a fairly typical engagement would see the venture partner taking fees at a number of different levels starting with 20% of the profit until the investor recovers 110% of their capital, then increasing to 40%, 50% and as high as 65%, in some instances, as the venture generates higher profit. Additionally, more often than not, there are management fees that can be as high as 3% per annum plus producer fees, production overheads and miscellaneous expenses that can be an additional 5% to 20%.

The revenue streams are impacted by the studios/distributors charging distribution fees in excess of 20% of the budget, as well as immediately recouping any print and advertising costs and other expenses they may have incurred (which are often hidden), with a margin built in on top. To further compound the investment's potential, the minimum number of projects over the term of the venture can be fairly low in comparison to the requisite capital commitment. Plus, the risk profile of the investment can be severely altered by the fact that these projects can actually be a mere subset of the total production of that studio or producer – “cherry picking” rather than an opportunity to truly co-finance all the products from that source.

#### Is transparency an issue? Accountability? Solutions?

The industry has a history of frequent litigation, obscure accountancy practices and general obfuscation. Clear, transparent and mutually beneficial terms must be agreed, with on-going monitoring and reporting which ensures that the investment maintains the same risk profile. It is essential to have full right of audit with all parties, across the entire supply chain. The objective is to achieve an alignment of interests: all parties that co-finance a deal must have interests which are aligned as exactly as possible.

#### Other peculiarities/ observations?

The equity investors are poorly positioned in typical film fund investment vehicles which rely heavily on tax rebates, debt financing and cross collateralisation - with inequitable fee structures, overheads and producer salaries. We believe it is possible to reverse this position by providing a flexible exit strategy at the end of the investment term.

#### Elaborate on the “unfunded approach” to investing in films?

The investor is providing a guarantee for a fixed term, multiple draw credit facility, or overdraft, for the life time of the fund via our panel of banks. Depending on the nature of these guarantees a small percentage of cash is maintained on account in the fund. The investor continues to manage their portfolio of assets whilst accessing the potentially uncorrelated returns that feature films are capable of generating, with minimal actual cash outlay (the guarantee could be against illiquid assets, such as real estate, or against assets under management). The recycling of revenue in films tends to be remarkably quick. Thus, with well placed, highly controlled film investments across a portfolio of slates, there is a strong chance of our fund generating profits in a relatively short term, which will afford the investor the option of short term liquidity, as the fund's cash surplus proportionally reduces the underlying investor's guarantees.

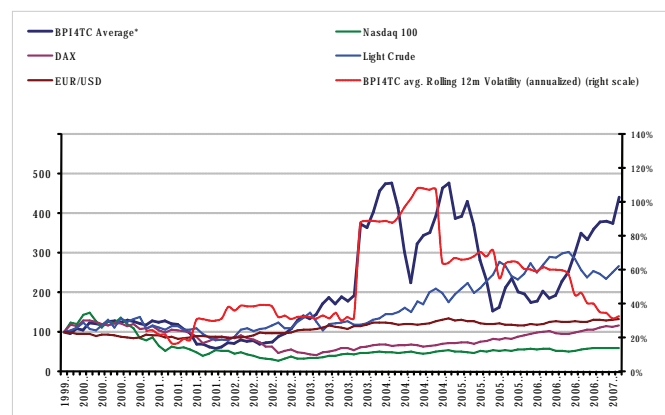
#### Why is it particularly well suited to institutional, pension, endowment investors?

These investors tend to have a longer investment horizon; seeking uncorrelated returns in order to diversify their risk. If this investment can be structured in a way, where it can provide the appropriate level of transparency and control, then it is ideally suited to this marketplace. The unfunded approach also allows the investor to better accommodate the investment within their existing risk budget.

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## SHIPPING



Title: Shipping correlations  
source: Okeanos Shipping Fund

## OKEANOS SHIPPING FUND

**Focus:** The fund generates performance by exploiting the persistent opportunities resulting from inefficiencies within the dry shipping market. It invests in both the derivatives and the physical shipping market

**Strengths:** Blends HF Navigator's sector specific expertise (chartering, FFAs - forward freight agreements) with Aquila Capital's hedge fund expertise

**Weaknesses:** • Better suited to investors with a medium to long term investment horizon

• Performance could be challenged in periods of low to ranging volatility; illiquid market conditions

**Opportunities:** • Currently it is a highly inefficient market (high risk premiums)

• Physical freight market: volatility has greatly increased over the past 4 years and is expected to stay high

(Performance is extracted from volatility which is high - max.20%)

**Threats:** Counterparty trading risk

### Risk Management

- Major risk: Directional risk in the case of FFAs in combination with a credit default
- Ability to identify and exploit relative value opportunities within the shipping and freight markets ☐ ☐ ☐ ☐ ☐
- Ability to exploit volatility: ☐ ☐ ☐ ☐ ☐
- Ability to secure credit: 85% of funds assets invested in daily liquid instruments
- Leverage used: max.150% - avg. 100%
- Currency related risk: (fund is invested in USD) ☐ ☐ ☐ ☐ ☐
- Key man risk: (team approach) ☐ ☐ ☐ ☐ ☐

☐ Low ☐ Low / Moderate ☐ Moderate ☐ Moderate to High ☐ High

- Ability to manage:
  - Market risk : managing positions and cash flows with own developed IT-System called "AC.mar" ☐ ☐ ☐ ☐ ☐
  - Geo-political risk: ☐ ☐ ☐ ☐ ☐
  - Counterparty risk: (in depth counterparty research; experience in trading FFA's OTC - fund has specific limits for each counterpart in terms of "how many days they will trade max with each" and ability to calculate profit and loss for each counterpart to manage limits) ☐ ☐ ☐ ☐ ☐
  - Liquidity related risk ☐ ☐ ☐ ☐ ☐
  - Valuation risk (using Baltic Forward Association (BFA) for FFA valuation; for physical valuation the administrator gets numbers from two independent companies) ☐ ☐ ☐ ☐ ☐

### Performance Parameters

☐ Low ☐ Low / Moderate ☐ Moderate ☐ Moderate to High ☐ High

- Avg. no. of positions held in the portfolio: fairly concentrated
- Ability to exploit dramatic structural changes: ☐ ☐ ☐ ☐
- Diversification achieved by:
  - strategy: FFA direction 50%; FFA Spreads 10%, Physical 40%
  - route :Trans-Atlantic, Trans-Pacific, Taiwan/Japan, Far East to Europe
  - vessel type: current focus Panamax
  - freight carried focus: dry freight
  - position time frames 1 day - 10 /12 months - avg. 6 months

- Conditions for the fund to outperform: increased use of shipping derivatives, growing world trade, dislocations
- Conditions that would lead to an underperformance: illiquid market conditions, low volatility
- Max. drawdown per day: -4% (probability of occurrence 2.5%)
- Max. drawdown per week: -8% (probability of occurrence 0.5 %)

### Outlook

- Barriers to entry: an in-depth understanding of the fast paced and highly complex freight trading environment; network
- Scope for a freight fund: upside potential
- Threat posed by competition: currently few market participants pursue a similar strategy
- Probable correlations to:
  - Stocks S&P500: 0.14; Nasdaq100: -0.18
  - Bonds: REX Index: 0.6
  - Commodities: Crude Oil: 0.50

- Performance in:
  - volatile markets: high
  - during periods of low vol. focus shifts to physical side: range bound
- Ability to deliver targeted returns over:
  - the next 12 months: high
  - over the next 3-5 years: range bound (shrinking risk premia) to high

### Investment

- Current AuM: 20 mn
- Targeted AuM: soft close at: USD35 mn; mid term capacity: USD150mn
- Targeted annual net returns of: 25%
- Target audience: sophisticated investor
- Level of complexity: high

- To optimise returns, recommended avg. holding period: 2 years
- Available to investors: (geographic restrictions): none
- Base currency: USD
- Transparency: high
- Manager/Fund is authorised by: Manager by BaFin (Germany)

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