FLETCHER CHALLENGE FORESTS

SALE OF FOREST ESTATE AND CAPITAL RETURN

Notice of Special Meeting and Explanatory Memorandum

16 January 2004

Notice is hereby given that a special meeting of Fletcher Challenge Forests Limited shareholders will be held at the ASB Bank Stand, Eden Park, Auckland, New Zealand, on 20 February 2004 commencing at 10.00 am

Forward-Looking Statements

This document includes “forward-looking statements”. All statements, other than statements of historical facts, included in this document that address activities, events or developments the Company expects or anticipates will or may occur in the future, including such things as projected earnings and financial positions, future cost savings or capital expenditures (including the amount and nature thereof), product prices, business strategy and measures to implement strategy, competitive strengths, goals, expansion and growth of the Company’s business and operations, plans, references to future success and other such matters are forward-looking statements. When used in this document, the words “estimate”, “project”, “anticipate”, “expect”, “intend”, “believe”, “forecast”, “prospective” and similar expressions are intended to identify forward-looking statements.

These forward-looking statements are based on assumptions and analyses made by the Company in the light of its experience and perception of historical trends, current conditions and expected future developments, as well as other factors the Company believes are relevant in the circumstances. However, whether actual future results and developments will conform to the Company’s expectations and predictions is subject to a number of risks and uncertainties. Factors that could cause actual results to materially differ from those implied by the forward-looking statements include, but are not limited to: increases or decreases in global production capacity; changes in market prices, exchange rates and interests rates; imports; industry cyclicality; availability and cost of raw materials; general economic, market and business conditions; the opportunities (or lack thereof) that may be presented to, and pursued by, the Company and its subsidiaries; competitive actions by other companies; changes in laws or regulations, including, without limitation, those relating to environmental compliance; terrorism; and other factors, many of which are beyond the Company’s control. Consequently, all of the forward-looking statements made in this document are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by the Company will be realised or, even if substantially realised, that they will have the expected consequences for, or effects on, the Company or its business or operations.

These cautionary statements should be considered in connection with any written or oral forward-looking statements that may subsequently be issued by the Company or persons authorised to act on its behalf. The Company does not undertake any obligation to release publicly any revisions to any forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events.

Important Information

The purpose of the Special Meeting is to seek shareholder approval for Fletcher Challenge Forests to sell its forest assets to a consortium led by Kiwi Forests Group Limited and return capital to the Company's shareholders.

This document includes the following information:

- a summary of the transaction, including a timetable of important dates;
- a letter from the Chairman of Fletcher Challenge Forests Limited;
- a description of the business of the Special Meeting; and
- an explanatory memorandum, which provides detailed information regarding the Forests Sale and the Capital Return, and their impact on the Company.

An independent report prepared by Grant Samuel & Associates Limited in relation to the Forests Sale is attached to this document.

Voting/Proxy Form

Accompanying this document is a voting/proxy form, to enable shareholders to vote on the resolutions either by:

- attending the Special Meeting; or
- lodging a postal vote; or
- appointing a proxy to vote on their behalf at the Special Meeting.

In view of the importance of the Forests Sale and the Capital Return, shareholders are urged to complete and return the voting/proxy form as soon as possible if they do not plan to attend the Special Meeting.

Enquiries

If you have questions regarding the Forests Sale and the Capital Return or the Special Meeting, please contact our shareholder information lines:

New Zealand	0800 200 106
Rest of the world	+64 9 488 8703
or email us at	enquiry@computershare.co.nz

Summary of the Proposed Transaction

Forests Sale Proposal

On 18 December 2003, Fletcher Challenge Forests reached an agreement with Kiwi Forests Group Limited, Viking Global New Zealand Limited and OTPP New Zealand Forest Investments Limited that is expected to result in it selling its Forest Assets for NZ$725 million.

The sale of the Forest Assets is subject to approval by the Company's shareholders and the receipt by the Purchasers of the approval of the Overseas Investment Commission (which is expected before the Special Meeting). The sale of a forestry right by Tarawera Forests Limited, a subsidiary of the Company, is also subject to Kiwi Forests Group Limited arranging finance for the acquisition of that asset by 30 January 2004. The purchase of the remaining Forest Assets is not subject to the Purchasers arranging financing.

The Company wishes to exit its plantation forestry activities, to allow it to:

- focus on its investment in higher-margin wood processing, marketing and distribution activities; and
- return significant surplus capital to the Company's shareholders.

As part of the Forests Sale, the Purchasers have agreed to long-term agreements for the supply of sawlogs and pulpwood for the ongoing supply of timber to Fletcher Challenge Forests' processing plants and to enable Fletcher Challenge Forests to meet pulpwood supply commitments to its major customers.

Capital Return

As a consequence of the sale of the Forest Assets, the Company's capital structure will be inefficient as it will have no net debt, and significant cash on its balance sheet. Assuming all of the forestry rights and leases are sold, up to $1.20 per existing share will be returned to shareholders in cash. This return will be made in two payments. Therefore the Company proposes to re-leverage its balance sheet to an appropriate level for the industry in which it operates, and to return all surplus capital to its shareholders.

FIRST RETURN

The amount of the first payment will depend on whether the financing condition is met which will allow the Tarawera Forestry Right to be transferred to Kiwi. If it is, the Company proposes an initial capital return whereby:

- three out of every four ordinary shares and three out of every four preference shares will be cancelled; and
- $1.25 will be paid to shareholders for every share cancelled (which will equate to a cash payment to shareholders of 93.75 cents for each share they hold in the Company prior to cancellation).

If Kiwi is not able to obtain the required finance for the purchase of the Tarawera Forestry Right, the total sales proceeds will be reduced by $165 million. As a result, the amount of surplus capital to be returned following the Forests Sale will be less and so, in those circumstances, the proposed initial capital return will be on the basis that:

- one out of every two ordinary shares and one out of every two preference shares will be cancelled; and
- $1.25 will be paid to shareholders for every share cancelled (which will equate to a cash payment to shareholders of 62.5 cents for each share they hold in the Company prior to cancellation).

SECOND RETURN

The Company expects to be able to make a further capital return in the second half of calendar 2004 of up to 26.25 cents per existing share (which, together with the first capital return of 93.75 cents per existing share, will equate to $1.20 per existing share) once it is able to complete the process of transferring to the Purchasers the forestry rights and forestry leases that make up part of Fletcher Challenge Forests' estate. If the Tarawera Forestry Right is not transferred to Kiwi (and hence the sale proceeds are not included in the initial capital return) but is subsequently sold to another party, the second capital return will increase from 26.25 cents per existing share to up to 57.5 cents per existing share, depending upon the sale proceeds received for that asset.

Grant Samuel & Associates Limited has undertaken an independent review of the sale of the Forest Assets and has concluded that the transaction is in the best interests of the Company's shareholders.

The Independent Directors recommend that shareholders vote to approve the sale of the Forest Assets and the Capital Return outlined in this document.

Important Dates

ALL TIMES ARE GIVEN IN NEW ZEALAND TIME UNLESS OTHERWISE SPECIFIED

5.00 pm, 14 January 2004	Record date set by the Depositary for holders of Company ADRs for determination of voting entitlements for the Special Meeting (New York time)
10.00 am, 13 February 2004	Latest date for receipt by the Depositary of postal votes and proxies in respect of Company ADRs (New York time)
5.00 pm, 13 February 2004	Record date for determination of voting entitlements for the Special Meeting (local time in jurisdiction in which the Company's share register or branch register is held)
10.00 am, 18 February 2004	Latest time for receipt by the Company of postal votes and proxies
10.00 am, 20 February 2004	Special Meeting of shareholders
On or about 27 February 2004	Principal completion date for sale of Forest Assets
Early March 2004	Final Court Hearing expected to approve initial capital return
March 2004	Initial capital return expected to be completed
Second half of calendar 2004	Second capital return expected to be completed

Chairman's Letter

FLETCHER CHALLENGE
FORESTS

Dear Shareholders,

The Independent Directors recommend that you approve the resolutions on the sale of Fletcher Challenge Forests' forests and related assets and the return of capital to the shareholders of the Company which will be considered at the Special Meeting.

The sale of the Forest Assets is expected to enable a capital return to you of up to $1.20 in cash for every Fletcher Challenge Forests share you hold. Combined with an implied valuation of the Company's remaining business of approximately 30 to 40 cents (assuming a multiple of 6-7 times projected EBITDA for the continuing business), that would place a total value on the Company of approximately $1.50 to $1.60 per share, which is 50 to 60 cents (or 50% to 60%) more than the share price of less than $1.00 in June 2003 when the Company first announced its intention to run a process to sell its forestry assets.

The Company proposes to return the surplus capital generated from the sale of the forestry assets to its shareholders in two payments. The amount of capital to be returned in the first payment is dependent upon whether the sale of a forestry right over one of the Company's partly owned forests, Tarawera, is completed as part of the sale of the Forest Assets. Assuming the sale of the Tarawera Forestry Right is completed (and Kiwi has expressed its confidence in achieving the financing condition in relation to that cutting right), the first return of capital will be of 93.75 cents per existing share. We expect that to be paid to shareholders in March 2004. In conjunction with that payment, it is proposed to cancel three out of every four existing ordinary shares and three out of every four existing preference shares, which translates into a payment of $1.25 per share being cancelled.

Chairman's Letter

If the sale of the Tarawera Forestry Right is not completed as part of the sale of the Forest Assets, then the first capital return will be reduced to 62.5 cents per existing share. In this case, the Company will cancel one out of every two existing ordinary and preference shares, which again translates into a payment of $1.25 per share cancelled.

The amount and timing of the second capital return is dependent on the transfer of Fletcher Challenge Forests' forestry rights and forestry leases to the purchasers. The approval of a number of third parties is required in order to transfer some of the forestry rights and forestry leases to the purchasers. This may take some time. It is expected that this process will be completed by August/September of this year at which time the Board will be able to determine with certainty the final amount that can be returned to shareholders.

If all the forestry rights and forestry leases are able to be transferred (and the Tarawera Forestry Right is transferred to Kiwi) and there is no deterioration in trading conditions, the Company expects to be able to return up to $1.20 per existing share in total to shareholders (which would imply a second capital return of 26.25 cents per existing share). The Board proposes to put to shareholders the further approvals required for the second capital return in the second half of calendar 2004.

This very satisfactory outcome is the result of a rigorous and competitive sales process pursued by the Company and its advisers over the past six months. The sale price of $725 million which has been agreed with the Kiwi Consortium is significantly higher than its initial offer, and also significantly more than the best offer from other bidders.

While the Company will no longer have its own forests, it will continue to enjoy the advantage of the proximity of its established processing plants to one of the world's most sustainable sources of good quality timber – the forest plantations of the central North Island of New Zealand. In negotiating the sale of its forestry assets to the Kiwi Consortium, arrangements have been made for the supply of logs to Fletcher Challenge Forests' processing plants and to meet long-term commitments to other customers.

The sale of the forestry assets progresses the strategy that the Company has been pursuing aggressively since it announced at the 2002 Annual Shareholders' Meeting that the Company would focus on:

- running the Company's existing business to world best standards of performance;

- selectively investing in high margin added value processing;
- increasing the Company's investment in marketing and distribution;
- reducing capital invested in the forest estate; and
- returning surplus capital to shareholders.

The proposal included in this document represents a major step in the implementation of this strategy, as it addresses both the complete exit from plantation forestry activities and a significant capital return to shareholders.

With this transaction, the Company can overcome the constraints that have prevented it from delivering satisfactory financial returns to investors since it was established as a stand-alone business. It will exit its lower margin forestry activities (which have a very long investment horizon and attendant risk profile) at a price 50%-60% greater than had been implied in our share price. In addition to releasing up to $1.20 per share of cash to be returned to all shareholders, it will allow the Company to focus on the higher returning downstream wood processing and distribution activities which are likely to be more fully valued by the equity markets.

For these reasons, the Independent Directors urge you to vote in favour of the transactions.

Yours faithfully

Sir Dryden Spring
Chairman

Business of the Special Meeting

Notice is hereby given that a special meeting of the shareholders of Fletcher Challenge Forests Limited will be held at the ASB Bank Stand, Eden Park, Auckland, New Zealand, on 20 February 2004 at 10.00 am.

Resolution 1 – Forests Sale – Ordinary Resolution

Under NZX listing rule 9.1, ASX listing rule 11.1.2 and clause 6.1 of the Company's constitution, to consider, and if thought fit, pass the following resolution as a single ordinary resolution:

> *That the sale of the Forest Assets on the terms set out in the Forests Sale Agreement for a price of approximately $725 million and the entry into the Wood Supply Agreements, in each case as described in the Explanatory Memorandum, be approved.*

This resolution is to be voted on by preference shareholders and ordinary shareholders, voting together.

Resolution 2 – Capital Return – Special Resolution

Pursuant to an order of the High Court of New Zealand made at Auckland on 16 January 2004, to consider, and if thought fit, pass the following resolution as a special resolution:

> *That, subject to resolution 1 being passed, the arrangement relating to the return of capital to the Company's shareholders, as described in the Explanatory Memorandum and the Arrangement Plan, under which the Company will return up to $523 million of capital to shareholders, be approved.*

This resolution is to be voted on by preference shareholders and ordinary shareholders, voting together.

Procedural Notes

(i) The meeting referred to in this Notice of Special Meeting has been convened by an order of the High Court of New Zealand made at Auckland on 16 January 2004.

(ii) Resolution 1 is an ordinary resolution and therefore is required to be passed by a simple majority of the votes of those shareholders entitled to vote and voting on that resolution. Resolution 2 is a special resolution and therefore is required to be passed by a majority of 75% or more of the votes of those shareholders entitled to vote and voting on that resolution.

(iii) Resolution 2 is subject to Resolution 1 being passed and will only take effect if Resolution 1 is approved by the required votes. Resolution 1 will take effect if passed, even if Resolution 2 is not passed.

(iv) The persons who will be entitled to vote on the resolutions at this Special Meeting are those persons who will be shareholders at 5.00 pm on Friday, 13 February 2004 (local time in the jurisdiction in which the Company's share register or branch register is held), and only the shares registered in those shareholders' names may be voted at the Special Meeting.

(v) The accompanying voting/proxy form should be used to vote on the resolutions. Shareholders can participate by postal vote, by proxy or by casting their vote in person at the Special Meeting.

(vi) You may cast a postal vote on the resolutions to be voted on at the Special Meeting by indicating your voting preference on the enclosed voting/proxy form, signing the form and sending it to the registered office of the Company, the office of the Share Registrar or the office of the branch registry. It is not necessary to also appoint a proxy. The completed voting/proxy form must be received no later than 10.00 am on 18 February 2004 (New Zealand time). The Company Secretary has been authorised by the Board to receive and count postal votes at the Special Meeting.

(vii) Any shareholder who is entitled to attend and vote at the Special Meeting may appoint a proxy to attend and vote in his/her/its place. A shareholder wishing to appoint a proxy should complete the enclosed voting/proxy form and send it to the registered office of the Company, the office of the Share Registrar or the office of the branch registry. The completed voting/proxy form must be received no later than 10.00 am on 18 February 2004 (New Zealand time). A proxy does not have to be a shareholder in the Company. A shareholder may appoint the Chairman of the Special Meeting to act as his/her/its proxy, or another person. The Chairman has advised that it is his intention to vote undirected proxies received by him in favour of the resolutions set out above.

(viii) The Company has requested that, where the Depositary has not received voting instructions from a holder of ADRs, the Depositary will not vote nor give a proxy in respect of the shares represented by such holder's ADRs.

(ix) This Notice of Special Meeting has been approved by New Zealand Exchange Limited in accordance with NZX listing rule 6.1.1. Australian Stock Exchange Limited has issued a "no-objection" letter in relation to this Notice of Special Meeting in accordance with ASX listing rule 15.1.7.

(x) If shareholders plan to attend the Special Meeting, their completion and return of the enclosed reply-paid attendance card would assist our planning.

By Order of the Board

Auckland
New Zealand
16 January 2004

Paul Gillard
Company Secretary
Fletcher Challenge Forests Limited

Discussion of the Shareholder Resolutions

Resolution 1 – Transaction – Ordinary Resolution

NZX Listing Rules

NZX listing rule 9.1 and clause 6.1 of the Company's constitution provide that the Company and its subsidiaries must not enter into a transaction, or series of linked or related transactions, to sell assets in respect of which the gross value is in excess of 50% of the lesser of the "average market capitalisation" or the "gross value of the assets" of the Company and its subsidiaries, except with the prior approval of an ordinary resolution of shareholders (or a special resolution if section 129 of the Companies Act also applies). The gross value of the assets that are proposed to be sold by subsidiaries of the Company under the Forests Sale is in excess of the relevant threshold and shareholder approval by way of ordinary resolution is therefore required.

The Company has received a judgment from the High Court declaring that the Forests Sale is not a "major transaction" for the Company for the purposes of section 129 of the Companies Act and that the appropriate voting threshold is that required for an ordinary resolution only.

ASX Listing Rules

Where the Company proposes to make a significant change, either directly or indirectly, to the nature and scale of its activities, under ASX listing rule 11.1.2 the ASX may require the Company to get the approval of the holders of "ordinary" securities (which, for the purposes of the ASX Listing Rules, includes both ordinary shares in the Company and preference shares in the Company). The ASX has required the Forests Sale to be approved by way of ordinary resolution.

Resolution Required

Resolution 1 will therefore be proposed as an ordinary resolution to satisfy NZX listing rule 9.1, the Company's constitution and ASX listing rule 11.1.2. An ordinary resolution is required to be passed by a simple majority of the votes of the shareholders entitled to vote and voting on the resolution. This requirement has been confirmed by the NZX, the ASX and by the High Court.

Resolution 2 – Capital Return – Special Resolution

Court Approved Capital Return

On 16 January 2004, the Company received initial orders granted by the High Court under section 236 of the Companies Act directing the Company to seek shareholder approval for the Capital Return which involves returning capital to shareholders under one of two formulations:

(a) if the Tarawera Forestry Right has been transferred to Kiwi by the principal completion date for the Forests Sale, the cancellation of three out of every four preference shares in the Company and three out of every four ordinary shares in the Company held by each shareholder, and the payment by the Company of \$1.25 for every preference share and every ordinary share cancelled (which equates to 93.75 cents for each share held immediately prior to the cancellation); or

Discussion of the Shareholder Resolutions

(b) if the Tarawera Forestry Right has not been transferred to Kiwi by the principal completion date for the Forests Sale, the cancellation of one out of every two preference shares in the Company and one out of every two ordinary shares in the Company held by each shareholder and the payment by the Company of $1.25 for every preference share and every ordinary share cancelled (which equates to 62.5 cents for each share held immediately prior to the cancellation).

Resolution Required

The High Court has required that the Capital Return be approved by a special resolution. Resolution 2 must be passed by a majority of 75% or more of the votes of those shareholders of the Company entitled to vote and voting on the resolution.

Resolution 2 is subject to Resolution 1 being passed. This approval will also satisfy the requirements of NZX listing rule 9.1 and ASX listing rule 11.1 (to the extent they are applicable) in the context of the Capital Return.

Important note for holders of American Depositary Receipts

Holders of ADRs are entitled to vote on the resolutions to the same extent as a holder of the Company's shares. Holders of ADRs may provide voting instructions to the Depositary, which will arrange for the shares in the Company underlying the ADRs to be voted. Such instructions must be received by the Depositary prior to 10.00 am on 13 February 2004 (New York time). Holders of ADRs who wish to change or revoke an instruction must do so by contacting the Depositary. No assurance can be given that the Depositary will be able to accommodate a change or revocation after 10.00 am on 13 February 2004 (New York time). Holders of ADRs will have received, with this document, special instructions for how they may vote their American Depositary Shares. Holders of ADRs are not entitled to attend the Special Meeting. The Company has instructed the Depositary that it will not accept a deemed discretionary proxy in respect of any shares underlying ADRs for which no voting instructions are received.

Voting Exclusion Statement required by the ASX Listing Rules

The Company will disregard any votes cast on Resolutions 1 and 2 by:

- a person (or class of persons) who might obtain a benefit, except a benefit solely in the capacity of a holder of shares in the Company, if the resolution is passed; and
- an associate of that person (or those persons).

However, the Company need not disregard a vote if:

- it is cast by a person as a proxy for a person who is entitled to vote, in accordance with the directions of the voting/proxy form; or
- it is cast by the person chairing the meeting as a proxy for a person who is entitled to vote, in accordance with a direction on the voting/proxy form to vote as the proxy decides.

Explanatory Memorandum

The Forests Sale

Introduction

In November 2002, the Board announced a strategy for the Company which would see it:

- run the Company's existing business to world best standards of performance;
- selectively invest in high margin added value processing;
- increase the Company's investment in marketing and distribution;
- reduce the capital invested in forestry estate; and
- return surplus capital to shareholders.

In order to advance this strategy, in June 2003 the Board announced that the Company would conduct a trade sale process for the Forest Assets. It was apparent from the earlier sale of cutting rights over a portion of the forest estate that direct third party investors would place a higher value on the Forest Assets than equity market participants, due in part to their longer investment time horizons and differing cost of capital return expectations. For this reason a trade sale was expected to gain greater economic value for shareholders than the alternative of establishing the Forest Assets within a stand alone publicly listed company.

Since that announcement, Fletcher Challenge Forests has undertaken a rigorous process targeted at identifying buyers prepared to pay the highest price for the Forest Assets. All major worldwide timber investors were contacted as part of that process and a number undertook a review of the information provided as part of assessing their level of interest in the Forest Assets.

The sales process has resulted in the announcement on 19 December 2003 of the conclusion of an agreement to sell the Forest Assets to a consortium of Kiwi, Viking and OTPP for $725 million.

The sale of the Forest Assets represents a major step in the strategic re-positioning of the Company. It will also permit the Company to return surplus capital to shareholders by way of a capital reduction. This will occur by way of two capital returns.

First Capital Return

If the Tarawera Forestry Right *has* been transferred by the principal completion date for the Forests Sale, three out of every four ordinary shares and three out of every four preference shares held by a shareholder will be cancelled and a payment will be made to shareholders equivalent to 93.75 cents for every share currently held (subject to rounding). A payment of 93.75 cents per existing share is equivalent to a payment of $1.25 for every share cancelled.

If the Tarawera Forestry Right *has not* been transferred by the principal completion date for the Forests Sale, one out of every two ordinary shares and one out of every two preference shares held by a shareholder will be cancelled and a payment will be made to shareholders equivalent to 62.5 cents for every share currently held (subject to rounding). A payment of 62.5 cents per existing share is equivalent to a payment of $1.25 for every share cancelled.

The Forests Sale

Second Capital Return

The Company proposes to make a further return of capital to the Company's shareholders once the process of transferring to the Purchasers the various forestry rights and forestry leases that make up some of the Forest Assets is completed. Assuming the transfer of assets (and also the transfer of the Tarawera Forestry Right to Kiwi) and that there is no deterioration of trading conditions, the Company expects the total return of capital to be up to $1.20 per existing share, with the first payment being made in March 2004 and the second payment to be made in the second half of calendar 2004. If the Tarawera Forestry Right is not transferred to Kiwi but is subsequently sold to a third party, the Company expects that the sale proceeds will form a part of the second capital return.

The purpose of this Explanatory Memorandum is to provide the Company's shareholders with the information material to their decision as to whether to approve the Forests Sale and the initial Capital Return. Included in this document on pages 28 to 40 is a description of the Company's future strategic direction following the Forests Sale and the Capital Return.

Expressions used in this Explanatory Memorandum are set out in the Glossary on pages 41 and 42.

Key Terms of the Forests Sale

Vendors:	Fletcher Challenge Forests Industries Limited Fletcher Challenge Forests (Manufacturing) Limited
Purchasers:	Kiwi Forests Group Limited Viking Global New Zealand Limited OTPP New Zealand Forest Investments Limited
Assets being sold:	All Fletcher Challenge Forests' forest estate and related assets including: • subsidiaries holding freehold land and the standing trees on that land; • forestry right, cutting right and forestry lease assets and the standing trees on the relevant land (as all necessary consents are received); • related equipment, fixed assets, improvements, records, intellectual property and resource consents; • related business agreements; and • a forestry right over the estate of the Company's 82.5% subsidiary, Tarawera Forests Limited.
Purchase price:	$725 million on the assumption that all non-freehold land interests (including the Tarawera Forestry Right) can be transferred.
Principal completion date:	The principal completion date is proposed to be as soon as practicable following the Special Meeting and in any event no later than 27 February 2004. The Vendors will transfer the subsidiaries holding the freehold land and all non-freehold land interests that are able to be transferred on that date.
Subsequent transfers:	There will be a series of rolling monthly settlements up until early-October 2004, as third party consents are subsequently obtained to transfer various assets to the Purchasers.

The Forests Sale

Purchasers

The purchasers under the Forests Sale Agreement are Kiwi Forests Group Limited, Viking Global New Zealand Limited and OTPP New Zealand Forest Investments Limited. Each of these companies is a special purpose company established to acquire the Forest Assets under the Forests Sale Agreement and, until completion of the Forests Sale Agreement, none of the companies will have any significant economic substance.

Kiwi Forests Group Limited is owned by four New Zealand-based investors: Trevor Farmer, Ross Green, Mark Wyborn and Adrian Burr. Kiwi was formed for the purposes of this acquisition, although its shareholders are each long term investors and have previously worked together successfully on a wide range of projects throughout New Zealand, including the 1996 acquisition of waterfront land from Ports of Auckland and the subsequent development of that land into Auckland's Viaduct Harbour.

OTPP New Zealand Forest Investments Limited is a wholly owned subsidiary of The Ontario Teachers' Pension Plan, which is one of Canada's largest financial institutions with assets of over C$68 billion at 20 June 2003. The Ontario Teachers' Pension Plan invests to secure the retirement income of over 330,000 active and retired teachers in the province of Ontario, Canada. The Ontario Teachers' Pension Plan has global infrastructure and timberland assets of C$1.9 billion, and is actively seeking to expand its portfolio.

Viking Global New Zealand Limited is a wholly owned subsidiary of a fund managed on behalf of institutional investors by Prudential Timber Investments, Inc., which is headquartered in Boston, Massachusetts, USA. PruTimber will manage the Viking and OTPP assets.

The Forest Assets

The Forest Assets consist of approximately 107,000 stocked hectares of predominantly Radiata pine forest almost exclusively located in the central North Island region of New Zealand, in which the Company's equity interest amounts to 100,000 hectares. Approximately 70% of the land interests that make up the Forest Assets is freehold land (including the land currently held by Tarawera Forests Limited). In addition, the Forest Assets include approximately 9,000 hectares of freehold land underlying the Tahorakuri and Tauhara forests in relation to which Fletcher Challenge Forests sold forestry rights to entities managed and advised by UBS Timber Investors in January 2003.

The balance of the land interests comprise forestry rights, cutting rights and forestry leases which entitle the grantee/lessee to plant, tend and harvest one or more crops of timber. The transfer of these assets is discussed in more detail in "Completion" below.

The Fletcher Challenge Forests estate is one of the most intensively managed and productive forests in New Zealand. The quality of Fletcher Challenge Forests' forestry management team is evidenced by the Company's ongoing Forestry Stewardship Council certification relating to its environmental and other management standards.

Under the Forests Sale Agreement, each of the three Purchasers will purchase separate parts of the forest estate and separately be liable for the relevant proportion of the purchase price.

As part of the sale of the Forest Assets, the Vendors have also agreed to arrange for the transfer by Fletcher Challenge Forests' 82.5% owned subsidiary, Tarawera Forests Limited, to Kiwi, effective on or around the principal completion date, of a forestry right over the standing crop on the freehold land currently owned by Tarawera Forests Limited. Under arrangements discussed with representatives of the minority shareholders in Tarawera Forests Limited, the minority shareholders will, upon completion of the sale of the Tarawera Forestry

The Forests Sale

Right to Kiwi, have an option to acquire the freehold land (subject to the Tarawera Forestry Right) and dispose of their interest in Tarawera Forests Limited to Fletcher Challenge Forests. Completion of the transfer of the Tarawera Forestry Right is subject to Kiwi arranging finance for the purchase of that asset by 30 January 2004.

As part of the sale of the Forest Assets, Fletcher Challenge Forests will transfer to the Purchasers almost all of the business agreements associated with those assets and will undertake a programme to reduce its overhead and other costs to reflect the sale of those assets. The Purchasers did not, however, agree to take a complete assignment of certain agreements, including certain wood supply obligations to third parties (refer "Wood Supply Arrangements" on page 19), and a strategic relationship agreement between the Company and Trees & Technology Limited (a subsidiary of Rubicon Limited) under which tree stocks are acquired by Fletcher Challenge Forests and product development work is undertaken in relation to those tree stocks. Certain aspects of the Company's obligations under these agreements will be met by certain back to back commitments between Fletcher Challenge Forests Industries Limited and the Purchasers. The assessed remaining costs to Fletcher Challenge Forests of the forestry-related agreements not being transferred have been taken into account in calculating the reorganisation costs resulting from the Forests Sale.

The sale will result in an accounting loss for the Fletcher Challenge Forests Group of $59 million (including transaction costs, reorganisation costs and the non-recognition of a deferred taxation asset which is not able to be recognised under NZ GAAP) which will be included as a component of earnings for discontinued operations in the Statement of Financial Performance for the year ended 30 June 2004 (refer to page 34).

Conditions to the Forests Sale

Settlement of the Forests Sale Agreement is subject only to approval by the Company's shareholders and the receipt by the Purchasers of approval from the Overseas Investment Commission (other than the Tarawera Forestry Right which is discussed further below).

The Purchasers have applied for consent to the acquisition of the relevant Forest Assets by them from the Overseas Investment Commission, and this is expected to be received prior to the Special Meeting. The Company will advise shareholders as soon as a decision is received from the Commission.

The transfer of the Tarawera Forestry Right is also conditional on Kiwi obtaining the required finance for the purchase of that asset by 30 January 2004. This condition relates solely to the purchase of that asset and is not a condition of the settlement of the sale and purchase of the remaining Forest Assets.

The dates for satisfaction of conditions (and the completion dates) may be altered by agreement between the parties to the Forests Sale Agreement.

Completion

On settlement of the Forests Sale Agreement, the Vendors will transfer most of the Forest Assets, including ownership of the freehold land and, if Kiwi has obtained finance, the Tarawera Forestry Right, to the Purchasers. The proceeds of this initial transfer of assets will, together with additional temporary borrowing if required by the Company pending further transfers of non-freehold assets as consents for those transfers become available, enable the Company to make an initial capital return of approximately $523 million to shareholders, equivalent to 93.75 cents per existing share.

If the Tarawera Forestry Right is not transferred to Kiwi, the initial capital return will be 62.5 cents per existing share (or approximately $349 million). If the Tarawera Forestry Right is subsequently transferred to a third party the sale proceeds are expected to form part of the second capital return.

A number of the forestry rights and forestry leases that are proposed to be transferred to the Purchasers may only be transferred with the prior approval of the grantor/lessor. Fletcher Challenge Forests has begun an extensive process in order to obtain the necessary consents but not all will be in place by the principal completion date. The Purchasers have therefore agreed a rolling completion mechanism whereby the affected forestry rights and leases will be transferred to the relevant Purchaser as the required consents are obtained over the six months between 1 March 2004 and 31 August 2004. The final date for completion is early-October 2004.

If all necessary consents to the transfer of a forestry right or a forestry lease are not obtained by the end of August 2004, then that particular property will not be sold under the Forests Sale Agreement. The Company expects that there will be very few circumstances where this will be the case. For the majority of the non-freehold forests, third party consents cannot be unreasonably withheld. For the remaining non-freehold forests to be transferred (representing approximately $80 million of the total sales price of $725 million) the Company expects that there will be very few cases where consents will not be granted.

The Company proposes to make a second capital return to shareholders as further surplus capital is released by the subsequent transfer of forestry rights and forestry leases to the Purchasers over this period. If all consents are received, this is expected to be up to 26.25 cents per existing share, depending on the final sale proceeds and the Company's financial position. This per-share amount would be higher if the sale proceeds of the Tarawera Forestry Right are not included in the first tranche of the capital return and Fletcher Challenge Forests is subseqently able to sell that asset to another purchaser.

The Company will make an announcement to shareholders once the second amount that can be returned to shareholders is known. This second return of capital is expected to be completed in the second half of calendar 2004.

Cancellation Rights

The Purchasers may cancel the Forests Sale Agreement prior to the principal completion date if any of the Vendors' warranties will be breached or any obligations of the Vendors to be fulfilled at or prior to that date, are unfulfilled in any respect which is "materially adverse" to the Forest Assets, taken as a whole, or the transactions contemplated by the Forests Sale Agreement, taken as a whole, including in any respect which is "materially adverse" to the Forest Assets to be acquired by Kiwi or OTPP, taken as a whole, or to the transactions contemplated by the Forests Sale Agreement in respect of Kiwi or OTPP, taken as a whole. The Purchasers may also elect to cancel the Forests Sale Agreement if the Forest Assets are lost, destroyed or materially damaged prior to the principal completion date and such loss is "materially adverse" to the Forest Assets taken as a whole.

A Purchaser may cancel its obligations in respect of a particular forestry right or forestry lease that is not transferred on the principal completion date if, at or prior to completion of the sale of that forestry block, any of the Vendors' warranties or obligations relating to that forestry block will be breached or not fulfilled in any respect that is "materially adverse" to that forestry block or the transactions contemplated by the Forests Sale Agreement in respect of that forestry block. The relevant Purchaser may also elect to cancel the Forests Sale Agreement in relation to that delayed forestry right or forestry lease if more than 25% of the standing trees on a delayed forestry block are lost, destroyed or materially damaged after the principal completion date but before the completion of the sale of the forestry right or lease.

The Purchasers are also entitled to cancel the Forests Sale Agreement where the Directors change their recommendation in relation to the Forests Sale or pursue an alternative offer – this is discussed under "Board Recommendation of Transaction/Non-solicitation" below.

The Forests Sale

The Vendors have similar cancellation rights in relation to breaches by the Purchasers of their obligations or warranties under the Forests Sale Agreement.

Purchase Price Adjustments

As discussed above, if all third party approvals are obtained in relation to the sale of the Forest Assets and Kiwi obtains finance for the purchase of the Tarawera Forestry Right, Fletcher Challenge Forests will receive $725 million. The amount to be received will be reduced proportionately to the extent that Fletcher Challenge Forests is not able to obtain consents to transfer particular Forest Assets.

The purchase price for forestry rights or forestry leases that are not transferred on the principal completion date will also be adjusted if they are harvested by Fletcher Challenge Forests before they are transferred to a Purchaser. This is discussed in "Management of Delayed Forestry Blocks" below.

There will also be minor adjustments to the sale proceeds to reflect the apportionment of periodic costs between the Vendors and the Purchasers. The Vendors have also agreed to make payments to Kiwi in respect of the specific roading infrastructure obligations (which were provided for within the Company's 30 June 2003 financial statements) that the Vendors have assigned to Kiwi should the Tarawera Forestry Right not be transferred to Kiwi.

Employees

As part of the Forests Sale, Kiwi has agreed to hire a small number of Fletcher Challenge Forests' existing forestry employees. The Company will be reviewing its staffing requirements following the Forests Sale. It is expected that there will be significant reductions in staff numbers reflecting the smaller size of Fletcher Challenge Forests and the sale of the forestry business.

Management of Delayed Forestry Blocks

Kiwi and PruTimber will be responsible for managing any non-freehold forestry blocks on the Vendors' behalf pending the obtaining of relevant third party consents to the transfer of those forestry blocks. The Vendors will pay the managers a fee for overhead charges associated with such management, together with reimbursement for any direct costs associated with any harvesting for the Vendors' benefit. The Vendors are entitled to the commercial benefit of any harvesting on these blocks after the principal completion date although there is a purchase price reduction to the extent of any such benefit derived by the Vendors, when a block is ultimately transferred to the relevant Purchaser.

Board Recommendation of Transaction/Non-solicitation

The Independent Directors of the Company have resolved to, and have, recommended that shareholders approve the Forests Sale. The Directors are restricted under the Forests Sale Agreement from changing or withdrawing such recommendation or otherwise commenting or acting adversely in respect of their recommendation, except to the extent that they reasonably believe, having taken appropriate advice, that they are required by their fiduciary duties under the Companies Act to do so. If the Directors do change or withdraw their recommendation, then OTPP or Kiwi are entitled to cancel the Forests Sale Agreement.

In addition, until the principal completion date, the Vendors and their related companies are restricted from encouraging or soliciting any further offers in respect of, or engaging in any other discussions or negotiations with a potential acquirer of, any of the Forest Assets except to the extent that, in relation to any unsolicited offer, the Board reasonably believes, having taken appropriate advice, that it is required by its fiduciary duties under the Companies Act to do so. If Fletcher Challenge Forests shareholders, having been advised of a new, unsolicited bid, do not approve this transaction and Fletcher Challenge Forests completes a transaction with that other bidder, then recognising the commitment the Purchasers have made to the sale process, and the signing of the Forests Sale Agreement, the Vendors have agreed to reimburse the Purchasers' costs up to a limit of $3 million. OTPP and Kiwi are entitled to cancel the Forests Sale Agreement if the Vendors receive a further bid and commence negotiations with a new bidder in respect of that offer (not being discussions solely for the purposes of evaluating that offer) or if they do not definitively reject a new offer within 10 business days of receiving it.

Break Fee Payable to The Campbell Group LLC

On 15 September 2003, the Company and the Vendors entered into a letter of intent with The Campbell Group LLC which documented a proposal that the Vendors enter into negotiations with the Campbell Group for the sale and purchase of the Forest Assets for $685 million. The Campbell Group required, as a condition to the Campbell Group's continuing participation in the forest sale process, that the Company agree to pay a break fee of $17 million to the Campbell Group if the Company wished to subsequently enter into negotiations with another party in relation to the sale of the Forest Assets.

Following the subsequent receipt of a higher offer from the Kiwi Consortium the Company negotiated a variation to the Campbell Group letter of intent to permit it to enter into discussions with the Kiwi Consortium. The Company was released from its exclusivity commitment in return for an immediate payment to the Campbell Group of $8.5 million. If the Forests Sale Agreement with the Kiwi Consortium becomes unconditional the Company is required to make a further final payment of $8.5 million to the Campbell Group.

Break fees are typical in transactions of this nature and the level of this fee, at $17 million or 2.5% of the price, is within an acceptable range. The Campbell Group offer was at that time the most attractive, by a significant margin, of the bids received by the Vendors at the completion of the bidding process. The break fee allowed negotiations with the Campbell Group to proceed but also gave the Company the ability to consider any better offers, the amount of which would have been increased by the presence of the break fee. Further, it was the Company's view that the variation to the Campbell Group letter of intent represented a value enhancing outcome for the Company as it preserved the Campbell offer and permitted the Company to pursue the higher sale price subsequently offered by the Kiwi Consortium which would more than compensate the Company and its shareholders for the full break fee. The break fee arrangements are also discussed in the Grant Samuel report attached to this Explanatory Memorandum.

Use of Sales Proceeds

The net proceeds of the Forests Sale of $681 million, after break fee, reorganisation and transaction costs of $44 million, will be used to fund the first and second capital returns, which are expected to total up to $669 million, and to reduce the Company's existing bank debt (by approximately $12 million).

Wood Supply Arrangements

In order to secure the ongoing supply of sawlogs to the Fletcher Challenge Forests' processing mills after the Forests Sale, Fletcher Challenge Forests (Manufacturing) Limited has entered into 10 year sawlog supply agreements with each of the Purchasers to acquire, in aggregate, 340,000 tonnes of sawlogs per annum for

The Forests Sale

years one to three of the term and 310,000 tonnes of sawlogs per annum for years four to ten. These volumes will be reduced proportionately to the extent that Fletcher Challenge Forests is not ultimately able to transfer forestry rights or forestry leases to the Purchasers.

The purchase price for this committed volume will be based on an open market price for sawlogs in the central North Island of New Zealand.

Where the Purchasers produce sawlogs in excess of the volume supplied to Fletcher Challenge Forests, then Fletcher Challenge Forests has a right of first refusal on such surplus up to a volume equal to the difference between the committed volumes described above and 50% of the Purchaser's total sawlog production and a right to compete, in good faith, for the balance. The parties have also mutually agreed to review an extension of the contract at the conclusion of the 10 year period.

The Purchasers are to use all reasonable endeavours to obtain Forestry Stewardship Council certification, which is important for supply of Fletcher Challenge Forests' supply of products into the United States market. Fletcher Challenge Forests may suspend its obligation to buy sawlogs under the agreements if the relevant Purchaser fails to hold Forestry Stewardship Council certification.

In addition, Fletcher Challenge Forests has a number of long-term pulpwood supply commitments to Norske Skog Tasman Limited and Carter Holt Harvey Limited for the supply of pulpwood to the Kawerau mill and Whakatane board mill respectively. The Norske Skog contracts include an evergreen commitment to provide up to 300,000m^3 per annum of pulp logs, arisings and thinnings which are used in the Kawerau mill (less what is delivered under a supply agreement between Tarawera Forests Limited and Norske Skog), and a commitment to deliver 40,000m^3 per annum of eucalypt pulp logs for five years commencing 1 July 2004 (likely to be deferred to 1 July 2005) which are also used in the Kawerau mill. The Carter Holt Harvey contract for the Whakatane board mill is an evergreen commitment to provide up to 115,000m^3 per annum of pulp logs as agreed with Carter Holt Harvey.

The Purchasers were not prepared to take an assignment of these commitments due to their unlimited duration. In order for Fletcher Challenge Forests to be able to continue to meet those commitments, Fletcher Challenge Forests Industries Limited has entered into back to back commitments with the Purchasers for the supply of the required quantities of pulpwood to Norske Skog for the 300,000m^3 per annum commitment on an evergreen basis (but for which the supply commitment can be terminated by either party after 25 years) and with Kiwi (as purchaser of the Matahina forest) for the five year term of the eucalypt commitment. Fletcher Challenge Forests Industries Limited has also entered into a back to back commitment with Viking and OTPP (being the purchasers of the relevant forests which are the supply sources) for the Carter Holt Harvey supply obligation for the 115,000m^3 per annum commitment on an evergreen basis but for which the supply commitment can be terminated by either party after 15 years. The back to back arrangements generally enable Fletcher Challenge Forests Industries Limited to pass on price and volume changes under the relevant contracts.

The harvest of pulp logs from the Tarawera Forests Limited estate will continue to be available to meet existing contractual obligations of Tarawera Forests Limited to Norske Skog under the terms of back to back commitments given by Kiwi for the term of the Tarawera Forestry Right. The amount of any supplies to Norske Skog will be credited against Fletcher Challenge Forests' 300,000m^3 supply obligation to Norske Skog.

In addition, Fletcher Challenge Forests Industries Limited has first right of refusal over any pulpwood produced by the Purchasers after termination of the obligations to supply the committed volumes. If supply was still required after the end of the committed volumes produced by the back to back arrangements described above (i.e., after the 25 and 15 year committed periods respectively), Fletcher Challenge Forests Industries Limited is confident that it would be able to put in place arrangements to meet its ongoing obligations to Norske Skog and Carter Holt Harvey at that time given the volumes of pulpwood that are expected to be produced in the central North Island and surrounding regions at that time and the right of first refusal discussed above. The Company has held discussions with Norske Skog and Carter Holt Harvey to advise them of the arrangements in place to enable Fletcher Challenge Forests Industries Limited and Tarawera Forests Limited to continue to be in a position to meet their commitments to them. Norske Skog and Carter Holt Harvey have formally reserved their rights at this stage, and have indicated that they would prefer a direct contractual relationship with the forest owner. Fletcher Challenge Forests is supportive of that and has proposed negotiations with a view to that outcome.

Warranties

Warranties have been given to the Purchasers in relation to the Forest Assets being sold. These include warranties covering title, access, minimum net stocked area, environmental and disclosure matters, which are generally qualified by due diligence disclosures. The Vendors are not aware of any matters that might give rise to a warranty claim by the Purchasers and the Purchasers have confirmed that they are not aware of any matter that would constitute a warranty claim. The aggregate cap on warranty claims has been set at $250 million.

Summary of Independent Advisers' Report to Shareholders

Grant Samuel & Associates Limited was commissioned by the Board to undertake an independent review of the Forests Sale. Grant Samuel have concluded that the Forests Sale is in the best interests of the Company's shareholders.

A full copy of the Grant Samuel report is set out in Appendix 4 to this Explanatory Memorandum.

Advisers' Reports to the Board

The Board has also received advice from Macquarie New Zealand Limited throughout the Forests Sale process. Macquarie New Zealand Limited is of the view that the proposals being put to shareholders are in the shareholders' best interests.

Board Recommendation

The Independent Directors consider that the completion of the Forests Sale and entry into the associated Wood Supply Agreements by Fletcher Challenge Forests is in the Company's best interests and of benefit to all shareholders and, as a result, recommend that shareholders support the transactions.

Luke Moriarty and Michael Andrews, as directors of Rubicon Limited, did not participate in the Board's approval of the Forests Sale as they were considered to be interested in the outcome of the transaction as subsidiaries of Rubicon Limited will receive a material financial benefit from the associated Capital Return.

The Capital Return

The Proposed Capital Return

On 16 January 2004, the Company received initial orders granted by the High Court under section 236 of the Companies Act directing the Company to seek shareholder approval for an arrangement under Part XV of the Companies Act which provides for:

(a) if the Tarawera Forestry Right has been transferred to Kiwi on or by the principal completion date for the Forests Sale, the cancellation of three out of every four ordinary shares in the Company and three out of every four preference shares in the Company registered in the name of a shareholder on the Record Date and the payment to each shareholder by the Company of $1.25 for every ordinary share and every preference share registered in the name of the shareholder that is cancelled (which is equivalent to 93.75 cents for each share held immediately prior to the share cancellation); or

(b) if the Tarawera Forestry Right has not been transferred to Kiwi on or by the principal completion date for the Forests Sale, the cancellation of one out of every two ordinary shares in the Company and one out of every two preference shares in the Company registered in the name of a shareholder on the Record Date and the payment to each shareholder by the Company of $1.25 for every ordinary share and every preference share registered in the name of the shareholder that is cancelled (which is equivalent to 62.5 cents for each share held immediately prior to the share cancellation); and

(c) the payment to the Company of a dividend of up to $580 million from its wholly owned subsidiary, Fletcher Challenge Industries Limited, in order to fund the Capital Return and the associated repayment of debt.

If (a) applies, to the extent that a shareholder does not have a number of shares exactly divisible by four, the surplus shares left following that division will be cancelled and a payment made in respect of those cancelled shares. If (b) applies, to the extent that a shareholder does not have a number of shares exactly divisible by two, the share remaining will be cancelled and payment made in respect of it.

The Court has directed that the Capital Return be put for the approval by special resolution of shareholders of the Company (that is 75% or more of the votes cast at the meeting).

The Company will apply to the High Court for final orders sanctioning the Capital Return if, at the Special Meeting, the Capital Return and the Forests Sale are approved by shareholders. If these orders are granted, the Capital Return will be binding on all shareholders and the Company. Providing no notices of opposition are filed, the Company expects the final orders from the High Court to be obtained in early March 2004, and the Capital Return completed and payment made to shareholders in mid-March 2004.

No minority buy-out rights arise under the Capital Return.

The Board has determined to return the capital to shareholders by way of a Court approved scheme because this is:

- consistent with the underlying nature of the transaction, which is to return to shareholders a significant amount of capital that is surplus to the Company's ongoing requirements; and
- fair to all shareholders as it achieves its objective of returning the desired amount of capital to shareholders on a pro rata basis and leaves relative voting rights unaffected.

Attached to this Explanatory Memorandum are:

- the initial Court orders given by the High Court on 16 January 2004 – see Appendix 2; and
- the form of the final Court orders that the Company will seek if the Capital Return is approved by shareholders, including the Arrangement Plan – see Appendix 3.

Conditions to the Capital Return

Completion of the Capital Return by way of payment to shareholders is conditional on:

- the approval of the Forests Sale by both preference shareholders and ordinary shareholders by way of ordinary resolution, voting together, and completion of that transaction;
- the approval of the Capital Return by both preference shareholders and ordinary shareholders by way of special resolution, voting together;
- the granting by the High Court of final orders approving and giving effect to the Capital Return;
- the Board remaining satisfied that the Company will, immediately after the Capital Return, satisfy the solvency test prescribed by the Companies Act; and
- receipt of a satisfactory ruling from the Commissioner of Inland Revenue (refer "Taxation Implications of the Capital Return" below).

Effect of the Capital Return

The effect of the Capital Return will be that, subject to the conditions to the Capital Return being satisfied:

(a) if the Tarawera Forestry Right has been transferred on or by the principal completion date for the Forests Sale, three out of every four ordinary shares and three out of every four preference shares registered in the name of a shareholder on the Record Date will be cancelled. To the extent that a shareholder does not have a number of shares exactly divisible by four, the surplus shares excluded from such division will be cancelled. Each shareholder will receive $1.25 for each share cancelled (which is equivalent to 93.75 cents for every share held immediately prior to the share cancellation); or

(b) if the Tarawera Forestry Right has not been transferred on or by the principal completion date for the Forests Sale, one out of every two ordinary shares and one out of every two preference shares registered in the name of a shareholder on the Record Date will be cancelled. To the extent that a shareholder does not have a number of shares exactly divisible by two, the surplus share excluded from such division will be cancelled and each shareholder will receive $1.25 for each share cancelled (which is equivalent to 62.5 cents for every share held immediately prior to the share cancellation).

If (a) applies approximately 418 million shares, or 75% of the total number of the Company's shares on issue, will be cancelled. If (b) applies, approximately 279 million shares, or 50% of the total number of the Company's shares on issue, will be cancelled.

Under the terms of the Company's constitution, in the event of liquidation of the Company:

- the Company's preference shares rank ahead of the Company's ordinary shares to the amount of $1.25 per share; and
- the ordinary shares are entitled to the next $1.25 per ordinary share,

The Capital Return

and thereafter preference shares and ordinary shares are entitled to share equally in the surplus. These preferential rights are in place until 15 December 2005.

One of the effects of the initial capital return is to remove up to $523 million from the Company's balance sheet (assuming the Tarawera Forestry Right is transferred to Kiwi). While this represents funds that would otherwise be available to preference shareholders ahead of ordinary shareholders in the unlikely event of the Company being placed in liquidation prior to 15 December 2005, as the preference shares make up 67% of the total shares on issue, preference shareholders will be receiving approximately $350 million of the initial $523 million surplus capital returned to shareholders. No change is required to preserve the economic value of the preference shareholders' preferential rights on liquidation (as described above) as a consequence of either of the possible Capital Return structures. Under both, the Company proposes to return an amount equal to the $1.25 preference amount for each preference and ordinary share being cancelled. Preference shareholders will retain a liquidation preference of $1.25 for every preference share they hold following the share cancellation.

Payment to Shareholders

The Company's share register will close at 5.00 pm (in the jurisdictions in which the Company's share register or branch register are located) on the first Friday following the 10th business day after the date on which the final orders from the High Court are made. This will be for the purpose of determining the number of shares to be cancelled and the amount to be returned to those shareholders recorded in the Company's share register at that time (the **Record Date**).

Payment to shareholders will be made by cheque or, in the case of New Zealand shareholders who have previously provided bank account details to the Company or the Share Registrar, by direct credit. Payments will be made in New Zealand dollars other than payments to those shareholders registered on the Company's Australian branch register which will be made in Australian dollars based on the NZ$:A$ exchange rate as at the Record Date. Cheques will be posted, or direct credits made, within five business days after the Record Date. Shareholders will be issued with new holding statements at the same time, showing the number of shares held following the cancellation of shares pursuant to the Capital Return.

Consequences of the Capital Return for Shareholders

The inital capital return involves either:

(a) three out of every four ordinary and preference shares of the Company being cancelled and shareholders receiving a cash payment of $1.25 for every share cancelled (which is equivalent to 93.75 cents for each share held immediately prior to the share cancellation); or

(b) one out of every two ordinary and preference shares of the Company being cancelled and shareholders receiving a cash payment of $1.25 for every share cancelled (which is equivalent to 62.5 cents for each share held immediately prior to the share cancellation),

depending on whether the Tarawera Forestry Right is transferred to Kiwi.

It is important to understand that following the return of capital and share cancellation, in either form (a) or (b) described above, the underlying value of shareholders' remaining shares in the Company should automatically increase and therefore the market price of the shares should adjust accordingly. An example for a shareholder holding 1,000 shares in the Company is as follows:

	Pre-Capital Return	*Post Capital Return (if Tarawera Forestry Right sold)*	*Post Capital Return (if Tarawera Forestry Right not sold)*
Shares held	1,000	250	500
Share price before return of capital (assumed)	$1.40	–	–
Value of shares before return of capital	$1,400	–	–
Value of shares after return of capital	–	$462.50 (estimated value $1.85 per share)	$775 (estimated value $1.55 per share)
Cash received	–	$937.50	$625
Total value	$1,400 (Shares only)	$1,400 (Cash and shares)	$1,400 (Cash and shares)

Overall, shareholders should therefore be in the same financial position after the Capital Return as they were in before. The impact of the Capital Return will ultimately depend on the actual movements in the Company's share price following the return.

Rationale for the Capital Return

As a result of the Forests Sale, the Company will have an inefficient capital structure, as it will have no net debt and significant cash on its balance sheet. That cash is surplus to the Company's projected requirements, and the Company is therefore in a position to return capital to its shareholders.

The Board is of the opinion that the Capital Return is the best use of that capital at this time.

Creditors

Following the completion of the Capital Return the Company will continue to satisfy the solvency test set out in the Companies Act and the Company's creditors will not be prejudiced by the Capital Return. The new banking facility recently finalised by the Company (refer page 50) will allow the proposed Capital Return to proceed. The Company has also obtained confirmation from the Company's bank syndicate that it has no objection to the Capital Return.

Taxation Implications of the Capital Return

The Capital Return is subject to receipt by the Company of confirmation from the Commissioner of Inland Revenue that the Capital Return (and the payment of the proposed second capital return) will not be classified as "dividends" for New Zealand income tax purposes. That confirmation has been sought and it is expected that a final decision will be made before the Special Meeting. If confirmation is received, the Company will not deduct any withholding taxes from payment of the Capital Return. For shareholders resident in New Zealand who hold their shares on capital account there would be no taxation implications.

There may be income tax consequences for shareholders resident in New Zealand who hold their shares on revenue account for income tax purposes. Such shareholders include those conducting an investment or share

The Capital Return

dealing business or who acquired shares with the purpose of resale or as part of a profitmaking undertaking or scheme. Such shareholders should obtain independent advice on the effect of the Capital Return on their individual tax position.

Shareholders not resident in New Zealand should also obtain independent advice on the effect of the Capital Return on their individual tax position.

Directors

Directors of the Company, and associated persons of Directors, who beneficially own shares in the Company will participate in the Capital Return in exactly the same way as all other shareholders in the Company. The number of shares in which Directors and/or their associated persons have relevant interests as at 16 January 2004, and the payments they will receive under the Capital Return, are noted in the table below (assuming a payment of 93.75 cents per existing share).

Shares held by Directors and/or associated persons

Director	*How held*	*Number of Ordinary Shares*	*Number of Preference Shares*	*NZ$ to be received*
M J Andrews	associated persons	31,850	63,700	89,578.75
R H Fisher	beneficially	4,000	2,000	5,625.00
W A Larsen	beneficially	20,000	–	18,750.00
	associated persons	202	403	568.75
S L Moriarty	beneficially	6,807	13,610	19,142.50
Sir Dryden Spring	beneficially	500	24,750	23,672.50
M C Walls	beneficially	–	6,000	5,625.00

Luke Moriarty and Michael Andrews are directors of Rubicon Limited, subsidiaries of which own 15,429,422 ordinary shares and 96,099,902 preference shares in the Company and, as a result, will receive approximately $104.6 million under the Capital Return if the Tarawera Forestry Right has been transferred before the principal completion date of the Forests Sale Agreement, or approximately $69.7 million if it has not. Mr Moriarty and Mr Andrews did not participate in the Board's approval of the Forests Sale and Capital Return.

Holders of ADRs

The Capital Return will affect holders of ADRs in an equivalent fashion to holders of the Company's ordinary or preference shares. One ADR represents ten ordinary shares or ten preference shares in the Company. ADR holders will be required to surrender their existing certificates in order to receive their proportionate payment and will be reissued new certificates reflecting their adjusted holdings.

The Depositary will distribute a notice to holders of ADRs advising them of the process for exchanging their certificates and receiving their proportionate payment following the Capital Return being made.

Right to be Heard for Final Orders

Unless the Independent Directors of the Company determine to abandon the Capital Return, then the application for final court orders will be heard before the presiding judge at 10.00 am on Friday, 5 March 2004.

Any shareholder or ADR holder of the Company who wishes to appear and be heard on the application for final court orders must file a notice of appearance or a notice of opposition (both containing an address for service) and any affidavits and a memorandum of submissions on which such shareholder intends to rely by 5.00 pm (New Zealand time) on Friday, 27 February 2004 and serve a copy on the Company at its address for service. The Company will serve upon that shareholder or ADR holder at their address for service a copy of the affidavits in support of the application for final court orders by 5.00 pm on Wednesday, 3 March 2004. If the application is opposed, it will be called at 10.00 am on Friday, 5 March 2004 and then adjourned to a date to be fixed by the Court for argument.

The Company's Future

The Independent Directors consider that the sale of Fletcher Challenge Forests' forest estate and related assets for $725 million, and the subsequent return of up to $669 million (up to $1.20 per existing share) to the Company's shareholders, is in the best interests of the Company, and will benefit all shareholders.

The completion of the Forests Sale:

- is consistent with the Company's strategy announced 12 months ago;
- will release significant cash to shareholders;
- will improve the Company's financial performance by removing an under-performing asset from its business activities; and
- will allow the Company to focus on its higher-margin processing, marketing and distribution activities.

The Forests Sale is a critical step that needs to be taken to release the Company from the strategic and structural restrictions that have limited its ability to deliver acceptable returns to its shareholders from the time of its establishment as a stand-alone company in March 2001.

Since that time, the Board has:

- addressed the financial structure of the Company, reducing net debt by 70% (to $86 million as at 30 June 2003), relieving the Company of restrictive bank-lending covenants;
- dealt with inherited accounting values for its forest assets by writing down those assets to values which are realistic in today's environment; and
- established a new management structure and team to take the Company forward.

Despite these improvements the Board concluded that further steps were required to deliver acceptable future returns to shareholders should the Company wish to remain a forest resource owner of scale.

The Company proposed a major initiative to gain efficiencies of increased scale, synergy benefits, a new cornerstone shareholder and additional capital through the acquisition and integration of the forest assets of the Central North Island Forest Partnership (in receivership) in June 2002. However, this proposal narrowly failed to attract the required level of 75% support when put to the Company's shareholders.

Without the scale and synergy benefits that could have been derived from an enlarged forest estate, the Company's prospects for improved performance would be largely governed by international demand for the timber industry's lowest value product – commodity logs. A long-run historical analysis of export log prices shows the volatility in prices for this commodity and also demonstrates the general decline in NZ dollar prices for logs over the past ten years. While no one can accurately predict future price trends there is no reason to assume that near term prices will improve sufficiently to enable even satisfactory returns to be consistently achieved. That analysis also shows that the margin in the forest resource to market chain is increasingly moving downstream, away from the forest resource and closer to the end market.

The Company's Future

The Board therefore concluded that the Company could generate more acceptable and consistent returns, in the future, by focusing on its value-added marketing and processing operations. While the Company had already begun to do this, the Board concluded that greater shareholder value would be created by more boldly pursuing a strategy to:

- strengthen Fletcher Challenge Forests' operations to world's best standards of efficiency;
- selectively increase the Company's investment in value adding wood processing capacity and in wood products marketing and distribution activities;
- reduce the Company's investment in forest plantations; and
- return surplus capital to shareholders.

Operational efficiency

The efficiency and effect of the Company's forestry operations has been verified through re-certification from the internationally respected Forest Stewardship Council that they meet the Council's strict environmental, social and economic standards. The efficiency of the Company's international supply chain has been demonstrated in the achievement of in-full, on-time delivery of the Company's Origin® brand products to in excess of 95% on average of all deliveries and a market-leading weekly delivery cycle to the West and East coasts of the United States.

Increased investment in marketing, processing and distribution

The Company has been increasing investment in its value adding wood products processing, marketing and distribution activities. Modest investments have been made to increase processing capacities at Fletcher Challenge Forests' Mount Maunganui plywood plant and Taupo moulding plant. The Company has also increased its ownership in The Empire Company from 33% to 67%.

Reduced investment in forestry plantations and return of capital

The first step to reduce Fletcher Challenge Forests' investment in trees has already been taken. In January 2003, the Company negotiated an agreement to sell cutting rights over approximately 9% of Fletcher Challenge Forests' forestry holdings to UBS Timber Investors for US$65 million – a price that was effectively 85% higher than the value of trees implied in the Company's share price of $1.00 in early January 2003.

The Forests Sale being considered at the Special Meeting will, if approved by shareholders, place a value on the Company's assets that is 50% to 60% higher than the share price at the time the sale programme was announced in June 2003, notwithstanding the adverse movement in the New Zealand dollar exchange rate during the year.

The Tahorakuri/Tauhara sales and the Forests Sale will allow the Company to make a significant return of capital to shareholders – in all, the Company intends to return up to $669 million to shareholders, or up to $1.20 per existing share.

The Company's Future

Risks

As with any significant strategic realignment, the Board acknowledges that the Forests Sale and Capital Return, as well as providing benefits, also create some new risks and heighten certain existing risks for the Company. The risks considered by the Board include:

- Sawlog supply – The Company will no longer own the sawlogs that are the key raw material input for its processing and distribution activities. However, the Company has entered into a 10 year sawlog supply agreement with each Purchaser for, in aggregate, 340,000 tonnes per annum for years one to three and 310,000 tonnes per annum for the remainder of the term. In addition the Company has a first right of refusal over any excess over the contracted volume, up to 50% of each Purchaser's total sawlog production and a right to compete for the balance of production. The secured supply represents approximately 23% of current mill requirements. Combined with the current supply from the former Central North Island Forest Partnership estate (discussed below) and the cutting rights sold to UBS Timber in January 2003, this means that approximately 60% of Fletcher Challenge Forests' current log supply requirements are covered by long-term contractually committed supply at prices reflecting open market prices in the central North Island. The Company is confident the residual supply requirements can be met by the rising wood volumes that will be available from the central North Island.

  The Company is satisfied that these arrangements are sufficient to ensure adequate availability of log feedstock to meet current and expected future requirements, at prices which reflect fair market. The Company will be exposed to paying a market price for sawlogs which will fluctuate over time, causing the Company's operating margin to fluctuate. The Company will be giving up some operational flexibility in terms of supply schedules and grade mixes and is dependent on the Purchasers' and other suppliers' ongoing performance of their supply obligations. The Company is also reliant upon the Purchasers achieving and maintaining Forestry Stewardship Council certification in order to utilise the sawlogs supplied in the Company's key United States market. However, the Board believes that this loss of flexibility and the risks are more than compensated for by the release of capital from the low margin ownership of plantation assets.

  Prior to the end of the ten-year term for the supply agreements Fletcher Challenge Forests will enter into discussions with the Purchasers over future supply arrangements.

  On 19 December 2003, Fletcher Challenge Forests was advised that the Central North Island Forest Partnership (in receivership) ("CNIFP") forests had been sold to entities owned by the Harvard endowment fund. On 22 December 2003, Harvard issued a notice of termination of the wood supply arrangements that Fletcher Challenge Forests had previously agreed with the receivers of the CNIFP. This means that Fletcher Challenge Forests' log supply from the CNIFP forests will, from 30 June 2004, be determined by the terms of the "Tasman Contracts", which allow for 440,000m^3 per annum of logs to be supplied on a "run of bush" basis. Fletcher Challenge Forests intends to enter into discussions with Harvard to determine whether the parties can mutually agree a substitute long term supply agreement. In the absence of reaching agreement, the Company will assert its rights under the Tasman Contracts referred to above.

- Pulpwood commitments – Fletcher Challenge Forests Industries Limited has perpetual commitments to Norske Skog and Carter Holt Harvey for supply of pulpwood. In order to continue to meet these commitments after the Forests Sale, Fletcher Challenge Forests Industries Limited has entered into back to back agreements with the Purchasers for the supply of equivalent quantities of pulpwood. The agreements with the Purchasers which cover the principal Norske Skog obligation is for the supply of 300,000m^3 per annum on an evergreen basis (terminable by either party after 25 years), while the Carter Holt Harvey volume is 115,000m^3 per annum also on an evergreen basis (terminable by either party after 15 years). In addition, Fletcher Challenge Forests has entered into back to back commitments from Kiwi for the existing obligation to supply Norske Skog up to 40,000m^3 per annum of eucalypt pulp logs from the Matahina forest for a period of five years commencing 1 July 2004 (expected to be delayed to 1 July 2005 and subject to there being sufficient eucalypt in the relevant supply source). The Purchasers have also granted Fletcher Challenge Forests Industries Limited a right of first refusal over any pulpwood produced by them after the end of the committed periods. The back to back agreements generally enable Fletcher Challenge Forests to pass on price and volume changes under the relevant contracts. The harvest of pulp logs from the Tarawera Forests Limited estate will continue to be available to meet Tarawera Forests Limited's existing contractual obligations to Norske Skog through a back to back commitment given by Kiwi for the term of the Tarawera Forestry Right. The amount of any supplies to Norske Skog will be credited against the 300,000m^3 supply obligation.

  Fletcher Challenge Forests Industries Limited's ability to meet its commitments to Norske Skog and Carter Holt Harvey is dependent, at least in part, on ongoing performance by the Purchasers of their obligations under the back to back arrangements and, if the fixed supply was withdrawn or reduced at the end of the committed periods, it would need to source replacement supply. Fletcher Challenge Forests considers that, if necessary, it would be able to source replacement volume given the volumes of pulpwood that are expected to be produced in the central North Island at that time, as well as from the first right of refusal over the pulpwood produced from the Forest Assets.

  The sawlog and pulplog supply commitments from the Purchasers are subject to suspension or reduction as a consequence of "force majeure" events which are outside the control of the Purchasers and which result in the Purchasers being unable to deliver the required supply. Such force majeure events include fire or destruction caused by other acts of God. Fletcher Challenge Forests is currently exposed to these risks which have not, historically, materially affected the Fletcher Challenge Forests estate.

  Fletcher Challenge Forests Industries Limited also has a commitment to Fletcher Building Limited for the supply of 100,000m^3 per annum of pulpwood and whole log chip, along with all residues from Fletcher Challenge Forests' processing facilities and all sawmill chip from Fletcher Challenge Forests' Taupo sawmill, for a term of twenty years from February 2001. At present, this supply obligation is being met entirely from whole log chip produced from pulp logs sourced from the Forest Assets and third party sources. Fletcher Challenge Forests believes that it can continue to meet this supply obligation without the need for any back-to-back agreement with the Purchasers.

- Warranty exposures – The Vendors have given warranties to the Purchasers in relation to the Forest Assets being sold. Whilst the Vendors and Purchasers are not aware of any matters that are expected to give rise to a warranty claim, there can be no assurance that a claim will not be made that will require the Vendors to make a payment to a Purchaser. Claims must be made within two years of the relevant transfer date (other than for tax matters where the time limit is six years) and there is a cap on aggregate warranty claims of $250 million.

The Company's Future

- Residual assets – The transfer of certain Forestry Assets (including the land interests of Tarawera Forests Limited) is subject to third party consents or actions. As a result, some of the affected assets may not be able to be sold, which will reduce the sale proceeds and the amount of surplus capital available for return to shareholders. The timing of third party consents may impact the projected interest income or expense. In addition, as Fletcher Challenge Forests will no longer retain forestry management capability, it will need either to contract a forest manager or seek an alternative purchaser for the affected assets. Further, if the minority shareholders in Tarawera Forests Limited do not elect to acquire the Tarawera freehold land, Fletcher Challenge Forests will remain with an indirect interest in the Tarawera land. The return on that land from the Tarawera Forestry Right is approximately $1 million per annum.

- Counterparty risk – The Vendors are contracting with single purpose companies whose sole assets are the assets being acquired from the Vendors and whose capital structure is not known. Each Purchaser is a separate entity and does not guarantee performance by the other Purchasers. As discussed above, the sawlog and pulpwood supply arrangements between the Vendors and the Purchasers will depend on the performance by the Purchasers of their obligations under those agreements and the ongoing solvency of those entities. That said, the physical proximity of Fletcher Challenge Forests' processing assets to these forests suggests that it should be well placed to agree economic terms for supply with any owner of the relevant forests. In addition, each of the Purchasers will, at least at the outset, be a substantial entity in its own right as a consequence of its purchase of the Forest Assets it is acquiring. The fact that more than one party is entering into wood supply agreements means that the risks associated with the failure of one counterparty is reduced.

- Tarawera Forests completion risk – If the sale of the forestry right by Tarawera Forests Limited to Kiwi is not completed, the sale of this asset to another purchaser at a later date may be at a different and lower price to the price agreed with Kiwi of $165 million. Additionally, the timing of the sale may differ from the alternative scenario outlined in Appendix 1, note 6, of June 2004. The amount of the second capital return may also be reduced if the minority shareholders in Tarawera Forests Limited decide not to exercise their option to acquire the freehold land owned currently by that company and instead seek to acquire a share of the proceeds of the sale of the Tarawera Forestry Right.

- Foreign exchange risks – The Company's Operating Earnings are sensitive to movements in the New Zealand dollar exchange rate. The Company maintains United States dollar denominated debt as a natural hedge for approximately 12 months' net United States dollar revenues. A strengthening of the New Zealand dollar against the United States dollar will reduce Operating Earnings, but will also result in a gain from the revaluation of the Company's United States denominated debt. The timing of the change in exchange rates will impact earnings as the full amount of the gain or loss on the revaluation of the Company's United States dollar debt will be recorded immediately, while the offsetting impact on Operating Earnings will flow over the subsequent period. The Company will also employ derivative financial instruments to reduce the impact of adverse movements in changes in foreign exchange rates.

- Restructuring cost risks – The Company has estimated that it will incur restructuring and transaction costs of $44 million. The amount and timing of the restructuring costs and the timing of the reduction in shared services costs may alter as the restructuring plans are implemented.

- Other risks (refer also to pages 13 to 21) – As a result of the downsizing of Fletcher Challenge Forests and its reduced diversity and scale of operations it may be less able to withstand adverse events in respect of certain existing risks. Such risks include pressure on operating margins arising from the loss of scale. The change in business focus also increases the importance of key supplier relationships such as those that American Wood Moulding has with The Home Depot, The Empire Company has with Lowe's and Fletcher Challenge Forests has with PlaceMakers. Fletcher Challenge Forests is also targeting growth in relatively new markets (e.g., furniture manufacturing in Asia). As a significantly smaller company in terms of share market capitalisation, there will also be implications for trading in the Company's shares which might include reduced coverage by equity analysts, reduced weightings by index based institutional investors and reduced liquidity in the Company's shares.

  Fletcher Challenge Forests is projecting growth and improved performance in its continuing activities. There is a risk that this will not be achieved as the Company will continue to be exposed to a range of existing commercial risks that confront its business which include:

  – it is experiencing strong competition in its North American appearance product businesses and some of its products are subject to competition from products which perform the same or similar functions;

  – its operations could be negatively affected by various forms of government action in countries where it operates or provides services to customers; and

  – it will retain some exposure to residual liabilities relating to the Divisions of Fletcher Challenge Limited that were sold or transferred into stand-alone companies that would require the Company to exercise its rights under the separation agreements in order to seek compensation from the successor to the relevant Division.

Overall, the Independent Directors consider the potential benefits to be gained from the Forests Sale and capital return outweigh possible risks.

The Company's Future

Financial Considerations

The following table shows the adjustments to the June 2003 Financial Position of Fletcher Challenge Forests arising from the proposed Forests Sale and the initial capital return.

NZ$ million	Fletcher Challenge Forests (as published)	Sale of Forests Operations and Reorganisation Costs(1)	Initial Capital Return(2)	Other(3)	Fletcher Challenge Forests
Assets					
Cash and Liquid Deposits	47	–	–	30	77
Stocks	66	–	–	–	66
Debtors	54	–	–	–	54
Total Current Assets	167	–	–	30	197
Fixed Assets	322	-200	–	–	122
Forest Crop	582	-582	–	–	–
Investments	35	–	–	–	35
Total Group Assets	1,106	-782	–	30	354
Liabilities and Equity					
Liabilities					
Creditors	93	-4	–	–	89
Total Current Liabilities	93	-4	–	–	89
Term Debt	133	-686	523	30	–
Provision for Deferred Taxation	-5	-31	–	14	-22
Total Group Liabilities	221	-721	523	44	67
Equity					
Group Equity	864	-40	-523	-14	287
Minority Equity	21	-21	–	–	–
Total Group Equity	885	-61	-523	-14	287
Total Group Liabilities and Equity	1,106	-782	–	30	354

(1) Proceeds of $725 million excluding transaction and reorganisation costs of $44 million and deconsolidation of minority debt of $5 million.

(2) Assumes that the sale of the Tarawera Forestry Right settles and the initial capital return of 93.75 cents per existing share occurs.

(3) Represents deferred taxation not able to be recognised ($14 million) and reclassification of cash held ($30 million).

Discontinued Operations

The proceeds from the sale of the Forest Assets, assuming all necessary consents to the transfer of non-freehold property are obtained and that the minority Tarawera Forests shareholders acquire the Tarawera Forests Limited freehold land, will total $725 million, compared to an estimated book value of $741 million. As a result of the transaction the Company will incur transaction and reorganisation costs of approximately $44 million, including the break fee payable to the Campbell Group (refer page 19). This results in an estimated net accounting loss of $59 million including the non-recognition of a deferred taxation asset of $18 million which is not able to be recognised under NZ GAAP, which, along with the Forests and Supply segment earnings for the period to settlement, will be disclosed as earnings from discontinued operations in the Fletcher Challenge Forests Group Statement of Financial Performance for the June 2004 year.

Continuing Operations

Prospective financial information for the Company's continuing marketing, manufacturing and distribution activities, including a Statement of Prospective Financial Performance, a Statement of Prospective Financial Position and a Statement of Prospective Cash Flows as at and for the years ended 30 June 2004 and 30 June 2005 have been prepared and are set out in Appendix 1. The prospective operating earnings information is summarised in the following table along with three years' historical comparatives.

Segmental Summary

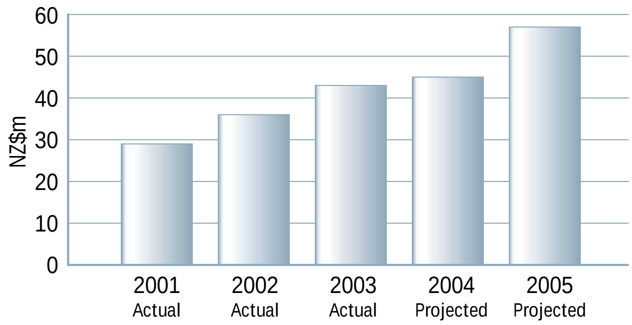
	Actual			*Prospective*	
NZ$ million	*2001*	*2002*	*2003*	*2004*	*2005*
Operating Revenue					
Australasian and Asian Consumer Solutions	203	215	226	225	267
North American Consumer Solutions(1)	145	194	167	274	411
Shared Services	–	–	–	1	–
	348	409	393	500	678
Earnings before Interest, Taxation, Depreciation and Amortisation (EBITDA)					
Australasian and Asian Consumer Solutions	13	5	20	24	26
North American Consumer Solutions	16	31	23	25	44
Shared Services(2)	–	–	–	-4	-13
	29	36	43	45	57
Other(3)	–	18	19	1	-1
Unusual Items	-1	-3	–	–	–
Total EBITDA	28	51	62	46	56
Depreciation/Amortisation	-15	-15	-13	-15	-17
Operating Earnings (EBIT)(2)	13	36	49	31	39

(1) The increase in revenue in 2004 and 2005 primarily reflects the consolidation of The Empire Company from 1 November 2003 (refer below).

(2) Shared Services overheads not specific to the processing and distribution businesses have historically been included within the Forests and Supply segment. The prospective financial information assumes that these overheads are charged to the continuing operations from the principal completion date.

(3) Relates to foreign exchange gains/losses on net foreign denominated debt instruments not attributed to a specific business unit.

EBITDA over 5 Years(1)



(1) EBITDA for Continuing Operations excluding foreign exchange gains and unusual items.

The Company's Future

The prospective financial information should be viewed in conjunction with the assumptions on which the forward estimates are based. The prospective financial information is likely to vary from actual results and any variation may be materially positive or negative because the assumptions, and therefore the prospective financial information, are by their very nature subject to risks and uncertainties, many of which are outside the control of Fletcher Challenge Forests and are not predictable. The prospective financial information is qualified by the cautionary statements contained in the Forward-Looking Statements section on the inside cover of the Notice of Meeting.

The Company recently announced that it had increased its ownership in The Empire Company from 33% to 67%, effective 1 November 2003, with an agreement to purchase the remaining one third any time after 1 November 2004, at the discretion of the minority partner. As a result of the increase in shareholding, the results of Empire are fully consolidated from 1 November 2003. Empire had revenues of approximately US$126 million in 2003.

The prospective financial information has been prepared to assist shareholders to assess the potential future performance of the Company. As can be seen from the graph, the Company's manufacturing, distribution and marketing operations have shown consistent EBITDA growth (prior to accounting for foreign exchange gains) over the past three years and this is projected to continue. Based on the key assumptions underlying the prospective financial information set out below, and off what is already a solid base, the prospective financial information clearly shows strong growth trends with:

- increasing revenue
- improving profitability
- improving returns on equity

which is all expected to translate into an improved economic value added performance by the Company.

The Board is committed to creating value for shareholders. The Company will invest capital only in projects that are expected to produce a return in excess of its cost of capital. To reinforce this value creation discipline, the Company's senior executive remuneration will be directly linked to the achievement of positive economic value added (EVA) performance for the Company as a whole.

The Company also anticipates the payment of dividends to shareholders. The Company will finalise its formal dividend policy at a later date, but the intention is to target a dividend payout ratio of between 20% and 40% of net cash from operating activities. Ultimately, dividend payments will be dependent on earnings, cash flow and new investment opportunities that might arise in the future. Subject to those factors, dividend payments are expected to commence in respect of earnings for the 2005 financial year, with the first payment anticipated to be made in the second half of calendar 2005.

Of course, if the Forests Sale is approved by shareholders, in the 2004 financial year shareholders will receive a capital return of either 93.75 cents (assuming the Tarawera Forestry Right is transferred to Kiwi as part of the Forests Sale), or 62.5 cents per existing share and in the 2005 financial year an additional capital return of up to 26.25 cents per existing share, or up to 57.5 cents per existing share if the Tarawera Forestry Right is not transferred to Kiwi but is subsequently sold to another party at the same price.

Further comment on the financial position of the Continuing Operations is contained in the Grant Samuel report in Appendix 4.

The Future Company

The strategic plan for the next five years of the Company’s evolution after the realisation of cash from the sale of investment in forestry assets, includes the following key developments:

- further investment in the Company’s processing facilities;
- further development of the Company’s premier position in North American wood products manufacturing and distribution activity;
- new wood products marketing and distribution initiatives in Europe, South-East Asia and China; and
- a targeted reduction in the Company’s shared services functions, reducing annual overhead costs by $13 million, to approximately $15 million per annum.

The strategy pursued by the Company since November last year has laid a strong foundation for the Company’s transition from a price-taking commodity producer to a consumer-focused manufacturer and marketer of more sophisticated, higher margin wood products.

The Company already has well established interests in the marketing, processing and remanufacturing of wood products, distribution partnerships in key markets which are facilitating market penetration, and clearly identified opportunities for growth. Including the turnover of the Company’s associate American Wood Moulding, these businesses already have a combined revenue nearing $1 billion.

The key business attributes that will drive the future of the Company are:

- A leadership position in marketing premium wood products to the markets in the Pacific Rim.
- A core of established processing and remanufacturing plants in New Zealand which are efficient and cost effective by New Zealand and global standards. Capacity and efficiency can be further increased with modest capital outlay.
- The base established by its marketing and processing capabilities, combined with infrastructure and distribution advantages, will supply customers worldwide with high quality products at globally competitive costs, and on reliable delivery schedules.
- An established position in the higher value structural and appearance segments across diverse markets.
- Effective distribution channels and relationships in key markets, which take the Company’s products into market dominant retail chains. In the United States, the Company has entered the market through distribution partnerships which have ensured access to the two leading United States home improvement retail chains. In New Zealand there is a key relationship with the leading building materials chain, PlaceMakers.
- The partnership strategy is also reflected in arrangements with major transport interests, in the United States and New Zealand, which contribute both to customer service and cost effectiveness.
- Strong consumer choice attributes and product differentiation. This is achieved through:
  - an established branding programme, built on the Origin® brand;
  - the internationally recognised environmental certification of New Zealand’s Radiata wood resource;
  - a policy of structuring sales and marketing teams around product segments and solutions, to fully service the customer relationship at all key points; and
  - expertise in fully leveraging the wood products supply chain.

The Company's Future

North America

"high value category – distribution partnerships"

The Company's strategy in the United States is based on market entry and penetration through existing equity partnerships with two strong distribution companies. These companies in turn have marketing and distribution links with the largest home improvement chains in the United States – The Home Depot and Lowe's.

Empire is a "preferred" supplier of mouldings to the Lowe's chain of DIY stores. American Wood Moulding is a "preferred" supplier to The Home Depot and in recognition of superior product and service quality was recently selected by The Home Depot as their 2003 Moulding Category Vendor of the Year. Fletcher Challenge Forests owns 67% and 50% respectively of Empire and American Wood Moulding, giving the Company a leading position in the mouldings category with the two largest home improvement retailers in the United States, servicing over 900 stores across the country.

The success of the strategy in North America was marked by the Company winning the Trade New Zealand Export Award as "Exporter of the Year" in the Building Wood and Interiors category. Fletcher Challenge Forests was commended for adding value at several points of the integrated supply chain through a combination of environmentally certified product, a strong market presence and a very effective "door to door" delivery.

Today, Fletcher Challenge Forests, with an estimated 11% market share, is the largest manufacturer of imported solid wood mouldings for the United States market, utilising the high value clear wood manufactured at the Taupo plant. Combined with the strong performance of the Company's distribution associates this has contributed to a 38% rise in United States dollar sales (including the Fletcher Challenge Forests' share of associate company revenues) over the past two years.

The Company is working with its equity partners to develop new opportunities.

A recent acquisition of 50% of a related business, Ornamental Mouldings Inc., by the Company's equity partner American Wood Moulding, has increased the value of American Wood Moulding's domestic business, and therefore the equity partnership, and extended the reach of the business into Canada, another high demand market.

New Zealand, Australia and Asia

"growth and opportunity across diverse markets"

As it looks to expand its business across the varied markets of New Zealand, Australia and Asia, the Company will continue to focus on building the success it has achieved with the Origin® brand.

Origin® – fulfilling the brand promise

Over the last five years the Company has reinvented its wood business in New Zealand, moving from a commodity approach to a focus on brand product and solutions.

The launch of Origin® in 1998 committed the Company to a brand and service philosophy founded on reliability, service, innovation and the progressive development of a range of products that meet the evolving needs of customers. Origin® products are extending the capacity of wood, utilising advanced wood engineering techniques to provide a range of building solutions. In doing this the Origin® team is continually extending its understanding and response to all influences and interests in the building industry as well as those of the end customer, and is actively encouraging designers, architects and builders to explore the full potential of wood.

Origin® product sales have been growing steadily since the brand was launched, and now represent 46% by value of the Company's Australasian wood product sales.

Three key factors have contributed to the success of Origin® products in the New Zealand marketplace – brand recognition, customer loyalty and customer satisfaction. Origin® products have been able to attract a price premium over those of competitors while still maintaining market share, something that is seldom heard of in New Zealand's building sector where price has been a major driver of purchase decisions. A Customer Value Added survey undertaken in September 2002 clearly highlighted that over the last two years in particular, the Origin® brand is differentiated in the marketplace on the basis of quality products, quality service and innovation.

Strong distribution relationships underpin the Company's business, and are essential for future expansion in New Zealand, the key market for structural products. The Company is the primary supplier to the PlaceMakers chain, and is also a significant supplier to ITM, Mitre 10, Bunnings/Benchmark and Carters.

The Company's specialist business, Ramsey Roundwood, with its posts and poles operation continues to be an important contributor in the structural wood products category, targeting in particular the farming and wine growing sectors in New Zealand.

Furniture component manufacture – a key future strategy

In the medium term, the most rewarding expansion opportunities will lie with relatively new product and market areas where the flexibility and quality of Radiata pine is just beginning to be appreciated. Furniture component manufacture is a prime example. At the moment the Company has only modest interests in furniture component manufacture, however a number of factors are accelerating this opportunity.

South-East Asia and China have become important furniture manufacturing centres, with product produced in Asia being re-exported to the United States and to Europe. This market opportunity, together with Asian domestic demand, identifies an area for product expansion.

There are also opportunities for the direct export of furniture components. Both United States and European producers are looking to the potential of processed Radiata pine clear wood, given the limited availability of such wood in their own regions.

This interest is being assisted by new technologies and processing techniques that are increasing the adaptability and appearance value of Radiata pine still further.

As part of its interest in accessing this new area of opportunity, the Company is actively working with other parties to assess market potential and identify manufacturing and distribution opportunities.

The Company's Future

Further penetration into the industrial markets

As the Company concentrates on greater production of structural and clear wood products, it must also increase the range and value of products that utilise the non-clear wood grades of timber derived from Radiata logs. Focusing on specific market needs for these grades is important to maximising the total overall return.

The key opportunities lie in the areas of packaging, such as boxing and pallets, and in "outdoor" products for landscaping and recreational developments. There is a strong established customer base among industrial, agricultural and horticultural end users in New Zealand. There is also a growing Asian customer base, primarily in Taiwan and Thailand, focused on pallets and packaging.

Summary

The Company has established a strong base for the implementation of its product and market development programme. It owns highly cost-efficient processing plants in close proximity to one of the world's fastest growing and most sustainable timber sources, in a region with a highly developed and efficient transport infrastructure. It has supply chains of proven reliability to domestic and key offshore markets. It has effective wood products marketing capabilities and arrangements with leading distributors and retailers to place its products before consumers in all its markets.

The Board has confidence that following the Forests Sale and Capital Return, the Company will be soundly positioned to implement the strategic development programme, address future challenges and opportunities, and produce attractive and competitive returns for its shareholders.

Glossary

The following terms have the following meanings when used in this Notice of Special Meeting:

"ADR" means an American depositary receipt;

"Arrangement Plan" means the arrangement plan attached to the form of final Court orders that the Company proposes to seek approving the Capital Return, set out in Appendix 3;

"ASX" means Australian Stock Exchange Limited;

"Board" means the board of directors of the Company;

"Capital Return" means the return of capital on terms set out in this Explanatory Memorandum to be approved by the High Court as an arrangement under Part XV of the Companies Act;

"Company" means Fletcher Challenge Forests Limited;

"Companies Act" means the Companies Act 1993 (New Zealand);

"Depositary" means Citibank, N.A. as depositary in respect of the Company ADRs;

"Directors" means the directors of the Company;

"Explanatory Memorandum" means the explanatory memorandum that forms part of the Notice of Special Meeting;

"Fletcher Challenge Forests" means the group comprising the Company and its subsidiaries;

"Forest Assets" means the Fletcher Challenge Forests forest estate and related assets including shares in the subsidiaries holding the freehold land and certain forestry rights, non-freehold forestry rights and leasehold interests (including a forestry right to be granted by Tarawera Forests Limited), standing trees and related improvements, equipment, business agreements, records, resource consents and intellectual property, but excluding related working capital;

"Forests Sale Agreement" means the sale and purchase agreement relating to the FCF estate dated 18 December 2003 between the Vendors, Kiwi, Viking and OTPP;

"Forests Sale" means the sale of the Forest Assets under the terms of the Forests Sale Agreement;

"High Court" means the High Court of New Zealand;

"Independent Directors" means all Directors of the Board, excluding M J Andrews and S L Moriarty who are also directors of Rubicon Limited;

"Kiwi" means Kiwi Forests Group Limited;

"Kiwi Consortium" means the consortium of Kiwi, Viking and OTPP;

"Notice of Special Meeting" means this notice of special meeting and explanatory memorandum issued by the Company for the purpose of calling the Special Meeting;

"NYSE" means the New York Stock Exchange, Inc.;

"NZ$" and "$" means New Zealand dollars;

Glossary

"NZX" means New Zealand Exchange Limited;

"OTPP" means OTPP New Zealand Forest Investments Limited, a wholly owned subsidiary of The Ontario Teachers Pension Plan;

"PruTimber" means Prudential Timber Investments, Inc.;

"Purchasers" means Kiwi, Viking and OTPP;

"Record Date" is defined under "Payment to Shareholders" on page 24 of the Explanatory Memorandum;

"Share Registrar" means Computershare Investor Services Limited;

"Special Meeting" means the special meeting of shareholders of the Company, to be held on 20 February 2004, and any adjournments or postponements thereof;

"Tarawera Forestry Right" means the forestry right proposed to be transferred by Tarawera Forests Limited to Kiwi under the Forests Sale Agreement;

"US$" means United States dollars;

"Vendors" means Fletcher Challenge Forests Industries Limited and Fletcher Challenge Forests (Manufacturing) Limited;

"Viking" means Viking Global New Zealand Limited, a wholly owned subsidiary of Viking Global Fund LLC; and

"Wood Supply Agreements" means the agreements between the Purchasers and Fletcher Challenge Forests relating to the supply of sawlogs and pulpwood described under "Wood Supply Arrangements" in the Explanatory Memorandum.

Appendices

APPENDIX 1: Prospective Financial Information

Prospective financial information as at and for the years ended 30 June 2004 and 30 June 2005 has been prepared in accordance with NZ GAAP. The financial information has been prepared on a basis consistent with Fletcher Challenge Forests' accounting policies as set out in the Group's audited financial statements as at 30 June 2003.

The prospective financial information has been prepared by the Company to project the performance of the continuing operations of Fletcher Challenge Forests and is based upon the key assumptions as listed below, which are in line with the actions the Company intends to take, including the sale of its plantation forestry activities and the subsequent capital returns as disclosed within this Explanatory Memorandum. The prospective financial information is a projection and is based on hypothetical assumptions which are realistic possible outcomes, but not necessarily the most probable outcome. A projection as defined in New Zealand Financial Reporting Standard No. 29 "Prospective Financial Information" is not a forecast. A forecast is prospective financial information prepared based on assumptions as to the future events which the Company reasonably expects to occur. Investors must consider the hypothetical assumptions described below in order to fully understand the prospective financial information. The projections are presented solely for the purposes of this Explanatory Memorandum and must be read in conjunction with the key assumptions listed below.

The prospective financial information is likely to vary from actual results and any variation may be materially positive or negative because the assumptions, and therefore the prospective financial information, are by their very nature subject to risks and uncertainties, many of which are outside the control of the Company and are not predictable. Some key risks resulting from the Forests Sale and Capital Return are set out in the Explanatory Memorandum together with a number of ongoing business risks including in relation to the consequences of exchange rate movements, the amount and timing of the reduction in shared services costs, receipt of third party consents, the impact of the strong competition faced in Fletcher Challenge Forests' key markets, continuing availability of wood supply, reliance on key customers such as PlaceMakers, The Home Depot and Lowe's, changes in government regulation and remaining issues connected with the separation of the Fletcher Challenge Group. The impact of these risks could adversely affect Fletcher Challenge Forests' future financial condition or results. The prospective financial information is further qualified by the cautionary statements contained in the Forward-Looking Statements section on the inside cover of the Notice of Meeting.

Prospective Financial Information (unaudited)

STATEMENT OF PROSPECTIVE FINANCIAL PERFORMANCE – CONTINUING ACTIVITIES

For year ended 30 June

NZ$ million	*2004*	*2005*
Operating Revenue	500	678
Operating Expenses	-469	-639
Operating Earnings	31	39
Funding Costs	-3	-6
Earnings before Taxation	28	33
Taxation	-5	-9
Earnings after Taxation	23	24
Minority Interest	-1	-1
Net Earnings from Continuing Operations	22	23

FLETCHER CHALLENGE FORESTS

Prospective Financial Information (unaudited)

STATEMENT OF PROSPECTIVE FINANCIAL POSITION

As at 30 June

NZ$ million	*2004*	*2005*
Assets		
Cash and Liquid Deposits	45	5
Stocks	74	76
Debtors	62	71
Deferred Settlement	20	–
Total Current Assets	201	152
Fixed Assets	119	112
Intangible Assets	11	23
Deferred Taxation Asset	22	22
Investments	35	35
Total Group Assets	388	344

Liabilities and Equity		
Liabilities		
Creditors	65	66
Total Current Liabilities	65	66
Term Debt	14	99
Total Group Liabilities	79	165
Equity		
Group Equity	302	179
Minority Equity	7	–
Total Group Equity	309	179
Total Group Liabilities and Equity	388	344

STATEMENT OF PROSPECTIVE CASH FLOWS

For year ended 30 June

NZ$ million	*2004*	*2005*
Cash was Provided:		
From Operating Activities		
Receipts from Customers	474	652
Dividends Received	7	6
Interest Received	3	1
Total Provided	484	659
Payments to Suppliers, Employees and Other	447	622
Interest Paid	3	7
Income Tax Paid	5	9
Total Applied	455	638
Net Cash from Operating Activities	29	21
From Investing Activities		
Repayment of Loan by Associate	–	10
Total Provided	–	10
Purchase of Fixed Assets	16	9
Purchase of Empire Investment and Minority Interest	16	21
Total Applied	32	30
Net Cash to Investing Activities	-32	-20
From Financing Activities		
Debt Drawdowns	18	106
Total Provided	18	106
Capital Return	523	146
Debt Settlements	144	21
Total Applied	667	167
Net Cash to Financing Activities	-649	-61
Net Cash from Discontinued Operations	652	20
Net Movement in Cash Held	–	-40
Add Opening Cash and Liquid Deposits	47	45
Effect of Exchange Rate Changes on Net Cash	-2	–
Closing Cash and Liquid Deposits	45	5
Net Earnings from Continuing Operations	22	23
Adjustment for Items not involving Cash:		
Depreciation, Amortisation and Provisions	13	17
Minority Interest in Earnings of Subsidiaries	1	1
Equity Earnings	-8	-10
Cash Flow from Operations before Net Working Capital Movements	28	31
Net Working Capital Movements	1	-10
Net Cash from Operating Activities	29	21

FLETCHER CHALLENGE FORESTS

Notes to the Prospective Financial Information

1 Basis of Presentation

The prospective financial information of Fletcher Challenge Forests is presented in New Zealand dollars and has been prepared in accordance with the accounting policies of Fletcher Challenge Forests (generally accepted accounting practice in New Zealand, NZ GAAP) as published in the Fletcher Challenge Forests' June 2003 Annual Report.

The prospective financial information incorporates:

- a projection for the year ended 30 June 2004 for the Fletcher Challenge Forests continuing operations based upon actual results for the five months to November 2003, which have been extracted from the Fletcher Challenge Forests management accounts, and a projection for the seven months to June 2004 based on the assumptions detailed below; and
- a projection for the year ended 30 June 2005 based upon the assumptions detailed below.

The prospective financial information is presented solely for the purpose of inclusion in this Explanatory Memorandum and must be read in conjunction with the key assumptions listed below. The prospective financial information was approved by the Directors on 16 January 2004. It is not intended that the prospective financial information will be updated subsequent to the issue of this Explanatory Memorandum.

The prospective financial information is likely to vary from actual results and any variation may be materially positive or negative because the assumptions, and therefore the prospective financial information, are by their very nature subject to risks and uncertainties, many of which are outside the control of the Company and are not predictable. Some key risks resulting from the Forests Sale and Capital Return are set out in the Explanatory Memorandum together with a number of ongoing business risks including in relation to the consequences of exchange rate movements, the amount and timing of the reduction in shared services costs, receipt of third party consents, the impact of the strong competition faced in Fletcher Challenge Forests' key markets, continuing availability of wood supply, reliance on key customers such as PlaceMakers, The Home Depot and Lowe's, changes in government regulation and remaining issues connected with the separation of the Fletcher Challenge Group. The impact of these risks could adversely affect Fletcher Challenge Forests' future financial condition or results. The prospective financial information is further qualified by the cautionary statements contained in the Forward-Looking Statements section on the inside cover of the Notice of Meeting.

2 Key Assumptions

The key assumptions are summarised below:

2(a) The Prospective Statement of Financial Performance relates to the Fletcher Challenge Forests' continuing operations

The continuing operations of the Fletcher Challenge Forests group relate to the marketing, manufacturing and distribution activities of the group and exclude the operations previously disclosed as the Forests and Supply segment (discontinued operations), which are to be sold as disclosed in this Explanatory Memorandum.

2(b) The sale of the Fletcher Challenge Forests' forest estate is completed

The sale of the Fletcher Challenge Forests plantation forestry activities, as disclosed in this Explanatory Memorandum including the sale of the forestry right by Tarawera Forests Limited, effective 28 February 2004 and includes settlement of $516 million as at the effective date, and outstanding deferred settlements of $130 million, $59 million and $20 million in April 2004, June 2004 and August 2004 respectively.

2(c) *Return of capital to shareholders is completed*

The capital return of 93.75 cents per existing Fletcher Challenge Forests share and 26.25 cents per existing Fletcher Challenge Forests share, as disclosed in this Explanation Memorandum, are included within the projected financial information with an effective date of March 2004 and September 2004 respectively.

2(d) *Log Purchase Prices*

The following average log purchase prices have been assumed.

(real dollars)	*2004* *NZ\$/m³*	*2005* *NZ\$/m³*
Radiata – Pruned	147	147
Radiata – Unpruned	80	80

2(e) *Sales Prices*

Sales prices have been assumed at November 2003 levels. June 2004 real average prices are assumed for 2005.

Operating revenue includes revenue from The Empire Company, which is consolidated from 1 November 2003. Projected annual operating revenue for The Empire Company totals approximately US\$150 million for the 12 months to June 2004. June 2005 assumes an 8% growth in The Empire Company's earnings.

2(f) *Sales Volumes*

The following sales volumes have been assumed for the manufacturing businesses.

	2004 *000m³*	*2005* *000m³*
Solid Lineal Mouldings	32	40
Laminated and Finger-Jointed Product	74	74
Lumber and Roundwood	595	684
	701	798
Third Party Lumber Trading	31	31
Total	732	829

2(g) *Overheads and Expenses*

Shared Services overheads not specific to the Processing and Distribution businesses have historically been included within the Forests and Supply segment. Following the sale of the forestry activities Fletcher Challenge Forests is projecting an ongoing overhead of \$15 million per annum (including depreciation). Included within the operating expenses from continuing operations in the prospective financial information are overheads of \$6 million for June 2004, (being costs post the forestry activities sale) and \$15 million for the year ended 30 June 2005. In addition, operating revenue for the year ended 30 June 2004 includes interest income of \$1 million relating to cash balances held between the settlement of the Forests Sale and the initial Capital Return.

The June 2005 projection includes an inflation increase of 2% to processing and other costs from June 2004 average costs.

2(h) Exchange Rates

The following exchange rates have been assumed.

		2004	*2005*
New Zealand dollar versus:			
United States dollar	– average rate	0.63	0.60
	– period end rate	0.60	0.60
Australian dollar	– average rate	0.89	0.89
	– period end rate	0.89	0.89

The average United States dollar exchange rate assumed for the projected seven months from 1 December 2003 to 30 June 2004 is 0.65.

2(i) Debt/Interest Rates

Fletcher Challenge Forests has received commitments from a syndicate of banks, arranged by Bank of New Zealand, for a revolving loan facility totalling $150 million. The loan facility will comprise a three-year revolving credit facility (with advances in either New Zealand or United States dollars). Bank of New Zealand has also agreed to provide a three-year term overdraft facility of $15 million (advanced in New Zealand dollars). There are no mandatory repayment amounts during the three-year period of either facility (although the overdraft facility is repayable on demand).

The interest rate payable on the syndicated bank facility will be the base rate plus a commitment fee for the entire facility amount plus a margin for the borrowed amount. The commitment fee (ranging from 0.35% to 0.5%) and margin (ranging from 0.45% to 0.75%) are charged based on the Company's Gearing Ratio covenant at the time.

Establishment fees of $0.1 million will be expensed in the June 2004 Statement of Financial Performance.

The following weighted average interest rates have been assumed in the projected financial information:

	2004	*2005*
NZ dollar	7.7%	7.7%
US dollar	4.9%	4.9%
Weighted average rate	5.5%	5.5%

Fletcher Challenge Forests currently has an interest rate risk management policy to fix interest rates on between 40%-70% of its debt. Fletcher Challenge Forests' foreign exchange risk policy is to manage liability foreign exchange risk by maintaining foreign currency denominated debt in the currencies in which Fletcher Challenge Forests has significant net revenue streams. This provides a natural hedge. Consistent with this policy, debt is assumed to be drawn in New Zealand dollars (20%) and United States dollars (80%).

In addition to the above facility, the Company has minority debt relating to third party debt held in a non-wholly owned subsidiary of $14 million as at June 2004. The associated interest charge of $1 million for the year ended June 2004 is included within Funding Costs.

2(j) *Income Tax*

The income tax rate for New Zealand and the United States has been assumed to be 33% and 39% respectively and there will be no change in the taxation environments in which Fletcher Challenge Forests operates.

Following the sale of the forestry activities the Company will have taxation assets in excess of the amount that can be recognised under NZ GAAP. NZ GAAP allows the recognition of taxation assets when utilisation is considered virtually certain, which is subject to the future earnings of the Fletcher Challenge Forests group. In line with NZ GAAP Fletcher Challenge Forests has only recognised tax assets of $22 million in the prospective financial information. Due to the existence of non-recognised New Zealand taxation benefits, no New Zealand jurisdictional taxation expense has been included in the prospective financial information, as unrecognised losses will be progressively recognised to offset any New Zealand jurisdictional taxation charge during the prospective periods. The projected taxation expense relates to tax obligations in the United States.

2(k) *Capital Investment*

During 2004 Fletcher Challenge Forests exercised a purchase option to increase its shareholding in The Empire Company, Inc to 67% for a total cost of $16 million. Following the exercise of this option, The Empire Company has been consolidated as a subsidiary of the group from 1 November 2003. Fletcher Challenge Forests has an agreement to purchase the remaining one third after 1 November 2004 at the discretion of the minority partner. The prospective financial information assumes the exercise of the option on 1 November 2004 for a cost of $21 million.

The prospective financial information includes capital expenditure, to maintain current operating capacity of $16 million and $9 million for 2004 and 2005 respectively, over and above expenditure made on the acquisition of increased ownership in The Empire Company.

3 Segmental Summary

	2004 *NZ$m*	*2005* *NZ$m*
Operating Revenue		
Australasian and Asian Consumer Solutions	225	267
North American Consumer Solutions	274	411
Shared Services	1	–
	500	678
Earnings before Interest, Taxation, Depreciation and Amortisations (EBITDA)		
Australasian and Asian Consumer Solutions	24	26
North American Consumer Solutions	25	44
Shared Services	-4	-13
	45	57
Other(1)	1	-1
Total EBITDA	46	56
Depreciation/Amortisation	-15	-17
Operating Earnings	31	39

(1) Relates to foreign exchange gains/losses on the net foreign denominated debt instruments not attributed to a specific business unit.

FLETCHER CHALLENGE FORESTS

Notes to the Prospective Financial Information (continued)

4 Sensitivity Analysis

The Company's earnings are influenced by movements in a number of key variables. Set out below is a summary, which demonstrates the financial effect on EBITDA and Operating Earnings from changes in key variables for the projected June 2004 (seven months projection from 1 December 2003 to 30 June 2004) and June 2005 financial information. Care should be taken in interpreting these sensitivities. The sensitivity analysis demonstrates the impact on the prospective financial information of a change in any one variable in isolation from changes in other variables and assumes no management or competitor response. This is unlikely to be the actual situation should a change in a variable actually occur.

	2004 NZ$m	*2005 NZ$m*
Change in the NZD/USD exchange rate by $0.01[1]	1	1
10% change in log purchase prices	8	16
10% change in sales prices[2]	19	39
10% change in lumber sales volume	7	9
10% change in processing costs	6	13

(1) A strengthening of the New Zealand dollar will result in a decrease in Operating Earnings (excludes the impact on debt instruments). The impact of a strengthening of the New Zealand dollar will also result in a NZ$1 million gain on the revaluation of US dollar denominated debt, which is held as a natural hedge to the Company's Operating Earnings exposure.

(2) Excludes distribution businesses of The Empire Company and AWM.

5 Bank Debt Covenants

The syndicated bank facility requires the Company to comply with the following financial ratios reported on a quarterly test basis:

(a) Gearing Ratio: the ratio of Net Debt/EBITDA of the group shall not exceed three times on any quarterly test date;

(b) Interest Cover Ratio: the ratio of EBIT to Interest Expense of the group is not less than three times on any quarterly test date;

(c) Net Debt to Total Tangible Asset Ratio: the percentage of Net Debt to Total Tangible Assets of the group at all times will be not more than 50%; and

(d) Minimum Net Tangible Assets: the Minimum Net Tangible Assets of the group will not at any time be less than NZ$125 million until 31 March 2006 and NZ$150 million thereafter.

Bank Covenant Ratio Compliance

		2004			*2005*	
	Projected	*Required*	*Headroom*	*Projected*	*Required*	*Headroom*
Gearing Ratio						
(Net Debt/EBITDA) (times)	-0.9	3.0	3.9	1.7	3.0	1.3
Interest Cover Ratio						
(EBIT/Interest) (times)	11.6	3.0	8.6	6.5	3.0	3.5
Net Debt/Total Tangible Assets	-16%	50%	66%	31%	50%	19%
Minimum Net Tangible Assets						
($ million)	269	125	144	134	125	9

Non-wholly owned US subsidiaries are to be treated as associate companies for bank covenant reporting purposes.

6 Impact of Tarawera Financing Condition

The sale of a forestry right by Tarawera Forests Limited, a subsidiary of the Company, is subject to Kiwi Forests Group Limited arranging finance for the acquisition of that asset by 30 January 2004. The purchase of the remaining assets is not subject to financing.

If the sale of the Tarawera Forestry Right is not completed as part of the sale of the Forest Assets, then the first capital return will be reduced to 62.5 cents per existing share and the Tarawera forest estate will be marketed for sale to other parties.

The following tables show the impact of Kiwi Forests Group Limited not meeting the finance condition with regards the sale of the Tarawera Forestry Right and assumes the sale of the Tarawera Forestry Right is completed (at an equivalent value) with a third party by 30 June 2004 with the sale proceeds forming part of the second capital return.

STATEMENT OF PROSPECTIVE FINANCIAL PERFORMANCE – CONTINUING OPERATIONS (unaudited)

For year ended 30 June

	Projection	*Delay in Tarawera Settlement*	*Alternative Projection*	*Projection*	*Increase Second Capital Return*	*Alternative Projection*
NZ$ million	*2004*		*2004*	*2005*		*2005*
Operating Revenue	500	-1	499	678	2	680
Operating Expenses	-469	–	-469	-639	–	-639
Operating Earnings	31	-1	30	39	2	41
Funding Costs	-3	–	-3	-6	–	-6
Earnings before Taxation	28	-1	27	33	2	35
Taxation	-5	–	-5	-9	–	-9
Earnings after Taxation	23	-1	22	24	2	26
Minority Interest	-1	–	-1	-1	–	-1
Net Earnings from Continuing Operations	22	-1	21	23	2	25

Notes to the Prospective Financial Information (continued)

STATEMENT OF PROSPECTIVE FINANCIAL POSITION (unaudited)

As at 30 June

NZ$ million	*Projection 2004*	*Delay in Tarawera Settlement*	*Alternative Projection 2004*	*Projection 2005*	*Increase Second Capital Return*	*Alternative Projection 2005*
Assets						
Cash and Liquid Deposits	45	173	218	5	–	5
Stocks	74	–	74	76	–	76
Debtors	62	–	62	71	–	71
Deferred Settlement	20	–	20	–	–	–
Total Current Assets	201	173	374	152	–	152
Fixed Assets	119	–	119	112	–	112
Intangible Assets	11	–	11	23	–	23
Deferred Taxation Asset	22	–	22	22	–	22
Investments	35	–	35	35	–	35
Total Group Assets	388	173	561	344	–	344
Liabilities and Equity						
Liabilities						
Creditors	65	–	65	66	–	66
Total Current Liabilities	65	–	65	66	–	66
Term Debt	14	–	14	99	-1	98
Total Group Liabilities	79	–	79	165	-1	164
Equity						
Group Equity	302	173	475	179	1	180
Minority Equity	7	–	7	–	–	–
Total Group Equity	309	173	482	179	1	180
Total Group Liabilities and Equity	388	173	561	344	–	344

STATEMENT OF PROSPECTIVE CASH FLOWS (unaudited)

For period ended 30 June

NZ$ million	*Projection* 2004	*Delay in Tarawera Settlement*	*Alternative Projection* 2004	*Projection* 2005	*Increase Second Capital Return*	*Alternative Projection* 2005
Cash was Provided:						
From Operating Activities						
Receipts from Customers	474	–	474	652	–	652
Dividends Received	7	–	7	6	–	6
Interest Received	3	-1	2	1	2	3
Total Provided	484	-1	483	659	2	661
Payments to Suppliers, Employees and Other	447	–	447	622	–	622
Interest Paid	3	–	3	7	–	7
Income Tax Paid	5	–	5	9	–	9
Total Applied	455	–	455	638	–	638
Net Cash from Operating Activities	29	-1	28	21	2	23
From Investing Activities						
Repayment of loan by Associate	–	–	–	10	–	10
Total Provided	–	–	–	10	–	10
Purchase of Fixed Assets	16	–	16	9	–	9
Purchase of Empire Investment and Minority Interest	16	–	16	21	–	21
Total Applied	32	–	32	30	–	30
Net Cash to Investing Activities	-32	–	-32	-20	–	-20
From Financing Activities						
Debt Drawdowns	18	–	18	106	-1	105
Total Provided	18	–	18	106	-1	105
Capital Return	523	-174	349	146	174	320
Debt Settlements	144	–	144	21	–	21
Total Applied	667	-174	493	167	174	341
Net Cash (to)/from Financing Activities	-649	174	-475	-61	-175	-236
Net Cash from Discontinued Operations	652	–	652	20	–	20
Net Movement in Cash Held	–	173	173	-40	-173	-213
Add Opening Cash and Liquid Deposits	47	–	47	45	173	218
Effect of Exchange Rate Changes on Net Cash	-2	–	-2	–	–	–
Closing Cash and Liquid Deposits	45	173	218	5	–	5
Net Earnings from Continuing Operations	22	-1	21	23	2	25
Adjustment for Items not involving Cash:						
Depreciation, Amortisation, and Provisions	13	–	13	17	–	17
Minority Interest in Earnings of Subsidiaries	1	–	1	1	–	1
Equity Earnings	-8	–	-8	-10	–	-10
Cash Flow from Operations before Net Working Capital Movements	28	-1	27	31	2	33
Net Working Capital Movements	1	–	1	-10	–	-10
Net Cash from Operating Activities	29	-1	28	21	2	23

The Directors
Fletcher Challenge Forests Limited
Private Bag 92036
Penrose
Auckland

PRICEWATERHOUSECOOPERS

16 January 2004

Accountants' report for inclusion in the Explanatory Memorandum

Dear Directors

As independent accountants we have prepared this report for inclusion in an Explanatory Memorandum to be dated 16 January 2004.

Directors' responsibilities

The Company Directors are responsible for the preparation and presentation of the prospective financial information of the Company, being projected financial information for the years ending 30 June 2004 and 30 June 2005, including the assumptions on which they are based.

Accountants' responsibilities

We are responsible for expressing an independent opinion on the compilation of the prospective financial information of the Company for the years ending 30 June 2004 and 30 June 2005.

The firm carries out other assignments for the Company and certain of its subsidiaries in the areas of audit, taxation compliance and financial assurance services. The firm has no other relationships with or interests in the Company or any of its subsidiaries.

Basis of opinion on the prospective financial information

To meet our reporting responsibilities we have examined the prospective financial information for the years ending 30 June 2004 and 30 June 2005 to confirm that, so far as the accounting policies and calculations are concerned, the prospective financial information has been properly compiled on the footing of the assumptions made or adopted by the Directors as set out on pages 48 to 51 of this Explanatory Memorandum and are presented on a basis consistent with the accounting policies normally adopted by the Company.

Unqualified opinion on the prospective financial information

In our opinion, the prospective financial information for the years ending 30 June 2004 and 30 June 2005, on pages 44 to 55, so far as the accounting policies and calculations are concerned, has been properly compiled on the footing of the assumptions made or adopted by the Directors of the Company as set out on pages 48 to 51 of this Explanatory Memorandum and is presented on a basis consistent with the accounting policies normally adopted by the Company.

Actual results are likely to be different from the prospective financial information since anticipated events frequently do not occur as expected and any variation could be material. Accordingly, we express no opinion as to whether the prospective financial information will be achieved.

Yours faithfully

PricewaterhouseCoopers

Chartered Accountants Auckland

APPENDIX 2: Initial Court Orders

In the High Court of New Zealand CIV 2004-404-99
Auckland Registry

In the matter of an Arrangement under Part XV of the Companies Act 1993

Fletcher Challenge Forests Limited an incorporated company having its registered office at Auckland

Applicant

Initial orders under section 236 of the Companies Act 1993 relating to an originating application for orders approving an Arrangement under Part XV of the Companies Act 1993

16 January 2004

APPENDIX 2: Initial Court Orders

BEFORE THE HONOURABLE JUSTICE RANDERSON

Friday the 16th day of January 2004

UPON READING the originating application for orders approving an arrangement under Part XV of the Companies Act 1993, the *ex parte* notice of interlocutory application for initial orders under section 236 of the Companies Act 1993 dated 14 January 2004, the affidavits of Sir Dryden Spring, John Anthony Dell, Paul Martin Dougherty and Andrew Cyril Petersen sworn in support of those applications and UPON HEARING Mr R G Simpson and Mr H S Wong, counsel for the applicant, THIS COURT ORDERS:

A. Special meeting of Shareholders

1. Subject to order 6 below, the applicant is directed to hold a special meeting (**Shareholders' Meeting**) of its shareholders at the ASB Bank Stand at Eden Park, Auckland at 10.00 am on Friday, 20 February 2004. At the Shareholders' Meeting, the applicant is directed to put to its shareholders for their consideration and approval in the manner specified in order 2 below, the proposed arrangement (**Arrangement**) to cancel a portion of the shares in the applicant registered in the name of each shareholder on the Record Date and to make a cash payment of NZ$1.25 per cancelled share to its shareholders by way of a return of capital. The key elements of the Arrangement are described in the arrangement plan (**Arrangement Plan**) annexed to the originating application for final Court orders approving the Arrangement (**Application for Final Court Orders**).

2. The Arrangement will be put to the shareholders of the applicant for approval by way of a special resolution (**Special Resolution**) of 75% or more of the votes cast by those shareholders entitled to vote and voting on the Special Resolution at the Shareholders' Meeting.

3. The applicant is permitted to make such amendments, revisions and/or supplements to the Arrangement and the Arrangement Plan as it may determine are in its best interests and in the best interests of its shareholders. The Arrangement as so amended, revised and/or supplemented will be the Arrangement to be submitted to the shareholders for their approval at the Shareholders' Meeting. The applicant is also permitted to make consequential amendments, revisions and/or supplements to the Special Resolution and the Shareholders' Meeting Materials referred to in order 8 below. Should it make any material amendments, revisions and/or supplements to the Arrangement, the Arrangement Plan or the Special Resolution after it has sent the Shareholders' Meeting Materials to those persons referred to in orders 8 and 9 below, it will send to those persons a supplementary memorandum by ordinary mail advising them of such amendments, revisions and/or supplements.

4. The shareholders of the applicant are authorised to vote by postal vote or proxy at the Shareholders' Meeting provided that they deliver their postal voting forms or proxy forms to the registered office of the applicant, the office of the share registry of the applicant or the office of the branch registry by 10.00 am on Wednesday, 18 February 2004 (New Zealand time). The applicant is entitled to disregard any postal votes or proxy forms received after this deadline. However, the applicant may in its discretion waive the deadline for the delivery of postal votes or proxies by its shareholders if it deems it to be in its best interests and in the best interests of its shareholders to do so. Shareholders may revoke their proxies by giving written notice of revocation to the registered office of the applicant, the office of the share registry of the applicant or the office of the branch registry by 10.00 am Wednesday, 18 February 2004 (New Zealand time). The applicant is authorised to solicit proxies from its shareholders.

5. Only those shareholders whose names appear in the register of shareholders of the applicant as at 5.00 pm on Friday, 13 February 2004 (local time in the jurisdictions in which the applicant's share register or branch register are held) will be entitled to be represented and vote at the Shareholders' Meeting or any adjournment(s) or postponement(s) thereof.

6. If the applicant does not receive a tax ruling from the Inland Revenue Department that the payments to be made by the applicant to its shareholders under the Arrangement are not to be classified as "dividends" for income tax purposes in a form satisfactory to the applicant's Board of Directors prior to the Shareholders' Meeting, then the Chairman of the Shareholders' Meeting is permitted to cancel, adjourn or postpone the meeting on one or more occasions, without the necessity of first convening the meeting or first obtaining any vote of the shareholders entitled to attend the meeting regarding the cancellation, adjournment or postponement.

7. Subject to the terms of these orders, the Shareholders' Meeting will be otherwise conducted in accordance with the provisions of the Companies Act 1993 and the constitution of the applicant.

B. Notice of Shareholders' Meeting and Application for Final Court Orders

8. The applicant will give notice of the Shareholders' Meeting and the Application for Final Court Orders, by mailing, using prepaid ordinary mail, not less than 15 clear working days prior to the date of the meeting, the following materials:

   (a) A notice of the Shareholders' Meeting that will include a description of the Arrangement, together with:

      (i) A letter from the Chairman of the Board of Directors of the applicant to the shareholders of the applicant explaining and recommending support for the Arrangement;

      (ii) A description of the business of the Shareholders' Meeting;

      (iii) An explanatory memorandum providing detailed information regarding the sale of the Forest Assets, the Arrangement and their impact on the applicant;

      (iv) A statement to shareholders of their rights to appear and be heard on the Application for Final Court Orders;

      (v) An independent report by Grant Samuel & Associates Limited in relation to the sale of the Forest Assets;

      (vi) A copy of the initial court orders made pursuant to this application; and

      (vii) The Application for Final Court Orders; and

   (b) A postal voting and proxy form for use by the applicant's shareholders at the Shareholders' Meeting,

(collectively the Shareholders' Meeting Materials) in substantially the forms referred and annexed to the affidavit of Sir Dryden Spring sworn and filed herein, with such amendments, revisions and/or supplements as counsel may advise are necessary or desirable (provided that such amendments, revisions and/or supplements are not inconsistent with the terms of this order) to the following persons:

   (c) The directors and auditors of the applicant;

   (d) The shareholders in the applicant entered on its register of shareholders at the addresses that appear on such register as at 5.00 pm on Friday, 16 January 2004 (local time in the jurisdictions in which

APPENDIX 2: Initial Court Orders

the applicant's share register or branch register are held) being the date fixed by the Board of Directors of the applicant for the determination of the shareholders entitled to notice of the meeting pursuant to section 125 of the Companies Act 1993; and

(e) The holders of Fletcher Challenge Forests Limited American Depositary Shares (American Depositary Shareholders) at the addresses that appear on the register of American Depositary Shareholders of the applicant as at 5.00 pm on Wednesday, 14 January 2004 (New York time).

9. The applicant will provide a copy of the Shareholders' Meeting Materials on request to:

   (a) Any person who is entered on the share register between 5.00 pm on Friday, 16 January 2004 and 5.00 pm on Friday, 13 February 2004 (local time in the jurisdiction in which the applicant's share register or branch register are held); and

   (b) Any person who is entered on the register of American Depositary Shareholders between 5.00 pm on Wednesday, 14 January 2004 and 10.00 am on Friday, 13 February 2004 (New York time).

10. The applicant is granted leave to give notice of the Application for Final Court Orders to persons outside the jurisdiction of this Court in the manner prescribed in orders 8 and 9 above.

11. The accidental failure or omission by the applicant to send the Shareholders' Meeting Materials and the Application for Final Court Orders to the persons specified in orders 8 and 9 above or the non-receipt of such documents by such persons will not constitute a breach of the orders nor invalidate any resolution passed or proceedings taken at the Shareholders' Meeting. If any such failure or omission is brought to the attention of the applicant, then it shall use its best endeavours to rectify it by the method and in the time most reasonably practicable in the circumstances.

C. Reporting of Results of Shareholders' Meeting

12. The applicant shall, prior to the hearing of the Application for Final Court Orders, file with this Court an affidavit verifying the actions taken and the resolutions passed by the shareholders at the Shareholders' Meetings.

13. Unless the directors of the applicant determine to abandon the Arrangement, the Application for Final Court Orders will be heard before the presiding Judge at 10.00 am on Friday 5 March 2004.

D. Shareholder Rights of Opposition

14. Any shareholder or American Depositary Shareholder of the applicant who wishes to appear and be heard on the Application for Final Court Orders must file a notice of appearance or a notice of opposition (both containing an address for service) and any affidavits and a memorandum of submissions on which such shareholder intends to rely by 5.00 pm on Friday 27 February 2004 and serve a copy on the applicant at its address for service. The applicant will serve upon that shareholder or American Depositary Shareholder at their address for service a copy of the affidavits in support of the Application for Final Court Orders by 5.00 pm on Wednesday 3 March 2004.

15. The only persons entitled to appear and be heard at the hearing of the Application for Final Court Orders will be:

   (a) The applicant;

(b) Those shareholders and American Depositary Shareholders of the applicant who file a notice of appearance or a notice of opposition to the Application for Final Court Orders in accordance with order 14 above; and

(c) Any other person with leave of the Court.

16. If the hearing of the Application for Final Court Orders approving the Arrangement is adjourned, only those persons referred to in order 15 above need be served with notice of the adjourned date.

17. Except as provided in orders 8, 9, and 14 above, the applicant is not required to serve any other documents on the persons specified in those orders.

18. The applicant is granted leave to apply at short notice to vary these orders and apply for such further orders as may be appropriate.

BY THE COURT

R A Campbell
....
(Deputy) Registrar

Sealed this 16th day of January 2004

APPENDIX 3: Application for Final Court Orders

In the High Court of New Zealand CIV 2004-404
Auckland Registry

In the matter of an Arrangement under Part XV of the Companies Act 1993

Fletcher Challenge Forests Limited an incorporated company having its registered office at Auckland

Applicant

Originating application for orders approving an Arrangement under Part XV of the Companies Act 1993

14 January 2004

APPENDIX 3: Application for Final Court Orders

TAKE NOTICE that on Friday the 5th day of March 2004 at 10.00 am or as soon thereafter as counsel may be heard the applicant will move the Court FOR ORDERS that:

1. The proposed arrangement (**Arrangement**) to cancel a portion of the shares in the applicant registered in the name of each shareholder on the Record Date and to make a cash payment of NZ$1.25 per cancelled share to its shareholders by way of a return of capital, the key elements of which are described in the arrangement plan (**Arrangement Plan**) annexed to this application, is approved and is binding upon the applicant and its shareholders with effect from the Record Date defined in the Arrangement Plan, subject to:

   (a) The satisfaction, waiver or release of the terms and conditions of the Arrangement described in the Arrangement Plan; and

   (b) Any amendment, modification or supplement to the Arrangement made in accordance with the Arrangement Plan.

2. The applicant is granted leave to apply to the Court at short notice if further orders or directions are required.

UPON THE GROUNDS that:

(a) Section 236(1) of the Companies Act 1993 empowers the Court to make orders that the Arrangement is binding on the applicant, its shareholders and on such other persons as the Court may specify and upon such terms and conditions as the Court thinks fit.

(b) Section 237(1) of the Companies Act 1993 provides the Court with the power to make additional orders to give effect to the Arrangement.

(c) By the date on which this application is determined the applicant will have complied with the initial orders made by this Court and the requirements of Part XV of the Companies Act 1993 and the conditions to the Arrangement (other than the granting of the final orders) will have been satisfied.

(d) The terms and conditions of the Arrangement are fair and reasonable to the applicant and its shareholders.

(e) The Arrangement is such that an intelligent and honest person of business acting in respect of his or her own interest would reasonably approve it.

(f) The Arrangement is in the best interests of the applicant and its shareholders.

(g) The applicant will satisfy the solvency test prescribed by sections 4 and 52 of the Companies Act 1993 on completion of the Arrangement.

(h) The Arrangement is not adverse to the interests of creditors of the applicant.

(i) Appear in the affidavits of Sir Dryden Spring, John Anthony Dell and Paul Martin Dougherty filed in support of this application.

(j) Appear in the memoranda of counsel filed in support of the ex parte application for initial orders and in support of this application.

This application is made in reliance on Part XV of the Companies Act 1993 and upon Rule 4 and Part IVA of the High Court Rules.

Dated at Auckland on 14th January 2004.

R G Simpson
....
R G Simpson
Solicitor for the Applicant

To: The Registrar of the High Court at Auckland
And To: The Parties entitled to be served with this application

APPENDIX 3: Application for Final Court Orders

Schedule 1: Arrangement Plan

ARRANGEMENT PURSUANT TO PART XV OF THE COMPANIES ACT 1993

BETWEEN Fletcher Challenge Forests Limited and the holders of its ordinary shares and preference shares.

1. INTERPRETATION

In this document, unless the context otherwise requires:

Arrangement means the arrangement described in this document;

Board means the board of directors of the Company;

Business Day means a day on which the NZSX market operated by the New Zealand Exchange Limited is open for trading;

Company means Fletcher Challenge Forests Limited;

Conditions means the conditions to the Arrangement set out in clause 4;

Principal Completion Date means the principal completion date for the sale and purchase by certain subsidiaries of the Company of certain forestry assets pursuant to the Sale Agreement which is to be the first practicable business day following the date of satisfaction of the conditions to that agreement and in any event a business day that is no later than five business days after such date of satisfaction (or such later date as the parties may agree, acting reasonably);

Record Date means the first Friday which is a Business Day following the 10th Business Day, or the previous day if that Friday is not a Business Day, after the date an order is made by the High Court of New Zealand pursuant to section 236(1) of the Companies Act 1993 in respect of the Arrangement recorded in this document;

Related Company means a company which is related to another company in any of the following ways:

(a) the other company is its holding company or subsidiary; or

(b) more than half of the issued shares of the company, other than shares that carry no right to participate beyond a specified amount in a distribution of either profits or capital, is held by the other company and companies related to that other company (whether directly or indirectly, but other than in a fiduciary capacity); or

(c) more than half of the issued shares, other than shares that carry no right to participate beyond a specified amount in a distribution of either profits or capital, of each of them is held by members of the other (whether directly or indirectly, but other than in a fiduciary capacity); or

(d) the businesses of the companies have been so carried on that the separate business of each company, or a substantial part of it, is not readily identifiable; or

(e) there is another company to which both companies are related;

Sale Agreement means an agreement dated 18 December 2003 between Fletcher Challenge Forests (Manufacturing) Limited, Fletcher Challenge Forests Industries Limited, Kiwi Forests Group Limited, Viking Global New Zealand Limited and OTPP New Zealand Forest Investments Limited;

Share means an ordinary share or a preference share in the Company;

Shareholder means each person who is registered in the share register of the Company as the holder of a Share on the Record Date; and

Tarawera Forestry Right means the forestry right to be transferred by Tarawera Forests Limited to Kiwi Forests Group Limited (or a Related Company thereof or other nominee approved by the Company) under the Sale Agreement.

2. FUNDING

The Company will receive a dividend payment of up to $580 million from its wholly-owned subsidiary, Fletcher Challenge Industries Limited.

3. CANCELLATION OF SHARES

(a) Subject to the prior satisfaction of each of the Conditions and receipt of the dividend referred to in clause 2, at 5.00 pm on the Record Date (local time in the jurisdictions in which the Company's share register or branch register are held):

(i) if the sale of the Tarawera Forestry Right to Kiwi Forests Group Limited (or a Related Company thereof or other nominee approved by the Company) is completed by or on the Principal Completion Date, three out of every four ordinary Shares and three out of every four preference Shares registered in the name of each Shareholder will be cancelled. To the extent a Shareholder does not have a number of ordinary or preference Shares exactly divisible by four, the surplus Shares excluded from such division will be cancelled; or

(ii) if the sale of the Tarawera Forestry Right to Kiwi Forests Group Limited (or a Related Company thereof or other nominee approved by the Company) is not completed by or on the Principal Completion Date, one out of every two ordinary Shares and one out of every two preference Shares registered in the name of each Shareholder will be cancelled. To the extent a Shareholder does not have a number of ordinary or preference Shares exactly divisible by two, the surplus Share excluded from such division will be cancelled.

(b) No later than five Business Days after the Record Date, the Company will pay to each Shareholder NZ$1.25 for each Share registered on the Company's share register in the name of that Shareholder on the Record Date which has been cancelled in accordance with clause 3(a).

4. CONDITIONS

Completion of the Arrangement is conditional on:

(a) the completion on the Principal Completion Date of the sale by certain subsidiaries of the Company of certain of their forest estate and assets to a consortium led by Kiwi Forests Group Limited under the Sale Agreement;

(b) the receipt by the Company of a ruling from the Commissioner of Inland Revenue that the payment made to each shareholder under the Arrangement will not constitute a "dividend" for New Zealand income tax purposes, in a form satisfactory to the Board; and

(c) the Board remaining satisfied that the Company will, immediately after implementation of the Arrangement, continue to satisfy the solvency test prescribed by section 4 of the Companies Act 1993 as modified by section 52(4) of the Companies Act 1993.

FLETCHER CHALLENGE
FORESTS

REPORT TO SHAREHOLDERS ON SALE OF FOREST ASSETS

GRANT SAMUEL

January 2004

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1 Details of the Proposed Transaction

On 19 December 2003 Fletcher Challenge Forests Limited ("FC Forests") announced that an agreement had been signed to sell all the forests and related assets owned by its subsidiaries (collectively the "Forest Assets") to the Kiwi Forests Group Consortium ("Kiwi Forests Group") for a price of NZ$725 million, payable in cash (the "Proposed Transaction"). The Forest Assets proposed to be sold comprise all of FC Forests' forest estate and related assets including:

- subsidiaries holding freehold land and the standing trees on that land;
- forestry rights, forestry lease assets and the standing trees on the relevant land (as all necessary consents are received from landowners);
- related equipment, fixed assets, improvements, records, intellectual property and resource consents;
- related business agreements; and
- a forestry cutting right over the estate of the Company's 82.5% subsidiary, Tarawera Forests Limited ("Tarawera Forests").

Kiwi Forests Group comprises a consortium of local investors ("NZ Investors") through Kiwi Forests Group Limited, Viking Global New Zealand Limited ("Viking Global") and a wholly owned subsidiary of Ontario Teachers Pension Plan ("OTPP"). The NZ Investors are Messrs Ross Green, Adrian Burr, Mark Wyborn and Trevor Farmer. Viking Global is a subsidiary of a fund managed on behalf of institutional investors by Prudential Timber Investments, Inc. ("PruTimber"). PruTimber will manage the Viking and OTPP investments. OTPP had assets of over C$68 billion as at 20 June 2003, and invests to secure the retirement income of over 330,000 active and retired teachers in the province of Ontario, Canada.

The Proposed Transaction is structured as three separate transactions - one with each of the three entities comprising the Kiwi Forests Group. Each transaction involves specific and separate parts of the Forest Assets. The majority of the consideration is to be paid by the NZ Investors.

The majority of the assets being sold will be transferred on the principal completion date which is proposed to be as soon as practicable following the Special Meeting and in any event no later than 27 February 2004.

There will then be a series of rolling monthly settlements up until mid-October 2004, as third party consents to the transfer of forestry rights and forestry leases are obtained. Consents not obtained by the end of August 2004 will result in the particular property not being sold and retained by FC Forests. The expectation is that there will be very few, if any, consents withheld particularly as for the majority of the non-freehold forests, third party consents cannot be unreasonably withheld. The remaining assets represent approximately $80 million of the total sale price of $725 million.

As part of the sale of the Forest Assets, FC Forests will transfer to Kiwi Forests Group almost all of the business agreements associated with those assets except certain wood supply agreements with third parties which will remain with FC Forests and a strategic relationship agreement with Rubicon subsidiary Trees and Technology Limited. To satisfy its obligations under the wood supply agreements FC Forests has entered into back-to-back wood supply agreements with Kiwi Forests Group.

To secure an ongoing supply of sawlogs for its own processing mills FC Forests has entered into an agreement with Kiwi Forest Group, the principal terms of which are summarised below:

- between 310,000 and 340,000 tonnes of sawlogs in aggregate generated from the forestry assets purchased under the Agreement will be supplied;
- where Kiwi Forests Group produce sawlogs over and above the committed volume to be supplied to FC Forests, FC Forests has:
  - a first right of refusal on up to half of the total production;
  - the opportunity to compete, in good faith, for the remaining half; and

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- FC Forests is entitled to on-sell any sawlogs it purchases under the Sawlog Supply Agreement provided that they are first offered to Kiwi Forests Group to purchase at the price at which Kiwi Forests Group sold them to FC Forests;

- the term of the Sawlog Supply Agreement will be ten years. Six months before the term expires the parties will decide on a possible extension.

The agreement with Trees and Technology provides for FC Forests to purchase specified quantities of seedlings and for Trees and Technology to undertake research and development on behalf of FC Forests. Kiwi Forests Group has agreed to take a portion of the seedlings. It is expected that FC Forests will incur losses into the future under this agreement. Provision for these losses is included in the $44 million transaction and reorganisation costs referred to in the Explanatory Memorandum.

The Proposed Transaction is subject to FC Forests' shareholder approval by way of an ordinary resolution requiring 50% of all shares voted to be in favour of the resolution to succeed. This resolution will be voted on by preference shareholders and ordinary shareholders, voting together. The sale of the forest cutting rights in respect of Tarawera Forests to the NZ Investors is conditional on the NZ Investors obtaining financing by 30 January 2004. If that condition is not satisfied the sale of the Tarawera Forest cutting rights will not take place on the principal completion date. The balance of the sale of Forest Assets will otherwise proceed if the Proposed Transaction is approved by FC Forests' shareholders. In addition the proposed Transaction is subject to receipt of approval to the acquisition by the Overseas Investment Commission. Approval has been sought and is expected to be received prior to the Special Meeting.

If the Proposed Transaction is approved by FC Forests' shareholders, it is proposed to return the surplus capital generated by the sale of up to $1.20 per existing share to shareholders in two tranches. The first return of capital will be 93.75 cents per existing share (or 62.5 cents per share if the purchase of the Tarawera Forests forestry right by the NZ Investors does not proceed or is delayed), and will be undertaken following completion of the sale. The amount and timing of the second capital return is dependent on the transfer of certain forestry rights and forestry leases to Kiwi Forests Group and potentially on the timing of the completion of the Tarawera Forests purchase and exercise of an option by the minority shareholders of Tarawera Forests to acquire in lieu of a share of the proceeds of the Tarawera Forestry right the freehold land owned by Tarawera Forests. It is expected that the second capital repayment will be up to 26.25 cents per share assuming the Tarawera Forests cutting right is transferred prior to the first capital return.

The first return of capital is subject to shareholder approval by way of a special resolution, requiring 75% of all shares voted to be in favour of the resolution to succeed. This resolution is to be voted on by FC Forests' preference shareholders and ordinary shareholders, voting together.

The resolution relating to the sale of the Forest Assets will take effect if passed, even if the resolution relating to the capital repayment is not passed. The resolution relating to the capital repayment will only take effect if the resolution relating to the sale of the Forest Assets is approved by the required votes. If FC Forests shareholders approve the proposed sale of the Forest Assets, then the Viking Global, OTPP and the NZ Investors component transactions are expected to be settled on or around 27 February 2004.

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2 Scope of the Report

2.1 Purpose of the Report

The Proposed Transaction involves the sale of FC Forests' major asset. The Proposed Transaction is subject to, amongst other things, the provisions of the New Zealand Exchange Limited ("NZX") Listing Rules and the approval of FC Forests' shareholders. A special meeting of all shareholders of FC Forests is scheduled to be held on 20 February 2004 to vote on the Proposed Transaction.

The proposed sale by FC Forests of its Forest Assets changes the essential business nature of FC Forests and represents a significant disposal of assets. If the Proposed Transaction is completed as envisaged FC Forests will change from being predominantly a forest resource owner to a market-focused company concentrating on the marketing, manufacture and distribution of high quality wood products to global markets. FC Forests will also have a different capital structure. Further detail on the pro forma and post-completion statement of earnings and financial position is contained in section 4.4 of this report.

On 9 December the High Court issued a declaratory judgement that the required voting threshold for the Proposed Transaction would be 50% of the votes being cast when the matter is put to the company's shareholders for the purposes of NZX Listing Rule 9.1.1 and FC Forests' Constitution. FC Forests sought a declaratory judgement from the High Court to confirm the appropriate voting threshold to apply to the Proposed Transaction. The Court held that section 129 of the Companies Act 1993 (which imposes the requirement to obtain approval by way of special resolution to a major transaction) did not apply to FC Forests as a company in the context of the sale of the Forest Assets because that company is not a party to the relevant transactions. Rather, the vendors of the Forest Assets are certain wholly-owned subsidiaries of FC Forests that have held those assets since being acquired by FC Forests. In these circumstances, the Court confirmed that the requirement for shareholder approval of the sale of the Proposed Transaction arose under FC Forests' constitution and the NZX/ASX listing rules, which require approval by way of ordinary resolution only. NZX Listing Rule 9.1.2 requires that the notice of meeting containing the resolution to approve a major transaction contain or be accompanied by such information, reports, valuations, and other material as are necessary to enable the holders of securities to appraise the implications of the transactions.

The Directors of FC Forests have requested Grant Samuel & Associates Limited ("Grant Samuel") to prepare an Independent Report to assist FC Forests shareholders in appraising the implications of the Proposed Transaction. An Independent Report is not a specific requirement of the NZX Listing Rules or the Companies Act 1993 in terms of the form of the information to be provided to shareholders to assist in the appraisal of the Proposed Transaction. However the Directors of FC Forests have requested Grant Samuel to prepare a report to ensure shareholders are adequately informed as to the implications of the Proposed Transaction. The report is to be sent to shareholders of FC Forests together with the notice of special meeting and explanatory memorandum.

2.2 Basis of Assessment

In Grant Samuel's opinion, the most appropriate basis for evaluating the Proposed Transaction is to assess its overall impact on the shareholders of FC Forests by weighing up the advantages and disadvantages of the proposal. Grant Samuel considers that an assessment of the Proposed Transaction should be a broad test and should incorporate an assessment of the benefits, disadvantages and risks of the Proposed Transaction including:

- the sale price of the Forest Assets, with a particular focus on the sale process itself;
- the impact of the Proposed Transaction on the financial position of FC Forests;
- the impact of the Proposed Transaction on the business operations of FC Forests;
- the implications for FC Forests if the Proposed Transaction is not completed;
- the intended use of the sale proceeds.

This report has been prepared by Grant Samuel to assist the Directors of FC Forests in advising shareholders in relation to the Proposed Transaction. This report should not be used for any other purpose. Grant Samuel's opinion on the Proposed Transaction should be considered as a whole. Selecting portions of the analyses or factors considered by it, without considering all the factors and analyses together, could create a misleading view of the process underlying the opinion. The preparation of an opinion is a complex process and is not necessarily susceptible to partial analysis or summary.

2.3 Sources of Information

The following information was used and relied upon in preparing this report:

Publicly Available Information

- the explanatory memorandum to FC Forests shareholders accompanying this report;
- annual reports of FC Forests for the years ended 30 June 1999, 2000, 2001, 2002 and 2003;
- half year reports of FC Forests for the six month periods ended 31 December 2001 and 2002;
- recent press articles on FC Forests;
- FC Forests NZX announcements;
- information from the FC Forests website;
- recent broker reports on FC Forests, the forestry industry and comparable publicly listed companies from a variety of broking firms;
- industry reports prepared by international forestry consultants; and
- other information on the international forestry and timber processing industries and publicly listed companies with operations broadly comparable to FC Forests including annual reports, interim financial results, press reports, industry studies and information regarding the prospective financial performance of such companies.

Non Public Information

- Information memorandum and supplementary documentation prepared by Macquarie Bank and provided to prospective acquirers of FC Forests' Forest Assets;
- Budget and revised projections for FC Forests for the year ending 30 June 2004;
- projected earnings, balance sheets and cash flows for FC Forests' Processing & Distribution businesses only for the year ending 30 June 2005;
- recent board papers of FC Forests;
- agreement for sale and purchase of the Forest Assets;
- selected due diligence information made available to the prospective acquirers of the Forest Assets;
- monthly management accounts for FC Forests; and
- other confidential correspondence, legal advice and working papers.

Grant Samuel has also had discussions with and obtained information from senior management of FC Forests. Grant Samuel believes it has obtained all information desirable for the purposes of preparing the report.

2.4 Limitations and Reliance on Information

The report is based upon financial and other information provided by FC Forests. Grant Samuel has considered and relied upon this information. Grant Samuel believes that the information provided was reliable, complete and not misleading and has no reason to believe that any material facts have been withheld.

The information provided has been evaluated through analysis, enquiry, and review for the purposes of forming an opinion as to the advantages and disadvantages of the Proposed Transaction. However, in such assignments time is limited and Grant Samuel does not warrant that these inquiries have identified or verified all of the matters which an audit, extensive examination or 'due diligence' investigation might disclose. In any event, the analysis is in the nature of an overall opinion rather than an audit or detailed investigation. Grant Samuel has not undertaken a due diligence investigation of FC Forests. In addition, preparation of this report does not imply that Grant Samuel has audited in any way the management accounts or other records of FC Forests. It is understood that, where appropriate, the accounting information provided to Grant Samuel was prepared in accordance with New Zealand generally accepted accounting principles and in a manner consistent with methods of accounting used in previous years.

An important part of the information base used in forming an opinion of the kind expressed in this report is the opinions and judgement of the management of the relevant enterprise. Grant Samuel held discussions with the management of FC Forests and that information was also evaluated through analysis, enquiry and review to the extent practical. However, it must be recognised that such information is not always capable of external verification or validation. The information provided to Grant Samuel included projections of future revenues and expenditures, profits, and cash flows of FC Forests prepared by the management of FC Forests. The projected financial information prepared by FC Forests and referred to in this report are projections based on hypothetical assumptions which are realistic possible outcomes, but not necessarily the most probable outcome. A projection is not a forecast as defined under New Zealand accounting standards. The assumptions underlying the financial projections are set out in the Explanatory Memorandum and Notice of Meeting. Grant Samuel has assumed that these projections were prepared fairly and honestly based on information available to management at the time and within the practical constraints and limitations of such projections. It is assumed that the projections do not reflect any material bias, either positive or negative. Grant Samuel has no reason to believe otherwise.

However, Grant Samuel in no way guarantees or otherwise warrants the achievability of the projections of future profits and cash flows prepared by the management of FC Forests. Projections are inherently uncertain. They are predictions by management of future events that cannot be assured and are necessarily based on assumptions, many of which are beyond the control of management. The actual future results may be significantly more or less favourable.

2.5 Current Market Conditions

The opinion of Grant Samuel is based on economic, market and other conditions prevailing at the date of this report. Such conditions can change significantly over relatively short periods of time.

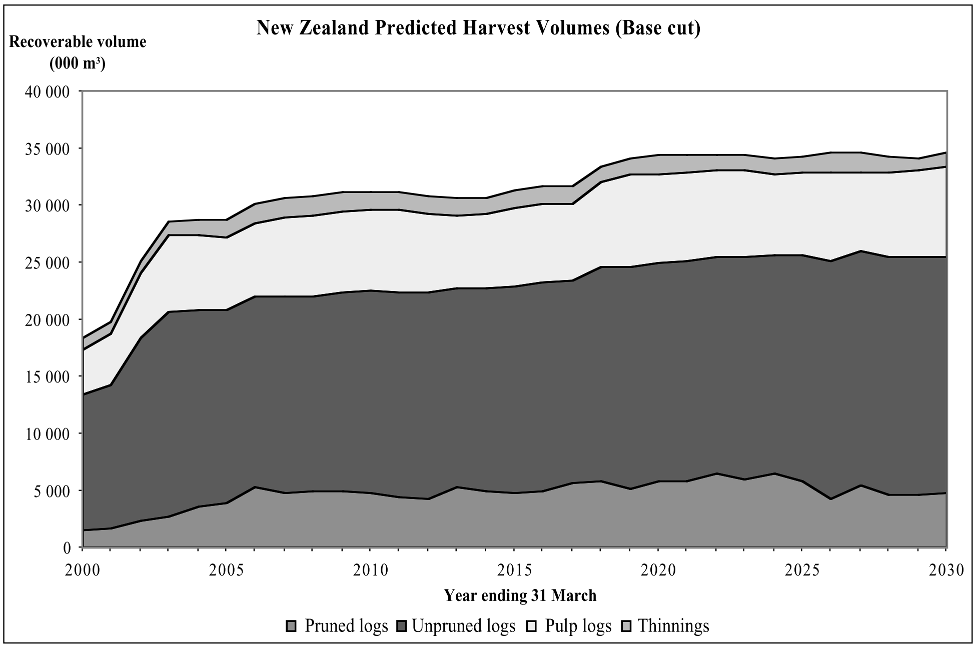
3 Profile of the Forestry Industry

3.1 Background

The global forestry industry supplies timber to processors for conversion into a wide variety of end products including:

- lumber and mouldings;
- plywood and veneer;
- reconstituted boards (MDF and particleboard);
- paper; and
- packaging.

The majority of timber is grown and processed into end use products in the geographic regions within which it is grown. Globally, New Zealand accounts for approximately 1.1% of the world's supply of industrial wood and 1.3% of wood traded. New Zealand has approximately 1.77 million hectares of plantation forests, 90% of which is radiata pine. The current annual harvest of approximately 20 million m^3 is forecast to increase by 75% by 2020 to approximately 35 million m^3.



Source: NEFD Report 2000

New Zealand's forecast log supply significantly exceeds domestic processing capacity and domestic demand, providing a large volume of logs for export. This forecast is based only on an availability to supply. Actual harvest levels will depend on the competitiveness of New Zealand forest product exports and demand in the domestic market. Over the last two decades, a proportion of New Zealand's plantation has been established in small remote blocks on steep terrain. Higher harvesting, road construction and transport costs associated with this terrain may mean that some of New Zealand's projected forest supply will not be economically viable to harvest unless log prices in NZ dollar terms improve. Forest owners with large scale operations located on relatively flat terrain close to both domestic customers and export market outlets are best positioned to compete in the export market at the lowest end of the supply cost curve. Forests located in the central North Island fall into this category.

The outlook for the global forestry industry over the next 15 years is for a significant shift in the sources of supply, due largely to the unsustainability of large volumes from traditional sources.

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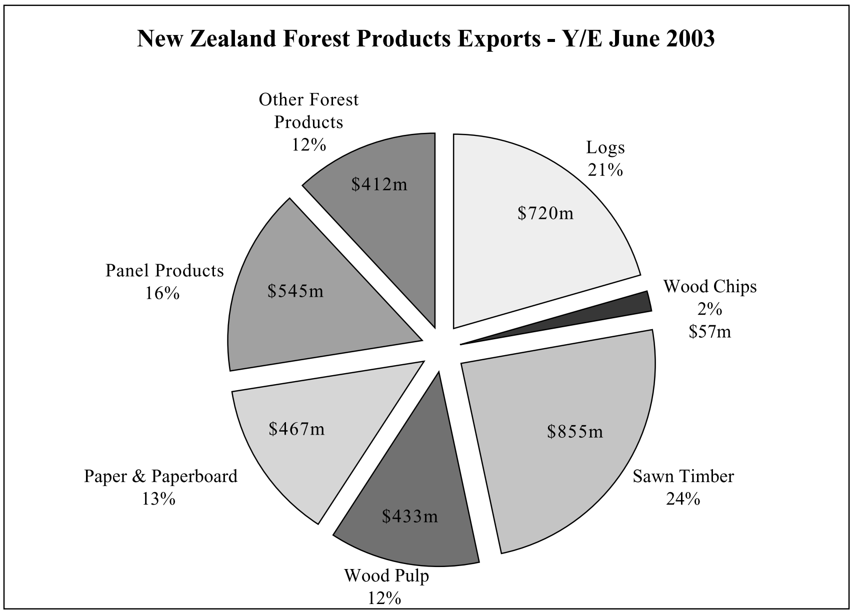
The main growth regions in the global wood supply are the fast growing plantations (in South America, Oceania, South East Asia and Africa) and Eastern European/Russian forests. The volume of global sawlog trade is forecast to decrease in the next ten years primarily due to the reduced availability of logs from North America. The reduction in the volume of logs traded is expected to be more than compensated for by an increasing trade in sawn wood, plywood and other value added products. The global trade in pulpwood and chips is also expected to expand with pulpwood coming largely from the fast growing plantations in South America, Australia and New Zealand. The proportion of pulpwood logs in Australia is forecast to progressively decline to around 30%, with a commensurate increase in the volume of sawlogs. This has implications for New Zealand exports to Australia and possibly other markets if Australia continues to expand its export markets.

As at 30 September 2003 approximately 14.6m^3 of timber was processed locally in New Zealand and of this amount approximately 6.5 million m^3 was consumed locally. Local consumption is forecast to grow slowly, reaching approximately 10 million m^3 by 2040. Log demand in New Zealand is primarily affected by demand for export processed products from Asia, Australia and the United States. The lack of established markets for processed radiata and the likelihood that the New Zealand wood processing industry may not be able to expand sufficiently to keep up with the increase in sawlog supply, means that log exports are likely to become an increasing component of the export mix.

In the year ending 30 June 2002 forestry exports totalled $3,695 million, representing an 11.4% increase in the volume of exports offset by an 8.0% decline in NZ dollar prices over the same period. In the year ending 30 June 2003 forestry exports totalled $3,488 million, with volumes increasing by 4.7% and prices declining a further 9.2%. A large proportion of the price contraction can be attributed to the increases in the value of the New Zealand dollar. Forest produce exports are forecast to decline in NZ dollar value terms in 2004.

The mix of exports measured by value is shown in the chart below:



Source: NZMAF 2003

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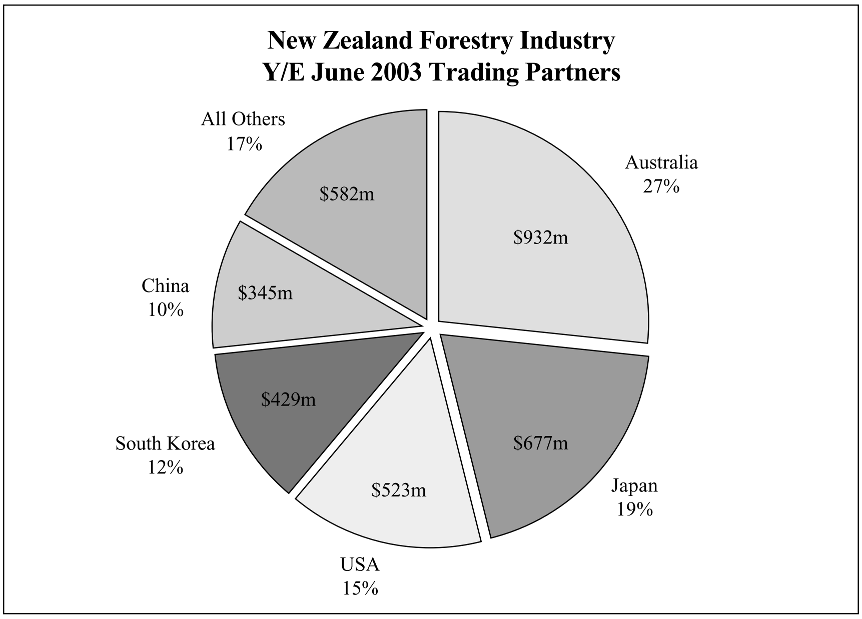
New Zealand's forestry trading partners by volume and value in 2003 are summarised in the table below:



Source: NZMAF 2003

Australia is New Zealand's largest export market. The major exports to Australia in the year ending 30 June 2003 were paper and paper board $279 million, sawn timber $248 million, and wood pulp $105 million. USA is the largest market for New Zealand sawn timber taking $356 million in the year ending 30 June 2003.

The estimated total of all forest products exported was 16.5 million m^3 in the year ending 30 June 2003, an increase of 5% over the previous year total of 15.6 million m^3. By volume, logs and poles account for over half of the total exports, yet represent only 21% of the total value of exports. In contrast sawn timber exports total 1.8 million m^3 (or 11% of volume), but represent approximately 24% of total value.

Of critical importance to the continuing businesses of FC Forests is the price for sawlogs and lumber in the USA. Prior to 1997 North America was a significant exporter of forest products. The Asian crisis in August 1997 resulted in wood formerly destined for Asian markets being redirected to other markets, in particular the USA. Since 1997 there has been relatively weak demand for wood globally.

NZMAF is forecasting the annual value of forestry exports to rise to approximately $4.6 billion by 2008 due mainly to an increase in the volume. Sawn timber is forecast to remain the largest export category by value but closely followed by logs and poles where an average annual volume increase of 7.6% is forecast compared with an annual average increase of only 4.3% for sawn timber. Pulp and paper volume increases are much smaller reflecting in part capacity constraints.

3.2 Price Outlook

Forecast stronger world economic growth in 2004 is expected to see some timber being diverted away from the USA and is likely to result in some upwards price pressure in the USA for saw log and lumber. From FC Forests' perspective the expected increase in US dollar prices is not expected to offset the significant loss from the decrease in the value of the US dollar experienced over the last 12 months.

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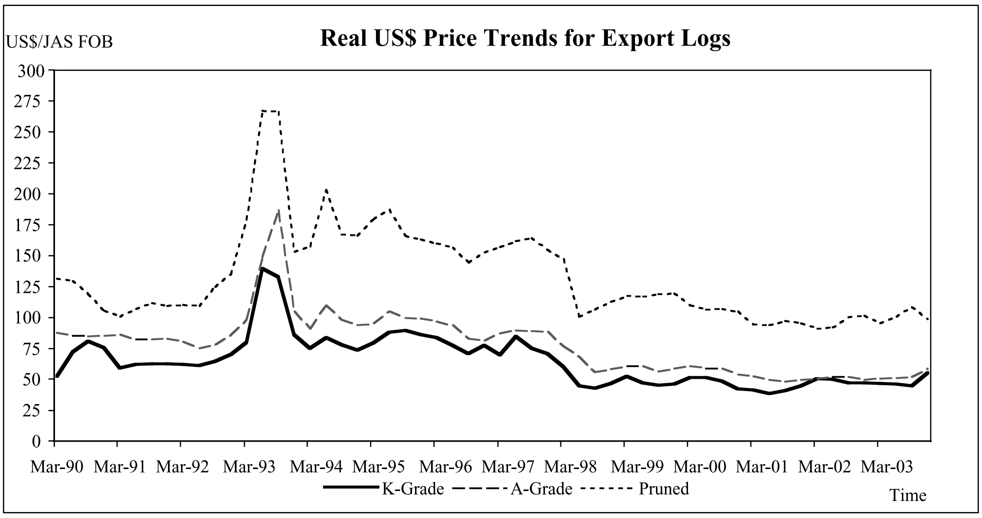
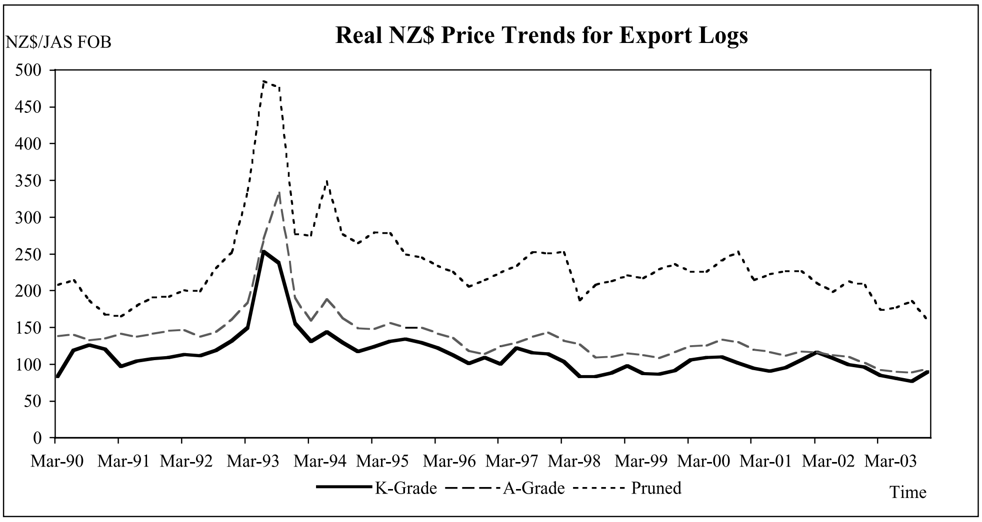
International forestry consultant Jaakko Pöyry[1] believes that global wood prices are tending to converge as the traditionally low priced North American market has experienced increasing real prices of wood, while the traditionally high priced European and Scandinavian markets have experienced declining real prices.

In real terms there has been a long run downward trend in log prices for New Zealand exporters both in US dollars and NZ dollars, with prices being relatively stable over the last five years compared with the early 1990s.

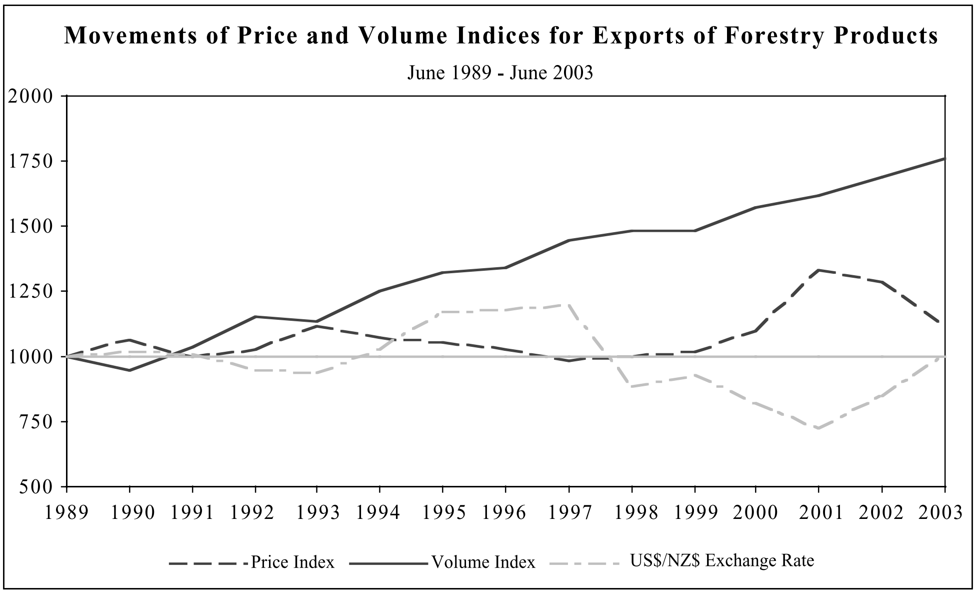


Regions with fast growing plantations such as New Zealand continue to be the source of the lowest cost softwood sawlogs. Sawlog prices in New Zealand have declined in US dollar terms since the mid 1990s, reflecting the increasing supply compared to the relatively small domestic market and the recession in export markets (particularly in Asia) for both sawlogs and processed products.



[1] *Source: Global Wood Prices and their impact on Competitiveness of Forest Industry: Jaako Pöyry*

The chart below illustrates an inverse relationship in recent years between the NZ dollar log prices index and the US$: NZ$ exchange rate and the substantial increase in export log volumes:



Radiata pine products compete with a range of other products that perform the same or similar functions including medium density fibreboard and wood alternatives such as plastics. Changes in consumer preference in favour of these alternative products, price relativities with the competing products and technological advances of such products could all materially affect the prices that can be charged for radiata pine.

3.3 Summary

The current outlook for the New Zealand forest sector is at best mixed. The volumes of forestry exports are forecast to increase. If the NZ dollar remains high relative to its main trading partners in the USA and Asia, profitability will remain constrained. The costs of production, in particular harvesting and shipping, have risen over the past 12 months constraining earnings further. New Zealand is a price taker for the majority of its forestry exports. An expected recovery in the world economy will assist the demand for forestry products. Any significant increase in demand has not historically resulted in long term price increases, as marginal volume is brought into production in response to higher prices.

4 Profile of FC Forests

4.1 Background to FC Forests

In December 1999 Fletcher Challenge announced that it was dismantling its targeted share structure. On 3 April 2000 Fletcher Challenge announced the sale of Fletcher Challenge Paper ("FC Paper") to Norske Skog. The sale of FC Paper was completed on 28 July 2000. On 10 October 2000, Fletcher Challenge announced a proposal for the completion of the dismantling of its targeted share structure. The proposal involved the sale of Fletcher Challenge Energy ("FC Energy") to Shell Overseas Holdings Limited and Apache Corporation and the separation of Fletcher Challenge Building ("FC Building") as a stand alone listed company, leaving FC Forests as the only remaining division of Fletcher Challenge. A new company, Rubicon, was formed to recapitalise FC Forests to allow it to stand-alone. Rubicon also acquired certain assets of FC Energy which Shell would not purchase, as well as certain forestry and biotechnology assets from FC Forests. As part of the separation transactions FC Forests received NZ$90 million from a placement of FC Forests shares to Rubicon and NZ$80 million from the sale of its South American and biotechnology assets to Rubicon. The separation was approved by Fletcher Challenge shareholders and the separation was implemented in March 2001. Following the separation Fletcher Challenge changed its name to FC Forests. Since then, FC Forests has operated as a stand alone entity.

At the time of FC Forests' formation in 1993 as a targeted share, the assets assigned to FC Forests consisted of all the solid wood plantation forestry assets and the log trading activities of Fletcher Challenge. The other wood based businesses including pulp and paper, wood panels, sawn timber and plywood remained as part of Fletcher Challenge. FC Forests later acquired the sawn timber and plywood operations of FC Building for NZ$93 million.

FC Forests is considered a world leader in solid wood radiata plantation forestry and the provision of solid wood based solutions to consumers in New Zealand, Australia, and the USA. It is also a significant supplier of logs to industrial customers in New Zealand and throughout Asia. In the year to 30 June 2003, sales volumes from the Forest Assets to both internal and external customers totalled 2.1 million m^3, while logs sold on behalf of third parties totalled 1.4 million m^3. FC Forests' total volume of timber is small in the international context, representing approximately 0.4% of total world production.

In 1996 FC Forests acquired the business of Forestry Corporation of New Zealand ("FCNZ"), and simultaneously transferred all of the assets into the Central North Island Forest Partnership ("CNIFP"). The initial partners of the CNIFP were FCNZ, Brierley Investments Limited and a New Zealand subsidiary of the China International Trust and Investment Corporation ("CITIC NZ"). The acquisition included the cutting rights and related downstream solid wood processing activities, but excluded the land on which the forests are situated. In September 1998 FCNZ and CITIC NZ each acquired 50% of Brierley Investments interest in the CNIFP. The syndicate of banks that had financed the CNIFP placed the two remaining partners, FCNZ and CITIC NZ into receivership on 26 February 2001. The receivers were appointed after FCNZ and CITIC NZ failed to satisfy certain financial covenants under the banking syndicate's facilities. In June 2002 FC Forests announced that it had reached agreement with the receivers of the partners of the CNIFP to purchase all of the operating assets of the CNIFP, comprising 162,000 planted hectares of forest and associated processing facilities, for a consideration of approximately US$650 million. The proposed acquisition of the CNIFP assets was intended to provide FC Forests with the scale, synergy and marketing benefits associated with owning and operating a substantially larger forest estate. However at a special meeting FC Forests' shareholders did not approve the transaction. In October 2003 the receivers of the CNIFP announced that they had reached agreement to sell the CNIFP forest assets to GMO Harvard Renewable Resources for an undisclosed consideration. Market commentators estimated the sale price to be US$600 - $625 million. That transaction was concluded on 19 December 2003.

Following the rejection of the acquisition of the CNIFP assets by FC Forests shareholders, the Directors and management of FC Forests abandoned the forestry growth strategy and instead sought to refocus the business on the higher yielding wood processing, marketing and distribution activities.

In March 2003 FC Forests sold the Tahorakuri and Tauhara forestry assets comprising 8,940 hectares of cutting rights to entities managed by UBS Timber Investors for a consideration of US$65 million. The successful sale of the Tahorakuri and Tauhara forest assets was followed by the announced decision to seek a purchaser for the remaining Forest Assets.

4.2 Principal Business Activities

Over the past few years, FC Forests has focussed on being a customer driven supplier of high value solid wood products to the housing and furniture sectors. To implement this strategy, FC Forests has integrated downstream processing and distribution operations. In parallel, a number of marketing initiatives have been undertaken to stimulate demand for radiata pine, FC Forests' principal forest resource. Radiata pine is New Zealand's preferred softwood species due to its strong growth rate over a range of sites, its compatibility with New Zealand's climate and its suitability for both solid wood and fibre products. In solid wood applications, radiata pine is used for the production of veneers, plywood, laminated and finger-jointed products and appearance, structural and industrial lumber. Radiata pine lumber is increasingly being substituted for Ponderosa pine in the USA mouldings and millwork sectors. Radiata pine is also suited to the manufacture of high quality wood pulp and reconstituted wood products.

Plantation forestry is a term used to describe forests that are intensively managed and grown as a separate economic endeavour to supply wood to an open market. The trees are planted, thinned, pruned, sometimes fertilised and finally harvested on a regular cycle. Historically, the principal source of revenue for FC Forests has been from the sale of logs and processed solid wood products from its plantation forests.

Today, FC Forests is separated into two distinct parts – the Forest Assets and the processing, marketing and distribution assets. A profile of these two asset groupings is set out below.

4.2.1 The Forest Assets

The Forest Assets consist of approximately 107,000 net stocked hectares almost exclusively located in the central North Island region of New Zealand. The locality is widely regarded as providing an ideal blend of climate and soils, resulting in some of the fastest softwood growth rates in the world and is in close proximity to ports, processing plants and distribution infrastructure. Of the net stocked area, approximately 96 percent is planted in radiata pine, approximately 4 percent in Douglas fir and the balance predominantly in eucalyptus. A profile of the Forest Assets is outlined below.

FC Forests – Profile of Forest Assets

Key Feature	Total
Net stocked area freehold	71,216 ha
Net stocked area non-freehold	35,530 ha
Total net stocked area	106,746 ha
Average age	14.1 years
Mean annual increment	21.4 m^3/ha/year
Average distance to:	
Port	117 km
Sawmills	37 km
Pulp mills	60 km
Gross Book Value of forest crops and land at 30 June 2003[1]	NZ$763m

Approximately 71,000 net stocked hectares (66 percent) of the Forest Assets are located on freehold land, including the land owned by Tarawera Forests Limited ("Tarawera Forests"). In addition a further 9,000 hectares of freehold land suitable for replanting will be progressively returned to FC Forests over the next 10 years as the Tahorakuri and Tauhara cutting right areas are felled. FC Forests owns 82.5 percent interest in Tarawera Forests, Maori Investments Limited (representing the combined interests of the original Maori owners of a portion of the Tarawera Forest estate) owns 10.8 percent and the Crown owns the remaining 6.7 percent. Tarawera Forests has a net stocked area of 20,700 hectares. FC Forests manages the forestry operations and markets the harvest of Tarawera Forests. The balance of the land interests comprise forestry rights, cutting rights and leases which entitle the grantee/lessee to plant, tend and harvest one or more crops of timber.

[1] Gross Book Value includes minority interests but excludes the deferred tax liability attributable to the forest crop.

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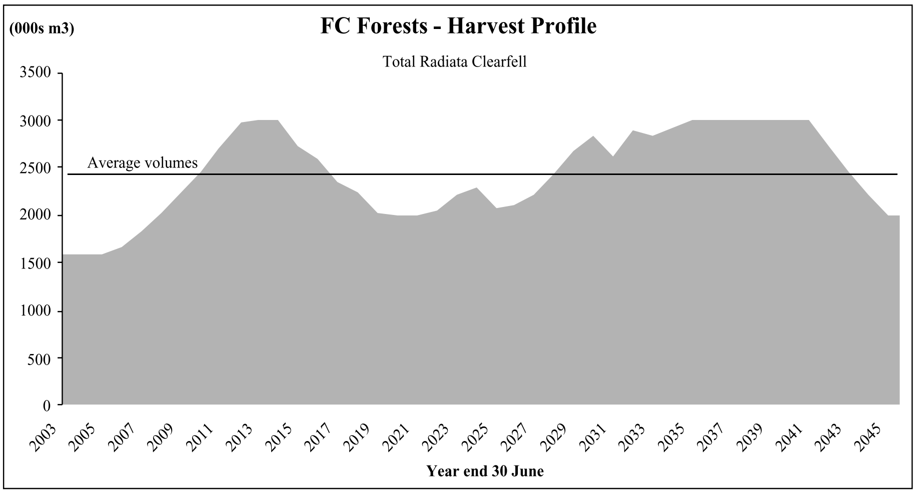
The projected annual harvest profile of the Forest Assets is set out in the table below. The projected harvest profit includes 100% of the output from Tarawera Forest (82.5% owned) and 100% of the volume from non-freehold areas where the landowner has rights to a portion of the harvest proceeds. Thinnings volumes are excluded.



FC Forests' harvest consists of:

- ***Pruned logs***: high quality larger logs, containing a substantial proportion of clearwood, used primarily in the veneer and plywood industries in the production of clearwood lumber for furniture, and interior and exterior finishing uses;
- ***Sawlogs***: medium quality logs used in the lumber industry to produce construction, packaging and appearance grade lumber products, and industrial plywood;
- ***Pulplogs***: low grade logs used as fibre input into the manufacture of pulp and paper and reconstituted wood products; and
- ***Thinnings***: by-products of forest thinning, generally used as fibre input in the manufacture of pulp and paper, and reconstituted wood products.

FC Forests also undertakes forest establishment and management, harvesting, transport, and supply chain planning activities for the estate. This business, known as Forests & Supply, sources logs, industrial lumber and chips from both FC Forests' operations and third parties. Forest & Supply sells primarily to industrial customers in New Zealand (including FC Forests' own mills) and Asia. Forest & Supply is developing a number of markets in Asia, among them core and appearance veneer, packaging componentry, and furniture componentry.

Set out below is a summary of actual gross sales volumes (before inter-company eliminations) by estate for the year ended 30 June 2003 and projected sales volumes for the current year:

Sales Volumes by Estate ($000m^3$)		
	Year end 30 June	
Forest Estate	**2003A**	**2004P**
FC Forests	1,431	1,298
Tarawera	550	533
Sub total – Forest Assets	1,981	1,831
Third Party Trading (including logs and residues)	2,430	1,757
Tahorakuri and Tauhara	87	360
Total all estates	**4,498**	**3,948**

FC Forests is a party to five material Pulpwood Supply contracts. Tarawera Forests is also a party to a supply contract with Norske Skog.

Whakatane Board Mill Supply Agreement

FC Forests has an agreement to supply pulpwood to the Whakatane Board Mill owned by CHH. This is a perpetual contract that operates for so long as the Whakatane Board Mill continues to produce pulp. Under this contract, FC Forests is obliged to supply 115,000 green tonnes of pulplogs per annum and 25,000 green tonnes of wood chip per annum, unless a different volume is agreed with CHH.

CHH has recently announced it intends to upgrade the Whakatane Board Mill, indicating that the mill will continue to operate in the foreseeable future.

OTPP and Viking Global has entered into back-to-back supply agreements with FC Forests for a minimum term of 15 years to supply the pulplog requirements of this contract.

Eucalypt Supply Agreement

FC Forests has a five year agreement to supply Norske Skog under which it must supply 40,000 cubic metres of Eucalypt logs per annum. Norske Skog has in turn agreed to supply those logs to CHH Tasman for use in its Kawerau Pulp Mill under a commitment that commences in July 2005. The logs will be harvested from Eucalypt trees planted especially to meet this supply commitment. FC Forests believes there may now be a shortfall in the available harvest, principally due to pest damage. The contract allows FC Forests to source Eucalypt logs from alternative sources but they are in short supply. Kiwi Forests Group is to enter into a back-to-back agreement with FC Forests in relation to this supply agreement, although it requires FC Forests to bear the risk of any shortfall of supply out of the Matahina Forest.

Inter-division Agreement

FC Forests has a perpetual Inter-division pulpwood supply agreement with Norske Skog which was established with Tasman Pulp and Paper prior to the separation of the Fletcher Challenge Group. Under the agreement FC Forests must make available for supply the following pulpwood volumes to Norske Skog:

- 300,000 cubic metres of pulplogs, although this supply commitment is reduced to the extent of supply by Tarawera Forests Limited under the Tarawera sales agreement; and
- 100% of the sawmill chip produced by all of FC Forests' mills, except for Taupo. In relation to the sawmill chip produced at the Taupo Mill, Norske Skog has second option after Fletcher Building.

Kiwi Forests Group has entered into back-to-back supply agreements for a minimum term of 25 years in respect of the 300,000 cubic metre pulplog component of the Inter-division agreement. FC Forests will remain responsible for the chip component.

Tarawera Sales Agreement

Under this agreement, Tarawera Forests must supply, and Norske Skog must purchase, the total output of its forest produce. Tarawera can elect to not supply product that Norske Skog will not be using itself. At present, Tarawera has elected not to supply products other than pulpwood utilised by Norske Skog, and the remaining product is sold to third parties including FC Forests.

The interrelationship between the Tarawera supply contract and the Inter-division agreement requires that if Tarawera Forests Limited reduces its harvest, FC Forests can be required to make up the balance of the 300,000 cubic metre commitment to Norske Skog under the Inter-Division Agreement from the FC Forests estate. At present, the Tarawera forest is providing 80,000 to 100,000 cubic metres of pulplogs and whole log chip per annum to Norske Skog/CHH. The FC Forests' estate is making up the balance of the 300,000 cubic metre commitment under the Inder-Division Agreement. The Tarawera estate is also producing

400,000 cubic metres of sawlogs per annum. Around 40% of this is sold to the FC Forests mills. The balance is either exported or sold to third party mills. Kiwi Forests Group has entered into a back-to-back supply agreement for the term of the Tarawera Forestry right in respect of Tarawera Forests' obligations under this agreement (subject to the Tarawera Forestry right being transferred to it).

Fletcher Building Supply Agreement

This supply agreement runs for a term of 20 years from February 2001. Under this agreement FC Forests is obliged to supply:

- 100,000 cubic metres of pulpwood and whole log chip;
- an additional entitlement to 100,000 cubic metres of pulpwood/whole log chip, if available, subject to the existing supply commitments to Norske Skog and CHH;
- all residues from FC Forests' processing facilities; and
- all sawmill chip from the Taupo Mill (and a second option over sawmill chip from FC Forests' other mills after Norske Skog and CHH).

FC Forests believes that it can manage this supply agreement without any "back to back" arrangement with the purchaser of its estate.

Back-up Agreement to the Tasman Supply Contracts

The back-up agreement to the Tasman supply contracts is between FC Forests and Norske Skog and runs through to 2020. At present, the supply commitment is 500,000 cubic metres of pulpwood per annum, which will reduce to 400,000 cubic metres per annum on 31 March 2005. FC Forests meets its obligations under the Back-up Agreement from supply to FC Forests under the Tasman Supply Contracts between FC Forests and the owner of the Central North Island Forest Partnership estate for equivalent volumes. FC Forests is not requiring Kiwi Forests Group to meet any of the Back-up Agreement commitments.

4.2.2 Processing, Marketing and Distribution

FC Forests has the following processing operations in New Zealand:

FC Forests – Processing Facilities		
Plant	**Products**	**Capacity (m^3/year)**
Kawerau Sawmill	Kiln-dried machine stress-graded framing for New Zealand and Australia. Feedstock for Kawerau Remanufacturing Plant.	320,000
Rainbow Mountain Sawmill	Kiln-dried visually graded framing for New Zealand and Australia. Outdoor treated lumber products.	185,000
Taupo Sawmill	North American appearance grades. Feedstock for Taupo Mouldings Plant.	210,000
Mt Maunganui Plywood Mill	Standard and treated structural plywood. Dried veneer. Joist I-beams.	45,000
Kawerau Remanufacturing Plant	Finger-jointed and laminated lumber for Australasian housing markets.	35,000
Taupo Moulding Plant	Solid lineal mouldings for North American homes.	37,000
Ramsey Roundwood	Posts and poles, landscaping and outdoor treated products.	60,000
Total		**892,000**

The following table sets out selected processing volumes relating to FC Forests for the periods indicated:

FC Forests – Processing Volumes (000s m^3)					
Year ended 30 June	**1999**	**2000**	**2001**	**2002**	**2003**
Lumber and roundwood	492	517	498	553	571
Re-manufactured products[2]	83	95	103	115	123

Of the total logs harvested from FC Forests' Forest Assets approximately 40% is exported as logs primarily to Japan, Korea and China. Approximately 40% is sold domestically (largely to Norske Skog and Carter Holt Harvey) and 20% is processed into high value lumber, mouldings, laminated beams and other products. In the year to 30 June 2003, approximately 55 percent by value of FC Forests' revenue was derived from the export of logs, lumber and remanufactured solid wood products to countries in the Pacific Rim region and North America. The balance was sold in New Zealand to a range of domestic processors and end users, including Fletcher Building and Norske Skog.

FC Forests' principal offshore markets are the USA, Australia, China, Japan and South Korea. FC Forests has sales offices in China and the USA, in addition to its operational base in New Zealand. The distribution operations in the USA are carried out by American Wood Moulding ("AWM") (half owned by FC Forests), The Empire Company ("Empire") (two thirds owned by FC Forests) and by FC Forests in its own right.

FC Forests' strategy is to move radiata logs to their highest value end-uses. This strategy has been implemented through two business units that have a specific market and product focus:

Australasian Asian Consumer Solutions ("AACS")

AACS undertakes the production, marketing and distribution function of lumber products in New Zealand, Australia, Japan and Asia. In New Zealand and Australia AACS supplies framing, plywood and treated products to the residential and light commercial building sectors. Through the introduction of kiln-dried, machine stress-graded lumber under the brand Origin® Timeframe, AACS has expanded its share of the New Zealand framing market. Other branded products are Origin® Plywood (structural and interior plywood), Origin® Outdoor (decking, fencing and landscaping lumber) and Origin® I-beam (flooring). AACS's growth opportunities include further engineered products (frame and truss), and flooring and rafter systems. Eventually AACS plans to provide a complete radiata housing system to home builders.

North American Consumer Solutions ("NACS")

FC Forests manufactures high value, environmentally certified clearwood products from pruned radiata logs at its Taupo plant for export to the USA, where NACS has an estimated 11% market share and is the largest manufacturer of imported solid wood mouldings. Radiata substitutes in many applications for diminishing USA supplies of Ponderosa pine.

FC Forests owns 67% of Empire and 50% of AWM and these businesses form an integral part of NACS' marketing and distribution network in North America. Empire is a preferred supplier of mouldings to Lowe's and AWM is a preferred supplier to The Home Depot, the two largest home improvement chains in the USA. NACS focuses on fully leveraging its wood products supply chain and has significant growth potential in increasing volumes and expanding the range of products sold via well established marketing and distribution channels.

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2 Includes primary plywood, laminated and finger-jointed wood products and solid lineal mouldings.

4.3 Financial Profile if the Forest Asset sale is not effected

4.3.1 Financial Performance

Set out below is a summary of the audited financial performance of FC Forests for the year ended 30 June 2002 and 30 June 2003, and projections for the year ending 30 June 2004 assuming no sale of the Forest Assets and no capital return. The projections for the year ending 30 June 2004 are based on the assumptions outlined in the Notice of Meeting and Explanatory Memorandum.

FC Forests – Financial Performance (Status Quo)			
	Year End 30 June (NZ$ millions)		
	2002A	**2003A**	**2004P**
Operating revenue	664	678	705
Operating expenses	(606)	(620)	(676)
Operating earnings	**58**	**58**	**29**
Forex gains/(losses)	25	23	(2)
Non-recurring items	(351)	(31)	(19)
Forest crop revaluations	53	(451)	-
EBIT	(215)	(401)	8
Funding costs	(22)	(18)	(5)
Earnings before tax & minorities	(237)	(419)	3
Taxation	(9)	140	(3)
Minority interests	(3)	8	(2)
Net earnings	**(249)**	**(271)**	**(2)**

There are no current Board approved financial projections available for the Forest Assets beyond the year ending 30 June 2004.

Grant Samuel has treated the following as non-recurring items:

- a $349 million write down of FC Forests investment in CNIFP in 2002;
- a $29 million loss on sale of the cutting rights for 8,940 hectares of Tahorakuri and Tauhara forest estate in 2003; and
- the break fee payable to the Campbell Group.

Set out below is a breakdown of operating results by the two business segments, Processing and Distribution and Forest Assets:

FC Forests – Operating Results by Business Segment (Status Quo)				
	Year End 30 June (NZ$ millions)			
	2002A	**2003A**	**2004P**	**2005P**
Operating revenues:				
NACS	194	167	274	411
AACS	215	226	225	267
Corporate	-	-	1	-
Processing & Distribution	409	393	500	678
Forest Assets	255	285	205	na
Total operating revenues	**664**	**678**	**705**	**na**
Operating earnings:				
NACS	26	18	19	37
AACS	(5)	12	16	18
Share of Support Services	-	-	(5)	(15)
Processing & Distribution	21	30	30	40
Forest Assets	57	48	19	na
Share of Support Services	(20)	(20)	(20)	na
Operating earnings	**58**	**58**	**29**	**na**

na = not available

The projections for the year ending 30 June 2004 reflect the actual results for FC Forests for the five months ended 30 November 2003. The following comments are relevant to an analysis of the financial performance of FC Forests:

Processing, Marketing and Distribution

- Empire was consolidated for the first time effective 1 November 2003 following FC Forests' acquisition of a second one-third equity interest in that company. A put option exists for the balance of the shares in Empire not already owned by FC Forests;
- operating revenue for the processing, marketing and distribution business in the year to 30 June 2003 declined 4% to $393 million on total sales volumes of 747,000m^3. Exports accounted for 50% of revenue, split between North America (36%), Australia (9%) and Asia (5%);
- the New Zealand residential housing market was very strong in 2003, influenced in part by high immigration numbers and low interest rates. Housing starts for the year to June 2003 were 29,100, compared with 22,700 in the prior year. 2003 housing starts were 26% above the ten year New Zealand average of 23,000;
- in contrast FC Forests' North American business segment experienced two markedly different six month periods in the year ended 30 June 2003. From a record performance in the first half, which generated 94% of the full year operating earnings, profitability fell significantly in the second six months due to weakening US prices and a strong NZ dollar. Moulding and better lumber grade prices fell 30% from June 2002 to June 2003, from US$1,300 per thousand board feet to US$900, the equivalent of a 40% decline when measured in NZ dollars;
- fluctuations in the US dollar has an indirect impact on operating results for AACS in terms of both log prices and volumes. The weaker US dollar exchange rate means lower returns from export sales, which encourages greater domestic competition. As a result of more intense domestic competition AACS has been experiencing lower than anticipated volumes of sales into Australia;
- the significant weakening of the US dollar against foreign currencies has negatively impacted on translation of FC Forests' US dollar denominated sales revenue into New Zealand dollars. The average US dollar exchange rate for the year ended 30 June 2003 was $0.52 compared to current projections, which use average exchange rates of US$0.63 for the year ending 30 June 2004 and US$0.60 for the year ending 30 June 2005. The operating performance of NACS in US dollars shows a more consistent trend;
- management is expecting significant growth in operating revenues for AWM and Empire as a result of volume growth and higher average moulding and lumber prices in the USA. Growth in revenues for AWM also in part reflects its recent acquisition of a smaller competitor, Ornamental Mouldings Inc.; and
- lower prices in NZ dollar terms in 2004 for AACS are expected to offset a projected increase in revenue from higher sales volumes.

Forest Assets

Lower export prices in NZ dollar terms and lower clearfell volumes resulted in significantly lower earnings for the Forest Assets.

FC Forests – Forest Assets only (NZ$million)

	Year End 30 June		
	2002A	**2003A**	**2004P**
Revenues	170	202	137
EBITDA	56	45	19
EBIT	55	42	16
A Grade (JAS/FOB) prices:			
US$	$49	$50	$58
NZ$	$113	$97	$92
Radiata clearfell volumes (000m^3)	1,573	1,825	1,643
US$:NZ$ Exchange rate	$0.43	$0.52	$0.63

The earnings from the Forest Assets are not consistent from year to year as they are a function of the rate of harvest, the type of tree harvested, the location and terrain profile of the harvest and the market demand for the product. Earnings patterns typically need to be viewed over a long period. In real terms log prices have trended downwards for 20 years with only the occasional temporary strengthening.

The decline in the projected operating revenues from the Forest Assets compared to historical results is in part attributable to the weakening US dollar. In addition, the projected operating results for the Forest Assets have been affected by:

- the sale of the cutting rights to Tahorakuri and Tauhara forest estates in January 2003 which means that FC Forest plans to clearfell approximately 300,000m^3 less radiata from the FC Forests' wholly owned estates and Tarawera estates in the current year than in the previous year;
- the rise in the NZ dollar exchange rate throughout the year against the major trading partners and competing suppliers. This had a direct effect on returns from the 45% of log sales which were exported, as well as having a flow-on effect on domestic prices. The average NZ dollar selling price of logs from the Forest Assets fell 5% year to year;
- strong overall log demand. Although South Korean demand declined as its economy slowed with log sales volumes down 21% for the year, strong demand from China more than compensated. Volumes to China increased 158% year on year, with China (at 30%) overtaking South Korea (at 29%) as FC Forests largest log market. The strong New Zealand residential housing market sustained domestic log sales volumes. Total log and residue sales volumes rose 17%;
- higher shipping costs. Spot daily charter rates climbed 50% over the last 12 months due to a shortage of bulk shipping capacity in the region, while fuel costs also rose; and
- increased harvesting costs as logging operations rotated to more difficult terrain and a shortage of labour due to the increased New Zealand harvest.

FC Forests lost the CNIFP management contract from 1 July 2003, resulting in a reduction in EBIT for the Forest Assets and, to a lesser extent, AACS going forward.

Support Services

Support Services represents mainly unallocated overheads of FC Forests' wholly owned businesses that arise in relation to centralised functions such as IT, Finance and Human Resources. In addition Support Services includes corporate and head office costs and the projections include approximately $2 million of depreciation on an annualised basis that relates mainly to capitalised software and IT systems supporting the forestry management and lumber production functions.

4.3.2 Cash Flow

FC Forests' actual operating cash flow for the year ended 30 June 2003 and projected operating cash flow for the year ending 30 June 2004 are summarised below:

FC Forests – Operating Cash flow (Status Quo)		
	Year End 30 June (NZ$ millions)	
	2003A	**2004P**
EBIT	(401)	8
Add back:		
Equity earnings	(5)	(8)
Depreciation, amortisation & revaluations	456	22
Loss/(gain) and disposal of assets	29	-
Interest paid	(17)	(5)
Tax paid	(7)	(6)
(Increase)/decrease in working capital	(9)	(16)
Operating cash flow	**46**	**(5)**

4.3.3 Financial Position

Set out below is a summary of the financial position of FC Forests at 30 June 2003 and projected for 30 June 2004:

FC Forests – Financial Position (Status Quo)		
	As at 30 June (NZ$ millions)	
	2003A	**2004P**
Assets		
Stocks	66	94
Debtors	54	74
Total current assets	120	168
Forest crops and land	763	762
Other fixed assets	141	138
Intangible assets	2	11
Investments	33	34
Total assets	**1,059**	**1,113**
Liabilities		
Creditors	(93)	(88)
Net debt	(86)	(144)
Provision for deferred tax	5	(8)
Net assets	**885**	**889**
Equity		
Reported capital	1,443	1,443
Reserves	(579)	(583)
Total group equity	864	860
Minority interest	21	29
Total equity	**885**	**889**

The following points should be noted in analysing the financial position above:

- the value of the forest crop is a function of market prices, harvest profiles, organic growth and replanting and key operating assumptions. Any change in assumptions regarding future market prices, key operating factors or cost of capital will have a significant impact on the carrying value of the estate and therefore net earnings. The projected balance sheet at 30 June 2004 is based on the assumption that there is no change in the carrying value of forest crops and land; and
- foreign currency denominated debt as at 30 June 2003 and 30 June 2004 has been converted at a fixed exchange rate of US$0.58 = $NZ1.00, and US$0.60:NZ1.00 respectively; and
- the projected financial position of FC Forests assumes that if the sale of Forest Assets does not take place there will be no capital return.

In June 2001 FC Forests changed its accounting policy in respect of the carrying value of the forest crop from a historical cost to a market value basis. The effect was to reduce the carrying value by $625 million from $1,748 million to $1,123 million. The table below summarises the movement in the carrying value of the forest crop since 30 June 2001:

FC Forests – Movement in Carrying Value of Forest Crop	
	NZ$ million
Carrying value at 30 June 2001	1,123
Movement in log prices	(280)
Change in discount rate	(145)
Sale of Tahorakuri and Tauhara Cutting Rights	(143)
Growth and replanting net of harvesting	65
Other	(38)
Carrying value at 30 June 2003	**582**

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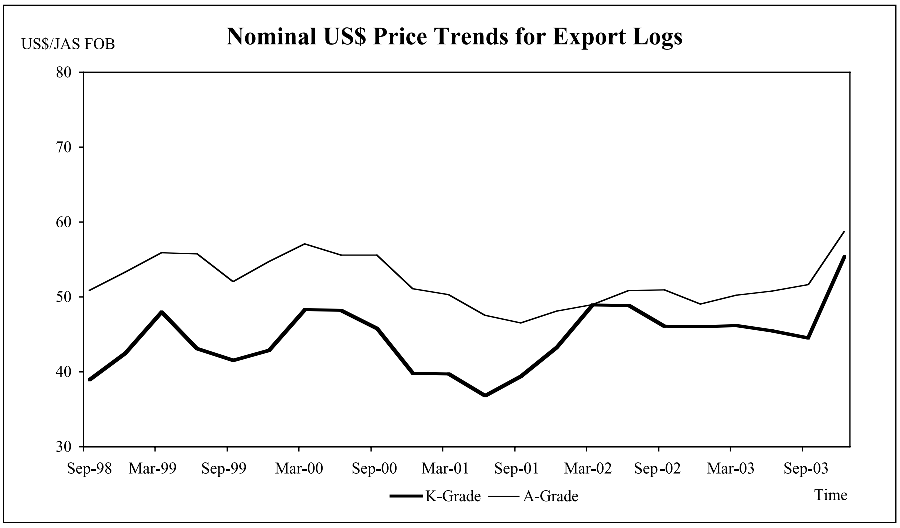
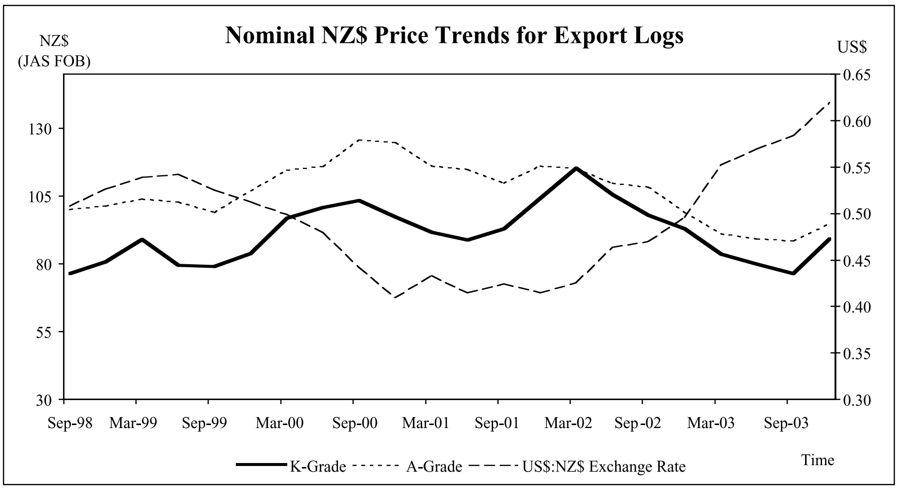
The single largest factor that has impacted on the carrying value of the forest crop is an adverse movement in log prices in NZ dollar terms of $280 million. The chart below shows a modest increase for A-grade and K- grade export log prices in US dollar terms since 30 June 2001:



The depreciation in the US$:NZ$ exchange rate has more than offset the increase in export US dollar log prices and resulted in a significant downward trend in NZ dollar terms since 30 June 2001:



In the context of the trade weighted index against major currencies the US dollar has reached historical lows in recent months. The uplift in NZ dollar log prices since June 2003 reflects in part a correction for the exceptionally weak US dollar and a general price increase driven by improving market conditions in Asia.

4.4 Projected Financial Profile if the Forest Asset sale is effected

4.4.1 Financial Performance

Set out below is a summary of the pro forma financial performance of FC Forests for the year ended 30 June 2002 and 30 June 2003, and projections for the years ending 30 June 2004 and 30 June 2005 assuming the sale of the Forest Assets and the full $1.20 per share capital return have taken place:

FC Forests – Financial Performance (Sale of Forest Assets)				
	Year End 30 June (NZ$ millions)			
	2002A	2003A	2004P	2005P
Operating revenue	409	393	500	678
Operating expenses	(388)	(363)	(470)	(638)
Operating earnings[3]	**21**	**30**	**30**	**40**
Forex gains/(losses)	18	19	1	(1)
Non-recurring items	(3)	-	-	-
EBIT	36	49	31	39
Funding costs	(3)	(3)	(3)	(6)
Earnings before tax and minorities	33	46	28	33
Taxation	(16)	(13)	(5)	(9)
Minority interests	-	-	(1)	(1)
Net earnings	**17**	**33**	**22**	**23**

4.4.2 Cash Flow

FC Forests' pro forma actual cash flow for the year ended 30 June 2003, and projections the years ending 30 June 2004 and 30 June 2005 assuming the sale of the Forest Assets and the full $1.20 per share capital return have taken place are summarised below:

FC Forests – Statement of Operating Cash Flow (Sale of Forest Assets)			
	Year End 30 June (NZ$ millions)		
	2003A	2004P	2005P
EBIT	49	31	39
Add back:			
Equity earnings	(5)	(8)	(10)
Depreciation, amortisation and revaluations	(5)	13	18
Net interest received/(paid)	(3)	(3)	(7)
Tax paid	(5)	(5)	(9)
(Increase)/decrease in working capital	(2)	1	(10)
Operating cash flow	**29**	**29**	**21**

3 Includes shared services costs of $5 million and $15 million in the 2004 and 2005 years respectively.

4.4.3 Financial Position

Set out below is a summary of the financial position of FC Forests at 30 June 2003 and projections as at 30 June 2004 and 30 June 2005, assuming the sale of the Forest Assets and the full $1.20 per share capital return have taken place:

FC Forests – Financial Position (Sale of Forest Assets)	As at 30 June (NZ$ millions)		
	2003A	2004P	2005P
Assets			
Stocks	66	74	76
Debtors	54	82	71
Total current assets	120	156	147
Fixed assets	122	119	112
Intangible assets	2	11	23
Investments	33	35	35
Total assets	**277**	**321**	**317**
Liabilities			
Creditors	(89)	(65)	(66)
Net cash at bank/(debt)	77	31	(94)
Provision for deferred tax	22	22	22
Net assets	**287**	**309**	**179**
Group equity	287	302	179
Minority interest	-	7	-
Total equity	**287**	**309**	**179**

4.5 Capital Structure and Ownership

FC Forests has two classes of shares on issue, Ordinary and Preference shares:

- FC Forest Preference shares were issued in December 2000 as a result of a renounceable pro rata rights issue at a price of 25 cents each;
- FC Forests Preference shares rank equally with FC Forest Ordinary shares in all respects except for a prior ranking to an amount equivalent to the issue price in the event of a liquidation of FC Forests. On 15 December 2005 the preferential right on liquidation lapses and Preference shares become identical in all respects to FC Forests Ordinary shares;
- in November 2002 FC Forests consolidated on a 1:5 basis all Ordinary and Preference shares on issue. Preference shares retained their preferential right on liquidation and, as a result of the consolidation, the priority liquidation entitlement increased to $1.25 per share; and
- approximately 1.5 million fully paid ordinary shares are held by the Fletcher Challenge Employee Share Purchase Scheme and accounted for under the Treasury stock method.

As at 24 December 2003 FC Forests' top ten registered shareholders held approximately 57% of the total Ordinary and Preference shares on issue. Many of the registered shareholders are nominees holding shares on behalf of a wide range of shareholders.

FC Forests – Top 10 Ordinary & Preference Shareholders	Ordinary Shares		Preference Shares		% of all
As at 24 December 2003	No. of Shares (000s)	% of total	No. of Shares (000s)	% of total	Shares on issue
Rubicon	15,429	8.3%	96,099	25.8%	19.9%
Citibank Nominees (NZ)	35,778	19.2%	21,902	5.9%	10.3%
Westpac Corporate Clients	11,385	6.1%	33,067	8.9%	8.0%
National Nominees NZ	13,074	7.0%	21,639	5.8%	6.2%
ANZ Nominees	7,808	4.2%	12,473	3.4%	3.6%
ACC	1,800	1.0%	13,679	3.7%	2.8%
ITHACA (Custodians)	440	0.2%	11,665	3.1%	2.2%
HSBC Nominees (NZ)	5,769	3.1%	3,465	0.9%	1.7%
AMP Investments Strategic Equity	-	-	7,739	2.1%	1.4%
Cogent Nominees	1,352	0.7%	6,297	1.7%	1.4%
Top 10 shareholders	**92,835**	**49.9%**	**226,663**	**61.3%**	**57.5%**
Other shareholders	93,078	50.1%	145,146	38.7%	42.5%
Total – all shareholders	**185,913**	**100.0%**	**371,809**	**100.0%**	**100.0%**

4.6 Share Price Performance

FC Forests' shares are traded on the NZX, ASX and New York Stock Exchange (as ADR's). The following table shows the trading history for FC Forests' shares on the NZX from 3 January 2001 to 31 December 2003. Volume data is the total of Ordinary and Preference shares traded in each period:

FC Forests – Share Price History

	Share Price (NZ$)			
	Close	**Low**	**High**	**Volume (000s)**
2001 (quarter ended)				
March	0.31	0.28	0.36	594,215
June	0.30	0.28	0.34	233,635
September	0.26	0.21	0.25	412,072
December	0.22	0.22	0.29	251,682
2002 (quarter ended)				
March	0.26	0.22	0.27	248,597
June	0.24	0.20	0.27	388,715
September	0.23	0.22	0.25	237,935
December	0.99	0.92	1.15	27,999
2003 (month ended)				
January	1.06	0.98	1.20	15,150
February	1.03	1.00	1.16	24,405
March	1.03	0.99	1.07	19,331
April	1.00	0.96	1.04	6,345
May	0.98	0.97	1.02	8,899
June	1.15	0.98	1.18	21,259
July	1.13	1.12	1.20	12,298
August	1.11	1.08	1.18	17,068
September	1.29	1.10	1.29	47,009
October	1.31	1.28	1.32	42,029
November	1.31	1.29	1.34	20,263
December	1.36	1.29	1.40	26,712

In December 2000 FC Forests undertook a 2 for 1 rights issue at 25 cents per Preference share. The share price came under pressure in January and February 2001 due to uncertainty surrounding the future of FC Forests' investment in CNIFP and the appointment of receivers to CNIFP in February 2001. FC Forests first announced its intention to purchase the CNIFP assets from the receivers in March 2002, subsequently withdrawing its bid in late April 2002. During this time the FC Forests' share price rose from 23 cents to 27 cents before closing at 22 cents when the offer was withdrawn. In June 2002 FC Forests released a proposal to acquire CNIFP, which was subsequently rejected by shareholders.

On 1 December 2002 FC Forests consolidated its shares on a 1:5 basis all Ordinary and Preference shares on issue. Only figures for the October and November months of the fourth quarter in 2002 have been adjusted for the consolidation. All figures prior to the fourth quarter of 2002 have not been adjusted for the consolidation. In June 2003 FC Forests' announced its intention to proceed with a formal sale process of its remaining forest assets and in September 2003 released details of the proposed sale and the then preferred bidder, The Campbell Group, LLC.

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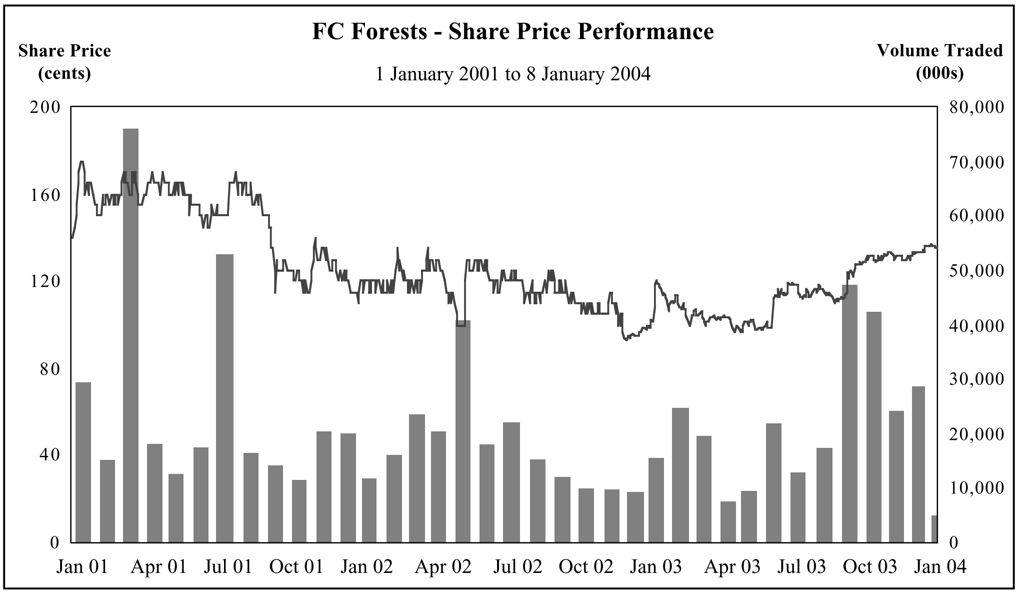
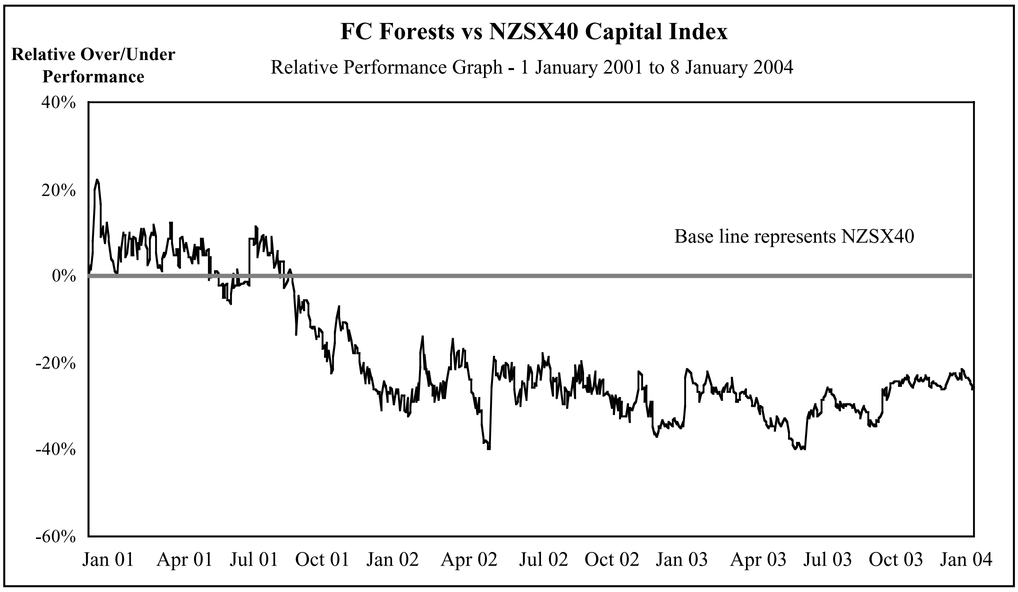
The share price performance of the FC Forests' Ordinary shares is illustrated in the following graph. Volumes traded are the total of Ordinary and Preference share trades over the period.



The historical prices and volumes have been adjusted to reflect the share consolidation that took place in December 2002 on a 1:5 basis.



5 Evaluation of the Proposed Transaction

5.1 Background to the Proposed Transaction

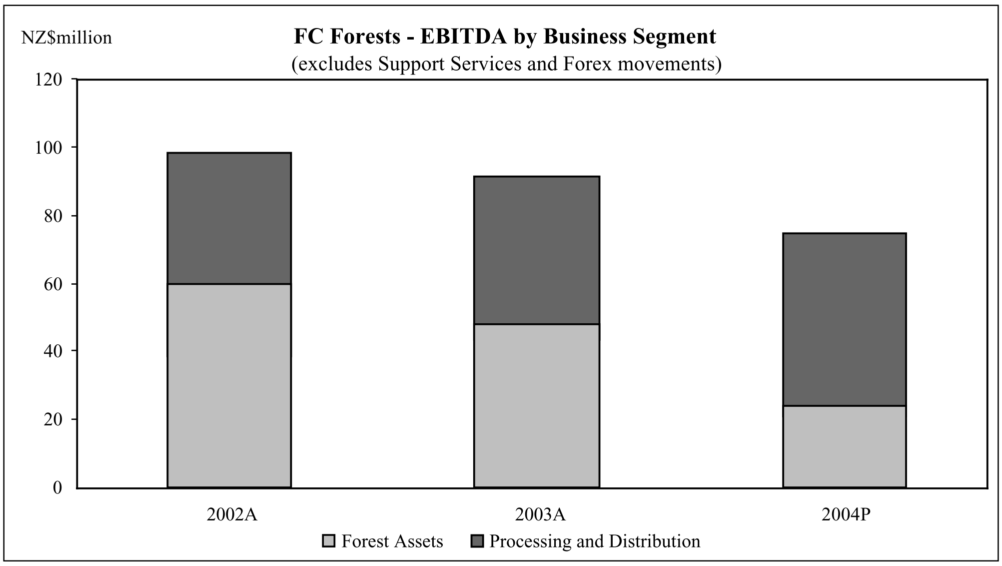
In June 2002 FC Forests announced that it intended to purchase all of the operating assets of the CNIFP from the receivers for a price of US$650 million. FC Forests stated at the time that the proposed acquisition of the CNIFP assets had a number of important benefits including:

- the purchase price for the CNIFP assets was attractive;
- the acquisition would have enabled FC Forests to consolidate the ownership of the CNIFP forests with the rest of its forest estate, providing a number of significant cost saving and synergy opportunities, and a range of efficiency advantages; and
- the acquisition was expected to remove the uncertainty associated with the receivership of the CNIFP assets and would therefore enable FC Forests to focus on enhancing the performance of the increased asset base.

The proposed acquisition of the operating assets of the CNIFP did not receive the necessary 75% approval from FC Forests' shareholders. The subsequent loss of the management contract over the CNIFP reduced both the earnings of FC Forests directly and indirectly through the loss of economies of scale from not being able to manage the two large forest estates as a single entity. As a result the Directors and management of FC Forests have reviewed the strategic direction of the company. In the absence of the potential scale, synergy and marketing benefits that would have been afforded by the purchase of the CNIFP assets, forestry growth by acquisition was not considered to be viable strategy for FC Forests. Indeed, the financial outlook for the Forest Assets was in itself not attractive:

- the loss of the management contract over the CNIFP assets eliminated the synergies from managing the forest estates as one unit, adding cost to FC Forests' operating structure;
- the operating return after the allocation of shared services on the revalued Forest Assets was between 3% and 4% per annum over the last two financial years. This is an unacceptably low level of return. FC Forests' management are of the opinion that the likelihood of achieving an acceptable return from the Forest Assets is many years away and the company would be better to focus on the value adding end of the wood chain;
- the current returns on capital invested being generated from the Forest Assets are substantially below those being earned from the wood processing and distribution operations. The trend in recent years has seen a movement towards lower margins on unprocessed logs and higher margins from secondary processing or value added wood products; and
- the outlook for the forest sector is at best mixed. The volume of forestry exports are forecast to increase but while the New Zealand dollar remains high relative to its main trading partners profitability will be constrained.

As a consequence of these market dynamics FC Forests' processing and distribution businesses have become an increasingly important part of the business, and are the better performing assets in terms of returns on the book value of capital invested. In the year to 30 June 2003 the processing and distribution businesses represented approximately 41% of total EBITA, representing a return on total assets at 30 June 2003 of approximately 9.4%:



It is expected that over the next few years the processing, marketing and distribution business will become even more important:

- the long term price outlook for logs in US dollar terms continues to be relatively flat. Over the past 20 years the price of grade "A" logs has in real terms declined from a historical high of US$187 in the September 1983 quarter to a low of US$52 in the September 2003 quarter, the latter as profiled in the graph on page 22 of this report. A long run historical analysis of log export prices demonstrates the general decline in NZ dollar prices for logs over the past 10 years;
- the New Zealand supply of radiata sawlogs is predicted to increase. FC Forests is one of the larger processors in New Zealand able to take advantage of the significant volumes of timber likely to be harvested; and
- FC Forests announced that it had increased its ownership of Empire in the USA from 33% to 67%. The US demand for processed wood products remains strong and radiata pine is now firmly established as a credible product in that market replacing scarce domestic sourced product.

The growth and success of the marketing, processing and distribution business has brought benefits for FC Forests shareholders. The growing earnings from this business have assisted FC Forests in maintaining relatively stable level of earnings before revaluations and non-recurring items over the past two years.

Notwithstanding the increasing reliance on the marketing, processing and distribution activities, the Directors of FC Forests also believed that the share market was valuing the Forest Assets at a significant discount to the underlying value of those assets. The Directors believed that the share price would continue to be constrained until such time as the market adequately recognised the value of the Forest Assets. In the first step to establishing an improved understanding of the value of the Forest Assets, FC Forests announced in January 2003 that it had agreed to sell cutting rights over a combined 8,940 hectares of mature age class trees for US$65 million to entities managed by the global timberlands investment manager UBS Timber Investors. The key feature of the transaction was that UBS Timber Investors would become entitled to harvest the designated trees over the next 13 years while FC Forests retained ownership of the underlying land. One of the drivers for the sale of the cutting rights was to seek to provide a market benchmark for the value of the remaining estate. FC Forests noted at the time that the sale price reflected values for the trees substantially in excess of the value implied by the then prevailing FC Forests' share price and commented that the *"Board and management of FC Forests are determined to close the significant discount that exists in the company's share price"*. The share price graph on page 26 shows how the FC Forests share price responded positively to the news of the sale of the cutting rights but after only a short period fell back to previous levels.

The Directors reviewed the businesses of FC Forests and concluded that the two businesses no longer needed to be under the same ownership, and that the processing, marketing and distribution business could benefit from being separated from the Forest Assets.

In March 2003 the FC Forests Board announced that it intended to introduce external investment into its forest estates and that it was in the process of evaluating the ways for this to be achieved, including a potential sale of the Forest Assets. The revised strategy was developed with the intention of transforming FC Forests into a business with a focus on access and supply, rather than direct ownership of the forest resource. In June 2003 FC Forests announced that the Directors had resolved to conduct a trade sale process of its Forest Assets. In the Directors' opinion the rationale for the decision to seek the sale of the Forest Assets had a number of elements:

- the view that certain direct third party investors would place a higher value on the Forest Assets than share market investors due to their significantly longer time horizons and likely lower cost of capital expectations;
- investment in the Forest Assets was unlikely to generate sufficient return on the capital employed in the foreseeable future;
- the focus on processing, marketing and distribution would eliminate FC Forests' exposure to the volatile price movements in the pulp and paper sector and the low margin logs and poles sector;
- the sale of the Forest Assets is seen as a key step to facilitating increased investment in the company's better returning marketing, processing and distribution activities; and
- a sale would allow the subsequent release of substantial surplus capital to shareholders.

Having concluded that the businesses should be separated the decision was taken to sell the Forest Assets rather than the alternative of establishing the Forest Assets as a separate listed entity by way of a spin out. The principal reason for this decision was the belief of the Directors, supported by its advisers, that shareholders would gain greater economic value from an out right sale to long term forest owners than by establishing a stand-alone listed forestry owning entity to be owned by FC Forests' shareholders.

The proposed sale incorporates arrangements for the supply of logs to the FC Forests processing plants and to meet FC Forests' long term commitments to existing customers. The Directors of FC Forests believe the focus on higher earning downstream wood processing, marketing and distribution activities is more likely to be fully valued by the equity markets. FC Forests' share price has reacted positively to the announcement to sell the Forest Assets.

5.2 Approach to Evaluation of the Proposed Transaction

The Proposed Transaction represents a significant change in the operating profile of FC Forests. The major implications of the Proposed Transaction are:

- FC Forests will no longer have an investment in plantation forestry and instead will be a business focussed on wood processing, marketing and distribution;
- the majority of the capital released is intended to be returned to shareholders. At this time the Directors anticipate a two stage capital return of up to $1.20 per existing Ordinary or Preference share; and
- following the proposed sale of the Forest Assets and capital repayment, FC Forests will be a substantially smaller company. The proposed transaction is projected to result in total assets reducing from $1,059 million as at 30 June 2003 to $321 million as at 30 June 2004.

In Grant Samuel's opinion the appropriate basis on which to evaluate the Proposed Transaction is to assess its overall impact on the shareholders of FC Forests and to form a judgement as to whether the expected benefits outweigh any disadvantages or risks that might result, to determine whether they are better off if the Proposed Transaction is implemented.

5.3 Benefits of the Proposed Transaction

The rationale underlying the Proposed Transaction is that the new business model will provide a superior platform from which to deliver acceptable returns to shareholders. The sale of the Forest Assets will enable FC Forests to complete its transformation from being a long term investor in plantation forestry to a processor, marketer and distributor of a broad range of higher value wood products. The key benefits of the Proposed Transaction are summarised below:

- **The outlook for the continuing businesses is positive**

  The move to a processing, marketing and distribution business will change the company from a production driven (supply of trees) operating approach to one driven by market pull (what the customer wants). Over time FC Forests' management expects the investment in processing to progressively reduce as a percentage of total assets as investment in the distribution and marketing chain is expanded. The significantly higher operating leverage available under the new business model should result in a higher return on investment and consequently a higher rate of growth of the share price.

- **A substantial capital repayment to shareholders is proposed**

  The transaction structure envisages settlement in two stages. Assuming the sale of the NZ$165 million Tarawera Forest cutting rights proceeds on the principal completion date, the first stage of the capital return will be 93.75 cents per existing share. If the sale of the Tarawera forestry right does not take place at that time, then the amount of the first stage capital return will be 62.5 cents per existing share. The process of securing third party consents to the sale of the non-freehold forests is expected to be completed by approximately August 2004, following which the second stage of the capital repayment is proposed. FC Forests expects the second stage capital repayment to be up to 26.25 cents per existing share depending on the final sale proceeds and the company's financial position. This amount could also be increased if the sale proceeds of the Tarawera forestry right are not included in the first stage of the capital return and FC Forests is subsequently able to sell that asset to another purchaser. FC Forests' management has advised that it is confident of its ability to fund the capital repayment, using the proceeds from the initial settlement and existing borrowing facilities, on the basis that sufficient funds should be available from the first settlement to more than cover the full amount of the return.

  If the capital payment is endorsed by shareholders they will receive 97.5% of the net cash proceeds of the sale of the Forest Assets:

  FC Forests – Application of Sales Proceeds

	$ million
Sale proceeds	725
Campbell exit payment	(17)
Transaction and reorganisation costs	(27)
	681
Return of capital	**669**

  The balance of the net proceeds will be used to reduce debt. It is arguable that a greater amount of the net sale proceeds should be retained by the company to fund future investment requirements or opportunities. In Grant Samuel's opinion the debt to equity ratio of the residual business is conservative and the interest cover ratios are adequate. This view is reinforced by new banking facilities which will provide for debt to be increased up to $165 million. The facility treats both AWM and Empire as associates until such time as those two companies become wholly owned by FC Forests, excluding the debt of those two companies from the charging group ratios. The new facility provides for a period of negotiation with a view to agreeing new terms on which the lenders would be willing to confirm making the facility available in the event of a change of control.

- **Increased investor interest is likely**

  FC Forests is regarded as a forest owning company. Forest crops and land represented 75% of FC Forests' total assets as at 30 June 2003 and the Forests & Supply division accounted for approximately 53% of EBITDA before allocation of support service costs for the same period. Most FC Forests shareholders are likely to have invested in the company primarily to gain exposure to the forestry sector. Potential investors who might otherwise be attracted to FC Forests' processing, marketing and distribution business under the current structure must accept investment exposure to the much larger and, possibly in their view, less attractive forestry business if they invest in FC Forests. The establishment of FC Forests as a focused wood processing, marketing and distribution company is likely to attract new investors who might not otherwise have invested in FC Forests. A name and branding change for the residual businesses is likely if the Proposed Transaction proceeds.

  The company will potentially be more attractive as a takeover target than FC Forests in its current form. At present, a potential acquiror of the processing, marketing and distribution business would have to make a takeover bid for the whole company. Equally an investor seeking a pure forest investment may be put off by the requirement to purchase the processing, marketing and distribution businesses.

  New Zealand listed company Rubicon holds 19.9% of FC Forests' shares and will receive approximately $134 million from the proposed capital repayment. Its decision on how to participate in any potential takeover offer will therefore be influential.

- **The focus on wood processing, marketing and distribution is expected to enhance shareholder returns**

  FC Forests' share price closed at $1.35 on 7 January 2004, which equates to a market capitalisation of approximately $753 million. FC Forests will receive $725 million from the sale of the Forest Assets and proposes to return to shareholders a maximum of $669 million of capital. This implies a market capitalisation of approximately $84 million or $0.75 cents per remaining share assuming the current share price is maintained and no market re-rating results. Based on the actual and projected earnings profile of the wood processing, marketing and distribution business, the implied multiples of earnings on the theoretical market capitalisation of approximately $84 million are as follows:

Implied Capitalisation Multiples (times)

	Year End June		
	2003A	**2004P**	**2005P**
EBITDA	4.0	4.0	3.6
EBIT	5.4	6.3	5.2
PE	3.6	3.6	3.6

  A consensus view of a selection of brokers surveyed indicated that international forest product companies trade at multiples of 5.0 to 8.5 times EBITDA. By comparison, at a share price of $0.75 post the sale of Forest Assets and capital reduction, the residual businesses would be trading at a multiple of 4.0 times forecast EBITDA for the year ending 30 June 2004. This is below the range of EBITDA multiples for similar companies and suggests that FC Forests may be re-rated by the share market. However any rerating may not take place for some time, if at all. It could also be argued that some of the potential rerating had already been factored into the current FC Forests share price following the announcement of the intention to sell the Forest Assets and the receipt of the Kiwi Forests Group offer.

  Grant Samuel believes that, ultimately, a higher gross value is likely to be attributed by the sharemarket to the new FC Forests and cash from the capital repayment than would be attributed to the existing FC Forests shares under the current asset profile.

- **The proposed sale will lead to greater management and board focus**

  If the Proposed Transaction is effected, FC Forests will be a substantially smaller business with a more concentrated range of business activities. The sale of the Forest Assets will enable remaining management to focus their attention exclusively on the wood processing, marketing and distribution businesses. It is realistic to expect that the sale of the Forest Assets will result in some benefits in terms of increased management focus. These benefits are difficult to quantify.

- **Increased likelihood of dividends**

  FC Forests has not paid a dividend since 1998, as substantially all surplus cash has either been reinvested in the business or applied to the reduction of debt. If the proposed transaction is effected FC Forests anticipates the reinstatement of the payment of dividends to shareholders. The intended target dividend payout ratio stated in the accompanying Explanatory Memorandum is between 20% and 40% of net cash from operating activities. If the proposed transaction is effected, the Directors of FC Forests expect dividend payments to commence in respect of earnings for the 2005 financial year, paid as a final dividend in the following year. This plan is clearly dependent on earnings, cash flow and new investment opportunities that may arise in the future.

5.4 Value Analysis

While there has been a number of forest sales internationally in recent years, the variability in the profile of the assets being sold means that the implied multiples derived from these transactions are not consistent. Forests may differ by size, geographic location, age of plantation, type of tree, proximity to processing facilities and whether the underlying land does or does not form part of the transaction. Moreover, the allocation of consideration between the land and the plantation forests is typically not disclosed. The multiples implied by the sale of the CNIFP assets in December 2003 would have been useful in benchmarking the sale price of the Forest Assets. However, the sale price has not been disclosed for these assets by the receivers of the CNIFP. Also all of the underlying land is leasehold. Accordingly, in evaluating the sale price of the Forest Assets Grant Samuel has placed primary focus on the sale process under which the Kiwi Forests Group offer was received.

The Kiwi Forests Group offer was the result of a competitive sale process in which all major global timber investors were contacted. The most reliable evidence as to the value of a business is the price at which the business or a comparable business has been bought and sold in an arm's length transaction. The sale to Kiwi Forests Group can be defined as such a transaction. Grant Samuel has reviewed the sale process to validate the number and quality of parties approached and the framework under which they were invited to tender for the Forest Assets.

FC Forests appointed Macquarie Bank ("Macquarie") as its financial advisers to progress the sale of the Forest Assets in mid 2003. In conjunction with FC Forests, Macquarie ran a standard two stage sale process requiring firm conditional offers in stage one and binding conditional offers to be submitted following the completion of due diligence by selected prospective purchasers. To maximise competitive interest and price tension in the sale process the advisers to FC Forests canvassed and approached substantially all of the international forest investors that could be expected to or had previously identified an interest in FC Forests' Forest Assets. The investors in and acquirers of sizeable forestry assets have tended to be US based funds managers with long term investment profiles. The fund managers typically operate investment funds on behalf of substantial investors such as pension funds and superannuation schemes. Examples of such funds managers include Global Forest Partnership (formerly UBS Timber Investors), The Campbell Group, Hancock Timber, Prudential Timber, TimberWest, Forest Investment Associates, Molpus Woodlands and GMO Renewable Resources.

The sale process conducted during the middle of the year resulted in two parties, Campbell and the Kiwi Forests Group, being asked to submit best and final offers in September 2003. These offers were as follows:

- Kiwi Forests Group offered $500 million in cash and $217 million in Evergreen Forests Limited shares; and
- Campbell offered $685 million in cash.

Campbell sought exclusivity which was declined. Campbell proposed a non-negotiable NZ$17 million (US$10 million) break fee in the event FC Forests entered into discussions with another party. Grant Samuel has been advised that Campbell offered no scope to negotiate either the terms or quantum of this break fee proposal leaving FC Forests in no doubt it was a take it or leave it offer. At that time the Kiwi Forests Group offer included Evergreen Forests shares with an attributed value of $217 million. In the opinion of FC Forests, a view which Grant Samuel agrees with, the then existing Kiwi Forests Group shares and cash offer had a value below that of the Campbell offer. The Campbell offer and break fee was announced to the market on 15 September 2003. Kiwi Forests Group submitted two additional offers on 16 September 2003 (which was subsequently withdrawn) and on 22 September 2003 for cash of $725 million (effectively $708 million after deducting the Campbell break fee).

Following the announcement of the Kiwi Forests Group offer FC Forests successfully renegotiated the Campbell break fee into two components. The first component comprised $8.5 million which was payable immediately, with a further $8.5 million payable in the event FC Forests' sale of the Forest Assets to the Kiwi Forests Group became unconditional. The initial $8.5 million was refundable in the event FC Forests sold the forests to Campbell.

The existence of the break fee appears to have been a major factor in securing the substantially improved offer from the Kiwi Forests Group. The break fee is not an insignificant sum and if the sale to the Kiwi Forests Group is approved by shareholders, a further $8.5 million will be paid to Campbell. The net proceeds of $708 million still exceed the Campbell offer by $23 million or 3.4%. The rapid depreciation of the US dollar against the New Zealand dollar may have affected Campbell's ability or willingness to match or exceed the net value of the Kiwi Forests Group offer. Break fees have become more common in situations where there is the expectation of a long time period between the announcement of a transaction and settlement. The bidder, in this instance Campbell, is required to commit substantial and expensive resources to the due diligence and contract negotiation process. In addition investment capital would need to be set aside in anticipation of an eventual settlement. The break fee is designed to in part compensate the bidder for economic loss and in part to discourage the vendor from seeking higher bids after the submission of best and final offers. The best and final offers for the Forest Assets were received on 12 September 2003.

The average break fee in the USA in 2000 was 3.8% of the transaction value. The Campbell break fee is 2.5% of its offered price of $685 million. FC Forests' management and its advisers are adamant that Campbell was not willing to accept a lower break fee.

While a higher alternative offer is possible at some future date, the likelihood in the current time frame is remote. The availability of FC Forests' Forest Assets has been well known for a considerable period. There is a limited number of realistic acquirers. All major industry participants and many other potential buyers were contacted through the sale process. The Kiwi Forests Group offer has been known to the market since September 2003. At the date of this report no higher alternative offer has been forthcoming.

Over the last two years there has been a significant shift in the ownership of forests in the USA in particular. At the end of October 2003 it was reported that up to six million acres (2.4 million hectares) of forestry assets were "in play". In comparison New Zealand's total area of plantation forest is approximately 1.8 million hectares. The trend over recent years has been for large processors such as International Paper, Weyerhauser, Louisiana Pacific, Domtar and MeadWestvaco to be sellers of forestry estates and institutional investors to be purchasers. This dynamic is also evident with the partners to the sale of the Forest Assets.

In the opinion of the Directors of FC Forests and its sale advisers the revised Kiwi Forest Group offer represents the highest value likely to be achieved in the current market. Plantation forests such as those owned by FC Forests are generally regarded as US dollar assets. The Kiwi Forest Group offer is denominated in NZ dollars. Since the Kiwi Forests Group offer was made on 23 September 2003 the US dollar has depreciated relative to the NZ dollar by approximately 8%. A US dollar denominated offer for the Forest Assets would have depreciated by an equivalent amount over that period.

In Grant Samuel's opinion the sale price of $725 million was arrived at from a comprehensive sales process and is accordingly a fair and reasonable price for the Forest Assets in today's market.

5.5 Impact of the Proposed Transaction

Set out below is an assessment of the financial impact of the Proposed Transaction and subsequent full capital repayment of $1.20 per existing share as measured by a selection of key ratios and indicators:

FC Forests – Impact of the Proposed Transaction		
	Year End 30 June	
	2003A	2004P
Earnings per share (cents)		
Status Quo	7.5	1.9
Sale of Forest Assets	29.6	19.7
Net assets per share($)		
Status Quo	$1.55	$1.54
Sale of Forest Assets	$2.57	$2.77

The following comments are relevant to an analysis of the financial indicators profiled above:

- earnings per share have been restated to reflect FC Forests' current operations only and exclude:
  - all non recurring items;
  - forest revaluations;
  - Tahorakuri and Tauhara forest estates; and
  - the CNIFP management contract;
- the Proposed Transaction will result in an immediate uplift in earnings per share. The uplift in earnings per share is a function of:
  - a higher level of operating earnings for the processing, marketing and distribution businesses relative to the level of capital employed; and
  - the substantial reduction in the number of shares on issue.

  Earnings per share represents a single period measure. Forest ownership is a long term investment and single period measures are unlikely to be representative of the long run average return that is expected to be derived from ownership of this type of asset under a status quo scenario; and
- FC Forests' projected clearfell volumes for the years ending 30 June 2004 and 30 June 2005 are significantly lower than the average projected annual volume over the current rotation (refer Harvest Profile in section 4.2.1). Low volumes and log prices in NZ dollars mean that forecast earnings from the Forest Assets over the short term are also low.

5.6 Disadvantages of the Proposed Transaction

The Proposed Transaction has a number of disadvantages and risks:

- **One-off transaction costs**

  FC Forests has estimated that the total transaction costs of the proposed transaction will be approximately NZ$44 million including the break fee payable to Campbell Group, professional fees and the cost of negotiating, publicising and implementing the Proposed Transaction. FC Forests has agreed to reimburse the Kiwi Forests Groups' costs up to an amount of NZ$3 million if a further unsolicited bid for the Forest Assets is received, the Kiwi Forests Group transaction is not approved by FC Forests' shareholders and a sale of the Forest Assets is concluded with that bidder.

- **FC Forests will be a substantially smaller company**

  As at 7 January 2004 FC Forests had a market capitalisation of approximately $753 million. The market capitalisation of the restructured FC Forests is difficult to estimate, but if no market re-rating occurs it would be approximately $84 million after the capital repayment. This assumes a share price of $0.75 per remaining share. This will make the new FC Forests a relatively small company with a large number of shareholders. As a smaller company FC Forests will attract a lower level of institutional and analyst interest. This could adversely impact the liquidity of its shares. However, if the projected net profit after tax for the year ending 30 June 2005 of 20 cents per share is achieved, a share price higher than $0.75 per remaining share could be expected. The market average price earnings multiples for NZ listed companies is approximately 14 which would suggest a share price above $0.75 per share. At this time FC Forests shareholders will have had the number of shares held reduced by 75% (3 out of 4) through the capital repayment process.

- **Sawlog and pulplog supply**

  The proposed sale of the Forest Assets will potentially expose FC Forests to supply and price risks as it will no longer own the source of raw material for its own processing plants and for satisfying its obligations under a number of existing long term pulpwood supply agreements.

  FC Forests' management has advised that it sees no difficulties in securing adequate supplies of sawlogs for its own processing requirements in the future. The sawlog supply arrangements agreed with Kiwi Forests Group provide for the supply of 340,000 tonnes per annum of sawlogs in aggregate from the three purchasers for the initial three years and 310,000 tonnes per annum for a further seven years.

  The pulp supply agreements with Norske Skog Tasman Limited and Carter Holt Harvey were not able to be assigned to the purchasers. The Norske Skog and Carter Holt Harvey agreements were ongoing commitments and are of no fixed duration. However, in order to meet the supply obligations under these two agreements FC Forests has entered into back to back supply agreements with the purchasers for a minimum term of 25 years (for the Norske Skog commitment) and a minimum term of 15 years (for the Carter Holt Harvey commitment). There remains a risk that Kiwi Forests Group will not meet its obligations under the back to back agreements and that when the agreements expire FC Forests is unable to arrange alternative supplies to meet the continuing supply obligations. FC Forests' management believe that for as long as there remains substantial forests in the Central North Island there will be an abundant source of pulpwood to enable FC Forests to meet its obligations under both of these potentially perpetual agreements and to meet its own requirements.

  In Grant Samuel's opinion the exposure of FC Forests for supply of sawlogs and pulplogs is very low. Given the significant period before there is any potential exposure the risk cannot be readily quantified.

- **There are uncertainties associated with the Tarawera Forests component of the Proposed Transaction**

  Tarawera Forests is owned 82.5% by FC Forests, 10.8% by Maori Investments Limited ("MIL") and 6.7% by the Crown. Through a relatively complex set of transactions it is proposed that:

  - FC Forests will receive $165 million from Kiwi Forests Group for the forestry rights over the Tarawera forest; and
  - MIL and the Crown will have the option to acquire the land on which the forest sits and to sell their combined 17.5% shareholding in Tarawera Forests to FC Forests.

  The shareholders in Tarawera Forests will receive cash for their shares in Tarawera Forests if they elect to sell them to FC Forests. MIL and the Crown will then be able to purchase the Tarawera Forests land from Tarawera Forests. There is a risk that either MIL, the Crown, or both, will choose not to exercise the option to purchase the Tarawera land. MIL have not yet sought approval from its shareholders and the Crown has not yet sought approval from the Cabinet for this Proposed Transaction. The expectation is that the transaction to buy the Tarawera Forests land from Tarawera Forests will proceed. In the event the latter transaction does not occur FC Forests will have a $29 million investment in land earning approximately $1 million per annum. In the overall scheme of the Proposed Transaction this is not material, albeit that it would be a sub-optimal outcome.

  Kiwi Forests Group has until 30 January 2004 to confirm that it has arranged finance to purchase the Tarawera forestry right. In the nearly four months since receipt of Kiwi Forests

Group offer the NZ dollar has appreciated by 14% against the US dollar. This change in the currency rate may impact upon the purchasers' current view of value of the Tarawera forestry right. Accordingly it is possible that the sale of the Tarawera forestry right may not proceed as currently envisaged.

FC Forests is committed to a sale of all forestry assets and if the sale to Kiwi Forests Group does not proceed it will seek to sell the forestry right to another party. There is no certainty that another party will pay $165 million for this asset. In Grant Samuel's opinion the change in the value of the US dollar may result in a price lower than $165 million.

- **Exposure to completion risk with three separate parties**

  Each of the three acquiring entities of the Kiwi Forests Group have committed to purchase separate parts of the Forest Assets. Each purchaser is a separate legal entity and will not be guaranteeing the performance of the other purchasers. It is possible, but considered to be unlikely, that one of the three purchasers defaults and does not settle. In this event FC Forests could be left with a part of its existing forest estate which it would then need to remarket. The sale and purchase agreement provides penalties for default and FC Forests may elect not to proceed with any purchase in these circumstances. Grant Samuel assesses the default risk as low.

- **The new business model is not without risks**

  FC Forests has developed expertise in the processing, marketing and distribution of solid wood products. At present a significant proportion of the processing, marketing and distribution division earnings comes from the North American market and FC Forests' shareholding in Empire and AWM. These businesses are dependent upon the two largest US hardware retailers, Lowe's and Home Depot. Grant Samuel understands that the relationship with these two retailers is very sound and has the potential to be expanded beyond the current range of wood mouldings. FC Forests is aware that moving into new markets and geographic areas carries risk, and that success cannot be assured. The Asian market has historically been difficult to achieve the desired level of traction in respect of product specification and distribution channel.

- **The key US market will continue to produce variable returns**

  The impact of exchange rate movements will continue to provide variability in earnings. The recent significant fall in the value of the US dollar relative to the NZ dollar has reduced the NZ dollar earnings from the North American market significantly. The processing and distribution business operates in a highly competitive market. Chile is also a supplier of solid wood mouldings into the USA. To date it has not adopted FC Forests' model of ownership of the distribution chain and has as a result been less successful. This could change.

5.7 Alternatives

The Directors of FC Forests have considered a wide range of alternative transactions and potential structures before deciding to sell the Forest Assets through a formal trade sale process. While other alternatives might achieve some benefits, they either did not resolve all of the issues, created their own problems, or were not approved by FC Forests shareholders. For example:

- ***Acquisition of forestry assets***

  The proposed acquisition of the CNIFP assets which was not approved by the required 75% of FC Forests shareholders in August 2002 effectively eliminated the strategy to grow the forest asset base to achieve scale, synergy and efficiency advantages. There are no other forestry assets in New Zealand remotely near the size and geographic locality of the CNIFP assets, and in any event an agreement to sell the CNIFP assets themselves to another party has since been completed.

- ***Spinning out the Forest Assets to FC Forests shareholders***

  An in-specie distribution of new shares in a special purpose company formed to own either the Forest Assets or the processing, marketing and distribution assets would have created two separate listed entities with the same shareholders. The processing, marketing and distribution business, depending upon the allocation of debt between the two separated businesses, would be likely to be very similar to the outcome envisaged under the Proposed Transaction. The Forest Asset business would be the owner and manager of a forest estate with no downstream processing businesses. The FC Forests' share price has increased by approximately 25% following the announcement of the proposed sale of the Forest Assets. In Grant Samuel's opinion the concept of the Forest Assets being incorporated as a separate company would not readily find favour with a number of shareholders and therefore would be likely to place downwards pressure on the share price. The Proposed Transaction will in all probability provide shareholders who did not wish to have a pure forestry investment with a higher cash payment than selling shares in a separated forestry company. Those shareholders seeking a pure forestry investment have a limited number of alternative listed investments in New Zealand (Evergreen, Nuhaka and Opio).

- ***Maintaining the existing structure and contemplating a sale at a future date***

  FC Forest shareholders are being asked to consider whether to trade a long term investment in the Forest Assets for cash. An alternative is to maintain ownership and preserve the option to re-visit a sale of the Forest Assets at some future date. In forming a view on the timing of when to trade the Forest Assets, FC Forest shareholders need to consider:

  - the fact that the marketing and sale of the Forest Assets took place at the same time as the receivers of CNIFP were actively trying to sell a large scale and in many respects complementary forestry estate. The Forest Assets and CNIFP forest estates represent approximately 15% of the total commercial forest area in New Zealand. In a number of international markets and in the USA in particular there are a range of forest estates on the market and only a limited number of potential buyers. As evidenced by the Takorakuri, Tauhara, CNIFP and Kiwi Forests Group transactions, forest ownership is progressively being dominated by international fund managers with long term investment profiles. Equally, integrated forest owners and processors are the major sellers of forest assets in the current market;
  - the US dollar has depreciated against the NZ dollar falling by more than US$0.20 cents, or 50%, since 30 June 2001. As illustrated in section 4, the weaker US dollar has an important bearing on the value of the Forest Assets when translated into NZ dollar terms;
  - in US dollar terms log prices have remained reasonably stable over the last five years. Jaakko Poyry Consulting has formed the view, based on a detailed assessment of the factors influencing price movements, that only modest improvement in prices will be achieved in US dollar terms for New Zealand log exporters for the next five years;
  - there is currently an increasing supply of unprocessed wood or export logs from New Zealand and some forest owners have in the current market cut back clearfell volumes in an attempt to improve pricing. In terms of maturity of forest estates (including the Forest Assets) there will be a significant increase in acreage of trees reaching optimal felling age in 6-8 years time (refer charts in sections 3.1 and 4.2.1). Either demand for New Zealand radiata logs will need to increase substantially or there will need to be greater investment in domestic wood processing capacity if export log prices are not to fall further; and
  - shipping costs impact on the value of New Zealand forests because under standard terms of trade these costs are borne by the operator. Prices therefore include customs, insurance and freight costs, costs not borne in a free on board contract. Over the last 12-18 months shipping costs have doubled and in the current climate this increase has not been fully recovered from customers.

5.8 Other Considerations for FC Forests' shareholders

- **FC Forests' ability to effect subsequent transactions will be eroded if the Proposed Transaction does not proceed**

  FC Forests (when part of Fletcher Challenge Limited) has in the past sought to sell part or all of its forests but after receiving bids decided not to proceed. A feature of the latest sale process has been the scepticism with which a number of the major forest acquirers approached the process believing that FC Forests would again withdraw the Forest Assets from the market if an acceptable sale price was not received. Both the sale adviser and FC Forests' management are strongly of the opinion that if the Forest Assets were again withdrawn from sale by shareholders voting against the resolution that it could be some considerable time before any buyer with the financial capacity would be willing to undertake the time consuming and expensive process of due diligence and contract negotiation.

  If 50% or more of the shares voted to reject the resolution then the sale of the Forest Assets will not proceed. A likely consequence will be a decline in the share price. Prior to the announcement that FC Forests wished to sell its Forest Assets its share price was trading around \$1.00. Following the announcement it increased to \$1.10. On 15 September FC Forests announced that it had signed a letter of intent with The Campbell Group LLC to sell the forests for NZ\$685 million, and the share price increased to \$1.25 per share. Grant Samuel believes that substantially all of the share price improvement from \$1.00, where the shares had traded for over the previous three months, can be attributed to the intention to sell the Forest Assets. The retention of the Forest Assets is likely to result in a drop in FC Forests' share price from current levels due to the low expected future returns on the Forest Assets resulting in an overall low return on the market value of equity.

- **Tax consequences for shareholders**

  If the Proposed Transaction is effected the Directors of FC Forests intend to implement two capital repayments to shareholders of up to \$1.20 per share. Prior to the special meeting to consider the sale of the Forest Assets, FC Forests expects to receive a binding ruling from the IRD confirming that both returns of capital will not be "dividends" for New Zealand tax purposes. As a consequence FC Forests will not deduct any withholding taxes.

  For New Zealand resident shareholders who hold their shares on capital account each return on capital will therefore be tax free. For New Zealand resident shareholders who hold their shares on revenue account each return of capital may be taxable.

  The situation is less clear for both US and Australian resident shareholders. There are approximately 9,300 US resident shareholders and 1,000 Australian resident shareholders out of a total of approximately 57,000 shareholders. The US and Australian resident shareholders collectively hold approximately 6.0% of the issued capital (Ordinary and Preference shares combined). US and Australian shareholders should consult their tax advisers with respect to their tax position.

- **Treatment of Ordinary and Preference shareholders**

  Under the terms of the FC Forests constitution and until 15 December 2005, in the event of liquidation the Preference shares rank ahead of the Ordinary shares to the amount of \$1.25 per share. The Ordinary shares are entitled to the next \$1.25 per share and thereafter the shares rank equally. The proposed return of capital (assuming the Tarawera Forestry Right is transferred to the Kiwi Forests Group) will remove initially \$523 million of equity and subsequently up to a further \$146 million. This represents funds that would be available to Preference shareholders ahead of Ordinary shareholders in the unlikely event of a liquidation of FC Forests prior to 15 December 2005. The Preference shares preferential claim is for a total \$464 million dollars. In the first capital repayment Preference shareholders will receive \$1.25 per share on three of every four shares held or a total repayment of \$350 million.

5.9 Conclusion

In Grant Samuel's opinion, the Proposed Transaction is in the best interests of the shareholders of FC Forests. The decision to sell the Forest Assets reflects a number of factors including:

- the lack of economies of scale in the remaining Forest Assets in the absence of the ownership or management of the CNIFP assets;
- the low level of earnings from the Forest Assets relative to the substantial amount of capital invested;
- the relatively static longer term price outlook for softwood logs in US dollars;
- the opportunities being presented for investment in the higher yielding wood processing, marketing and distribution business; and
- the underlying value of the Forest Assets was not being adequately reflected in FC Forests' share price.

The Kiwi Forests Group offer was the outcome of a competitive sale process in which all major worldwide timber investors were contacted. The price of $725 million is the likely maximum price that a purchaser is prepared to pay in the current market.

The Proposed Transaction affords a number of advantages for FC Forests:

- a very substantial capital repayment to shareholders will be able to be made;
- the outlook for the continuing wood processing, marketing and distribution business is good;
- additional investor interest will be encouraged through a more focussed business, and in addition FC Forests will become a more attractive takeover target;
- the proposed reduction in debt has enabled new banking terms to be negotiated removing the existing restrictive bank-lending covenants;
- the consequential focus on wood processing, marketing and distribution could be expected to enhance shareholder returns, although the timing and extent of a market re-rating is uncertain; and
- there is an increased likelihood of dividend payments being resumed.

There are a number of disadvantages and risks of the Proposed Transaction. FC Forests will be a substantially smaller company and may suffer from a loss of institutional support and analyst coverage. The other disadvantages include:

- the residual exposure to ongoing and not assignable pulpwood supply contracts;
- the removal of control over the ownership of the raw material for the processing plants;
- the uncertainties associated with the sale of the Tarawera Forestry Right; and
- the market and currency risks associated with the residual wood processing, marketing and distribution businesses.

These disadvantages and risks are not inconsequential but, in Grant Samuel's opinion, they do not outweigh the benefits.

The markets' unwillingness to factor the underlying value of the Forest Assets into the FC Forests' share price, as indicated by the Kiwi Forests Group offer, means that there is likely to be a lower relative valuation under the status quo option than if the Forest Assets are sold.

An upturn in the fortune of forest investments may take place at some time in the future. The timing of any change cannot be determined. The long run trend for log prices, measured in NZ dollars has been downwards in both nominal and real terms. This has resulted in steady erosion in earnings from forestry which at the same time has faced price increases across the majority of its operating costs, particularly freight and harvesting costs.

Accordingly, Grant Samuel believes that the Proposed Transaction is in the best interests of the shareholders of FC Forests. Ultimately, they are more likely to be able to realise a higher value for their shareholdings if the Proposed Transaction is implemented than if it is not.

GRANT SAMUEL

6 Qualifications, Declarations and Consents

6.1 Qualifications

Grant Samuel and its related companies provide financial advisory services to corporate and other clients in relation to mergers and acquisitions, capital raisings, corporate restructuring, property and financial matters generally in Australia and New Zealand. One of its activities is the preparation of company and business valuations and the provision of independent advice and expert's reports in connection with mergers and acquisitions, takeovers and capital reconstructions. Since its inception in 1988, Grant Samuel and its related companies have prepared more than 280 public expert or appraisal reports.

The persons responsible for preparing this report on behalf of Grant Samuel are Michael Lorimer, BCA, CA, Simon Cotter, BCom, DipAppFin, ASIA, Peter Jackson, BCom CA, and Nick Hawkins MCom(Hons). Each has a significant number of years experience in relevant corporate advisory matters.

6.2 Disclaimers

It is not intended that this report should be used or relied upon for any purpose other than as an expression of Grant Samuel's opinion of the Proposed Transaction. Grant Samuel expressly disclaims any liability to any FC Forests shareholder who relies or purports to rely on this report for any other purpose and to any other party who relies or purports to rely on this report for any purpose.

This report has been prepared by Grant Samuel with care and diligence and the statements and opinions given by Grant Samuel in this report are given in good faith and in the belief on reasonable grounds that such statements and opinions are correct and not misleading. However, no responsibility is accepted by Grant Samuel or any of its officers or employees for errors or omissions however arising in the preparation of this report, provided that this shall not absolve Grant Samuel from liability arising from an opinion expressed recklessly or in bad faith.

Grant Samuel has had no involvement in the preparation of the Notice of Meeting or Explanatory Memorandum to be sent to shareholders of FC Forests in respect of the Proposed Transaction. Grant Samuel does not accept any responsibility for the contents of either of those documents (except for this report).

6.3 Independence

Grant Samuel does not have at the date of this report, and has not had within the previous two years, any shareholding in or other relationship with FC Forests that could reasonably be regarded as capable of affecting its ability to provide an unbiased opinion in relation to the Proposed Transaction. In July 2002 Grant Samuel prepared an Independent Report for FC Forests shareholders in relation to the proposed acquisition of the CNIF assets.

Grant Samuel had no part in the formulation of the Proposed Transaction. Its only role has been the preparation of this report and its summary. Grant Samuel will receive a fixed fee for the preparation of this report. Grant Samuel will receive no other benefit for the preparation of this report.

6.4 Information

Grant Samuel has obtained all the information, which it believes is desirable for the purposes of preparing this report, including all relevant information which is or should have been known to any Director of FC Forests and made available to the Directors. Grant Samuel confirms that in its opinion the information provided by FC Forests and contained within this report is sufficient to enable FC Forests shareholders to understand all relevant factors and make an informed decision, in respect of elements of the Proposed Transaction.

6.5 Declarations

FC Forests has agreed that to the extent permitted by law, it will indemnify Grant Samuel and its employees and officers in respect of any liability suffered or incurred as a result of or arising out of the preparation of this report. This indemnity will not apply in respect of the proportion of liability found by a court to be attributable to any conduct involving negligence or wilful misconduct by Grant Samuel. FC Forests has also agreed to indemnify Grant Samuel and its employees and officers for time spent and reasonable legal costs and expenses incurred in relation to any inquiry or proceeding initiated by any person except where Grant Samuel or its employees and officers are found to have been negligent or engaged in wilful misconduct in which case Grant Samuel shall bear such costs.

Advance drafts of this report (and parts of it) were provided to FC Forests. Certain changes were made to this report as a result of the circulation of the draft report. However, there was no alteration to the methodology, conclusions or recommendations made to FC Forests shareholders as a result of issuing the drafts. Grant Samuel's terms of reference for its engagement did not contain any term which materially restricted the scope of this report.

6.6 Consents

Grant Samuel consents to the issuing of this report in the form and context in which it is to be included in the information to be sent to FC Forests shareholders. Neither the whole nor any part of this report nor any reference thereto may be included in any other document without the prior written consent of Grant Samuel as to the form and context in which it appears.

GRANT SAMUEL & ASSOCIATES LIMITED
15 January 2004

Grant Samuel + Associates

FLETCHER CHALLENGE
FORESTS