

Tony Johnston – Chief Operating Officer's address

Good morning Ladies and Gentlemen,

It is great to be here, and I thank you for the opportunity. I am the new Chief Operating Officer for Tenon. I have a special connection with this company having been present at its birth as it were, 15 years ago and leading it through its formative stages. I left the company 11 years ago to do some other interesting things, mainly in the wood industry. In that time Tenon has grown and matured under good leadership, navigating considerable growth, and now through these economic storms. It is really great to be back, to be involved again in a great company that has done, and continues to do some quite amazing and smart things.

A couple of examples:

- 1) Connecting New Zealand's natural resources to North American consumers: From a NZ primary industry perspective, what Tenon does is tremendous – Tenon manufactures and sells consumer finished product, in scale quantities, to consumers in what is still the richest and most competitive consumer country in the world – not many other business in New Zealand can claim that – take a raw natural resource, convert it to a consumer product and then sell it competitively and profitably to international return consumers.
- 2) Providing a superb add value service to retailers in the USA and Canada. This service to our customers demonstrably optimises the margins that our customers earn from the products we supply them. That is why we enjoy their loyalty.

Let me explain that a bit more because it is quite exceptional. Your company provides a service to North American retailers that involve Tenon taking full responsibility for the right product being in the right place, at the right time displayed appealingly and well promoted with information on how to use it and even how a room might appear after it has been installed. Tenon ensures that this is always the case by having inventory in the retail store and in our nearby warehouse that can be delivered quickly to the store as required. That involves the complex coordination and management by a lot of people (720 in the USA), a lot of products, a lot of data and a lot of suppliers from all around the world. We promise our customers that we will have their shelves stocked to at least 98% accuracy on a continuous basis. If the sales are there to be had we organise things to make sure they happen. The product the consumers want is always there for them to get and the ideas and instructions on what projects to undertake and how to prepare and install the product is there as well.

Tenon carries a lot of products through to North American consumers - about 8,000 40-foot containers per year. We make some products ourselves in New Zealand, and also in the USA and Canada in our manufacturing operations there, and we also buy them from other manufacturers in the USA, Brazil, Chile and China. As we control the final delivery of these products to consumers we are in the position of being able to choose what we will manufacture ourselves and what we will buy in from other manufacturers, depending on what is the best solution for our customers and for Tenon. For example, we recently switched production of a number of our ornamental and decorative products from our own USA manufacturing to third party manufacture in China, it made good sense from a cost perspective to do so, and in addition it allowed us to redirect our NA manufacturing resources to the launch of the next generation of outdoor products that I will talk about in a moment.

That brings me to product and market development. Any business that doesn't spend on development is destined for difficulties. Growth and development is important to a business. It was development that we lead in the late 1990s that took Tenon into the USA in the first place and gave us alignment between resources and markets. It's our view that it's time now to seed some new growth options, develop in some new directions, but only where our existing skills, knowledge and market positioning give us advantage. We will be careful and we will do the job well, just like we did 10 years ago.

The world is currently in a difficult financial state that may not correct itself for some time yet. These very difficult market conditions mean we have to work harder and smarter to achieve acceptable financial and operational results. You will be pleased to know that much good work is being done by the Tenon team to out-perform our competitors and maintain our 'best-in-class' service to our key customers. I'd like to tell you about some of this good work.

The team at Taupo Manufacturing, led by Mark Taylor, who is here today if you wish to meet him, is doing some great work in adjusting to the reality of a significantly lower sales demand, a higher exchange rate with no commensurate price increases, and a high Radiata pine pruned log price. That combination can seriously impact earnings, absent any offsetting management initiatives. The Taupo leadership set themselves a profit improvement objective of being able to still be profitable when the US to the NZ dollar exchange rate is greater than 80 cents (every 1 US cent movement in the exchange rate impacts the earnings at Taupo by \$US 550,000). That plan is complete and they are now able to achieve profitability at that target level. They have shed capacity, coming back from four production shifts to three. They have improved productivity in many areas; more dollars of revenue for each dollar of cost. There has been a long list of individual projects on the way, cost out initiatives (by far the biggest overall initiative), conversion and recovery initiatives, more product in each container, new products with better pricing, back office consolidation etc., a quarter of a percent here and a quarter of a percent there. They are doing a great job at Taupo putting your assets to effective use and you can be proud of their achievements in a very difficult environment when others have struggled. The outcome of this plan will see Taupo site improve its financial performance in the order of \$US 4 million per annum, and the plant is operating profitably today. I believe Tenon Taupo is the best sawmill and remanufacturing operation in New Zealand. It processes the most prized saw logs that New Zealand's forests can produce into high value clearwood products, and it sells nearly everything it produces into the export market, through Tenon's own supply chains to consumers in North America that we reach directly, and into Asia. Of course, that's exactly what you want to see as shareholders, and that by the way is exactly what the NZ industry needs a lot more of. Selling unprocessed logs in large quantities to China and India may appear a short-term answer to the NZ's forestry sector, but it is actually a large opportunity lost for NZ.

Turning to North America, our teams at Empire, South West and Ornamental continue to grow Tenon's market share in both the Home Centre and the Professional Builder markets. By the way, that is a bit like running hard to stand still as the total market itself has continued to shrink through this downturn –it's sometimes difficult to grasp just how much the US market has declined. Housing starts are down 75% off their peak, nearly three million unsold houses overhang the market and this has strongly contributing to the lack of new home building. With the price of existing homes having declined by 30%, unemployment staying high along with mortgage delinquencies, consumer confidence has remained very low and consumers have reduced their spending generally, including of course on reinvesting into their homes. It's been a great effort by our Empire team, for example, to be selling to greater than a third more outlets in the last three years, when the competition for winning sales has been intense. The Tenon team in North America is winning its competitive clash because they offer the best package of add value services. It is difficult of course to maintain profitability and at the same time maintain excellence of service in this environment because service costs, but we are achieving that. Although overall demand has reduced across the board, we have set

out to counter this by adding in new outlets, new products and product ranges to mitigate the otherwise slowing sales. Empire is the best millwork distributor in the USA in my opinion. We can be proud of our business in the US, our customers certainly value us. When demand returns to the USA consumer market in housing, and remodelling and home improvement lifts, Tenon's USA and Canadian businesses will be well placed to take advantage of it. But we are not content by the way to wait for that time – we know we need to develop new opportunities, more on that in a minute.

In North America we operate a number of different brands, each serving different customer segments. They are all positioning moulding and millwork products in front of consumers in the USA and Canada. Although they operate and look differently, we see them more like different “shop windows into the same store”, not as separate operating entities. Tenon is one company in the USA but with separate offerings in service and product ranges that match the customer segment that they serve. Ornamental Mouldings serves the consumers who are looking for a decorative and elegant solution to the look of their rooms. South West Moulding sells to the retailers who serve the professional builders market in the southern states and Empire serves and maintains the mainline moulding and millwork requirements of middle America's retail stores.

We are continuing to build upon our One Company capabilities, to expand our centralised business intelligence and analytics capability that can for example quickly identify what is selling by SKU and where, and enhance our procurement capability to best determine the critical “make or buy” decision.

There is room for more “shop windows” in our store in North America. We are actively investigating opportunities to develop a wider presence in the North American market.

We are acutely aware that even though we are outperforming relative to our peers, our absolute level of financial return is not satisfactory. We know that we have to improve our earnings, but we also know we have ‘squeezed the lemon’ quite hard in the face of a shrinking market demand. There has been significant restructuring occurring to right size and reconfigure everywhere we can – which always comes at an upfront cost and we have invested approximately \$US 1 million so far this year. We know that we have to be very careful with our resources and keep our skills finely tuned and build for the future. We will not lose sight of our objectives. However we also know that to fight low demand, we must grow our business base, and in some places reinvent ourselves yet again.

We will continue to improve on what we are doing today, but we will also take what we do well today and start doing it in other locations and expand our consumer base. Our plan is to grow your company into areas where it makes sense, where the special skills we hold and the insights we have developed will let us succeed and let us grow the value of your business – substantially.

I would like to spend a few minutes outlining in general where we plan to develop the company.

Three broad areas are being worked on;

1) Firstly organic growth;

In the USA/Canada Market

- i. We will shortly be announcing the commencement of the distribution of a new innovative and exciting product range in the outdoor products segment in the US. Starting immediately with a large 100-store trial. A lot of growth potential is there for us if we are successful. Look for the press release early in the year.
- ii. A total remodelling of the Ornamental Mouldings retail display in some 700 retail stores in the US and Canada with additional product lines and new merchandising and marketing section.

- iii. Development of our Stair Parts and our Door businesses in the professional builders' market space in the US.
- iv. We will continue to seek expansion opportunities in distribution in North America, to achieve warehousing and logistics efficiencies and increase the reach of our add value service package.

With Clearwood in NZ

- i. Our vision is for our Taupo Manufacturing complex to be the acknowledged centre of excellence for processing NZ logs into high value consumer products. We have initiatives under investigation to substantially enhance our claim to this status.

2) Secondly Geographic growth

In Australia

We are developing a capacity to supply our broad product range of manufactured and sourced products to Australian consumers through a direct participation in that market.

In China and Japan

We are conducting two comprehensive reviews of opportunities to participate in the China and Japan wood businesses. We have a long history of trade into both China and Japan and we will be building on this to make a more substantial commitment in product and distribution. This is at an early stage. We are looking to replicate aspects of our successful North American model into markets into the emerging Asian countries.

3) And Thirdly Product growth

Product development

This is a continuous process for us – product innovation is a core part of our organic growth model. We will update you in the New Year on some of the initiatives we have underway.

Range extension

As I mentioned earlier, a new exciting range of outdoor wood products with real market potential will be launched shortly.

New Categories

Depending on the outcome of the China and Japan market reviews we will pursue the manufacture in New Zealand as well as sourcing globally of consumer ready wood products for both appearance and structural applications in those countries. These will be genuine step-out growth initiatives.

In summary, there is much going on – all of it good. We are working hard to grow and develop your company and deliver you a satisfactory total return on your investment. The message I wanted to leave with you is that we are following some very exciting prospects for growth and not simply waiting for markets to improve.

That concludes what I would like to say today, I will hand over to the Chairman now.

Forward-Looking Statements

There are statements in this document that are "forward-looking statements". As these forward-looking statements are predictive in nature, they are subject to a number of risks and uncertainties relating to Tenon, its operations, the markets in which it competes and other factors (some of which are beyond the control of Tenon). As a result of the foregoing, actual results and conditions may differ materially from those expressed or implied by such statements. In particular Tenon's operations and results are significantly influenced by the level of activity in the various sectors of the economies in which it competes. Fluctuations in industrial output, commercial and residential construction activity, changes in availability of capital, declining housing turnover and pricing, declining levels of repairs, remodelling and additions to existing homes in North America, relative exchange rates, interest rates in each market, and profitability of customers, can have a substantial impact on Tenon's results of operations and financial condition. Other risks include competitor product development and demand and pricing and customer concentration risk.