Rural Funds Group (RFF)

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Subject: Newsletter to Investors

Attached is the April 2014 Newsletter to Investors.

About Rural Funds Group (RFF) ARSN 112 951 578
RFF owns a diversified portfolio of high quality Australian agricultural assets. RFF's investment objective is to generate a stable income stream derived from leasing its assets to suitable counterparts and capital growth through any appreciation in the value of those assets. Rural Funds Management Ltd (RFM) is the responsible entity of RFF.

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Newsletter

from Rural Funds Management Ltd

Edition 1
April 2014

Rural
Funds
Management

Welcome

Dear investor,

Welcome to the first edition of our Newsletter.

Following the listing of the Rural Funds Group, we have simplified our communications to investors by reducing the number of funds that we report on and reducing the frequency of the Newsletter to two editions per year. These changes are intended to improve clarity and reduce cost. The new format will report on two funds: The Rural Funds Group, a fund listed on the ASX, and StockBank which is an unlisted fund.

The Newsletter will provide investors with relevant commentary on RFM investments and outline key dates for each Fund as well as practical information such as relevant contact information and how to trade securities.

We will continue to incorporate a main article in each edition to provide you some insight into the sector and investment environment in which we operate. In this first edition I present a comparison of the agriculture property leasing sector to commercial property leasing and indicate the scope of the opportunity for the Rural Funds Group and its investors.

As always, we welcome feedback from investors and encourage you to contact our investor services team should you have any comments.

I hope you find the Newsletter informative.

David Bryant

Managing Director

Rural Funds Management

RFF Market Perspectives

David Bryant, Managing Director

The Australian commercial property sector is well serviced with fund managers and investment funds designed to meet the needs of tenants and investors. In contrast the agricultural sector, though of comparable scale, has only one fund designed for this purpose: the Rural Funds Group (RFF).

A calculation of the total value of Australia's investment grade commercial property indicates that this asset class has a total value of around $280 billion. This figure was derived from national data relating to floor area multiplied by market values per square metre. Investment grade properties in this case, were properties valued greater than $10 million. Figure 1 sets out this data and demonstrates that the level of institutional ownership is on average 70%, with the balance owned privately. Interestingly, retail property is 95% institutionally owned, while industrial property has a lower level of investor ownership (47%), though this figure is changing rapidly with the expansion in number and scale of Real Estate Investment Trusts (REITs) focusing on this segment.

Figure 1: Summary of the Australian property investment market[1]

	Property investment market size total value AU$b	Institutionally owned property total value AU$b	Market coverage by institutional investors
Core Property Sector			
Office Investment Market	111	63	56%
Retail Investment Market	112	106	94%
Industrial Investment Market	55	26	47%
Total	**280**	**195**	**70%**

While the application of an investment grade threshold skews the data to a certain extent, these statistics relating to commercial property are interesting for two reasons.

Firstly, if 70% of these properties are owned by investors, it means that at least 70% of these assets are leased by tenants. Therefore, leasing commercial property is a very common practice among Australian businesses. Reasons why businesses lease premises, rather than own them include the flexibility that leasing provides as business space requirements expand or contract.

Leasing, rather than ownership also allows a business to more efficiently use its scarce capital. Rather than tying up equity in a building that could be rented for say 10%, many business owners choose to invest the money into expanding their business operations, where they may hope to make a return of 20%.

1 Higgins Dr D.M., Australian Commercial Property Investment Market: Styles, Performance and Funding, Australian Centre for Financial Studies, Melbourne, 2013

Academic research on the performance of listed companies, verifies that leasing is good for business[2]. A study of 2,343 listed UK companies over a 13 year period, revealed that companies lease property to reduce their debt, to finance growth prospects, and to conserve liquidity, namely cash. Companies that leased real estate were found to generate higher returns than those that did not, with the optimal ratio of leasing being 65% of a company's total property requirement.

The second reason why the data in Figure 1 is interesting is that it demonstrates a large commercial property funds management sector. The middle column shows that $195 billion of Australia's investment grade commercial property is managed by property fund managers. Of this amount, $89 billion is owned by REITs whose securities are traded on the ASX, $90 billion is owned by wholesale funds typically targeting large superannuation funds, and the remaining $16 billion is owned by property syndicates, that would tend to be owned by retail investors and their self-managed super funds.

From this statistical snap shot of Australia's commercial property, a picture emerges of a funds management sector that has grown to meet the needs of business. The success of this sector could not have occurred unless it delivered a product that both improved the bottom line and flexibility of businesses, while simultaneously delivering investment returns that satisfied the expectations of investors. In this respect a property fund manager is straddling two markets: the rental market for tenants, and the equity market for owners.

An analysis of these two markets and how they relate to agriculture reveals a very different picture – and an opportunity.

Australian agriculture utilises 405 million hectares of land, which is 53% of the country's total land area. The industry is relatively fragmented with 120,000 businesses reporting that farming is their principle business. RFM has estimated that the total value of≈the land and improvements of these businesses is just over $200 billion[3].

Added to this are substantial processing and infrastructure assets, typically owned by food processors and agricultural commodity marketers, whose total assets add tens of billions to the value of the agricultural property sector.

The threshold for investment grade agricultural assets is probably lower at around $5 million. This is because a property of this value is economically viable on a standalone basis, and could be efficiently managed and leased out by a fund manager. Possibly one third of Australia's farms would qualify as investment grade based on this criterion, while almost all processing assets tend to exceed this value threshold. Therefore the total value of investment grade assets in Australian agriculture is of the order of $150 billion, making it a larger sector than either the office, retail or industrial property sectors detailed in Figure 1.

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Despite the scale of the agricultural sector, it is estimated that only 4% of agricultural property in Australia is leased compared to around 40% for the US and many European countries. Why is Australia's leasing rate so low, and why has there been no equivalent emergence of property fund managers facilitating property leasing?

2 Lasfer, M., Why do companies lease real estate assets?, Cass Business School, London, 2005

3 While the Australian Bureau of Statistics (ABS) publishes data on the numbers and types of agricultural enterprises, there is little data available on the actual capital value of the industry. RFM has attempted to calculate this figure through a range of techniques such as obtaining data on the size of the national beef herd and multiplying this by the typical price paid for sufficient land to carry one cow. The same technique was used for sheep, with adjustments made in both cases for the lower feed requirements of non-breeding livestock. In the case of cropping, RFM analysed grain production, the area planted and applied a land value adjusted for productivity. Similar techniques were repeated for the major agricultural industries covering nearly 80% of the total farm population.

RFF has become Australia's first agricultural REIT to serve Australian farm businesses and meet the expectation of its owner: the RFF unitholders.

The main reason is the relatively low lease rentals paid by broadacre[4] farm enterprises.

Broadacre farms can be leased at a rental yield of 5% of the capital value of the farm. This compares with an office building in the centre of our cities that would lease on a yield of 6-7%, and industrial warehouses on the fringe of our cities that lease for around 9%. On the surface then, leasing commercial property would appear more attractive.

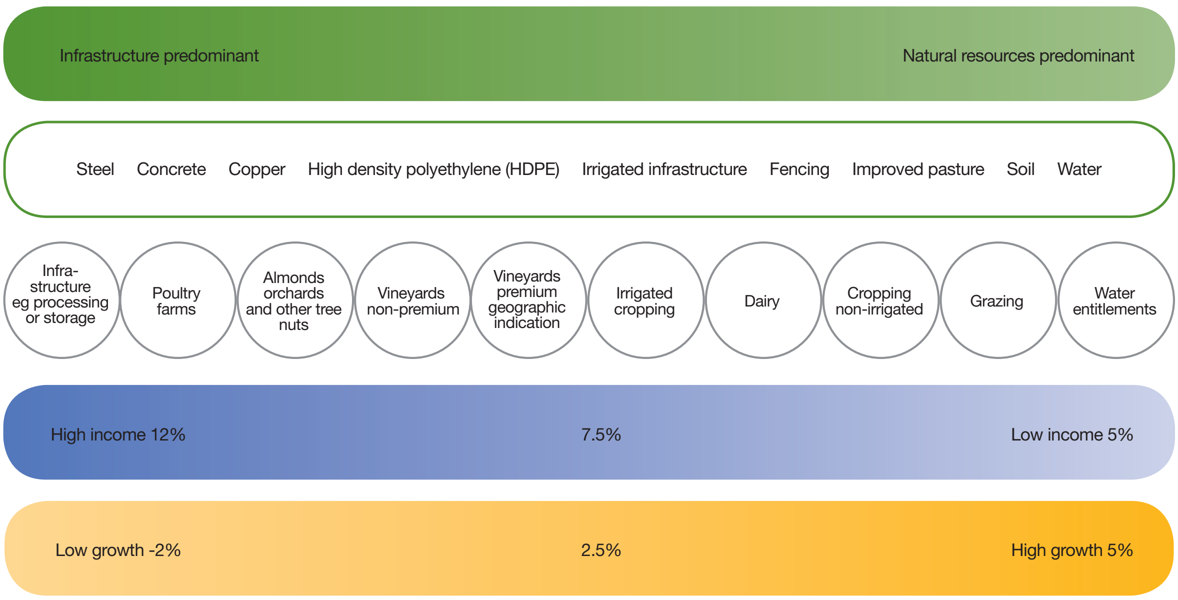
However higher lease rentals on commercial property may be due to the depreciation occurring on the structure or building that makes up the majority of a commercial property asset value. As the building ages, obsolescence will one day necessitate either the demolition or major upgrade of the building, and this comes at a cost that should be considered throughout the lifecycle of the asset. In contrast to commercial property, broadacre farms have much lower levels of depreciating infrastructure installed on them. In fact modern cropping properties often have no fences, no buildings and just a few dirt access roads.

As a consequence the asset is an almost pure natural resource with no wasting infrastructure detracting from long term returns.

While broadacre lease rentals may not be diminished by depreciation, the fact remains that the net yield generated by these assets is too low to compete with the investment yields historically generated by fund managers of commercial property. The Rural Funds Group (RFF) has addressed this dilemma by accumulating a mix of agricultural assets, that include the natural resources of land and water, but also substantial infrastructure capable of generating higher yields. As a consequence of this asset mix, RFF is able to distribute investment yields that exceed the majority of REITs.

RFF then is uniquely placed. Just as commercial property fund managers have provided a service that assists Australian business, while meeting the expectations of their investors, RFF has become Australia's first agricultural REIT to serve Australian farm businesses and meet the expectation of its owner: the RFF unitholders.

Figure 2: Spectrum of investment opportunities



4 The term broadacre describes less intensive enterprises such as livestock grazing and cropping. These contrast with intensive enterprises such as vineyards, almond orchards and poultry farms.

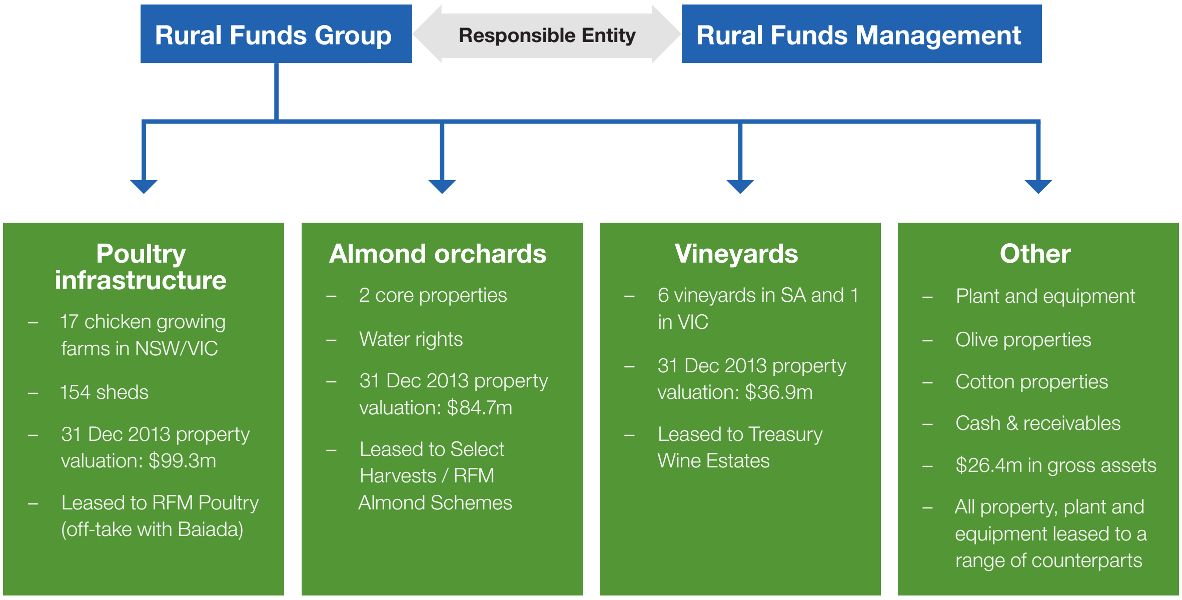
Rural Funds Group (RFF) Update

ARSN: 112 951 578

RFF was formed as the result of the December 2013 merger of three unlisted funds managed by RFM.

The new, diversified entity comprises assets within three main agricultural sectors leased to high quality tenants, including two ASX-listed companies. Figure 1 below describes RFF's assets:

Figure 1: RFF Assets



The merger proposal received overwhelming support and was viewed by Unitholders as a mechanism to strengthen their investment by providing a sustainable liquidity solution, greater access to capital markets and diversification amongst other benefits.

RFF commenced trading on the ASX on 14 February 2014 and very quickly confirmed that listing provided a successful liquidity mechanism for our Unitholders with a turnover of 11.5% of total units on issue in the 11 trading days until the end of February and 13.57% to the end of March.

"Providing liquidity for our investors was fundamental to the proposal put to Unitholders in forming RFF. It is gratifying the process has been successful in achieving this primary aim", said David Bryant.

"RFF has traded in a range of 72 cents to 89 cents since listing. We are now focused on growing RFF awareness in the listed marketplace with the aim of increasing the trading price."

Key to increasing the profile of RFF in the listed environment has been the initiation of research coverage, which in the first instance was undertaken by financial services firm Taylor Collison (report on RFF available at **www.ruralfunds.com.au**).

On 27 February 2014, RFF reported its first half year accounts as a listed entity for the six month period ending 31 December 2013. As part of its service to Unitholders, RFM made the presentation and accompanying audio available for download on the RFM website.

The half year accounts presentation highlighted key attributes of RFF including improved banking terms, the diversification of our tenants (see figure 2 below), expected distribution yield (forecast 8.6% for FY2015) and an attractive weighted average lease term of 13 years (see figure 3 below).

Later in the calendar year, RFM will seek Unitholder approval to amend RFF's constitution to reflect the listed environment it now operates in, and to align the structure of RFF with other REITs. Specifically RFM is recommending that RFF adopt a "stapled security" structure which would provide Unitholders with flow through taxation treatment on the majority of assets owned by RFF. More information will be provided to investors as it becomes available.

Figure 2: Tenant portfolio diversification by FY14 revenue

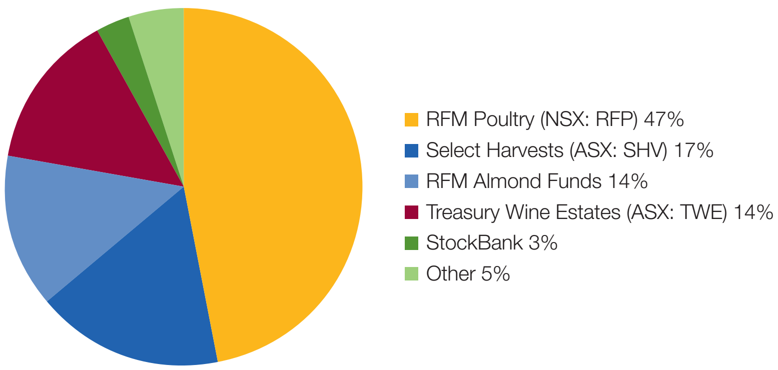
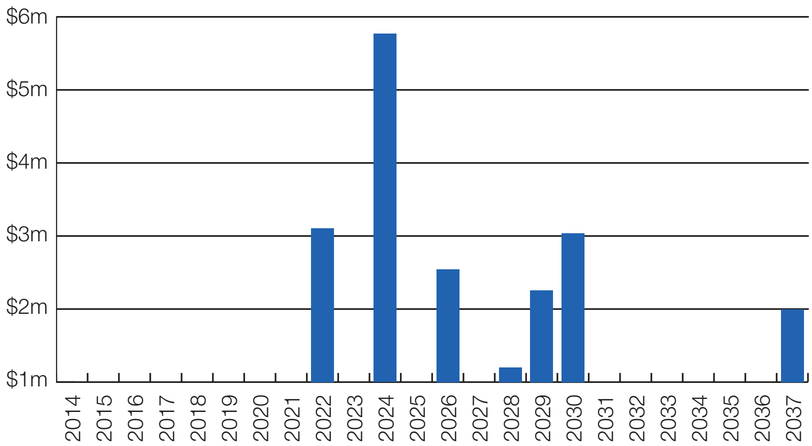


Figure 3: Lease expiry profile based on FY14 revenue



Looking ahead, RFM's strategy is focused on improving market awareness, cost control and ongoing assessment of additional agricultural leasing opportunities.

Key Portfolio & Financial Statistics – as at 31 December 2013

Total Assets	$247m
Net Asset Value (NAV)	$118m
NAV per unit	$1.01
Loan to Security Ratio (LSR)	41%
Forecast FY 2015 yield at NAV	8.55%
Weighted Average Lease Expiry (WALE)	13 years
Forecast 6 months ending 30 June 2014 distribution per unit	4.26 cents
Forecast FY2015 distribution per unit	8.59 cents
Forecast FY2015 payout ratio	90%
Number of properties	27
Occupancy rate	100%

Upcoming Key Dates

Quarterly distribution announcement	**June 2014**
Full year results announcement	**August 2014**
Quarterly distribution announcement	**September 2014**

RFF Investment Profile

RFF is structured as a specialised real estate investment trust that owns a diversified portfolio of high quality Australian agricultural assets primarily including mature almond orchards and associated water entitlements, commercial scale poultry growing infrastructure and premium vineyards and livestock all of which are leased to suitably qualified and experienced agricultural operators (or tenants).

RFF's investment strategy is to deliver a stable income stream from leasing assets and capital growth through the appreciation in the value of RFF's assets.

RFF benefits from strong industry dynamics with growth in Australian agriculture driven by increasing world population growth, the emerging Asian middle class and global constraints in the supply of agricultural land.

RFM StockBank Update

ARSN: 153 436 803

During 2013 StockBank raised over $5 million from retail investors increasing the size and geographic diversification of the Fund.

As a consequence of the increased scale, RFM has focused on growing the number of livestock agents we engage with, and increasing the number of sheep within the StockBank portfolio.

Livestock agents are key to StockBank's model as their skills and expertise are used to identify suitable farmers (Operators) to lease livestock. StockBank's leasing model continues to be well received with 80% to 90% of Operators repeating a leasing transaction.

"Sourcing new agents helps StockBank diversify our Operator base and ensure the Fund is not overly reliant on the performance or financial capacity (in the event of a shortfall) of any one Operator" said David Thomson – Business Manager, StockBank.

The move to increase sheep numbers within StockBank has been well timed with very positive lamb market fundamentals. Drier conditions have resulted in cheaper lambs and higher sales revenues from finished animals. A more stable food supply, backed by feed lots, has assisted StockBank Operators in benefiting from improved sales margins. Figure 1 below illustrates recent finished lamb prices compared to previous years.

While cattle prices have remained slightly lower as result of drier weather, the finished price of cattle has provided profit opportunities for Operators with access to feed or pasture.

Rainfall in February and the first week of March provided relief to stocking pressure in many cattle and sheep regions. Conditions have been tougher in Queensland with dry conditions continuing and StockBank's flexible leasing model has allowed the Fund to decrease its exposure to this region in response.

Market fundamentals for StockBank have remained strong. Overseas demand for cattle and sheep have hit record highs with new Australian export records set in February. Beef and veal exports exceeded 100,000 tonnes by shipping weight (SWT) and lamb exports surpassed 19,000 tonnes SWT.

A lower Australian dollar greatly improves Australian beef's competitive position in international markets. China in particular is emerging as a large market for Australian red meat with increasing demand and trading volumes.

Figure 1: Eastern States Trade Lamb Indicator (ESTLI)

Key Portfolio & Financial Statistics – as at 31 December 2013

Total Assets	$11.7m
Net Asset Value (NAV)	$11.3m
NAV per unit	$1.01
6mth cattle turnover	10,971 leased
	5,655 sold
	16,033 remain
6mth sheep turnover	31,571 leased
	11,250 sold
	37,765 remain
Change in livestock placements	Growth of 45% from $7m to $10.1m
Livestock locations	New South Wales: 10,882 cattle, 21,813 sheep
	Victoria: 1,428 cattle
	South Australia: 873 cattle
	Queensland: 294 cattle

Upcoming Key Dates

Half-yearly distribution record date	**30 September 2014**

StockBank Investment Profile

StockBank is a liquid, alternative investment fund that aims to provide investors with a reliable yield by financing the acquisition of livestock that are leased and grown out by Operators on a portfolio of diversified properties.

StockBank receives payment upon the sale of livestock calculated as a fixed return on capital regardless of livestock sale price, weight gain or mortality rates.

About Rural Funds Management

AFSL: 226 701

RFM is an experienced fund and asset manager that specialises in Australian agriculture.

RFM manages a diverse portfolio of large-scale farming and agricultural enterprises for investors who seek the opportunity to diversify their portfolios away from the traditional equity and property markets. Our primary assets are in land, water, infrastructure, poultry, cattle, sheep, viticulture, cotton and almonds.

Established in 1997, RFM is the responsible entity for seven agricultural investment funds and as of 30 December 2013, had approximately $308m of agricultural assets under management in New South Wales, South Australia, Victoria and Western Australia.

RFM is one of the oldest and most experienced managers of agricultural assets in Australia. In addition to RFM's corporate office located in Canberra, RFM has offices in Sydney, Melbourne and Western NSW and employs more than 60 staff in fund and asset management activities.

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To make an investment

Rural Funds Group (ASX: RFF) is a listed investment. StockBank operates as an unlisted fund (APR Code: RFM0009AU).

To make an investment in RFF please contact your broker or financial adviser.

To make an investment in Stock Bank please contact your financial adviser or RFM.

Provide us your email address

We use email to communicate with our investors. Please take the time to contact our Investor Services team and provide your email address so that you don't miss out on any important information.

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