Newsletter

from Rural Funds Management Ltd

Rural Funds Management

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TORTOISE & HARE:

Natural resource and infrastructure intensive assets

David Bryant, RFM Managing Director

You will only get two things when you buy a listed security such as the Rural Funds Group (RFF): the distributions and the price on the day you sell. Interestingly, the first thing (distributions) can to a large part determine the second thing (the value of your securities).

This article considers three measures used to monitor the sustainability of distributions, then examines the attributes of RFF's assets on the sustainability of investment returns.

Three key measurements

A primary measurement reported in RFF's financial results presentations is 'funds from operations' (FFO)[1], which is the net profit after tax, with an add back of non-cash items, such as depreciation and the changes in the valuation of assets. Put more simply, it is the actual cash available each year that can be used to fund distributions. For the purposes of this article, the term FFO is interchangeable with 'cash'.

Cover and image above: Droughtmaster cattle grazing on Rewan Station, RFF's blue-ribbon cattle property located adjacent to Carnarvon Gorge in central Queensland. Photo by Tanya Millewski

Bottom: Farm 68 with twelve of RFF's poultry sheds, located outside Griffith NSW

A second measurement is designed to test the sustainability of distributions and is called the 'payout ratio'. This is the amount of distributions paid relative to the amount of cash generated each year from RFF assets. If the payout ratio was greater than 100%, the fund would be paying investors more cash than it is generating – which cannot be sustained indefinitely. RFF's current payout ratio is 78%, one of the lowest among comparable real estate investment trusts (REITs).

A third measurement in REIT investment analysis is the growth rate of distributions backed by the growth rate of cash generation. The quantum and sustainability of this growth has a substantial influence on the present-day value of a security. Consequently, if you can pick a stock that grows its cash generation and annual distributions, you will increase the two things from owning a listed security: more distributions and a likely higher price when you sell.

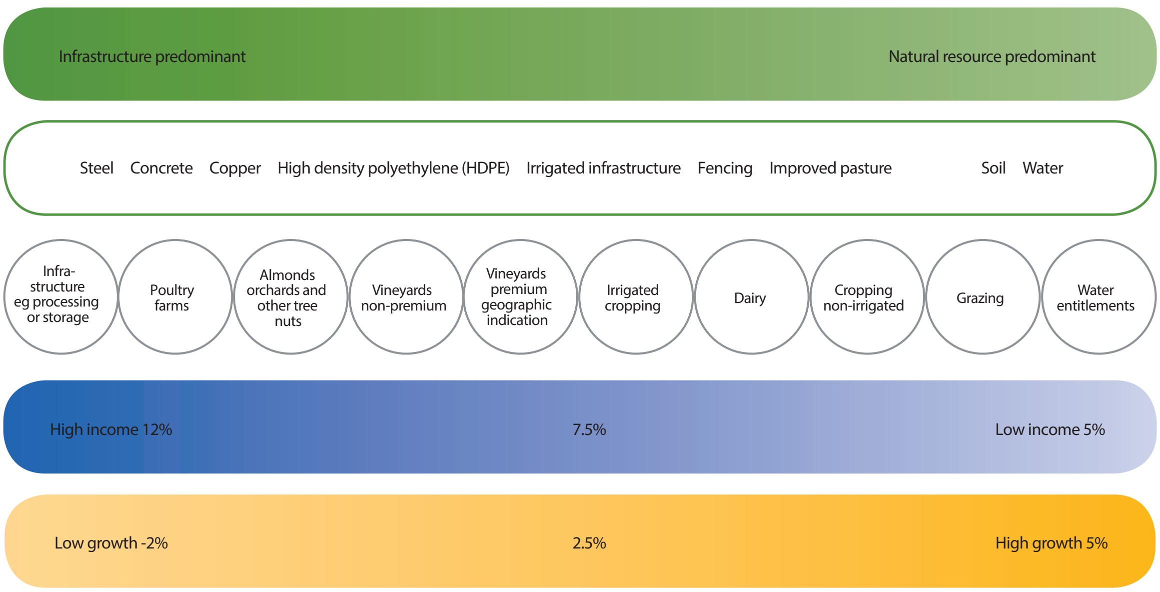
Because of these three measurements, most REIT managers aim to maintain a portfolio of assets that can sustainably generate cash to fund distributions and ideally fund an increase in these distributions over time. Let's now turn to the RFF portfolio and examine it through this lens.

The RFF portfolio

Four years ago, RFM developed the diagram presented in Figure 1, to provide investors an understanding of the characteristics of assets in Australia's agricultural sector. The diagram creates a differentiation between assets with high levels of infrastructure compared to those assets which are more intrinsically a natural resource. It provides examples of the materials used in infrastructure at left, transitioning through to elements of assets that are a natural resource. It also aligns examples of assets arrayed from left to right, in an order consistent with this method of classification.

The final two rows of the diagram suggest income and capital growth rates for both ends of the spectrum. Assets to the left provide high rates of income, but negative capital growth, because they depreciate over the useful life of the infrastructure, while natural resource assets, on the right, generate lower rates of income, but higher rates of capital growth.

Figure 1 - range of agricultural investments[2]



The spectrum diagram above was published by RFM in 2013 prior to RFF being listed on the ASX

[1] In the case of RFF, 'adjusted funds from operations' (AFFO) is used. These adjustments relate to the tax treatment of the entities within the Group. The adjustments have the effect of producing numbers that are consistent with FFO reported within the sector.

[2] The income and growth figures presented in Figure 1 have been provided to differentiate the profile of income and growth that can be derived from different assets. They are based on RFM's experience and observations of agricultural lease transactions and historical rates of growth. They are neither forecasts nor projections of future returns. Past performance is not a guide to future performance.

Poultry sheds owned by RFF in Griffith (left) are infrastructure intensive assets which are high income but depreciate as they age. Conversely, Rewan, a cattle station in central Queensland (right) is a natural resource predominant asset which may generate lower initial cash flows, but will consume little or no additional cash when leases are renewed

Income generated from RFF's assets feed through to the cash metric (or FFO) discussed above, while indexation mechanisms contained in the leases over RFF's assets, feed through to cash growth. Capital growth may also feed through to cash growth, though by the indirect route of market reviews. This means that high rates of capital growth in assets are of no use, unless they can be monetised by a market review confirming an asset has increased in value, and that the lessee should pay more rent.

The preceding discussion is interesting because it proposes another dimension to the concept of diversification. It is clear that RFF owns assets operated in a diverse range of agricultural industries. Moreover, RFM has articulated a strategy of climatic diversification. This will provide RFF exposure to lessees operating in climatic zones with low correlation to its existing assets, and as a function of these different conditions, further diversification by industry. What Figure 1 does is consider the diversity of financial characteristics of RFF's portfolio of assets. This is an important consideration for balancing immediate cash generation and cash growth.

RFF's asset base has been skewed towards infrastructure predominant assets such as poultry farms, almond orchards and vineyards – which is why it can provide a relatively high rate of distributions to investors. More recently, RFF has acquired assets with larger natural resource components, being approximately $34m of high security water entitlements and three cattle properties acquired for $42m, all within the past six months. This represents a measured shift in the balance of the portfolio's financial characteristics.

In the investor presentation dated 4 November 2016, RFM advised that we expect RFF can sustain an annual distribution growth rate of 4% per annum. This growth is funded by growth in cash and buffered by RFF's low payout ratio. An implication of a shift towards lower yielding natural resource assets is that cash generated per unit may be diluted initially, as new equity is raised to fund acquisitions. This will not, however, affect the growth in your distributions for two reasons: the shift to natural resources is measured, and RFF's low payout ratio will buffer any divergence between growth in distributions and the cash growth needed to fund them.

A limitation to the cash metric (FFO) is it ignores future lumpy cash consuming events, such as the major reconstruction of an asset after it has become obsolete. For example, the oldest of RFF's poultry farms, currently valued at $41.5m, will require reconstruction or disposal in eight years' time. Other examples within the REIT sector include office and commercial buildings that periodically need major refurbishment. Unsurprisingly, it is more infrastructure predominant assets that require these refurbishments. To overcome this limitation, RFM conducts a whole of life analysis of all RFF assets, and incorporates funding requirements for refurbishments into its long term modelling.

Natural resource predominant assets are much less exposed to lumpy cash consuming events because they have relatively little infrastructure that could become obsolete.

Cattle grazing on RFF's Rewan Station, with the forage legume 'leucaena' visible in the background and winter forage crops in the foreground

Natural resource predominant assets are much less exposed to lumpy cash consuming events because they have relatively little infrastructure that could become obsolete. What is apparent from this discussion is infrastructure assets generate higher initial cash flows, but will consume cash when a lease is renewed at some point in the future. In contrast, natural resource assets generate lower initial cash flows, but will consume little or no cash when leases are renewed. This means that over time, the natural resource tortoises may overtake the infrastructure hares.

Over the past two years, RFM has been investigating natural resource assets in northern Australia, visiting numerous properties and meeting with management, agricultural scientists and the people who value these assets. In that process we have observed much greater potential for productivity gains from modest additional capital investment.

Several examples of 'productivity capex' are outlined on page eight of this Newsletter, including the central Queensland cattle properties acquired by RFF in mid-2016. Capital improvements costing $1m are being rolled out over the next eighteen months across the properties, which aim to lift the carrying capacity and daily weight gain of the cattle bred or fattened on them. On the fifth anniversary of the lease, the properties will be revalued for the purposes of a rent review where productivity gains may lead to a rental uplift due to improvements to the properties' cattle carrying capacity. Acquiring and improving more assets like this would be of great benefit to RFF.

RFM continues to analyse investment opportunities that can enhance RFF's portfolio, increase the scale of the Fund and therefore increase liquidity of its securities. These opportunities include assets with high infrastructure components, such as poultry farms or almond orchards, and more natural resource predominant assets such as cattle properties. In so doing, the priority remains building a balanced portfolio of assets that can generate the highest total returns over their lifecycle, to maximise the two things you will get from your investment in RFF: the distributions and the price on the day you sell.

Droughtmaster cattle graze on forage oats on RFF's Rewan cattle station, central Queensland

Rural Funds Group (RFF) Update

RFF is a stapled security comprising Rural Funds Trust ARSN 112 951 578 &
RF Active ARSN 168 740 805

In this section:

- Natural resource acquisitions

- Productivity capex

- $61m equity raise & FY16 results

The acquisition of three Queensland cattle properties and the 9,549 ML Murrumbidgee water entitlement add natural resource predominant assets to the RFF portfolio.

Longer-term RFF investors would be familiar with the graphic in David Bryant's article on page three, which provides examples of the various types of agricultural assets. To the left of the spectrum are infrastructure intensive assets – which are generally higher income but will depreciate in value over time. The cattle assets and water entitlements outlined in this section sit to the right of the spectrum, with lower initial income but higher potential capital growth opportunities.

Queensland cattle assets

In July 2016, RFF announced the purchase of three properties - the fund's first major acquisition in the cattle sector. This included two breeding properties, Mutton Hole and Oakland Park, situated near the Gulf of Carpentaria, totalling 225,800 ha and purchased for $18.4m. The two Gulf properties are suitable for breeding cattle, the majority of which will be transported by the lessee and finished on the third property in the transaction, Rewan Station.

Rewan is a high value backgrounding and finishing property of 17,500 ha located near Rolleston in central Queensland and purchased for $31.6m. Together, the properties form an integrated breeding and finishing operation designed to attract corporate lessees. The operation is currently managed by Cattle JV (CJV), a wholly owned subsidiary of Rural Funds Management, under a ten year property lease. The RFF breeding herd is leased to CJV under a separate ten year herd lease. CJV is structured to accept investment with suitable joint venture partners. CJV will carry the operational risk associated with managing the property.

RFF will collect rent from CJV and may also benefit from higher cattle prices. The property and herd leases include an annual rental indexation, with an adjustment mechanism based on the performance of the Eastern Young Cattle Index (up to an additional 150 basis points above a base rate) providing RFF with some exposure to the benefits of higher cattle prices. The property lease includes a market based review after five years, providing an added incentive for RFF to finance prudent improvements to the property to increase its market value.

CJV commenced quarterly rental payments to RFF in late September 2016, which coincided with CJV's first bi-annual muster of cattle on the two Gulf properties. At the conclusion of the muster, around 11,900 head of cattle were recorded, with 8,300 head on Mutton Hole and 3,600 head on Oakland Park. The herd lease with RFF requires CJV to maintain herd dynamics. That is, to ensure that 11,000 head of breeding cattle remain in the herd owned by RFF. It is also important that herd quality is maintained as the herd's offspring will generate income for CJV as the lessee.

With capital expenditure funded by RFF, CJV aims to increase the carrying capacity, weight gain and calving rates on the three properties, and thus improve herd performance and property values. It is expected that CJV will deploy $1m of improvements over the next 18 months including additional water infrastructure, improvements to roads on the properties and the planting of highly nutritious grasses and forage legumes to support increased cattle weight gain. Additional rent is paid immediately on this investment.

RFF Cattle asset acquisition snapshot

Purchase price	Name & location	Property type	Size
$18.4m	**Mutton Hole** Carpentaria, Queensland	**Breeding**	**140,300 ha**
		Mutton Hole is a large scale cattle breeding property located near Normanton on the south eastern corner of the Gulf of Carpentaria. The property is serviced by extensive water infrastructure including dams, bores, creeks and river frontages.	
	Oakland Park Croydon, Queensland	**Breeding**	**85,500 ha**
		Similar to Mutton Hole, Oakland Park is a large scale cattle breeding property located on the Gulf of Carpentaria near Croydon. The property has extensive water infrastructure, and pastures include Stylo legumes and Wynn Cassia grasses.	
	Breeding herd		
		The two properties include approximately 11,000 head of Brahman cattle located on Mutton Hole and Oakland Park. At the time of purchase, the propeties had a combined carrying capacity of over 16,500 head of cattle, which the lessee, CJV, aims to improve (see the 'property capex' section overleaf).	
$31.6m	**Rewan** Rolleston, Queensland	**Backgrounding and finishing**	**17,500 ha**
		Rewan Station is a high-quality backgrounding and finishing property located 55 kilometres south of Rolleston in central Queensland within commercial proximity of multiple market facilities including feedlots, abattoirs, saleyards and ports. The property includes a large feedlot and plantings of forage legumes leucaena and lablab, as well as extensive water infrastructure. At the time of purchase, Rewan had an initial carrying capacity of 7,200 head of cattle which the lessee, CJV, also aims to improve.	

High security water

In addition to the cattle properties outlined above, RFF has contracted to acquire a 9,549 megalitre high security Murrumbidgee River water entitlement for approximately $34.4m, in one of the largest ever sales of high security Murrumbidgee River water entitlements.

The entitlement will provide a cornerstone resource for future asset developments such as almond orchards. In RFM's experience, lessees are attracted to properties which come with high security water allocations to sustain the biological assets such as almond orchards.

In the interim, as new horticulture developments are being planned, RFF will use the entitlements to generate revenue from the sale of annual water allocations. The Murrumbidgee water entitlement transaction is contracted to settle in December 2016 and will be funded from existing balance sheet capacity.

Productivity capex

RFM aims to improve the productivity of RFF's properties by funding capital improvements which aim to increase returns to RFF investors over time.

RFF is making modest capital investments on several of its properties outlined in the section below. RFF investors are expected to benefit from this ‘productivity capex’ through the immediate increase in rent paid by lessees, driving RFF’s adjusted funds from operations (AFFO), or in other words generate more cash to underpin distribution growth. Equally, more productive properties are usually more profitable for RFF lessees and therefore improve their financial stability.

Higher rental returns for RFF can be achieved in two ways:

1. Lessees pay additional rent to RFF for the productivity capex deployed.

2. Rents are increased as a result of property valuation uplifts. This occurs in cases where leases include a market based rent review mechanism, such as the cattle asset leases.

The below table includes examples where RFF is funding productivity capex on the properties it owns and leases to experienced operators.

Leucaena is a nutritious legume for cattle

Watering points on Rewan Station reduce cattle walking distances

Improved cattle station carrying capacity

RFF is funding productivity improvements on the Rewan Cattle station through the further establishment of leucaena, a deep rooted perennial legume which is highly nutritious for cattle. A deep root system allows leucaena to provide green forage longer into the dry season. In addition, another forage legume, lablab, is also being planted for grazing, producing high quality feed.

Similarly, Stylo is another high protein legume being planted on Mutton Hole and Oakland Park to improve productivity. Stylos are exceptionally hardy plants, as once established, are able to persist through periods of drought due to their deep tap roots which can access moisture well below the roots of the native grasses currently present on the properties.

New watering points are being installed on Mutton Hole and Oakland Park to improve weight gain by reducing the amount of energy used by cattle walking between watering points. The construction of eight new dams and expansion of four existing dams across the two properties will greatly decrease the distances that cattle need to walk to find water. This also allows cattle to access areas which were previously unavailable for grazing due to a lack of water.

The above measures aim to secure lessee profitability and improve the three properties’ carrying capacity - the average number of head that a property can support, which in turn supports cattle property valuations.

Automated irrigation infrastructure delivers water to macadamia orchards

Upgraded irrigation on macadamia orchards

The automated irrigation systems on the macadamia farms owned by RFF near Bundaberg will allow the farm manager to more efficiently apply water and reduce labour costs. It is estimated to have already saved 320 hours of labour in 2016.

The system aims to provide the 2007 Macgrove Project higher yields and cost savings, while also increasing the market value of the properties. RFF will also generate additional rental income by funding the expenditure.

New varieties of grapes can be grafted to improve vineyards assets

Grafting vineyards

RFF is tailoring its vineyard assets to the lessee's needs by funding the conversion of over 70 ha of vines by grafting preferred varieties to vines in the Adelaide Hills and Kleinig vineyards over the next three years.

As part of the program, RFF is funding the grafting of around 40 ha of Cabernet Sauvignon and 30 ha of Shiraz, to vines that previoulsy produced varieties such as Chardonnay, Pinot Noir or Grenache.

The lessee, Treasury Wine Estates, will access a preferred product and the capital expenditure will be reflected in the lease at the next scheduled review. Leases for six vineyards with Treasury Wine Estates were recently extended to 2026.

RFF successfully raises $61m & delivers positive FY16 Results

Shortly after announcing the Queensland cattle property acquisitions, RFF successfully raised $61.0m through a non-renounceable Entitlement Offer in July 2016. Almost 60% ($35.8m) of New Units were taken up by existing Unitholders. The remaining New Units were taken-up by new and existing RFF institutional investors, with demand for these units significantly oversubscribed.

The proceeds of the equity raise, in combination with debt and retained earnings, has funded the purchase of the three Queensland cattle properties and breeding herd. The proceeds will also be used in the 1,000 ha Kerarbury almond orchard expansion and the purchase of three macadamia orchards located near Bundaberg. The equity raising was the third since RFF listed on the ASX in 2014.

The RFF 2016 annual financial results were released on 24 August, with key highlights including an uplift in adjusted funds from operations from $11.0m to $14.3m, and an increase in adjusted Net Asset Value per unit from $1.22 to $1.43. RFF maintained the FY17 forecast distribution of 9.64 cents per unit funded from AFFO of 12.42 cents, representing a lowering of the payout ratio from 95% to 78%, which will provide RFF expansion capability with less reliance on debt.

The cattle assets and Murrumbidgee water entitlement acquisitions bring the fund's unaudited adjusted total asset value to over half a billion dollars. RFF currently holds 34 high quality properties leased to experienced tenants, and the fund was the top performing Australian Real Estate Investment Trust (A-REIT) in FY16 according to the *Australian Financial Review*.

Figure 1 - Total Shareholder Returns[3]

RFF maintained the FY17 forecast distribution of 9.64 cents per unit funded from AFFO of 12.42 cents, representing a lowering of the payout ratio from 95% to 78% which will provide RFF expansion capability with less reliance on debt.

[3] Total return assumes $1.00 invested 30 June 2014 and all distributions reinvested at the Dividend Reinvestment Price. Total return of indices as provided by Standard & Poor. Past peformance is not an indicator of future performance

Table 1: Key portfolio & financial statistics – as at 30 September 2016

Adjusted total assets[4]	$510.1m
Adjusted net assets[4]	$295.7m
Adjusted NAV per unit[4]	$1.43
Market capitalisation ($1.60 per unit)	$331.1m
Number of properties	34
Weighted average lease expiry (WALE)[5]	14.8 years
Gearing[6]	37.5%
AFFO per unit (FY17 forecast)	12.42 cents
Distributions per unit (FY17 forecast)	9.64 cents
Distribution payment frequency	Quarterly
Forecast distribution yield (paid quarterly)[7]	6%
Forecast distribution growth	4%

Upcoming Key Dates[8]

Quarterly distribution payment date	**31 January 2017**
Half-year financial results announced	**21 February 2017**
Quarterly distribution payment date	**28 April 2017**

RFF Investment Profile

RFF is structured as a specialised real estate investment trust that owns a diversified portfolio of high quality Australian agricultural assets including almond and macadamia orchards, associated water entitlements, commercial scale poultry growing infrastructure, premium vineyards and cattle assets, 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 constraints in the global supply of agricultural land.

[4] Pro forma based on unaudited results to 30 September 2016, with an adjustment to include the Murrumbidgee high security (HS) water acquisition announced 10 October 2016 (settlement scheduled December 2016). Adjusted assets incorporates independent property valuations, inclusive of water entitlements

[5] Lease expiries weighted by forecast FY17 rental income, expressed in years from 30 September 2016. Pro forma weighted assumes cattle assets, macadamias, and all almond developments complete and excludes Murrumbidgee HS water

[6] Gearing calculated as external borrowings/adjusted total assets and Murrumbidgee HS water

[7] Calculated forecast FY17 distribution of 9.64 cpu divided by 12 October 2016 closing price of $1.60

[8] Dates are subject to change

Day-old chicks are delivered by the processor to the RFP poultry sheds in Lethbridge, Victoria, before being grown-out and then collected after several weeks.

RFM Poultry (RFP) Update

ARSN 164 851 218

RFM Poultry will welcome a new counterpart in November 2016 with the transfer of Victorian chicken grower contracts to the State's largest chicken processor, Turi Foods Pty Ltd.

RFM Poultry is a key lessee for the RFF, managing infrastructure that grows around 30 million chickens per year in 134 sheds in Griffith, New South Wales, and 20 larger sheds in Lethbridge, Victoria. At present all of the operations occur under growing contracts with the largest Australian owned chicken processor, Baiada Poultry Pty Ltd.

RFM Poultry announced on 22 August 2016 that the grower contracts held with Baiada for the Lethbridge operations will be transferred to Turi. The Lethbridge operations represent about 20 per cent of RFM Poultry's production by area.

The transfer will provide counterpart diversification and future security for RFM Poultry as Turi is Victoria's largest processor with its Geelong processing plant in close vicinity to the RFM Poultry Lethbridge operations. The first batches of chickens from Turi are expected to start to enter the RFM Poultry facilities in November 2016, with no major disruptions to operations anticipated.

Turi has agreements with over 85 contract broiler growers across Victoria, and has fully integrated operations including breeder farms, hatcheries, broiler farms, processing plants and warehousing.

Operating for more than 40 years, since 1976, Turi is the largest chicken processor in Victoria, with two poultry processing plants.

Turi's Breakwater plant, around 35 kilometres from RFM Poultry's Lethbridge farms, distributes chicken products through major and independent supermarkets, Quick Service Restaurants and other chicken outlets. It employs approximately 400 people.

Turi's Thomastown facility, in the northern suburbs of Melbourne, supplies mainly charcoal chicken outlets and specialty chicken stores and distributors. It employs approximately 250 people.

Turi's key brands include 'La Ionica', 'Golden Farms' and 'Bannockburn Free Range'.

Chicken market fundamentals remain positive

Chicken continues to be the nation's most consumed meat, with Australians on average each currently consuming more than 46 kilograms of chicken in 2015-16[9]. This is well-ahead of beef (27kg), pork (26kg) and sheep meat (9kg).

To put these figures in context, Australians each ate an average of just seven kilograms of chicken in 1966, with the affordability of chicken behind the remarkable growth in popularity. The Australian Chicken Meat Federation says the industry has continuously reduced the cost of chicken production through improved productivity and efficiencies, through better bird nutrition and breeding practices.

The vast majority of chicken produced in Australia continues to be consumed domestically and there is very little competition from imports of raw chicken due to quarantine rules. However, in September 2016, the Australian Department of Agriculture and Water Resources announced new import conditions for uncooked chicken meat and chicken meat products from New Zealand. Uncanned or unretorted meat for human consumption can now be imported from New Zealand, subject to strict import conditions.

While this may open the door to some additional imports, the scale of the New Zealand chicken industry is relatively small and RFM will monitor any market effects in consultation with chicken processors.

RFP delivers solid FY16 results

RFM Poultry (NSX: RFP) saw a 40 per cent trading price improvement over the 2016 financial year. A total of 14.36 cents per unit (including franking) was paid in distributions, representing an 11.8% return on the 30 June 2016 closing price of $1.22 per unit.

Other highlights included net profit after income tax of $0.87m, and the maintenance of FY17 forecast distributions of 10.05 cpu and franking credits of 4.31 cpu (total 14.36 cpu).

RFM Chief Operating Officer, Stuart Waight, and Investor Relations Manager James Powell presented the FY16 results via an investor webinar in September 2016. Operationally, FY16 saw the RFM Poultry management team focus on the continuous improvement of operations, maintenance of RSPCA endorsement of the Griffith operations and biosecurity vigilance following a minor outbreak of the ILT chicken respiratory disease in the wider Griffith area. A recording of the results presentation can be viewed on the RFM website: www.ruralfunds.com.au

Table 1: Key portfolio & financial statistics – as at 30 June 2016

Total assets	$8.98m
Net Asset Value (NAV)	$7.67m
NAV per unit	$1.11

Upcoming Key Dates - RFM Poultry[10]

Quarterly distribution payment date	**31 January 2017**
Half-year financial results announced	**2 March 2017**
Quarterly distribution payment date	**28 April 2017**

RFP Fund Profile

RFM Poultry is a large scale chicken broiler farm operator with experienced management, with RFM having managed the assets since 2003. RFM is the responsible entity of the Fund which undertakes chicken growing activities for Baiada Poultry Pty Ltd, and will commence growing activities with Turi Foods in November 2016. RFM Poultry listed on the NSX in March 2014.

[9] Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) Agricultural commodities report, September 2016

[10] Dates are subject to change

RFM Almond Funds Update

AF06 (ARSN 117 859 391), AF07 (ARSN 124 998 527) & AF08 (ARSN 127 947 960)

Growers in the almond schemes managed by RFM received significant returns in 2016, based on the large 2015 harvest and record high almond prices.

Participants in the RFM Almond Schemes 2006, 2007 and 2008 welcomed a substantial distribution in late October thanks to the favourable conditions in 2015. Net benefit to Growers per almondlot including GST refund, was $6,073 for AF06, $4,660 for AF07 and $4,771 for AF08.

However, almond prices have recently demonstrated volatility with the price peaking above $11/kg in 2015 and falling to around $7.50/kg in 2016. A lower almond price in 2016, combined with a lighter crop due to the 'biennial bearing' orchards, is expected to influence the 2017 distributions.

What is biennial bearing?

The biennial bearing nature is observed in many perennial flowering trees. The alternation of large and small crops is thought to be caused by the trees internal competition for nutrients between the current season's crop and the coming season's flower buds. As a result, Growers may notice an alternating pattern of slightly higher and then lower almond crop yields.

The heavy winter and spring rainfall experienced in eastern Australia led to floods in the western NSW area, affecting townships along the Lachlan River, such as Forbes. While some minor flooding was experienced during October and November on the outer edges of the Hillston almond properties managed by RFM, the almond trees were unaffected.

This may be attributed to the measures put in place when developing the orchards, where RFM referenced aerial images of the 1990 flood and located the plantings out of prior flood zones. Earthen levy banks were also constructed in areas that could be subject to inundation.

Bees and pollination

Bees are important to almond orchard management as they pollinate the flowers which form the fruit and then the nuts. Two pathogens have have been reported in Australia this year.

A strain of Varroa mite (Varroa jacobsoni) was detected on Asian honey bees in Townsville in mid-2016. A containment and eradication program is being undertaken by Australian authorities. Varroa jacobsoni does not readily move to European honey bees used in almond orchard pollination. A separate variety (Varroa destructor) is connected with bee hive decline in the northern hemisphere but has not been detected in Australia.

Nosema disease has been reported in Victoria in 2016, affecting a reported 30-40% of bee hives in the State. The disease is associated with cool and wet weather in coastal areas. RFM experienced no major hive supply issues related to Nosema during the critical pollination period in 2016.

Bees are important to many horticultural industries for pollination of trees and Australian State and Federal Government biosecurity agencies place a high priority on protecting bee health. RFM will also continue to maintain a high level of focus on biosecurity status amongst the bee hives contracted to pollinate the orchards.

Bee hives assist pollination at RFF's Swan Ridge macadamia orchard, Bundaberg Queensland

2007 Macgrove Project (MP07) update

ARSN 119 560 235

Growers in the 2007 Macgrove Project (MP07) have benefited from higher yields at a time when the macadamia price is at high levels, well above $5 per kilogram.

Growers were paid a distribution by RFM in late October 2016, which was based on a 2016 harvest of over 650 tonnes nut-in-shell (NIS), an increase of 62% on 2015. This was the first distribution since the orchards underpinning the Project were purchased by the Rural Funds Group and the appointment of RFM as responsible entity for the Project.

The larger 2016 crop was due to the combined effect of the orchards continuing to mature, improved irrigation and targeted fertiliser application. Looking ahead, RFM plans to improve the orchards by further expanding the automated irrigation system as a key project in 2017.

On the funds management side of the Project, RFM will not invoice Growers as per the arrangements under the previous responsible entity, and Growers will receive an annual distribution net of expenses. This is consistent with the process RFM applies to other almond managed investment schemes and aims to reduce administrative requirements and costs for both the Project and individual Growers.

The broader outlook for the macadamia market remains positive, with global demand for Australian macadamias outstripping supply. As with many other nuts, consumers are attracted to the health benefits of nut consumption.

RFM provided Growers an annual update via webinars held in late October, with a recording available at the RFM website: www.ruralfunds.com.au

Record haul

The 2016 harvest delivered a new price record, with a single b-double truck loaded with 36.6 tonnes of nuts delivered to Macadamia Processing Co Limited (MPC).

The record haul provided 45% sound kernel recovery, with only 1.6% of nuts rejected (unsound), which is very high quality given the RFM managed orchards delivered an average of around 38% sound kernal recovery in 2016.

Due to the high quality of the nuts, a price of more than $7 per kilogram was paid which resulted in a $260,000 return in one truckload.

RFM became responsible entity for the 2007 Macgrove Project in February 2016 and looks forward to delivering more positive results as the orchards continue to mature.

About Rural Funds Management Ltd

AFSL: 226701

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 under management include land, water, poultry infrastructure, almond and macadamia orchards, vineyards, and cattle assets.

Established in 1997, RFM is the responsible entity for seven agricultural investment funds and as of 28 October 2016, had approximately $570m of agricultural assets under management in New South Wales, South Australia, Queensland and Victoria.

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, Western NSW, and south east Queensland, and employs more than 70 staff in fund and asset management activities.

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To make an investment

Rural Funds Group (ASX: RFF) is a listed investment.

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

RFP is a listed investment on the National Stock Exchange of Australia (NSX: RFP).

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

Australian Executor Trustees Limited (AET) Privacy Policy

AET is the custodian for the Rural Funds Group and RFM Poultry. To read more about its privacy principles, please visit:
www.aetlimited.com.au/privacy-policy

Registry

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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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