

CLOUDY BAY SUSTAINABLE FORESTRY LIMITED

Social and Environmental Report for 2010



Vision

Our company vision is to become a household name as the leader in certified sustainable forest products in Papua New Guinea.

In order to achieve this vision we have been working hard over the past year to make our operations sustainable and to implementing systems and practices that can be certified by external auditors which will ensure we are doing things correctly and sustainably.

Becoming a household name may take a long time as we need to have the products available in the market for Papua New Guineans to purchase so that we become well known for our quality, social and environmental commitment.

Executive Summary

The project development in Cloudy Bay has been underway for 4 years already and much has been achieved. The first 3 years were focused on getting a temporary saw mill operating and developing the systems and people to manage the project according to the development agreement.

In 2010 we have seen the most development with the construction and commissioning of the new saw mill in the base camp in Bam, as well as our work on the environment, social, safety and infrastructure.

There is still much work to be done but the company now has a secure base from which to grow. The following report is aimed at providing a transparent and continuous flow of information to the land owners and other interested and affected parties.

Construction

The construction of the Saw Mill in Bam was completed by August 2010 and commissioning of this plant has been ongoing for the past 4 months. This project started in 2008 with the purchase of two old second-hand saw mills from Australia which we refurbished in Australia before being sent to Cloudy Bay packed in 23 containers.

The construction faced many challenges with problems in delivery to site due to the fact that all materials had to be transported by water as there were no roads at that time.

There were also delays caused by the heavy rainfall in the area which also delayed the construction of the road from the jetty to the site.

The project was also made more difficult by the fact that some of the complex equipment had to be installed by suppliers from outside PNG.

However the mill is now complete and although we still have some small problems to sort out this mill is well built and is as good as any hardwood mill in Australia.

Safety and Security

The issue of safety is one faced by all forestry companies and is a very important element of managing a company that wants to be recognised as a safe place to work. We do not want anyone to be injured while working for the company. A number of things need to be done to prevent accidents:

- Safe practices – The company has had Industrial Engineers study 56 different processes and all the employees involved with these processes received training.
- Training – All work is a process and training is required to ensure that all staff follow the correct process steps which are designed to prevent accidents.
- Protective Equipment – All staff are issued with personal protective clothing and equipment to do their jobs safely.
- Commitment – The management and the staff must be committed to working in a safe manner at all times.
- Condition Monitoring – All equipment that could cause an injury is regularly monitored to ensure it operates as designed and is in a serviceable condition.
- Behaviour – The behaviour of staff in thinking and working safely is critical if we are to prevent accidents. No amount of training will help if we do not all behave in a safe manner at work and at home.

Very unfortunately, due to a number of factors we had a fatality on 29th August 2010 where one of our harvesting cutters was struck by a tree. The company has taken this accident very seriously and all the

harvesting crew that work with chainsaws have been completely re-trained to Australian Standards during 2010.

Security for the company and the community was enhanced at the beginning of the project when the company organised policemen to be stationed in the camp. Recently a Police Station was constructed and the company is in negotiations with the Police Commissioner to allocate 4 fulltime policemen to this remote location.

Environmental Performance

The responsible management of the environment is critical if the company wants to manage the forests in a sustainable way.

In 2010 the company employed a PNG company to do a survey on the High Conservation Value forests in the FMA and this has identified all areas where the company could have an impact on the environment and where special care needs to be taken by the company. In addition this survey provides a baseline so that future surveys can be undertaken to check that our actions are not doing any damage.

The company also employs a PNG Company to do voluntary bi-annual environmental assessments of our operations in Cloudy Bay as well as 9 Mile and the actions identified in these reports are implemented by management. These reports are also sent to the Department of Environment & Conservation.

The company has chosen the Forest Stewardship Council (FSC) environmental standard in which to be certified and has appointed Woodmark Australia to carry out annual assessments to check that we are operating according to the FSC principles and criteria. The first pre-assessment and assessment audits will be carried out in 2011 and the company's objective is to

achieve Chain of Custody and Forest Management Certificates by the end of 2011.

Infrastructure Development

The project agreement calls for certain infrastructure projects to be completed. In June 2009 the shareholder approved funds of K48m and since then work has been focused on catching up the project backlog.

The construction of 22kms of the extension of the Magi Highway up to the Bam village was completed in 2010 and construction is now underway to further extend this Highway to Doma village. The Oio, Bam and Darava No.2 villages have had village access roads constructed in 2010.

The company decided to allocate all the building construction work to the land owners in each village to earn income and develop skills. The company provides the supervision of this work to ensure a consistent standard is maintained.

The hand over of 4 new school classrooms and 4 new teacher's houses in Bonoabo was done in October 2010. The company also supplied the materials for 6 classrooms and 2 teacher's houses in Abu Island and this project was almost completed in 2010.

In mid 2010 construction commenced on the Primary School and Technical High School and teacher's houses in the Bam community area. This is a big project which will only be completed by mid 2011 and all building work is again carried out by land owners under company supervision.

In 2011 the company will focus on school construction in Sogeri, Anave, Ganai, Duramu and Doma as well as the road construction from Darava No.2 to the coast.

In addition the company has decided to sell at cost a small range of untreated rough

sawn timber to Cloudy Bay FMA land owners for their private consumption to build housing from the Shelter Development Levy that is paid by the company.

Local Business Development

The company has tried to develop local businesses within its own operations wherever it is practical to do so. This is a long term program as there is a skills shortage in the project area and the company needs to focus on this while also building capacity inside the company.

However there has been a lot of work contracted out over the last two years with over 40 contracts entered into with land owners for Nursery, Planting, Land clearing, Road-line clearing, Cleaning services, Catering services, Timber stacking services, Building contracts and Purchasing of fruit and vegetables from local farmers for our staff canteen consumption.

We have also recently set up a Trade Store for the sale of consumable items to the community where the company provides and replenishes the stock at cost and makes no money out of the sale of this stock.

Social Mapping

The Project Development Agreement is based on the understanding that the land owners will be represented through their ILG Chairmen and that the Developer will only deal with these Chairmen in all land owner matters. In addition all Royalty and Levy payments would be paid in the village to these Chairmen.

However there have been numerous disputes over the past 4 years since the project started due to disputes over who

the rightful Chairmen are and also over where the Clan Boundaries are.

In 2010 the company has commenced a program of Social Mapping which is done by local leaders for which the company pays a daily fee, and this mapping is carried out to determine the genealogical descendents for each Clan and also to establish agreed Clan boundaries. These boundaries are then recorded by the companies GPS System and Maps are then produced and given to the Clans for future reference.

Health Care

The company established a small Clinic in its temporary camp in Bonoabo when operations commenced in 2007. This Clinic was established for the companies own staff but soon started treating sick people from the surrounding villages. This treatment was provided free of charge on an "All Care – No Responsibility" basis.

The Clinic was later moved to a new location and equipped with beds for sick patients and a small maternity ward. The company then started to provide immunisation for babies and children.

The number of patients treated in this Clinic grew and in 2009 the Nursing Staff treated 6,999 patients.

In 2010 a new Clinic was established in Bam and the number of patients treated in 2010 was 13,445. Since the start of the project in 2007 the company has assisted in the delivery of over 40 babies in its Clinics'.

Workforce Development

The development of our employee workforce as well as our contractor workforce is central to achieving our Vision.

The company spent K288, 000 on staff training in 2010 and will continue to invest in training every year to develop the skills of the workforce in Cloudy Bay.

In addition we have trained contract workers in timber bundle stacking, building construction, nursery production, road construction and re-establishment planting.

When the project started in 2006 very few workers were employed from local villages and the employment of locals has steadily increased over time. By 2008 40% of the total workforces were locals from Cloudy Bay. By December 2010 this number has increased to 70% of the 193 staff employed in Cloudy Bay and this will continue to increase as skills are developed in the local workforce.

Project Development Committee

The company is required to pay a Domestic Processing Benefit Levy of K10/m³, half of which is invested in an interest bearing Trust Account. This account was set up as per the Project Agreement and the total deposits for the project to date up to December 2010 are K176,927 of which K45,779 has been disbursed, mostly on fees for Tertiary Education of land owner children.

The Cloudy Bay Project Development Committee is responsible for managing the funds in the Trust Account and this committee was formed during early 2010 and had its first meeting in April 2010 and has had four meetings in 2010 and progress was made by the committee in developing its mandate and guidelines on which funding requests are to be considered to deliver projects to the people of Cloudy Bay.