INVESTING IN WATER: Australia’s limiting resource

BLUE SKY ALTERNATIVE INVESTMENTS LIMITED

JUNE 2015
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RESTRICTIONS ON OFFERS AND SALES OF INTERESTS IN THE FUND

GENERAL

THE FUND IS A MANAGED INVESTMENT SCHEME UNDER THE CORPORATIONS ACT 2001 (CTH) AND WILL NOT BE REGISTERED WITH THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION. INTERESTS IN THE FUND HAVE NOT BEEN AND WILL NOT BE APPROVED OR DISAPPROVED BY ANY SECURITIES REGULATORY AUTHORITY OR ANY JURISDICTION. NOR HAS ANY SUCH AUTHORITY OR COMMISSION PASSED ON THE ACCURACY OR ADEQUACY OF THE MATERIALS. THERE WILL BE NO PUBLIC MARKET FOR THE INTERESTS IN THE FUND. THE TRANSFER OR RESALE OF THE SECURITIES WILL BE SUBJECT TO CERTAIN LIMITATIONS. RECIPIENTS WHO ULTIMATELY DECIDE TO INVEST SHOULD HAVE THE FINANCIAL ABILITY AND WILLINGNESS TO ACCEPT THE RISKS AND LACK OF LIQUIDITY THAT WILL BE CHARACTERISTIC OF AN INVESTMENT IN THE FUND.

AUSTRALIA

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UNITED STATES


OTHER JURISDICTIONS OUTSIDE AUSTRALIA

INTERESTS IN THE FUND WILL NOT BE OFFERED OR SOLD IN ANY OTHER JURISDICTION EXCEPT TO PERSONS TO WHOM SUCH OFFER, SALE OR DISTRIBUTIONS IS PERMITTED UNDER APPLICABLE LAW.
Why water?
The key input to Australia’s agri-industry
Uncorrelated returns – yield and growth

PORTFOLIO BACKTESTING - GROSS RETURNS - BLUE SKY WATER - TARGET PORTFOLIO SINCE 2004/05

< Record low flow (drought) in Murray Darling

Year of Australia's record rainfall >

The chart sets out annual yield and capital growth for Blue Sky's Target Portfolio comprised of the most liquidly traded Australian water entitlements. Capital growth is calculated as the difference between the annual opening and closing prices of Water Entitlements (as determined on a monthly VWAP basis). Annual yield is calculated using the average Water Allocation price observed throughout the Water Year for a given Water Entitlement, multiplied by the allocation volume received (%) and divided by the capital deployed at the opening VWAP for each entitlement for the year. It is assumed the Portfolio is rebalanced to target weights at the start of each Water Year.
Fund returns since 1 September 2012 – Accumulated AUD Master Trust

<table>
<thead>
<tr>
<th>Performance</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performance 1 month</td>
<td>1.60%</td>
</tr>
<tr>
<td>Performance rolling 3 months</td>
<td>3.42%</td>
</tr>
<tr>
<td>Performance rolling 6 months</td>
<td>7.52%</td>
</tr>
<tr>
<td>FYTD</td>
<td>15.80%</td>
</tr>
<tr>
<td>Calendar to Date</td>
<td>4.59%</td>
</tr>
<tr>
<td>Rolling 12 months (1 Year)</td>
<td>20.33%</td>
</tr>
<tr>
<td>Performance since inception</td>
<td>37.43%</td>
</tr>
<tr>
<td>Since Inception ANNUALISED (p.a.)</td>
<td>12.55%</td>
</tr>
</tbody>
</table>

The performance table details accumulated returns for the initial and lead unit series of the Blue Sky Water Fund Master Trust in AUD terms. All returns are net of management and performance fees and gross of tax (prior to tax provisions).
An overview of the water market
Terminology explained

Water Entitlement

- A perpetual entitlement to a share of water from a specified water resource
- Separated from land titles
- Recorded in a Government-controlled register
- Transferable, divisible, fungible, mortgageable and valued at market
- Classified according to reliability (i.e. the frequency with which water allocated to a Water Entitlement is able to be supplied in full)
- Depending on State jurisdiction are also known in Australia as a water right, water licence, water access licence, or a water share

Water Allocation

- The volume of water allocated to the Water Entitlement holder each year.
- A volume of water available for consumptive use, or sale to other water users in the market
- Volumes typically expressed as a percentage of the Water Entitlement volume owned
- Determined by the relevant State water authority in accordance with a transparent public water sharing plan
- Allocation announcements are made progressively through the water year (July to June), depending on seasonal conditions and river/dam inflows etc.
- Water Allocations can be carried over from one year to the next in certain circumstances

“PERMANENT” WATER MARKET

“TEMPORARY” WATER MARKET
Significant market scale

**Map of Australia showing water resources by state and type:***
- **Northern Territory:**
  - Surface Water (GL): 186
  - Ground Water (GL): 125
  - 60% Surface Water, 40% Ground Water

- **Queensland:**
  - Surface Water (GL): 4,862
  - Ground Water (GL): 1,008
  - 83% Surface Water, 17% Ground Water

- **South Australia:**
  - Surface Water (GL): 1,127
  - Ground Water (GL): 620
  - 65% Surface Water, 35% Ground Water

- **Western Australia:**
  - Surface Water (GL): 921
  - Ground Water (GL): 1,713
  - 35% Surface Water, 65% Ground Water

- **New South Wales:**
  - Surface Water (GL): 11,223
  - Ground Water (GL): 2,056
  - 85% Surface Water, 15% Ground Water

- **Victoria:**
  - Surface Water (GL): 5,715
  - Ground Water (GL): 950
  - 86% Surface Water, 14% Ground Water

- **ACT:**
  - Surface Water (GL): 75
  - Ground Water (GL): 1
  - 99% Surface Water, 1% Ground Water

- **Tasmania:**
  - Surface Water (GL): 1,794
  - 100% Surface Water

**Table of Total Water Resources by Type:**

<table>
<thead>
<tr>
<th>Australia Type</th>
<th>Gigalitres</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Surface Water</td>
<td>25,903</td>
<td>80.0%</td>
</tr>
<tr>
<td>Ground Water</td>
<td>6,473</td>
<td>20.0%</td>
</tr>
<tr>
<td>Total</td>
<td>32,376</td>
<td>100%</td>
</tr>
</tbody>
</table>

*Source: BLUE SKY WATER PARTNERS*
Tradability: a deliberate policy
Full storage – November 2012

Murray-Darling Basin Government Irrigation Storages - 07 November

The assessment of water storage does not include water in private storage.

Please note if the current storages volume is higher than the total storage capacity, this is due to surcharge levels. Figures in brackets refer to storage capacity in Gigalitres.
Scarcity – May 2015


Storage Air Space
Current Storage Volume
Rivers
Northern Basin
Lachlan
Southern Basin

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The assessment of water in storage does not include water in private storage. Please note, if the current storages volume is higher than the total storage capacity, this is due to surcharge levels. Figures in bracket refer to storage capacity in gigalitres.
Lack of correlation; climate cycle
Volatile water price: a function of annual water availability

Severe drought – price spiked above $1,000/ML

Record rainfall back to back. Price as low as $5/ML
Positive trend in market turnover

AUSTRALIAN WATER ALLOCATION MARKET - VOLUME TRADED - GIGALITRES

- 2007-08
- 2008-09
- 2009-10
- 2010-11
- 2011-12
- 2012-13

[Bar chart showing increasing volume traded from 2007-08 to 2012-13]
Water entitlement asset values

Water entitlement values – Monthly volume weighted average price ($/ML)

Price Data sourced from Government Registers or Independent Valuer (since September 2012)

- SA Murray
- NSW Murray High
- NSW Murray General
- Murrumbidgee General
- VIC Murray Zone 7
Investing in water as an asset class
The investment proposition:

• Invest capital to own a diversified portfolio of Australian water entitlements; perpetual rights to annual allocations of fresh water from specific surface and ground water resources.

• Such resources are limited by physical, geographical, hydrological and sustainability constraints and form part of the world’s most highly developed ‘cap and trade’ water market.

• Generate annual income by selling annual volumes of water allocated to the water entitlements, or alternatively leasing the water entitlements to irrigation farmers in return for annual rental income.

• Participate in capital growth driven by increasing competition for this scarce natural resource; the lifeblood of Australia’s most highly productive and profitable agricultural industries.

• Diversified exposure across several geographies and climatic zones servicing Australia’s key agricultural regions.
Market drivers – marginal returns

**Irrigated RICE – annual crop:**
- Murray & Murrumbidgee
- Uses 12-16 megalitres per hectare per year
- Australia has world’s highest rice yields per megalitre of water
- Gross margin – circa $80 - $120 per ML of water used

**Irrigated COTTON – annual crop:**
- Central & Northern NSW, Queensland
- Murrumbidgee
- Uses 8 - 10 megalitres per hectare per year
- Australia has world’s highest cotton yields per megalitre of water
- Gross margin – circa $250 - $500 per ML of water used

**Permanent TREE CROPS:**
- Murray, Goulburn, Murrumbidgee
- Use 10 - 15 megalitres per hectare per year
- Various competitive global positions (almonds, wine grapes, olives, avocado)
- Gross margin circa $1,000 to $1,500 per ML of water used

CROPS OUTCOMPETE FOR SCARCE WATER – TRANSITION TO HIGHER VALUE AGRI OUTPUT
Productivity growth

Total Factor Productivity\(^3\) in Australian Broadacre Agriculture\(^4\)

Index

- 1953
- 1956
- 1959
- 1962
- 1965
- 1968
- 1971
- 1974
- 1977
- 1980
- 1983
- 1986
- 1989
- 1992
- 1995
- 1998
- 2001
- 2004

\(^3\) Source: ABS

\(^4\) Source: ABS, Foster & Shadbolt, 1996

BLUE SKY WATER PARTNERS
To 30th April 2015, the Commonwealth Government has acquired 1,845.3 GL of average annual yield of water via buy-backs and infrastructure grants.

Approximately 15% of annual average historical consumptive use.
Summary

- Investing in the lifeblood of Australia’s agricultural industries
- A scarce asset – supply is limited
- Derives an annual yield
- Growth via changing marginal returns to water as a key input over time
- Portfolio construction is key to mitigate volatility of annual returns
- A portfolio diversifier that produces income
- A hedge against other agricultural investments