



Adviser Edge

TFS Sandalwood Project 2015

INDEPENDENT ASSESSMENT

This report has been prepared for financial advisers only

24 April 2015

Scope

Adviser Edge independent assessments are conducted by Barik Pty Ltd trading as Adviser Edge Investment Research (Adviser Edge) which has developed a key industry sector review process that follows a methodology developed specifically for this asset class.

Key Principles

The underlying principles of the assessment process are to:

- identify the long term commercial potential of the project;
- evaluate project management's capabilities, previous performance in the specific industry and the stability of the organisation;
- evaluate identified markets (domestic and international – existence, stability and growth potential);
- benchmark key performance assumptions and variables against industry and other MIS projects;
- weigh up the relevant risks of the project against projected returns;
- assess project structure and ownership;
- compare and substantiate project fees and expenses;
- determine if the project is structured in such a way as to protect investor's interests; and
- allow an opinion to be formed regarding the investment quality of the project.

Site Assessment

Adviser Edge conducts a detailed site inspection of the project, meets with all levels of project management and inspects the project's infrastructure and market accessibility.

The site assessment considers the following areas:

- suitability of the project site for the purpose intended;
- performance of previous project stages located within close proximity to the proposed site;
- management skills, qualifications, capabilities and experience; and
- associated project risks and their management.

Star Rating

Projects are awarded a star rating out of a possible five stars and placed on the Adviser Edge web site www.adviseredge.com.au

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Adviser Edge Rating



Recommended Client Risk Tolerance

Project Details

Project Name	TFS Sandalwood Project 2015
Product	Indian sandalwood timber
Responsible Entity	TFS Properties Ltd
Parent Company	TFS Corporation Ltd

Investment Details

Investment Term	Approximately 15–17 years
Investment Unit Size	0.083ha
Units Available	4,800
Application Fee	1–11 lots: \$6,250 (ex. GST) per lot 12+ lots: \$6,000 (ex. GST) per lot
Ongoing Fee Structure	Two alternative fee structures (annual or annual/deferred)
Minimum Investment	One lot
Close Date for FY2013	30 June 2015
Investor Finance	Available
ATO Product Ruling	Pending

Investor Returns	Annual Investment Option	Annual Deferred Investment Option
Potential Investment Returns (p.a.) – pre tax	5.9%–12.9%	6.5%–14.0%
Adviser Edge Base Case (pre & post-tax)	11.5%	12.8%

Investor suitability

As a general note, investment in agribusiness should represent a balance between the various potential risks and the forecast returns. The level of investment should reflect the risk tolerance of the investor to ensure an over-weighting bias does not occur.

The Project offers a medium to high-risk profile over the long term, with strong returns across the estimated range. The Project should be considered as part of a well-diversified portfolio by investors who are cognisant of the risks associated with an investment of this nature.

Key Points:

Key Investment Risks

- Sandalwood survival rates, which are currently high for recent projects, may decline to below 80%.
- Ability of the sandalwood trees to produce heartwood in line with TFS expectations.
- Sandalwood oil within the heartwood develops sufficiently within a 14 to 16 year rotation.
- TFS remains solvent throughout the term of the project.
- New high value markets need to be developed and nurtured by TFS to cater for the expected increase in oil that will result from harvesting ~1,500ha of sandalwood annually.

Strengths of Project

- TFS has 16 years of sandalwood experience to bring to the project, with improved site selection and silvicultural skills leading to improved survival, weed control and tree growth rates.
- Recent harvest trials have provided good support for the oil recovery levels projected by TFS.
- A 16-year project term is likely to lead to higher levels of heartwood and oil relative to a short rotation.
- There is strong existing and latent demand for Indian sandalwood, both for oil and carving.
- Developing pharmaceutical markets are going to be important to future supply and demand dynamics.

Weaknesses of Project

- The factors that drive heartwood development and oil levels are still not well understood, although a strong commitment to R&D by TFS is reducing the knowledge gap.
- There is a strong reliance on TFS as the 'market maker' to develop new markets to cater for significant increases in sandalwood production.

Other Project considerations

- While the investment should be considered generally long-term and illiquid, there is a secondary market for TFS project units, albeit at reduced values to reflect the risk that a buyer is taking on.

Investment Specifications

Location	Western Australia, Northern Territory, Far North Queensland
Investment unit size	0.083ha (one lot)
Number of trees per unit	Approximately 42 Indian sandalwood trees/lot, with targeted survival of 35 trees/lot
Minimum application	One lot
Liquidity	Yes but at discounts to NPV. Most trades occurring after four years
Insurance	Recommended but only compulsory if finance is used
Investor finance provider	Finance available through Arwon Finance Pty Ltd, a subsidiary of TFS

TFS Properties Limited (TFS Properties) is offering investors the opportunity to participate in the plantation Indian sandalwood industry through the offer of lots in the TFS Sandalwood Project 2015. Each lot will be 0.083ha in size, and will be planted with approximately 42 sandalwood trees. The stocking rate aims to provide 35 trees per lot at harvest, based on an estimated survival rate of approximately 83%.

The Project, which involves the establishment, growing and harvesting of Indian sandalwood trees, will be established in one or more of the regions where TFS has existing sandalwood plantations: Ord River Irrigation Area (WA), Katherine (NT) or Burdekin (QLD). Adviser Edge believes that it is more likely that the plantations will be established across more than one region, subject to subscription levels.

The Indian sandalwood logs produced by the Project will most likely be sold to TFS, which will then sell the processed Indian sandalwood oil and heartwood into the international fragrance, carving and pharmaceutical markets. The plantation will be harvested 14 to 16 years after planting (prior to 31 December 2032).

Proceeds from the sale of the sandalwood (excluding seeds, which remain the property of TFS) will be pooled and distributed to investors on a pro-rata basis, after the deduction of all relevant costs and deferred fees. It is expected that proceeds will be distributed following the harvest of the 2015 Project plantation, which will occur within the three-year period leading up to 30 June 2032. The precise timing of the harvest may fluctuate in order to maximise the revenue of the Project, with TFS responsible for harvest scheduling.

TFS Properties will insure the trees, both in the nursery and when planted, against fire for 90% of their full value at cost until the end of the establishment period, being 18 months from the Project commencement date (30 June 2015). Any proceeds from an insurance claim during this period will be used to replace or replant the trees. TFS Properties has also indicated in the PDS that

Key Points

- Investors can choose from two different fee options.
- A discount on the application fee is provided for an investment in twelve or more lots.
- Two security accounts have been put in place to ensure that the plantations will be established regardless of TFS solvency, and to provide incentive for a new Responsible Entity.
- The term of the Project is flexible, with TFS having the discretion to delay harvest by up to two years at its discretion.
- Establishment and management fees are comparatively high on a per hectare basis, reflecting the intensive nature of irrigated sandalwood and TFS IP.

it will replant any relevant lots where it is deemed necessary by the Responsible Entity (RE), at the cost of the RE. However, there is no minimum stocking guarantee in place.

Project structure and agreements

When investors are accepted into the Project, they will be bound by a number of legal agreements that outline the rights and responsibilities of each party involved in the investment scheme. These agreements are outlined in the Project's Product Disclosure Statement (PDS).

It is recommended that each potential investor and their adviser read and understand the Project agreements so as to ensure that the Project is suitable for the investor's objectives.

Investors in the Project will have direct and indirect counterparty risk to the Responsible Entity, TFS Properties, and the parent entity, TFS Corporation Limited (TFS). As a result of a cross guarantee in accordance with ASIC Class Order (98/1418) between TFS and its subsidiaries, counterparty exposure mainly lies with the parent entity. TFS is responsible for the provision of plantation management services under the Plantation Management Agreement, and TFS Properties provides Responsible Entity services to the Project. Land is leased from TFS Leasing Pty Ltd (TFS Leasing). As the Project is structured so that a substantial amount of fees are collected upfront, investors are reliant on TFS, TFS Properties and TFS Leasing to remain solvent in order to meet obligations to growers. However, the large deferred fee, or ongoing annual fee, helps to mitigate this to an extent, and acts as a strong financial incentive for TFS.

While investors have the option of paying fees annually, they also have the option to defer some or all of these fees until harvest. This may affect TFS Properties' ongoing cash flow. It should be noted that this risk reduces as plantations age, as ongoing management costs decrease due to the affect of canopy closure. As trees age the inherent value in the plantation increases, particularly in the last third of

the rotation when the development of heartwood and oil occurs. As TFS is a significant owner of sandalwood lots in previous projects, the value of this asset on the company balance sheet acts increases annually.

In the event that the RE, TFS Properties, enters administration, the presence of a switching fee means that all investors are compulsorily required to pay ongoing annual fees, regardless of which payment option they elect. This structure is designed to facilitate change to an alternative manager in the event of the insolvency of any of the management counterparties.

At the commencement of the Project, TFS will establish two separate accounts with the independent custodian, Australian Executor Trustees Ltd:

- The *Establishment Fund*
- The *Maintenance Reserve Fund*

The *Establishment Fund* will hold funds equivalent to 50% of the application fee. These funds must be deposited in the established trust account within 14 days from the Commencement Date, being 30 June 2015. Half of the funds will be released quarterly as the plantation is established, with the remaining 50% held in reserve to be released in the event that a replacement RE is required prior to establishment of the plantation.

The *Maintenance Reserve Fund* will hold the equivalent of one year's annual management fee and rent, which are prepaid by investors at the time of application. Similar to the *Establishment Fund*, these funds would also become available to a replacement RE in the event TFS Properties becomes insolvent to assist in the payment of any ongoing lease and management fees. If TFS Properties remains solvent as expected for the course of the Project, these funds will be released to meet the final annual payment of management and rent fees, which will be dependent on the timing of harvest.

These accounts will accrue interest on the funds held, which will remain in the account for the benefit of investors.

Within 15 months of the commencement of the Project, TFS will ensure that an instrument conferring the right to use the relevant land is lodged for registration with the land titles office in the state or territory in which the plantations are established in the name of TFS Properties, either as trustee for the growers or otherwise in accordance with its duties as RE of the Project. While this does provide some protection against third parties with respect to growers' Woodlots, it should be noted that rent payments are payable by TFS Properties or TFS Leasing, and may need to be met in order to maintain investor protection.

The establishment of the two security accounts with the independent custodian provides investors with a level

of security that initial establishment services will be completed. This reduces the reliance on the solvency of TFS and TFS Properties in the establishment phase of the Project, which has been an inherent risk in past projects offered by TFS and certainly a broader industry issue in the past. However, the ability of investors to defer all of their annual management and lease fees exposes them to the solvency of TFS throughout the life of the Project. The segregation of one year's annual lease and management fees in a security account does help to mitigate insolvency risk.

If an insolvency event occurs in a year following the establishment period, such as year three, due to the switching mechanism all investors will be required to commence the payment of annual management and lease fees, which will be slightly subsidised through the release of one year's annual management and lease fees from the security account.

Fee schedule

The fees outlined in the following tables relate to an investment made on or before 30 June 2015. The fee structure for the Project involves two payment options. These are:

- *Annual investment option* – this includes an upfront establishment fee, and ongoing annual lease and management fees.
- *Annual deferred investment option* – this includes an upfront establishment fee and ongoing annual lease and management fees, although investors may elect to forgo some or all of the annual payments. When this option is selected, these fees are deferred and deducted as a percentage of harvest proceeds.

Initial Cost to the Investor – Both payment options

Payment Type	Cost Per Woodlot (ex GST)
Application fee	
Between 1 and 11 Lots	\$6,250
12 or more lots	\$6,000
One year's annual management fee*	\$375
One year's annual lease fee*	\$125
TOTAL	
Between 1 and 11 lots	\$6,750
12 or more lots	\$6,500

* Held in custodial accounts.

Investors are required to pay an application fee which covers the costs associated with the initial development of the Indian sandalwood plantation, including land preparation, irrigation works, procuring the supply of seedlings, and planting. In addition to the application fee, investors are required to pay one year's

annual management and rent fee per Woodlot. This amount will be held by an independent custodian, and will not be released until the earlier of Project year 14, or an insolvency event, in which it becomes available to a replacement Responsible Entity. While this amount (\$500) is technically an ongoing fee, investors are required to pay it along with the establishment fee, and it is therefore considered as part of the application fee.

Ongoing Fees (per lot, excluding GST)

Payment Type	Annual Investment Option	Annual Deferred Investment Option
Annual management fee	\$375*	When deferring lease and management fees, the percentage of Gross Proceeds of Sale to be paid for each year that the management and lease fee is deferred is set out below: FY2017–18: 3% per year FY2019–20: 2% per year FY2021–30: 1% per year
Annual lease fee	\$125*	
Selling and marketing fee	5.0% of Gross Proceeds of Sale	
Harvesting and processing costs	Estimated by TFS at \$1,333 (ex GST). Actual harvesting and processing costs will be determined at harvest and deducted from Gross Proceeds of Sale	
Incentive fee	30% of Net Proceeds of Sale above threshold	

* Subject to an increase of 3% p.a., first invoiced on 1 January 2016 and thereafter annually through to the year prior to harvest.

'Gross Proceeds of Sale' means the gross amount received by TFS from the sale of the sandalwood.

'Net Proceeds of Sale' means the Gross Proceeds of Sale, less the cost of harvesting and processing, and the selling and marketing fee.

Each year investors are provided with the option to pay or defer annual management and lease fees. Investors that select the annual fee option in any given year will be invoiced for annual management and annual lease fees. In addition to annual fees, investors will be required to pay a selling and marketing fee of 5% of the Gross Proceeds of Sale.

For investors selecting the deferred fee option in any given year, the annual lease and management fees are replaced by a fee calculated as a percentage of Gross Proceeds of Sale, as set out in the previous table. If an investor decides to forgo all annual payments, the total deferred fees to investors are 20% of the Gross Proceeds of Sale for annual lease and management, plus 5% of Gross Proceeds of Sale for selling and marketing.

In the event that the RE becomes insolvent, the annual fee option switches from being optional to compulsory for all investors. There is no switching fee charged when this occurs.

If plantation trees are wholly destroyed, investors who elect to defer part or all of their annual lease and management fees will

be liable to pay 55% of all Lease and Management fee payments that were deferred prior to the destruction event, and which would otherwise have been paid if they had taken the annual investment option. TFS believes that, as long as the appropriate cover has been taken out, insurance will cover this amount. The typical destructive event is fire, with there being no referral to the cause of such an event. Significant events that are not covered include pest and wind damage.

Performance incentive fee

TFS is entitled to a performance incentive fee equalling 30% of the amount of any Net Proceeds of Sale that exceed \$100,000 per lot. The Net Proceeds of Sale refers to the Gross Proceeds of Sale, less harvesting and processing costs and the selling and marketing fee. Gross Proceeds of Sale refers to the gross amount received by TFS Properties from the sale of the clean sandalwood logs.

Fee Analysis

With any forestry MIS project, the application fee is controlled by the actual development cost of establishing the plantation, including land preparation, seedling supply and planting costs, and other administration costs such as corporate overheads, marketing and PDS development expenses, and the profit margin taken by the Project Manager.

Both the establishment fee and the annual management and rent fees remain unchanged from the 2014 Project.

Adviser Edge has been provided with the Direct Forestry Expenditure models prepared for the ATO, which are required by the ATO to ensure that TFS meets its obligation to prove that 70% or more of the fees paid by investors are spend on the plantations, including such as lease costs, plantation establishment, ongoing management expenses and harvesting

It is difficult to conduct a comparative analysis of the GST exclusive, per hectare year one establishment fee of \$75,000 (\$72,000 excluding GST when twelve or more units are purchased), as the Project is the only standalone MIS Indian sandalwood project in the market. As a result, Adviser Edge has compared the establishment fee with the estimated cost of establishing an Indian sandalwood plantation in the ORIA over the first three years of the project. Three years has been selected to give consideration to the intensive works required to establish a sandalwood tree, which includes site preparation, irrigation equipment installation, weed control, planting and the ongoing management and maintenance of the plantation through to canopy closure occurring.

While the costs associated with establishing an Indian sandalwood plantation are high due to the complexity of management and high labour requirements, including in the two years following the year of establishment. Based on the Direct Forestry Expenditure models prepared for the ATO, Adviser Edge estimates that just

under 70% of the combined establishment cost and year one and year two management fees charged by TFS are spent on the plantations.

Investors need to weigh up the healthy pre-tax margin that TFS incorporates into its unit price with the benefits of having their investment managed by a company that is in sound financial health. They should also consider how TFS uses its profits to invest in sandalwood research and development, market development and new product development, all activities that will be beneficial to investors in this and other projects.

Adviser Edge believes that while the establishment fee is high when compared to the costs of establishing an Indian sandalwood plantation over the first three years of the Project, the healthy profit margin has been an important factor in TFS' financial stability, especially when the high level of investors electing the deferred fee option is considered.

Ongoing expenses for managing Indian sandalwood plantations include weed and pest control, soil nutrition, irrigation operations and maintenance, the removal of vines and dead host species, fire management, termite management and plantation inventory management.

Following analysis of the annual costs involved in the management of an Indian sandalwood plantation, Adviser Edge considers the annual management fee of \$4,500 per hectare (excluding GST), which is payable and indexed from FY2016 onwards, to be high, with the actual costs incurred by TFS estimated to be much lower than this figure.

Adviser Edge has compared the annual fees payable under the annual fees option with the corresponding deferred fees under the deferred fees option. Whether an investor should opt for the deferred fee option or the annual fee option depends on the investor's personal circumstances, including the investor's expected cash flow over the term of the Project, the investor's marginal rate of tax (both at harvest and in the year the annual fee is payable), and the investor's cost of capital. Adviser Edge's analysis of the two pricing options indicates a preference for the deferred fee option in terms of returns, particularly if it is assumed that investors are subject to static marginal tax rates.

Adviser Edge believes that one factor in deciding whether to pay the annual fee or to defer is investors' performance expectations of the Project. If investors defer the annual fees, TFS is entitled to a higher proportion of the harvest proceeds, and therefore the total fees paid are higher when the performance of the Project is higher. Having TFS involved as a co-owner of the proceeds is expected to positively influence their management of plantations, creating good alignment of interests.

Although the deferred fee option appears to be more attractive, Adviser Edge recommends that investors obtain independent financial advice in determining whether to use the deferred fee option or the annual fee option.

The calculation of the incentive fee is the same as previous years and is not activated if TFS' base case assumptions prevail over the Project term.

Adviser Edge believes that the benchmark and the level of the Incentive Fee is appropriate, particularly under the annual investment option, providing added incentive for TFS to maximise investor returns.

Harvesting costs will be determined once the harvest is completed, and invoiced to growers at actual cost. TFS has estimated a current-day harvest cost of \$16,000/ha to produce cleaned heartwood logs at the farm gate, although it is important to note that the actual cost could vary significantly from the estimated amount. TFS commenced its first commercial harvest in 2013, and will harvest each year from now on. By the time the 2015 Project is due for harvest it is expected that the process will be refined and costs reflective of economies of scale that TFS should be able to achieve as a consequence of their large estate.

Risk apportionment

Risk apportionment refers to the level of risk that a Project Manager/RE shares with investors as a consequence of the Project fee structure. When ongoing Project fees are linked to harvest proceeds, and therefore Project performance, the risk sharing between investors and the Project manager is considered to be more evenly aligned. It also provides a measure of risk mitigation in the event of the RE's insolvency by providing the potential for adequate compensation for a replacement RE.

In the event that an investor elects to pay annual fees, the marketing fee in combination with the incentive fee also helps to provide a degree of risk apportionment. In addition, the structural safeguards put in place in order to ensure the trees are adequately established need to be considered.

The Project fee structure incorporates both a deferred fee option and an annual fee option. Adviser Edge believes that the deferred fee investment option not only provides extra incentive for TFS to perform, but also reduces investor exposure to the volatility of underlying performance factors. Consequently, the deferred fee results in an alignment of risk between both the manager and the investor. However, the higher the proportion of investors that elect the deferred fee option, the greater the pressure this places on TFS' operating cash flows. The commencement of commercial harvests should act to ameliorate this risk to some extent.

Additional Information

Taxation

TFS has applied for and received an ATO product ruling for the Project, which is PR 2015/3. A product ruling is considered important as it provides a degree of certainty in relation to the taxation consequences of investing in the Project. It should be noted that Growers cannot rely on the product ruling for the Project if they elect to collect their own sandalwood, as opposed to having it processed and sold by TFS.

Adviser Edge does not conduct detailed analysis on the implications of the Project's product ruling, and it is advised that investors seek appropriate professional advice in relation to the full financial and taxation implications of their investment. An investment in the Project is not recommended until a product ruling is issued.

Insurance

TFS will insure the trees until the end of the establishment period for 90% of their value. However, following this investors will be responsible for arranging insurance themselves if they wish to insure their Indian sandalwood investment. The RE will assist investors to acquire appropriate insurance, which has been the case for previous TFS sandalwood projects. They will not charge a fee for doing so. Insurance will be compulsory for investors who obtain finance through Arwon Finance.

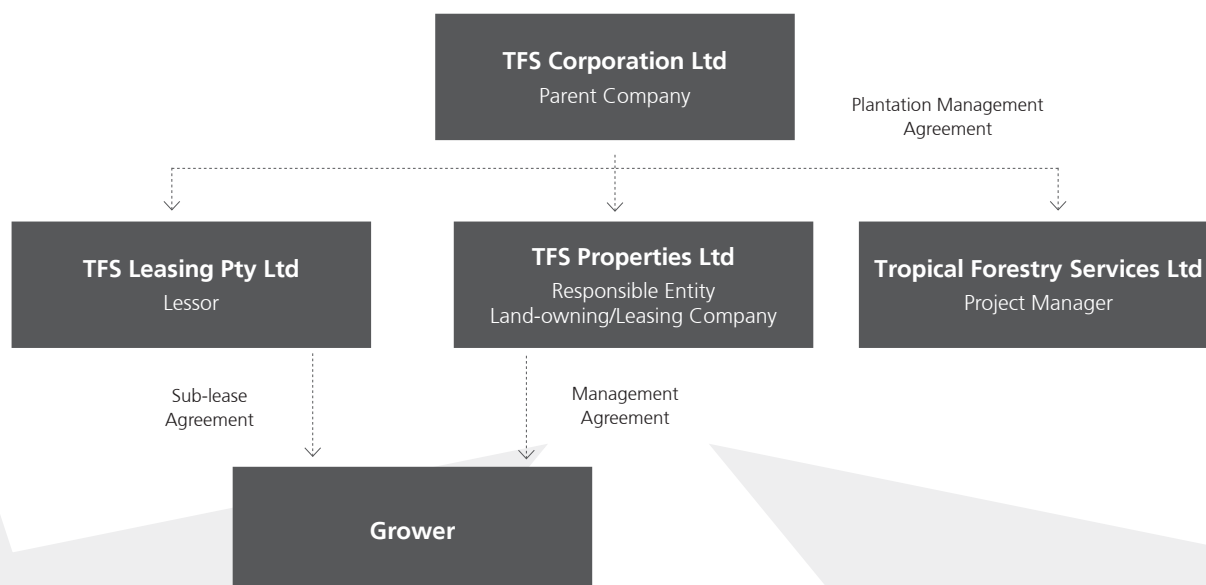
While investors' harvest proceeds are pooled, should any lots be destroyed due to some unforeseen event these lots may be removed from the pool and the investors may not receive or will otherwise have a reduced entitlement to income from their investments. Insurance should help to protect investors from this risk.

Given the high value of the sandalwood lots, it is expected that insurance will be a considerable cost over the Project term. Adviser Edge recommends that investors strongly consider the cost and benefits associated with insuring their lots, particularly given that TFS has the right to recoup deferred fees in the event of plantation failure.

Finance

Short and medium-term finance is available to approved applicants through Arwon Finance Pty Ltd, which is a subsidiary of TFS. The options are a 12 month interest free loan or a seven year principle and interest loan. Interested investors should contact TFS or the finance provider for full loan terms and conditions.

Key Counterparties



TFS Corporation Limited (Parent Company)

TFS Corporation Limited (TFS) was incorporated in 1997 and subsequently listed on the Australian Securities Exchange (ASX) in December 2004 under the stock ticker code TFC. TFS is the parent company and sole owner of the key management and operational entities for the TFS Sandalwood Project 2015.

TFS first established commercial plantations of Indian sandalwood on behalf of investors in 1999 and now manages 9,078ha (TFS-owned and on behalf of retail and institutional investors).

With its expanding production, TFS has increased its head count with 169 permanent employees at the end of 2014 (compared with 133 permanent employees in the previous year). In addition to permanent employees, TFS employs between 200 and 300 casual employees at its plantation operations. Forestry management has now been centralised in Darwin, with the appointment of Brett Blunden as General Manager Forestry.

In 2009, TFS launched a wholesale investment product, Beyond Carbon, with the first institutional investment coming from a US-based pension fund. Since then, TFS has established more than 3,300ha on behalf of institutional investors based in the US, Europe, the Middle East and UK, and continues to manage the plantations on their behalf.

During its first decade of operations TFS managed plantations were predominantly located in the East Kimberley region of Western Australia. In 2011 TFS established plantations in other regions in order to satisfy the growing institutional investor demand and to achieve greater geographic diversification. These plantations are located in the Katherine and the Douglas Daly regions of the Northern Territory and the Burdekin region in northern Queensland.

Key Points

- TFS has expanded its area under management to over 9,000ha, with institutional investors surpassing MIS investors as the largest owners of sandalwood plantations.
- The successful 2014 \$67million share placement to institutional investors has recapitalised the business.
- TFS boasts an experienced operations management team, with significant levels of intellectual property held by the company.

TFS has a corporate office in Perth, Western Australia, while forestry operations are split between the ORIA and the two Northern Territory regions. The company employs over 60 permanent employees and at peak times over 200 casual employees, mostly involved in planting and plantation maintenance works such as weeding.

Over the past four years TFS' staffing levels have grown significantly as a consequence of the acquisition of Mount Romance and the expansion into the Northern Territory and Queensland. Given the intention to continue expanding the plantation estate at around 1,500ha per annum the employment growth is expected to continue for the company in 2015 and beyond.

The 2008 acquisition of Mount Romance Australia, a Western Australian sandalwood processor and essential oils business has been very important to TFS. This acquisition has provided TFS with sandalwood processing and distillation capability, and has ensured that the company can defer capital expenditure on a potential northern Australia distillation plant until harvest volumes are sufficient to justify the cost.

Importantly, the acquisition of Mount Romance has allowed TFS to gain a presence in the global market prior to the first Indian sandalwood harvest in the ORIA.

The company is also investing further along the value chain via its 50/50 joint venture in Santalis Corporation Inc., which specialises in the development and licensing of over-the-counter pharmaceutical products and has entered into long-term supply agreements with pharmaceutical companies.

2014 highlights for the TFS business included:

- TFS continues to expand its direct ownership of plantations, with 2,900ha now owned by the company.
- TFS has an expanding share of future MIS sandalwood revenue as a consequence of investors electing to defer management fees and share harvest proceeds with the company. Adviser Edge does not see this changing in the medium term and there is a strong alignment between TFS and MIS investors as a consequence.
- Successful completion of a \$67 million share placement to institutional investors at A\$1.60/share. Funds raised by the placement will contribute to:
 - Increased direct ownership of plantations (with significant area already acquired)
 - Funding the tender for harvested MIS timber in 2014
 - Sourcing additional land for future MIS and Beyond Carbon plantations
 - Developing global markets for Indian sandalwood, including perfumery and cosmetics
 - Building new markets, with significant expansion opportunities identified in pharmaceutical and traditional eastern medicinal sectors
 - Investing in the joint venture vehicle Santalis Corporation, which develops and licences sandalwood-derived pharmaceutical products
- Continued expansion of plantings in Beyond Carbon, which focuses on global institutional investors.
- Development of a market for HNW Australian investors, which have further reduced the importance of MIS sales.
- In December 2014 the Church Commissioners of England completed their investment in two TFS managed sandalwood plantations.

TFS has achieved an important milestone for the business, with institutional investment in sandalwood plantations now surpassing the area of MIS plantations under management. The company is selling oil overseas and has recapitalised the business via the 2014 \$67 million share

placement. While sales in MIS were slack in 2014, there was strong uptake of TFS' HNW focused sandalwood product.

Board of Directors

The Board remained relatively stable in FY2014, with the only departures being non-executive director Adam Gilchrist. The current financial year has seen a refresh and expansion of the board with new appointments bringing diverse skills needed by a growing business as its business evolves with the maturation of its plantations. Stephen Atkinson and Patrick O'Connor have resigned as directors during FY2015, while new appointments include John Groppoli, Dalton Gooding, Gillian Franklin and Michael Kay.

Mr Groppoli has substantial legal experience having been a partner of national law firm Deacons (now Norton Rose). Dalton Gooding is now the chairman of TFS. Mr Gooding was a former partner of Ernst & Young and is currently the managing partner of accounting firm Gooding Partners. Michael Kay was previously the managing director of McMillan Shakespeare, Australia's largest provider of salary packaging and novated lease services. Prior to this role, Mr Kay held numerous senior positions including CEO of AAMI and is on the board of RAC Insurance (WA). Gillian Franklin is managing director of the Heat Group, a distributor of cosmetic brands in Australia. Ms Franklin also serves on a number of boards including the Australian Formula 1 Grand Prix, the Melbourne Theatre Company, and the Cosmetic Toiletry and Fragrance Association.

The TFS board has undergone a period of strengthening and renewal. The addition of new experience and expertise will benefit the strategic direction of TFS, following on from the improvements in governance and systems under Mr O'Connor.

Corporate governance and compliance

TFS has established a Compliance Committee for the Project, as required under the Corporations Act. The Compliance Committee is required to monitor the extent to which the RE complies with the Project Compliance Plan, and to report any breaches to the directors of the RE and, if necessary, ASIC.

The Compliance Committee is comprised of two external members, Chartered Accountant John O'Brien, and Robert Marusco, as well as one representative of the RE, Ronald Eacott, who is also the Chairman of the committee. In addition to this, TFS employs an external Compliance Officer, Doug Verley, who monitors the compliance of the RE and then reports to the Compliance Committee on the adherence to the Project's Constitution and Lease and Management Agreements. Doug Verley has 27 years of experience in senior corporate roles internationally and in Australia. Mr Verley is currently a corporate consultant with Focus 2XL Consulting.

Adviser Edge believes that TFS has adopted acceptable corporate and financial management procedures. The oversight of the

Compliance Committee will be critical to achieving sound corporate governance for the Project, given the relationship between the Responsible Entity, TFS Properties, and the contracted parties, namely Tropical Forestry Services Ltd, which share a common Board of Directors. The engagement of an external compliance officer is viewed very positively by Adviser Edge, providing the Project with an added level of oversight.

Financial performance

The following table presents the key financial data for TFS for the financial years FY2014 and FY2013.

Key Financial Data – As at 30 June		
Financial Profitability	2014	2013
Revenue (\$m)	146.3	122.9
Net profit (\$m)	82.5	55.7
Profit margin (%)	56.4	45.3
ROCE (%)	18.5	17.1
ROE (%)	17.7	17.2
Market Measures	2014	2013
EPS (basic/cents)	28.9	19.9
P/E ratio	25.2	6.7
DPS (cents)	3.0	3.0
Dividend yield (%)	1.8	5.9
Dividend payout ratio	10.4	15.1
Financial Liquidity/Solvency*	2014	2013
Net working Capital (\$m)	85.5	139.9
Current Ratio	1.8	3.9
Quick Ratio	1.6	3.4
Net debt to equity ratio	15.1	33.2
Interest Cover	6.7	5.7
NTA per Share (\$)	1.17	0.86

Source: TFS Corporation Ltd, Annual Report 2014.

* The financial ratios are based on share price information provided for the close of trading on the last day of the financial year for which they are quoted.

Product sales still accounts for around 80% of TFS' annual revenue, despite an increase in revenue from sandalwood products, which illustrates the still strong trajectory of new plantation sales. Net profit after tax in FY2014 is up 48% compared to the previous year, at \$82.5 million. This is on top of FY2013's net profit increase of a more than 100%.

However, as is expected, this growth has affected financial liquidity indicators as increased activity requires an increased

investment in working capital. TFS has demonstrated its ability to access alternative sources of cash in FY2014 with an equity capital raising. However, it should be noted that the ability to access equity capital markets is dependent on a reasonably strong share price, which is difficult to predict over the long term.

The continued increase in plantation sales via Beyond Carbon, the High Net Worth product, and to a lesser extent MIS bodes well for TFS' balance sheet. As the TFS-managed plantations continue to approach maturity, Adviser Edge anticipates TFS will need to gradually adjust its business from a plantation establishment company to a more mature business that operates across the entire life cycle of Indian sandalwood production. With TFS' sizeable interest in these harvests through direct ownership and deferred entitlements, TFS' financial position is anticipated to continue to firm.

Despite the increased turnover in the business, net operating cash flow declined in FY2014 to \$7.2 million. However, the FY2013 result was boosted by the sale of TFS' loan book. Nonetheless, FY2014 net operating cash flow is still an improvement over underlying performance in both FY2013 and FY2012 where net operating cash flow was slightly positive and negative, respectively.

The strong profit and operating cash flow has enabled the board to continue with a dividend of 3.0 cents per share.

Mount Romance continues to grow its sales, with \$20.5 million of revenue earned in FY2014 (FY2013: \$18.4 million). This was a strong result considering the strength in the Australian dollar in FY2014. There is potential for a significant increase in sales during FY2015, due to the subsequent dramatic fall in the Australian dollar and the availability of Indian sandalwood from recent harvests.

The benefit of the fall in the Australian dollar can be seen in the December 2014 half-year report, where TFS reported significant improvements in its balance sheet as a result of the fall in the Australian dollar. TFS increased the value of its biological assets by \$444 million, up 28% due to higher oil price assumptions, increased tree maturity and an improvement in the value of the US dollar. However, the stronger US dollar also affected TFS borrowings, which are denominated in US dollars.

TFS is subject to the liquidity risk associated with being reliant on continued establishment of new plantations to offset the negative cash flow associated with investors deferring their annual management fee. However, this risk continues to decline as TFS' plantations approach maturity, when TFS can realise its interest in the plantations. In the meantime, TFS has historically managed the cash flow mismatches with equity and debt capital raises, most recently in 2014.

Although its balance sheet liquidity has fallen as business activity has increased, Adviser Edge does not consider TFS to have any immediate liquidity needs to meet current operational requirements. However, should a mismatch again occur between the time of establishment works and the settlement of institutional investments, additional cash may be required to fund operations and meet debt obligations. Given the improvement in TFS' share price and a positive outlook for the sandalwood market, TFS should be able to undertake additional equity raisings to strengthen its balance sheet.

Adviser Edge has reviewed TFS' financial position and believes its current balance sheet is sufficient for its current operations. TFS should maintain continued vigilance on ensuring the organisation has sufficient flexibility in its fixed costs, particularly in the event that institutional sales significantly decline.

TFS Properties Ltd (Responsible Entity)

TFS Properties Ltd (AFSL no. 241192) is the Responsible Entity (RE) for the Project and is a wholly-owned subsidiary of TFS Limited. As a wholly owned subsidiary of TFS, TFS Properties is covered by deed of cross guarantee and, as such, TFS has applied the ASIC Class Order (98/1418) applicable to wholly-owned entities. TFS is therefore not required to file accounts for TFS Properties. As a result of this guarantee, Adviser Edge has not analysed the financial position of the RE, but rather that of the parent entity.

TFS Properties has the same Board of Directors as the parent company, TFS Corporation Limited. Given that there is likely to be a number of related party transactions involved in the Project, including contracting of the plantation management operations and possibly the purchase of the heartwood logs, the oversight of the Compliance Committee will be critical to ensure that TFS Properties fulfils its obligations to investors as the RE.

TFS Properties and TFS Leasing Pty Ltd have provided a guarantee to the Bank of New York Mellon in relation to the US\$150 million in secured notes raised by TFS in 2011. Under the guarantee, TFS Properties and TFS Leasing guarantee the full payment of all amounts owing under the bonds.

In this report, unless specified, TFS refers to the parent company or any underlying subsidiary.

Responsible entity financial requirements

ASIC has minimum financial requirements for Responsible Entities of managed investment schemes. While these changes are not designed to prevent REs from becoming insolvent, the changes are designed to limit the risk that an RE becomes insolvent as a result of assuming liability for the debts of others and to provide some level of assurance that, if the RE does fail, there is sufficient money available for the orderly transition to a new RE or to wind up the scheme. TFS has advised that it complies with these requirements.

Adviser Edge is of the view that while these requirements improve the financial position of REs, they will not necessarily prevent the failures of forestry MIS managers, such as those which have occurred in recent years. Many of these managers failed, in part, because their project structures provided a cash flow mismatch due to high up-front fees and the substantial deferral of ongoing fees.

TFS Properties expects that the funding sources of the TFS Group will be sufficient to meet the costs of management, harvesting and processing the trees. However, TFS Properties cannot guarantee that it will have sufficient working capital to meet these costs. This is a risk of which advisers and investors must be aware.

While the Project does have an ongoing fee structure option, there is still a risk associated with the deferred fee option and its effect on working capital requirements for the Project. Balancing this risk is the requirement of investors to pay one year's management fees in advance, which will be held in trust in the event of RE insolvency and the switching fee mechanism.

Tropical Forestry Services Ltd (Project Manager)

Under the Plantation Management Agreement, the RE will engage Tropical Forestry Services Limited (TFSL) to fulfil the plantation management requirements over the Project term. TFSL has acted in this capacity for projects since 1999 and employs tertiary-qualified staff to manage each of the plantation sites. TFSL is a wholly-owned subsidiary of TFS Corporation Ltd.

Key Operational Personnel – Tropical Forestry Services Ltd

Key Personnel	Credentials	Industry	MIS
Frank Wilson – CEO	★	★	★
Alistair Stevens – COO	★	★	★
Quentin Megson – GM Operations & Corporate Services	★	★	★
Mario Di Lallo – Head of Global & Retail Sales	★	★	★
Brett Blunden – GM Forestry	★	★	★
Matt Barnes – Assistant GM Forestry	★	★	★
Nick Common – Regional Manager NT	★	★	★
Brendon Carr – Regional Manager WA	★	★	★
Andrew Brown – Head of Product R&D and Estate Inventory	★	★	★

TFS has a very clear organisational structure, with different divisions established for each section of operations (i.e. land acquisition, development, seedling supply, plantation establishment and plantation management). However, the expansion into the Northern Territory and Queensland has resulted in the relocation of some senior staff. This has led to a relatively flat management structure with several regional managers, and a number of support staff at each location.

Adviser Edge is confident of TFS' ability to manage the Project to the highest possible standard, with the staffing pool now including a large number of skilled staff with many years experience developing and managing sandalwood plantations. TFS' ability to retain key personnel is enhanced under the relatively flat organisational structure, which provides career enhancement opportunities within the organisation.

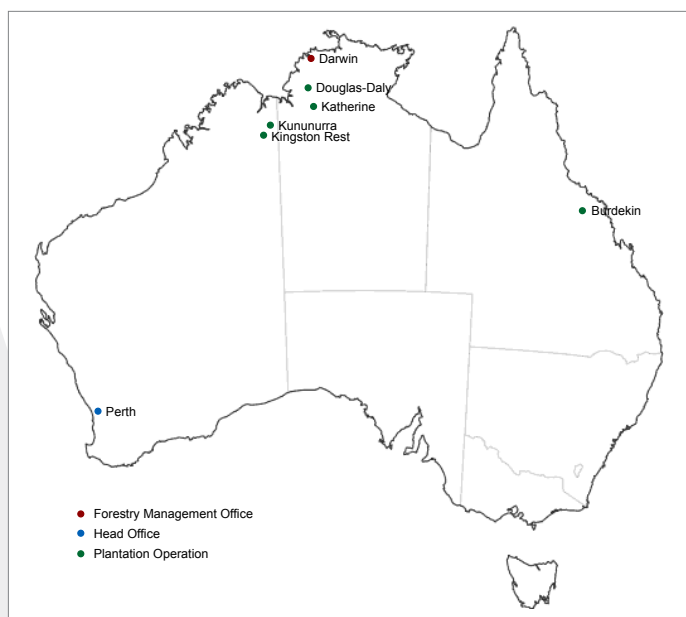
Independent experts

TFS has engaged two independent foresters to provide independent verification of the performance assumptions made in the offer documents, and to provide an overview of the global Indian sandalwood market.

Independent Foresters		
Name	Company	Focus
Richard Fremlin	Fremlin Consulting	Independent Expert's Report
Anantha Padmanabha	H.S Anantha Padmanabha	Market and pricing

Richard Fremlin has more than 45 years experience in the forestry sector. After training in South Africa, he spent many years at the Western Australian Forest Department and the Western Australian Forest Products Commission specialising in plantation establishment and silviculture. In 2006 he joined Great Southern, and is now a full-time forestry consultant. He has extensive experience with tree improvement and silviculture in tropical plantations in northern Australia, Africa, Indonesia and Africa.

Anantha Padmanabha has more than 35 years' experience in the scientific and marketing elements of the Indian forestry industry. Based in Bangalore, Mr Padmanabha is currently employed as director of Karnataka Research Foundation and Advances Science Technology Transfer, and is a consultant to Karnataka Soaps and Detergents Ltd (a major long-term buyer of Indian sandalwood). Mr Padmanabha also has considerable exposure to Indian sandalwood auctions, having attended sandalwood auctions to assess and buy sandalwood for over eight years.



Key Points

- TFS has centralised its forestry management team in Darwin, reflecting the expansion of sandalwood operations in the Northern Territory.
- Improving weed control in the Northern Territory has been a focus for TFS, with improvement evident year-on-year.
- Northern Territory sandalwood survival and growth rates continue to exceed those achieved in the ORIA.
- Growth rates at the Katherine properties were impressive but weed control is presenting some challenges.

Katherine or Douglas Daly regions. Until recently Adviser Edge has had a distinct preference for all new MIS to be established in the ORIA, due to TFS' deep knowledge of the region and its strong operations team in the region.

Adviser Edge undertook an inspection of the TFS plantation estate in the Northern Territory on 18 and 19 November 2014. Accompanying Adviser Edge over the course of the inspection was former TFS Admin and Procurement Manager Malcom Baker. During the course of the visit Adviser Edge met with Brett Blunden (General Manager Forestry), Matt Barnes (Assistant General Manager), Nick Common (Regional Manager Northern Territory) and Dan Firth (Plantation Manager Northern Territory).

The site inspection provided Adviser Edge with an opportunity to assess the quality of site preparation for the 2015 plantations to be established in coming months, as well as the performance of the now significant plantation estate in the Northern Territory.

Over the past two years there has been a particularly strong focus on the development of plantations in the Katherine and Douglas Daly regions of the Northern Territory. Consequently, TFS has centred its senior operational management team in Darwin. All facets of operational management are overseen from this location.

Brett Blunden, TFS' most experienced operations manager was elevated to General Manager Forestry in 2014. Mr Blunden is supported by Assistant General Manager Matt Barnes, another highly experienced TFS manager, who previously ran TFS' Queensland plantation operations.

TFS has a track record of retaining senior management, which is a real strength of the business given the complexities of sandalwood management. Retaining knowledge within the company is very important with the significant expansion experienced by the company over the past five years making it possible for members of the operations team to move to higher roles.

In late 2013 Adviser Edge undertook its first inspection of the Northern Territory operations, reflecting the expectation that some or all of the future MIS plantations will be located in either the

Since 2013 Adviser Edge has become much more comfortable with the Northern Territory region, based predominantly on the good operational outcomes being achieved by TFS. That is not to say that there will not be issues, just as there have been in the ORIA. For example, there were clearly weed control issues noted in 2013, which we were interested to review 12 months later.

What continues to impress is TFS' ability to adapt its management to overcome operational challenges. In the face of the weed management issue TFS explored ways to overcome this issue so as not to inhibit the future potential of the plantations. Using what could be loosely termed an internal 'think tank' approach, TFS' forestry management found a workable solution to the weed management dilemma. The solution involved the use of biodegradable tree guards on the sandalwood and host trees, which allowed for more aggressive chemical control of weeds.

The shift in weed management practice has also allowed TFS to significantly reduce operating expenditure on labour, albeit with a higher chemical costs (an overall net benefit according to TFS).

With greater knowledge of the weed issues prevalent in the Northern Territory, TFS is very focused on pre-site establishment weed control and the use of tree guards and targeted chemical application to ensure that sandalwood and host trees are not out-competed by weeds. Adviser Edge is now well satisfied in TFS' ability to manage this issue.

Plantation condition and growth

A key focus of the site inspection is to assess the quality of establishment works, plantation condition and growth rates being achieved. While not possessing the longer history of the ORIA estate, the Northern Territory operations have benefitted from the ORIA experience, which is evident in the overall quality of the plantations and the growth rates being achieved at this early stage.

The most recent measurements completed by TFS indicate that the 2012 planted trees in the Katherine area are performing at a level unmatched in the TFS estate. Large areas of consistent and suitable soils, matched with good silviculture and irrigation management have had a positive impact on tree growth, including both hosts and sandalwood.

That is not to say that there are no areas where under-performance is evident, as there are. However, in the main these are limited in area and likely to still produce fair to good sandalwood growth over the term of the rotation.

First wet season survival, an important benchmark for TFS, is very good across the entire Northern Territory estate. Some host tree rows are affected by pests or browsing damage, but again this is minimal. In some small areas infilling of hosts has occurred, which ensures a high sandalwood to host ratio is maintained.

Trees were generally in a very healthy condition, with sandalwood trees growing strongly on all sites. The growth of sandalwood trees is now very even, reflecting the improvements that TFS has made in tree selection for seed and seedling production.

The 2015 planting will be a beneficiary of TFS' commitment to continual improvement in sandalwood genetics, and silviculture. The results of the tree breeding program are clearly evident in plantations located in the Northern Territory. Survival post-wet is now averaging above 95%, with the vast majority of these trees performing towards the high end of the productivity distribution curve relative to the entire TFS estate.

Across the plantations inspected there were only a couple of minor pest and disease issues:

- Wallaby browsing damage was evident on some of the Douglas Daly sites, mostly where plantations bordered remnant vegetation (bush). Once the wet season commences in late November, this pressure will diminish and trees will recover. It should be noted that the damage viewed was mostly sustained by sesbania trees.
- In a small number of instances there was caterpillar damage to delbergia trees, which if left untreated could be an issue. TFS advised that it actively monitors this issue and has ongoing chemical control measures in place to reduce impact.
- Termites can be a problem in the Northern Territory, but with pre-emptive management any risk can be quite easily prevented. TFS treats trees that border plantations with a chemical control agent that is highly effective at reducing termite numbers. Creating a buffer zone in this way has been highly effective.

- TFS advised that there had been sporadic damage to irrigation drip lines caused by cockatoos. TFS is trialling a chilli additive to its grass control chemical mix, which will coat the drip tape and hopefully reduce damage. This is another example of how TFS responds to a management challenge, albeit on a lesser scale.

- TFS has commenced the process of identifying and employing a person to be responsible for monitoring plantations for pest and disease. Given the scale of operations in the region this is an appropriate step to take.

Adviser Edge continues to be impressed with TFS' Northern Territory operations. Sandalwood survival and growth rates have been excellent and the older 2012 plantations are exceeding by some margin the growth in ORIA. Weed control, which was a major concern of Adviser Edge in 2014, is considered to be largely under control, reflecting TFS' ability to adapt its management style to reflect what is happening in the plantation.

Region

TFS established its first Indian sandalwood plantation in 1999 and currently manages 9,078ha across its entire estate, with plantings located in the East Kimberley region of Western Australia (ORIA and Kingston Rest), the Northern Territory (the Katherine and Douglas Daly regions) and in Queensland (Burdekin). Each region has been selected due to the combination of a suitable climate, good soils and access to ample water for irrigation of the sandalwood plantations.

Kununurra is situated in the heart of the ORIA, which is the major irrigation district of northern Western Australia. The ORIA covers an area of approximately 17,000ha of flat productive soils, with the main industries being sandalwood, mangoes, citrus, melons, bananas, and a range of other fruit and vegetables.

The Douglas Daly and Katherine agricultural regions are located approximately 150km and 300km south of Darwin respectively. Both regions experience a similar climate to Kununurra, with a hot-humid tropical climate delivering a distinct six-month dry season. The wet season, running from November to March, provides rainfall of approximately 1,200mm and 1,000mm in each region respectively.

The Queensland site is located at Dalbeg in the Burdekin region, approximately 150km south of Townsville. Although this site is more southerly than Kununurra, it experiences a similar climate. Its average annual rainfall of 950mm is higher than Kununurra, and although it experiences a similar hot tropical climate, the wet and dry seasons are less pronounced. The risk of cyclones is higher in this region, although the plantations sites are located approximately 50km inland, which should reduce the impact of any cyclone.

TFS has not made a decision on where the 2015 Project will be located and it is possible that there may be more than one region represented. Adviser Edge has previously expressed a preference for MIS plantings to be focused on the ORIA; however, given the advances that have occurred in the Northern Territory, both in terms of plantation management systems and plantation growth rates, Adviser Edge no longer has a preference for the ORIA over the Northern Territory.

Species and varieties

The species to be grown in the Project is *Santalum album* (Indian Sandalwood), a semi-parasitic plant that relies on a number of host species for nutrients and water. The Indian sandalwood seedlings are germinated from seed collections made from existing seed sources in the ORIA, with the majority of the provenances originating from the Western Australian Conservation and Land Management (CALM) plantations which were established during the 1980s and 1990s, as well as from maturing TFS plantations. TFS has established its own seed orchards, which allows TFS to conduct provenance trials focused on identifying and bulking-up selected provenances with desired traits such as volume and heartwood and oil yield.

As a consequence of the parasitic nature of the Indian sandalwood and the requirement for host species, the required silvicultural management regimes are complex, with varying requirements for the weed, pest and irrigation controls to be applied across the plantations. TFS' host planting mix has evolved over time, reflecting the actual performance of existing plantations in the ORIA and more recently the Northern Territory.

Following are the host trees that are expected to be planted for the 2015 Project:

- *Alternanthera nana* (alternanthera) – Pot host
- *Sesbania formosa* (sesbania) – Short-term host
- *Acacia trachycarpa* (acacia) – Short to medium-term host
- *Cassia siamea* (cassia) – Long-term host
- *Dalbergia latifolia* (Indian rosewood) – Long-term host
- *Cathormion umbellatum* (cathormium) – Long-term host

The ratio of sesbania to sandalwood is reducing and management of the canopy is now more vigorous to prevent damage to sandalwood trees when sesbania die off. This short-term host has served its purpose by the time the tree is around three years old (longer in the Northern Territory), and the root volume of the Indian sandalwood tree will expand and form root associations with the remaining hosts after three to four years.

Indian sandalwood generally experiences a minor shock as the sesbania host naturally dies off and the Indian sandalwood becomes more reliant on the medium to long-term hosts. Once strong root associations are established with the long-term host, sandalwood trees continue to grow.

Adviser Edge believes that an evidence-based approach is likely to deliver better sandalwood growth rates, and reiterates the view that production risks for 2015 growers are considerably reduced relative to earlier projects.

TFS has made significant progress in host species selection and seed orchard capabilities. This is demonstrated by the improvement in the growth and uniformity of the TFS plantations over the years. It is expected that further advancement will occur as results from current research and development activities become available. The approach to selection of host species is very evidence-based, which has been a factor in improved sandalwood survival and growth rates, particularly notable in the Northern Territory plantations.

Site selection

Indian sandalwood grows naturally in a tropical monsoonal climate that experiences a wet season with heavy rainfall followed by a dry season of several months duration when no rain falls and temperatures may be very high.

The tropical north of Australia has this type of climate. However, suitable sites for establishing sandalwood plantations are limited to those with reasonably well drained soils, high average wet season rainfall and access to plentiful irrigation water. The regions targeted by TFS have a lower cyclone risk due to their location inland from the coastal areas most prone to cyclones.

Most sites selected have been previously used for agricultural activity. Some sites have higher weed seed burdens than others, reflecting the historical use, which requires more intensive management by TFS, both in terms of site development and post-planting weed control.

Based on past experience and the iterative improvement evident across the TFS estate, Adviser Edge is confident in TFS' ability to secure suitable land for the Project. TFS also maintains a land bank and is constantly seeking out suitable sites in the nominated regions.

Site development

TFS has taken greater control of site development. A specialist in-house team has been formed to manage the development process, including pre-purchase land due diligence, irrigation system design and management of site preparation works.

The intent is to ensure that all site development works are undertaken to a high standard and to reduce the overall costs of development to TFS through greater utilisation of the company's in-house expertise.

Site maintenance

Weeds will be controlled using both mechanical and chemical methods, with a particular focus on control in the first two years of the plantation's life, in order to ensure that the trees gain dominance over the site. The introduction of drip irrigation on most new planting sites has led to a significant reduction in the prevalence of weeds. Fertilisers will be applied to the Indian sandalwood and selected host species if there are obvious signs of nutrient deficiencies. While the Lease & Management Agreement only incorporates a general obligation to perform fertiliser, pesticide and herbicide applications as and when required, TFS has previously demonstrated its commitment to this obligation, with previous plantations appearing to have had appropriate and timely applications as seasonal conditions allowed.

TFS has responded well to high weed infestations prevalent in the 2013 plantations in the Northern Territory. TFS now uses biodegradable tree guards on all sandalwood and host trees, which allows more targeted application of chemicals to control weeds. This is an important change in management style, as prior to implementing the new management practice up to 70 people were required to spot spray and 'chip' weeds on the Katherine and Douglas Daly properties. Now 11 tractor drivers with over-row booms can achieve three or four passes for weed control relative to one for manual labour.

TFS has a well-developed integrated pest management system in place, ensuring the company can respond swiftly and effectively to pest and potential disease issues. The company has shown itself to be very adept at responding to management challenges.

Firebreaks will be established around the perimeter of the plantation sites and maintained at the start of each dry season, while roads will be formed to facilitate easy access for the harvesting equipment prior to harvest. The Indian sandalwood trees will be pruned to a height of 2.5m to 3.0m to ensure a clean butt log at harvest, while the host species will be pruned when necessary if these trees interfere with the growth of the Indian sandalwood trees, or impede access to the site.

Based on the 2014 site inspection and previous similar inspections, Adviser Edge is confident in TFS' ability to be an active and effective manager for the 2015 Project.

Irrigation and water source

For plantations located in the ORIA, both flood and drip irrigation will be used to manage the plantations' water requirements. These different techniques will be used either in tandem or separately, depending on the site. For example, drip irrigation has

been used by TFS on sandier sites and in order to increase survival rates in young plantations.

With groundwater being the water source utilised in the Katherine and Douglas Daly regions, all plantations will be irrigated through drip irrigation. For plantations located in the Burdekin region, both drip and flood irrigation will be used.

TFS has a preference for the use of drip irrigation, which has the advantage of reducing weed burdens and also broadens the range of sites that can be established to sandalwood; flood irrigation sites must be generally flat and often require heavier soils, such as those found in the ORIA. Adviser Edge is of the opinion that the combination of drip irrigation and good soils is likely to lead to better long-term outcomes when compared to the limitations of flood irrigation, providing water can be delivered in volumes that meet the needs of the sandalwood and host trees.

In the ORIA, the irrigation water is supplied from Lake Argyle, a storage dam located 55km south of Kununurra. The dam was constructed in the 1970s to provide a reliable source of water for 70,000ha of farmland in the region. To date, 14,000ha have been developed under Ord Stage 1, with 8,000ha of land being developed under Ord Stage 2 and approval for a further 6,000ha also being progressed.

The irrigation water source for the plantations in the ORIA is considered to be highly reliable.

For any plantations located at Katherine and in the Douglas Daly region in the Northern Territory, water will be sourced from bores that tap into the Ooloo aquifer. This aquifer is located beneath the Daly and Katherine Rivers and stretches from south-west of Katherine to beyond the Douglas River. A water allocation plan for the aquifer was completed in 2013, outlining rules for the sustainable use of water in terms of equitable allocation of water between environmental and human needs. The Ooloo aquifer has historically been unregulated, and while this plan will enforce maximum annual allocations for all bores that draw water from it, it is unlikely to affect existing holders of water licences, such as TFS.

TFS is effectively managing its water requirements within the constraints of the new water management plan. Adviser Edge understands that TFS is now the largest groundwater user in the Northern Territory.

Plantations in the Burdekin region will be both drip-irrigated with water drawn from the Burdekin River. The Burdekin River Irrigation Area (BRIA) was established in the 1950s, and in 1980 the largest land and water conservation scheme undertaken in Queensland was established, forming the Burdekin Houghton Water Supply Scheme. The large Burdekin Falls Dam feeds the system, in conjunction with the Clare and Gorge Weirs. Water is drawn from the scheme under high and medium security water licences.

High security water allocations under the Burdekin Haughton scheme are considered incredibly reliable, with 100% allocation each year considered normal.

The Project should benefit from drip-only irrigation, which enables strong early growth and high survival rates. The success of drip-only irrigation in the Northern Territory plantations is encouraging for plantations to be established under this Project.

Harvesting and processing

As a result of extensive research, TFS has lengthened the time to harvest, and expects to harvest the trees between ages 14 and 16. TFS will determine the exact timing of the harvesting operations based on market conditions and the state of the trees.

TFS has established a processing centre in Kununurra, with all harvested timber processed and stored here prior to dispatch to Mount Romance or elsewhere. The processing involves removing the sapwood from the log, and chipping all the residual timber that does not contain heartwood. The cost of harvesting sandalwood trees has been estimated at \$16,000/ha by TFS. The actual cost will be affected by the size of trees, sandalwood survival and the sites on which the trees are grown. It is reasonable to expect that harvest costs will decrease over time as productivity gains are made.

Market Overview

Product type	Indian sandalwood heartwood
Method of sale	Direct sale via tender of Project sandalwood post harvest and cleaning
Primary use	Fragrance oil, carvings, mouth fresheners, incense, natural medicine, and pharmaceuticals
Key target markets for TFS	France, India, China, USA, Taiwan, Hong Kong and UK
Competition	India, East Timor, Indonesia
Product Sales Agreements	No specific agreement in place for the Project

Project marketing strategy

TFS anticipates that the timber produced from the Project will be sold as cleaned heartwood logs at the farm gate. It is expected that the sale of the logs will be overseen by the Project Compliance Committee via an open tender process. Sandalwood harvested in 2013 and 2014 was sold to TFS via a competitive public tender, ensuring there is appropriate pricing tension for owners of the sandalwood.

While it is anticipated that TFS will be the ultimate buyer of most logs, and will then on-sell the logs or extract the oil at its Mount Romance facility, the open tender process adopted for selling Project timber will help to ensure a degree of market tension can be achieved.

Growers will not share directly in any downstream processing or other value-adding activities; however, they will benefit enormously from the market development work undertaken by TFS over the next 14 to 16 years.

TFS will need to build demand to match the higher supply, which is why the development of the pharmaceuticals market for sandalwood has been viewed so positively. Like other soft commodities, sandalwood demand is expected to benefit from increasing affluence in key markets such as India and China, underpinned by strong and inelastic demand associated with cultural and religious use.

TFS' purchase of Mount Romance has allowed the company to establish a presence in the global sandalwood market. This has given the company exposure and provided a springboard for when the first Indian sandalwood became available for oil and wood sales. TFS has sought to widen its field of focus, cultivating various end-markets while also investing in new and promising markets, most notably pharmaceuticals in the US.

Adviser Edge expects the success and scale of sandalwood derived pharmaceutical products will have a material effect on supply demand dynamics in the global sandalwood market, particularly

Key Points

- Sandalwood produced by the Project will be sold via an open tender. It is expected that TFS will acquire most wood sold.
- The global Indian sandalwood industry remains relatively opaque in nature, with illegal trade still a distorting factor in the market.
- With a declining native source, there will be a growing reliance on plantation sandalwood to satisfy latent demand for sandalwood logs and oil and to supply new buyers such as pharmaceutical companies.
- TFS is expected to be the largest player in the global Indian sandalwood market in the long term.
- The overall market outlook for Indian sandalwood is very positive.

as supply increases significantly from around 2024. There will also be increased demand from fine fragrance producers at the high-end of the market, who have limited use of Indian sandalwood due to concerns over chain of custody. Being able to source oil from sustainable source (i.e. plantations) will help build demand in this market segment.

Sandalwood currently being processed at TFS' Mount Romance facility has been pre-committed to global TFS customers, including pharmaceutical companies, fine fragrance and luxury cosmetic industries. TFS processed and shipped a total of 520kg of pharmaceutical-grade sandalwood oil to the US in 2014.

Over the past 12 months TFS has been actively developing its presence in the global sandalwood market.

- There has been further development of sandalwood-based pharmaceutical products in the US, with a strong focus on skin disorders such as acne. During 2014, the first sandalwood-derived products become available over the counter.
- TFS continues to enter into long-term supply arrangements with companies that are developing new products or seeking to underpin their ingredient supply for existing products. As the contracts being entered into by TFS have been denominated in US dollars, the company stands to benefit from a lower Australian dollar.
- TFS is developing its presence in the Chinese sandalwood market where there is unfulfilled demand for high quality heartwood for carving. Prices achieved for carving quality wood are high, making this an attractive alternative market for the Indian sandalwood being produced in TFS-managed plantations.

- TFS has entered into supply and JV arrangements with three international pharmaceutical companies:

- A supply agreement with US based ViroXis Corporation Inc., which is developing over-the-counter (OTC) products for the Human papillomavirus (HPV), targeting a 2015 launch. The company is also in Phase II trials for prescription drug candidates for HPV.
- A 50/50 joint venture with ViroXis Corporation Inc. in Santalis Pharmaceuticals Inc., a company undertaking advanced trials for prescription uses for sandalwood-based products, including for eczema (paediatric), actinic keratosis and acne.
- A long-term supply agreement with Galderma S.A., a wholly owned subsidiary of Nestlé. Galderma has licensed products developed by Santalis and has already received pharmaceutical-grade sandalwood oil exports from TFS' Mount Romance facility.

While there is no specific off-take agreement in place for the Project, TFS has been active in pursuing both new and existing markets for the potential supply of plantation-grown Indian sandalwood. Market expansion will be required to ensure prices are maintained at strong levels. While there is latent demand from inelastic cultural and religious markets, the development of new markets and reinvigoration of older ones (e.g. the fragrance industry) will be critical to the long-term financial success of the Project.

Product analysis

Indian sandalwood is a fragrant wood that is highly valued for its oil content, sourced from the heartwood of the tree. While the majority of the wood is sold for the extraction of this oil, some is also utilised for wood carving and worship or cremation purposes. Being relatively versatile, sandalwood is utilised in a number of industries and in a range of products. The most common use for sandalwood oil is in the fragrance industry, with the mouth freshener industry (i.e. chewing tobacco) recently becoming a source of demand.

Other uses include wood carving, as an ingredient in incense, as an additive in soaps and toiletries, and as an important ingredient in Indian and Chinese natural medicines. The pharmaceutical industry has also shown increasing interest in the use of sandalwood oil, particularly to treat skin disorders. There are already products available over-the-counter, and more are undergoing trials in the US.

Market overview

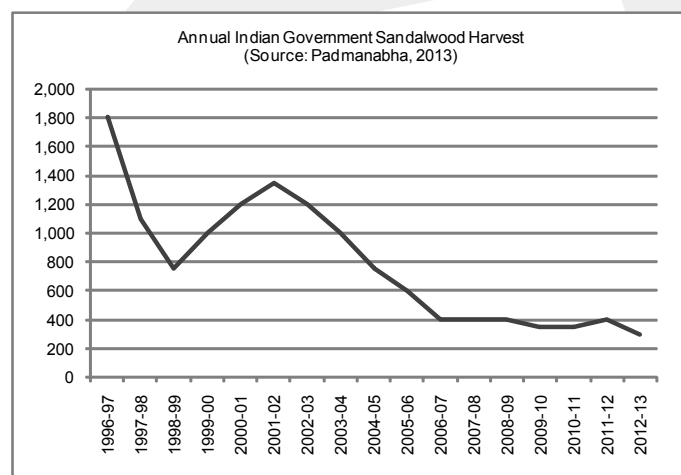
As the name of the species suggests, India has long been the centre of the Indian sandalwood industry, in production, trade and consumption. However, Indian sandalwood is also indigenous

to Sri Lanka, Indonesia and Fiji. Prior to the 1980s, Indonesia was the dominant exporter of unprocessed sandalwood; however, an export ban in FY1979 resulted in India having to meet export demand. India now dominates the supply of Indian sandalwood, accounting for around 95% of global production. Nearly all of Indian supply is sourced from native stands, with the southern states of Karnataka and Tamil Nadu providing most of the Indian supply. The balance of global supply is mostly from Indonesia, which is similarly affected by unsustainable harvesting rates.

Traditionally sandalwood trees in India are not harvested until they reach a much higher age, with harvesting of trees below 30 years of age illegal. However, due to the high value of the wood, the majority of Indian sandalwood is harvested illegally, and harvesting rates in the country have long been unsustainable. Containing illegal harvests and establishing plantations in India is difficult, as the high value of the wood requires a significant security presence to discourage theft. This is not such an issue in Australia; however, TFS has a security plan in place to ensure the valuable trees are protected from theft, particularly post-harvest.

Adviser Edge is aware of a small number of plantations established in India. Adviser Edge is also aware of plantations established in Sri Lanka, and plantations planned in a number of other south-east Asian countries. It is likely that any plantations being established overseas will be relatively small in scale and are likely to experience similar production issues to those evident in the earlier plantations established by TFS and others in the ORIA.

As a result of the high level of wood illegally harvested, the Indian government has reduced its official annual harvest from around 5,000 tonnes in the 1970s to a level of around 400 tonnes, in an attempt to promote sustainability (Padmanabha, 2013). The following graph illustrates the decline in the Indian government's official sandalwood harvest quota. Since 1998, Indian sandalwood has been listed as vulnerable on the International Union for Conservation of Nature (IUCN) red list of threatened species.

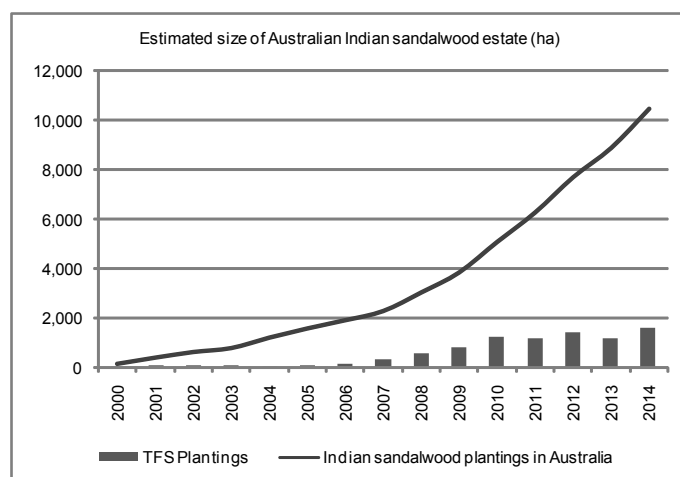


The Indian sandalwood market is characterised by a high level of usage of substitutes due to the scarcity of resources. These substitutes include synthetic products, oil from alternative sandalwood varieties such as Australian sandalwood (*Santalum spicatum*) and African sandalwood (*Osyris lanceolata*), and alternative wood products for the non-oil applications of Indian sandalwood. The market is highly opaque, unregulated and decentralised, resulting in limited information sharing and limited visibility with respect to the supply chain. In this context, and as a consequence of the high prices for Indian sandalwood, this has led to the prevalence of fake sandalwood being marketed as Indian sandalwood, and acceptance of fake sandalwood by the market in order to satisfy latent market demand (Inl, 2010).

Given the large amount of illegal harvesting, estimating global annual supply of Indian sandalwood is notoriously difficult. The sandalwood industry is highly secretive, with the large wholesalers reluctant to share information. Information that is shared publicly may not be completely reliable. However, there is some suggestion that output from illegal supply is four times that of the official harvest (Clarke, 2006). Consistent with this, Padmanabha estimates the annual harvest of Indian sandalwood at 2,000 tonnes per annum (Padmanabha, 2012). However, there are other market participants that have indicated production levels of Indian sandalwood at 3,000 to 4,000 tonnes, and oil at 120 tonnes to 150 tonnes, with 80 tonnes being consumed in the Indian domestic market.

In addition to India, there are a number of minor markets that produce sandalwood, including Indonesia; Timor Leste; Pacific nations such as Tonga, Fiji, Vanuatu and New Caledonia; and African countries such as Chad, Sudan, Ethiopia, Uganda, Kenya and Tanzania. However, these countries have historically produced non-Indian sandalwood varieties and future production is limited by over-harvesting and population pressures.

As a result, part of the market traditionally serviced by Indian sandalwood has increasingly been met by the supply of Australian sandalwood (*Santalum spicatum*). The harvest from native stands has allowed Australia to supply around half of the world sandalwood exports (Foster and Bird, 2009). As previously discussed, Australian sandalwood is considered to be an inferior substitute and the growth in consumption of this species has been borne by the increasingly depressed supply out of India and Indonesia, compelling merchants to seek out substitutes to satisfy their requirements. However, it is expected that, in the near future, current supplies of Indian sandalwood from native stands will be substantially supplemented with the expected harvests from plantation sources in Australia. The following graph illustrates the rapid increase in Indian sandalwood plantings in Australia, with TFS managing a majority of these plantations.



Indian sandalwood is used in a number of countries including China, India, Taiwan, Singapore, Australia, various Middle Eastern countries, Germany, Switzerland, France, the United Kingdom and the United States. Demand in western countries is predominantly driven by the fragrance industry, where Indian sandalwood oil has historically been an important ingredient in perfumes, soaps and other toiletries. In addition to its uses in the fragrance industry, Indian sandalwood is used in Eastern countries for a variety of other uses such as in wood carving, chewing products and cultural application such as the use in pastes (for the application of tilak), cremation and incense.

India remains the largest consumer of Indian sandalwood products. Compounding the difficulty in assessing the size of the market by reference to supply due to illegal harvests, measurement by reference to consumption is also difficult due to the sizeable and opaque domestic consumption in India. The Food and Agriculture Organisation of the United Nations (FAO) has previously stated that it believes consumption in India is probably greater than the rest of the world combined, making the size of the market difficult to estimate (FAO, 2011).

Padmanabha estimates the global demand for Indian sandalwood heartwood is in excess of 8,000 tonnes per annum (Padmanabha, 2010). He states that in India alone, sandalwood demand is estimated to be 5,000 tonnes per annum. Using a bottom-up analysis, Incipient Capital Group has estimated that current demand for Indian sandalwood heartwood is approximately 24,000 tonnes per annum (Morris, 2012), although no opinion was provided with respect to the price points for this level of demand.

Having surveyed the main consumers of Indian sandalwood, Inl expressed a view that the Indian market for Indian sandalwood logs at a price point of \$45/kg may be as much as 10,000 tonnes per annum. For wood below this price point (to \$2/kg) such as that used in the carving and cremation markets, the demand for Indian sandalwood is as much as 150,000 tonnes.

These estimates are based on an expectation of a substitution back to Indian sandalwood from inferior and fake products when a greater supply of Indian sandalwood is available. However, it should be noted that there has been a recent decline in demand due to government and legal action on food products containing tobacco such as gutka, which also includes sandalwood oil as one of its ingredients. There have been a number of estimates made with respect to the global supply of Indian sandalwood oil. Clarke suggests global Indian sandalwood oil supply at approximately 170 tonnes to 220 tonnes per annum (Clarke, 2006). Export of Indian sandalwood oil from India is estimated at around 5 tonnes to 15 tonnes in recent years. This is significantly less than the 100 tonnes India officially exported in the 1970s and does not take into account the illegal quantities that may have been exported at that time.

Based on the research undertaken by a number of third parties, it is clear that existing and latent demand for Indian sandalwood heartwood can absorb the estimated production from TFS managed plantations. New markets such as pharmaceuticals can be expected to further improve the demand outlook.

Market outlook

Mitigating the effect of the expected increase in the supply of Indian sandalwood from TFS-managed plantations is long-term global economic growth, the development of new products that use sandalwood oil, and an increase in demand from existing users as a result of the expected increased, and more consistent, supply of Indian sandalwood oil.

While the market for Indian sandalwood is global, it is expected that India will remain the largest market where Indian sandalwood has cultural significance. One of the important drivers of the potential growth in the Indian sandalwood market in India is population growth. The FAO estimated the Indian population will grow by an additional 225 million by 2030, an approximate 19% increase in its current population.

However, the market for Indian sandalwood products is expected to increase at a rate higher than the projected increase in population. Adviser Edge believes the size of the Indian sandalwood market should outpace population growth as a result of income growth by substantial segments of the Indian population and changes in demographics.

McKinsey & Co has estimated that with the economic growth expected in India, the size of the middle class will grow from 50 million currently to 583 million people by 2025, representing approximately 41% of the population (Farrell, 2007). Accordingly, the transition of Indian families into the middle class is projected to be a significant multiplier to increases in demand as a result of population growth. However, McKinsey & Co has indicated that this growth is expected to be more characterised by increases in volume than increases in per capita spending.

The positive economic outlook for the Indian market suggests a significant increase in size of the Indian middle class, which may translate into increased demand for Indian sandalwood products.

As previously mentioned, TFS is actively investing in the potential for Indian sandalwood to be used in the pharmaceutical industry. The potential market for this product is significant as HPV warts and acne are very common skin disorders. There is no known cure for HPV infection and current therapies are aimed at eliminating signs of symptoms (Lipke, 2006). However, there are a wide range of treatments with varying degrees of effectiveness and there can be no assurances whether ViroXis' research will result in the development of a new treatment that is more effective or is at a lower cost than existing treatments. Similarly with acne, the market is enormous and over-the-counter products that have been or will be released will compete directly with existing medications.

There is also a potential premium which may be applied to plantation-sourced Indian sandalwood, reflecting the preference of some customers, such as fragrance and pharmaceutical companies, for ingredients that are from sustainable sources. TFS is in a unique position, as the dominant Indian sandalwood plantation manager, to warrant the sustainability and authenticity of its resource. In the context of the current opaque markets, this may prove to be quite valuable. With commercial supplies of Indian sandalwood now a reality, TFS has been able to convert buyer demand for the product into prices that demonstrate a significant premium to the spot prices that have been quoted in Indian auction markets.

A combination of latent demand, market growth and the potential development of new products provides a positive outlook for the demand for Indian sandalwood products.

It is widely accepted that the native stocks of Indian sandalwood are dwindling due to unsustainable harvest practices (i.e. illegal harvests) driven by high prices and the death of many trees as a result of spike disease. As a long recognised issue, the Indian state governments have been attempting to encourage the planting of Indian sandalwood. However, past efforts have been limited due to difficulties in containing theft, the incidence of spike disease, government regulation, and the long lead time until harvest.

The Indian government has attempted to encourage plantation establishment by providing private ownership of plantations; however, establishment remains limited, with significant government restrictions acting to curtail plantation investment such as the control of harvesting and sale (in addition, to the other barriers). Given the lead time to plantation establishment there is unlikely to be significant competition from other non-TFS managed sources to supply Indian sandalwood at the projected time of harvest.

Adviser Edge expects that imbalances in demand and supply will persist in the future, even if existing regulatory and other barriers are overcome, as the market response to increasing the area planted to Indian sandalwood is affected by the long lead time until harvest. As a consequence, Adviser Edge believes that, other than the expected supply from TFS-managed sources (MIS and institutional plantations), there will be limited supply from other sources at the time the plantations are expected to be harvested.

Adviser Edge Returns Modelling

	Annual Investment Option		Annual Deferred Investment Option ³	
	Pre-Tax	Post-Tax ²	Pre-Tax	Post-Tax ²
Adviser Edge Base Case ¹	11.5%	11.5%	12.8%	12.8%
IRR Range ²	5.9%–12.9%	5.9%–12.9%	6.5%–14.0%	6.5%–14.0%
Median Return	8.8%	8.8%	9.5%	9.5%
Percentage of results that are break even or better	97.7%	97.7%	98.2%	98.2%
Percentage of results with an IRR of 10% or better	36%	36%	55.8%	55.8%

¹ The IRR range represents the range of results that occur within the 20th and 90th percentile in the simulated model. The range is based on Adviser Edge's modelling of potential outcomes for the Project using Monte Carlo simulations. These are subject to a number of limitations, which are discussed further below. Accordingly, the range is provided as a guide only. Investors should seek additional professional advice regarding the impact of changes in key variables on Project returns given their individual financial circumstances. The analysis does not consider investor finance arrangements.

² The analysis assumes a 46.5% marginal tax rate, that investors are registered for GST, and that all GST is rebated in the year paid.

³ The Annual Deferred Investment Option assumes that all annual fees are deferred and deducted as a percentage of harvest proceeds.

The following section provides an analysis of the potential investment returns for the Project. Please note that this analysis is based on estimated performance assumptions, which may change over the Project term. Investors need to be aware of the way in which these assumptions may influence investment returns, and should seek additional professional advice to determine whether or not this investment is suitable for their own risk and return objectives.

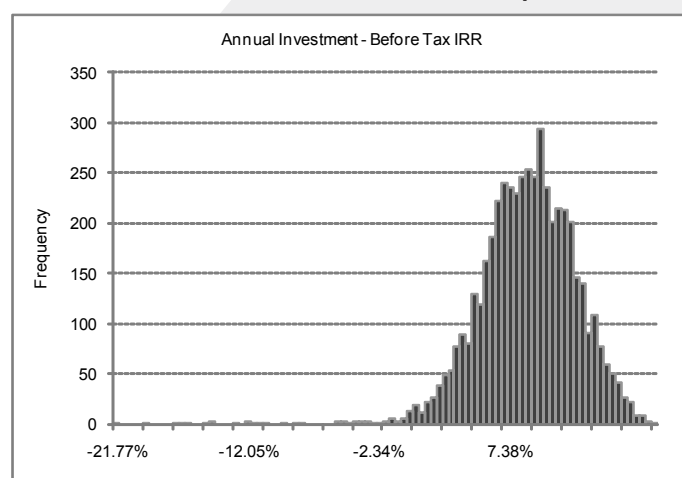
Scenario testing

In reviewing the Project, Adviser Edge has undertaken scenario testing of potential returns from the Project using Monte Carlo simulations. The scenario testing is based on variations to key assumptions relating to price, yield, quality, and the potential for severe adverse events to occur, as well as the relative impact of these events on returns. Investors should be aware of the limitations associated with this kind of scenario testing. The model used incorporates a number of subjective judgements made by Adviser Edge, which may not be empirically verifiable and does not include all the variables that affect returns. Accordingly, the predictive capability of financial modelling is limited. Nonetheless, Adviser Edge believes that the use of such modelling practices provides an improved insight on the risk/return profile of a particular investment, when compared with static investment modelling techniques.

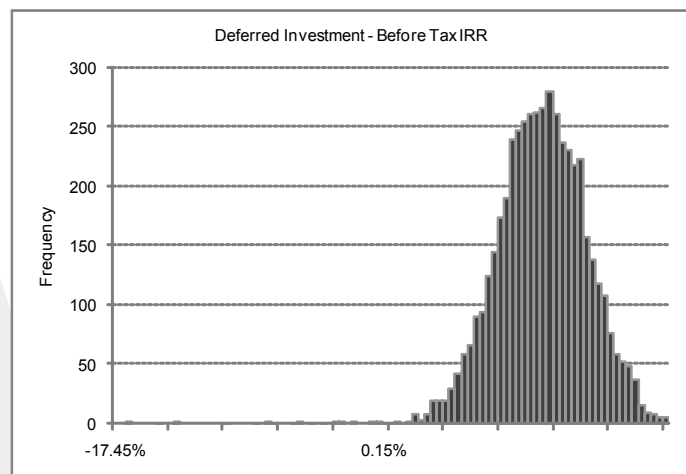
Returns modelling undertaken by Adviser Edge suggests that the annual deferred investment option provides a higher median return of 9.5% before tax when compared to the annual investment option's median return of 8.8% before tax. This is due to the higher net present value of fees paid under the annual investment option. However, investors should consider their personal circumstances when determining the most suitable investment option. The Monte Carlo analysis demonstrates an estimated returns range of -100% to 18.8% for the annual

deferred investment option, with 80% of values returns falling between 4.0% and 12.9%.

This wide returns range is largely caused by the modelling of the potential impact of manager insolvency or a natural disaster event. Ignoring the risk of manager insolvency increases the median return to 9.10% before tax for the annual investment option, and 10.7% for the annual deferred investment option. This reflects the skewed nature of modelled returns when such an event is included, and is caused by the low probability of an insolvency or natural disaster event occurring, but the high impact associated with such an event. The following graph illustrates the distribution of returns that resulted from Adviser Edge's analysis.

Pre-tax investor returns (Annual Investment Option)

Pre-tax investor returns (Annual Deferred Investment Option)



Note: The charts above include the potential impact of a natural disaster or insolvency event.

Key Investment Analysis Performance Assumptions

The estimated Project returns provided by Adviser Edge have been calculated using various performance assumptions. The key assumptions adopted by TFS and Adviser Edge are presented in the following section. These assumptions have been determined from information provided in the PDS, directly by TFS, from the independent foresters and independent market report, and from independent research performed by Adviser Edge.

Performance assumptions

Performance Assumptions	TFS	Adviser Edge
Age at harvest (rotation length)	14 to 16 years	16 years
Heartwood yield (kg/tree)	22.5 ¹	24.7 ²
Sandalwood survival rate	83%	80%
Heartwood oil content	3.70%	3.20%

¹ TFS' forecast at 14, 15 and 16 years of age.

² Adviser Edge's forecast at 16 years of age.

Rotation length

TFS has indicated in the PDS that it intends to harvest the sandalwood plantations between the ages of 14 (FY2030) and 16 (FY2032), remembering that the plantation will be established in FY2016. As the leases have a defined termination date, the latest the trees can be harvested is at age 16. While the optimal rotation length for Indian sandalwood has not been determined, the extension of the harvest window is supported by Adviser Edge. Research undertaken to date indicates that heartwood development and sandalwood oil levels increase with age; potentially well beyond 16 years. Consequently, Adviser Edge has a preference for, and has modelled accordingly, harvest to occur as close to the 16 year threshold as possible.

Sandalwood survival

TFS has undertaken an extensive and intensive inventory that covers all plantations under management. The data from the inventory provides a clear picture of sandalwood survival across a range of age classes. The inventory data clearly illustrates an improvement in sandalwood survival rates over time as a consequence of changes TFS has made to site selection and sandalwood silviculture practices.

Leaving aside the East Kimberley Sandalwood (EKS) Project and the TFS Sandalwood Project No.2 (TFS No.2), which were established using existing knowledge at the time, the TFS estate (2000 to 2011 projects) had achieved average sandalwood survival 71.41% as at 30 June 2014. A more granular analysis shows a clear upward shift in survival from the 2008 project, with Project years 2008 through 2014 achieving 89.17% survival, as opposed to 59.58% for the 2000 to 2007 projects.

The key factors that appear to be supporting the higher survival rates include:

- Improved site selection
- A settled and proven host species mix
- Weed control
- The high quality of seedlings being produced by the TFS nursery
- An increasing percentage of seedlings being produced from seed from the TFS seed nursery or selected trees within the estate
- The ability to use either drip or flood irrigation depending on soil conditions
- Skilled management

Based on the information at hand, Adviser Edge has decided to reduce its expectation for final harvest survival from 83% to 80% at age 16 years. Adviser Edge expects that survival after the first wet season will exceed 95% and may be as high as 99% (as in 2011), with an allowance made for mortality year to year. The reduction in Adviser Edge's estimated harvest survival reflects recent inventory outcomes. The adopted survival rate is below TFS' expectation and is considered to be a realistic assumption for the purposes of modelling investment outcomes.

Heartwood yield

The usual method of estimating the potential yield from a plantation forestry stand is to use developed biometric models, which predict future forest inventories (ACFA, 2009). These models are usually developed using existing plantation stand information to determine, statistically, the growth rate of the

plantations. There is very limited third party information available to estimate the growth rates for Indian sandalwood plantations. Older data from trial plantations undertaken by the Forests Products Commission has limited value due to the experimental nature of the plantations, limited management regime, older provenances being used, and the limited amount of information recorded on these plantations.

In order to determine the reasonableness of TFS' yield estimate, Adviser Edge originally sought to estimate the potential yield of the plantation using traditional volumetric techniques with verifiable data provided by TFS on basal area, bole length and taper assumptions to calculate the estimated yield of heartwood. However, it was concluded that differences between Indian sandalwood plantations (i.e. non-homogenous) limited the ability to predict volumes of Indian sandalwood heartwood and oil using this method.

The main difference is that the growth of heartwood is not proportional to the growth of the overall volume of the tree, which means the determination of heartwood volumes requires the inclusion of another factor, which can predict the volume of heartwood as a proportion of overall tree growth.

As a consequence Adviser Edge has given consideration to research and development work undertaken by TFS. While bole height, taper and other factors are widely used in the plantation forestry industry to calculate plantation volumes, work undertaken by TFS has indicated that bole length and taper do not provide significantly improved estimations of yield for an Indian sandalwood plantation. Rather, TFS has developed a growth model, which uses tree age and diameter over bark (DOB) at 20cm (above ground level) as the main inputs. Based on the trial harvests and other data obtained by TFS, heartwood volume predictions based on DOB size contained in the TFS research have so far demonstrated a high level of statistical significance.

The TFS research was a culmination of studies and data collection looking at tree growth rates, inventory and heartwood development, oil yield and quality and processing techniques. It involved the collection of data from five destructive harvests of 170 trees that ranged in age from 11 to 23 years, in conjunction with the Forest Products Commission (FPC), the Rural Industries Research and Development Corporation (RIRDC) and private foresters. This research was peer reviewed (to independently verify the results) by Dr Tanner of the University of Western Australia.

Given TFS' research and the absence of alternative models that can be reliably used to estimate volume, Adviser Edge has adopted TFS' growth model in estimating the potential yield for the plantation.

The best available source of information for estimating Indian sandalwood yield is from TFS' own research and development. Adviser Edge does note the potential risk

of bias in using TFS' own research; however, it is also noted that this research and development work is used for TFS' own internal planning purposes and has been peer reviewed by an appropriate external body. Adviser Edge has adopted a higher heartwood yield per tree to reflect the expectation that harvest will occur at or near to 16 years.

Sandalwood oil yield

In native sourced timber, oil yields from Indian sandalwood heartwood are typically between 3% and 8% as a percentage of dry ground heartwood. However, oil content is known to improve with age and ascertaining the oil yield content at the time of harvest is fraught with difficulties, given very few plantations have been brought to maturity and harvested.

It is believed that in the majority of instances Indian sandalwood heartwood does not start to produce oil until around 10 years of age, although some trial sampling indicates the presence of oil slightly earlier. TFS, in its financial model has estimated oil yields to be 3.70% of heartwood weight (at 25% moisture content).

The most comprehensive results recorded so far for Australian plantation-grown Indian sandalwood oil is the 2010 trial harvest. This trial recorded a mean oil yield for the 90 trees harvested at 4.9% of the heartwood woodchips at a moisture content of 25% by dry weight. There was a degree of variation in yields between 1.7% and 7.3%.

TFS has since undertaken a number of other harvests with trees aged between 11 and 17 years old, which have provided further confirmation on the oil content of sandalwood trees at different age groups. This research has enabled TFS to develop a growth model that can be used to estimate oil volumes in a standing plantation. Together with estimated growth rates in DOB, this model can be used to estimate future yield of Indian sandalwood oil plantations.

Based on this reported data, and confidential information provided by TFS, Adviser Edge has estimated the sandalwood oil yields at 16 years of age to be 3.2% (with a range of between 3.0% and 3.7 %). The rate at which oil develops in the heartwood is not linear and increases as the trees age. This is an important point as, when combined with increasing heartwood growth, the total volume of oil that can be extracted from harvested heartwood increases significantly each year from 10 years of age and would be expected to continue doing so beyond 16 years based on TFS' and other research.

Past performance

TFS established its first Indian sandalwood plantation in 1999, and currently has 9,078ha under management. The areas area established year-to-year varies, with planting peaking in 2014 when 1,586ha were planted.

The plantation estate includes trees that are managed on behalf of MIS investors, Australian wholesale investors and global institutional investors. In the period prior to 2010 sandalwood plantings were dominated by MIS investment. From 2010 onwards TFS had a much stronger focus on the global institutional market and more recently there has been strong interest from high net worth wholesale investors here in Australia.

Adviser Edge's focus with respect to past performance is on the 3,100ha of MIS plantations that were established between 2000 and 2014. Adviser Edge is of the view that the current planting system is largely derived from the 2000 project year. Nearly all plantations in the MIS managed estate are located in the ORIA.

Adviser Edge considers the MIS plantations established prior to 2000 to provide a good guide to oil levels in the sandalwood heartwood but they are not considered an appropriate peer for growth rates and survival due to the use of unsuitable host trees.

TFS has provided Adviser Edge with updated inventory, which covers all projects established up to the 2013 Project, which was established in 2014. 2014 was a particularly challenging growing season with very high rainfall occurring in February, which resulted in severe flooding. Consequently the growth rates measured in the ORIA were below TFS expectations. Some areas of the 2004 and 2005 Projects were also adversely affected by elevated boron, soil pH and salinity. These issues are very site specific and as such can be managed and contained.

Overall, mortality across the entire TFS managed estate was 3%, which is above TFS' expectation for annual mortality of around 2%. MIS mortality was higher at around 4.5%, reflecting the issues noted above and the greater exposure to the ORIA where survival rates have lagged other regions for reasons already discussed in the report.

The 2008 Project (planted in 2009), which covers an area of some 748ha has been subject to a heartwood yield downgrade to reflect actual inventory and how it sits relative to the TFS developed yield curve. This is not unexpected and the decline is of a lower magnitude than seen for projects that were established prior to 2009.

Notwithstanding the lower heartwood yield being predicted the trend for heartwood development in trees since 2007 is significantly better than for older projects. As an example the 2008 Project with estimated heartwood of 12kg/tree in 2014 is similar to estimates for trees that are up to 6 years older. This is not unexpected, reflecting improvements in TFS' forestry knowledge and site selection.

Survival rates have declined more than expected over the past 12 months, which has necessitated the adoption of a more conservative final harvest survival of 80%. Adviser Edge's

expectation is that survival rates in the Northern Territory will exceed the ORIA, even for more recent plantings, due to better quality soils and the adoption of more targeted drip irrigation.

The first harvest of real significance will be the 2000 project, which TFS is expected to start harvesting in the 2016 financial year (at the earliest).

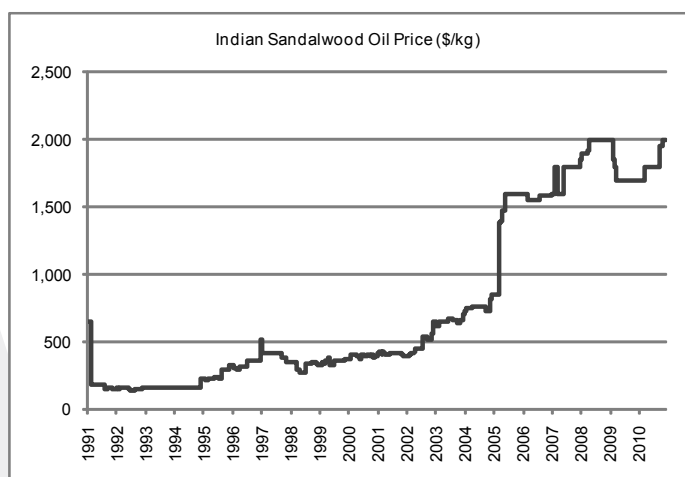
Very heavy rainfall in the ORIA during 2014 had a greater effect on the MIS estate than on the broader TFS estate. This is a good example of the variances that can be experienced year to year in agriculture. TFS is strongly committed to its inventory program, which provides good insights into annual growth and trends over time. This information is also allowing TFS' management team to target resources and personnel at areas where it is most needed, ensuring that the company can respond to challenges as it identifies them. Adviser Edge expects that there will be further improvement in plantation performance due to the knowledge gained across a sandalwood estate that spans 15 years.

Price

Performance Assumption	TFS	Adviser Edge
Farm-gate heartwood price (\$/kg)	A\$49.17/kg	A\$49.17/kg
Sandalwood price inflation	2.90%	2.90%
Estimated harvesting cost (\$/ha)	A\$16,000/ha	A\$16,000/ha
Cost inflation	2.30%	2.90%

In terms of pricing, the aromatic characteristics of the sandalwood oil largely determine the final price achieved, and these are normally judged by the buyer based on eventual end use. Because Indian sandalwood oil is deemed to have superior characteristics, it attracts a premium heartwood and final oil price compared with substitutes such as Australian sandalwood.

Since 1990, as native stocks started to decline, Indian sandalwood oil prices have grown at an annual compound rate of around 8% to 9% per annum, while world population growth over that period of time was only 1.3% per annum. This dynamic can be characterised as a supply constrained market, resulting in substantial increases in prices.



Source: Datastream.

However, Adviser Edge does not believe that the expected increase in supply as a result of the availability of plantation sources will result in any significant changes in this dynamic, despite projections of up to 8,000 tonnes per annum of Indian sandalwood heartwood being produced from plantation sources (around two to four times estimated current supply). This is due to the projected increase in the demand for Indian sandalwood products as a result of the predicted massive growth in the Indian middle class and new markets which are emerging, such as:

- Pharmaceutical industry demand for oil
- Chinese demand for carving wood
- Demand for sustainably harvested sandalwood (e.g. within the fragrance industry)

Notwithstanding the positive factors supporting a larger market over the medium to long-term, Adviser Edge believes that there will be limited scope for significant real price increases for Indian sandalwood above current elevated prices in more developed markets. Significantly higher prices are likely to be prohibitive for current customers and this could increase substitution and lead to a substantial reduction in consumption in response to markedly higher prices. This is less likely to be an issue in developing markets such as pharmaceuticals, as demonstrated by the recent announcement by TFS detailing a new supply agreement with an initial price of \$4,500/kg.

In terms of downside risks, Adviser Edge does not expect prices to fall to long-term historical levels. It should be noted that current supply is approximately 5%–10% of the amounts produced in the 1970s, when official Indian exports of sandalwood oil were approximately 100 tonnes and at a time when the global and Indian population was approximately 3.7 billion and 550 million respectively. With the current global population at around 7 billion and the Indian population at 1.2 billion, Adviser Edge would expect that even if historical supply levels were being achieved

today, Indian sandalwood will still be trading at a significantly higher real price than what was being achieved in the 1970s.

Adviser Edge has conducted returns modelling for the Project using a base Indian sandalwood oil price, accounting for variations in exchange rates, transportation and processing costs, and variations in the heartwood oil content.

Adviser Edge has adopted a base price of US\$1,500/kg of Indian sandalwood oil, and assessed a large range of prices in the returns modelling process. While this value is lower than prices currently being reported, Adviser Edge believes that a level of conservatism needs to be applied given the 14 to 16 year timeframe of the Project and the large volumes of heartwood and sandalwood oil that will be produced by TFS managed plantations.

Based on an average AUD to USD exchange rate of 0.85 and a heartwood oil content of 3.20%, a base farm-gate price of A\$49.17/kg for cleaned heartwood logs has been estimated by Adviser Edge. The estimated price also takes into account harvest costs, oil extraction costs and transport costs to the point of sale.

TFS has indicated that there is a transparent mechanism to ensure that investors in the project achieve fair market value for heartwood produced at harvest. The risk for investors is that the process designed for the purpose does not achieve the fair result expected.

Given the significant changes expected to occur in the Indian sandalwood market, it is extremely difficult to estimate a price likely to be achieved for Indian sandalwood oil, and therefore for heartwood logs at the time of harvest. It is also challenging to estimate the AUD to USD exchange rate, which has fluctuated across a US\$0.30 range during the period from 2005 to 2015. Accordingly, Adviser Edge has incorporated a relatively large real price range for Indian sandalwood prices at the time of harvest.

Harvesting costs

The harvesting costs for Indian sandalwood are significantly higher than traditional timber plantations because of the significant value of the tree being found in the butt and larger roots of the tree, which generally contain higher oil yield content.

Harvesting equipment was designed for the first commercial harvest in 2013, and found to be effective. The harvesting process is likely to be significantly refined prior to the harvest of the Project.

TFS estimates harvest costs to be \$16,000/ha. It should be noted that, based on the harvesting completed in 2013 and 2014 and extrapolating that to a fully stocked plantation of scale, TFS expects the cost of harvesting to be less than the long-held assumption of \$16,000/ha.

Adviser Edge has adopted TFS' harvest cost assumptions for investment modelling purposes. These harvest costs assumptions are only an estimate; however, due to the high value, low volume characteristics of sandalwood, harvesting costs are expected to be minimal when compared to heartwood prices.

Adviser Edge has indexed harvesting costs at the long-term forecast inflation rate of 2.9% p.a. A sensitivity analysis conducted around this assumption reflects the potential for changes in the CPI to affect harvesting costs.

Other assumptions

As well as assessing the key variables of yield and price, Adviser Edge has incorporated the potential for RE insolvency and its expected impact into the investment modelling, as well as the potential for destruction of the Project trees.

In assessing the likelihood of an insolvency event, Adviser Edge has taken into account TFS Limited's balance sheet, its ability to generate future cash flow, and its access to capital. TFS is in a decent financial position with a strong balance sheet but will continue to rely on future sales to institutional and retail investors as harvest and processing volumes begin to come online. As such, Adviser Edge has applied a relatively low default rate in its investment modelling.

The Project is structured in such a way that, in the event of the insolvency of the Responsible Entity, it is possible that a replacement RE will be appointed, given the incorporation of an annual fee and the presence of the custodial accounts which hold the equivalent of one year's management and lease fees. However, given the heavy reliance on the experience of TFS in the sandalwood industry, any insolvency is expected to have a

significant negative impact on Project outcomes. The impact of an insolvency event diminishes where the insolvency event occurs at a later stage in the Project's term, due to the increased value of the Project resource (the standing trees).

The modelling of Project returns has also incorporated the cost of insurance, the probability of an insurable event occurring, and the proceeds should an insurable event occur.

To reflect an unforeseen and uninsured natural disaster, or a disease or pest event which eliminates the ongoing production of a specific lot, Adviser Edge has incorporated a small probability of an investor's interest being terminated, with no returns being provided to investors.

It is difficult to estimate the probability and impact of these assumptions with regards to investment returns due to the limited information available to verify the underlying assumptions. However, Adviser Edge believes that by including its judgment on the potential impact of these events, investment returns modelling will be more reliable when compared to less sophisticated assessments.

Sensitivities

The Project's ability to achieve key assumptions is a function of both the inherent volatility of the underlying activity and the assumption risk, which is the accuracy of the initial estimate. Accordingly, the volatility used in Adviser Edge's modelling depends on the quality of the data supporting the assumptions, and an assessment of the expected volatility of the underlying activity during the course of the Project.

Yield



While the supporting information around yields continues to improve, the yield risk remains high and there remains a risk that the plantations will not achieve the anticipated heartwood or oil yields.

Price



There are significant risks associated with the price estimates used to model Project returns. The market is relatively shallow at present, making it challenging to predict future levels of demand and the ability of the market to absorb the significant increase in supply from TFS managed plantations. The developing pharmaceutical market could play an important role in maintaining prices into the future, while a lower AUD/USD exchange rate is also beneficial.

Costs



Investors in the Project are directly exposed to the costs associated with harvesting the sandalwood. While there is limited information to support the estimated cost of harvesting and extraction, given the relatively low cost compared to the high value of the commodity the variances in harvesting costs are not expected to significantly affect Project returns.

IRR sensitivity

Project returns are highly sensitive to heartwood oil yields, which are expected to significantly affect the price paid for the plantation-grown Indian sandalwood. Due to the limited empirical data to support oil yields, a reasonably high standard deviation has been applied when modelling returns (this is consistent with the results of the trial harvests), which affects the sensitivity displayed above. Oil price and survival rates are also expected to have a strong contribution to the variance in project returns, as does the potential for an uninsurable event and fluctuations in the prevailing AUD/USD exchange rate.

Investors in the TFS Indian Sandalwood Project 2015 will be subject to the risks associated with long-term forestry investments. All potential investors should carefully consider the risks outlined in the Project PDS, and the specific risks outlined in the Adviser Edge research report.

Management, structure, and fees risks

MIS management encompasses not only the operational capabilities of the Project counterparties, but also the corporate abilities of TFS Properties to monitor operational performance, and to meet the regulatory and statutory responsibilities required of it as Project RE.

For all MIS projects there is a risk that if the financial position or performance of management deteriorates, asset condition, project outcomes and/or regulatory outcomes may be temporarily or permanently compromised.

The Project incorporates two fee structures, whereby investors can elect to pay annual ongoing management and lease fees, or choose each year whether to pay or defer these fees to be taken as a percentage of harvest proceeds. The fee structure means that investors have some protection from unexpected increases in plantation management costs over the Project term. However, with overall fees weighted towards up-front fees rather than deferred fees, the Project is subject to continued Project manager solvency.

The continued solvency of TFS Properties, TFS Limited and TFS Leasing is required in order to meet ongoing obligations associated with plantation management and any land rental payments. While a cross-guarantee entered into by entities in the TFS group provides protection to investors contracting with TFS Properties, it should be noted that, under certain circumstances, this cross-guarantee can be revoked.

Should TFS Properties fail to meet any rental payments under any head lease, there is a risk that investors' interests in the Project will be terminated. Should this occur, this may result in individual investors not being able to participate in the Project pool. This risk is partly mitigated by the segregation of one year's lease and management fee, which is held by the custodian in a security account.

While the relatively large up-front fee provides investors with a tax-effective investment structure, the structure does mean that the Project is subject to higher risks earlier in the Project term, as the value of interests are significantly less marketable in the early years of the Project term.

Should the Project be wound up for any reason, it is expected that consideration for the interests will be subject to significant discounts due to the relative risk associated with the time to maturity and the ongoing costs of management.

However, the establishment of a secondary market for interests in TFS sandalwood projects mitigates the risk of interests being sold at a loss.

The most serious consequence of insolvency is if it results in the Project being wound up prior to the Sub-Land Interest Agreement being registered. Should this occur, there is a risk that investors will lose all, or substantially all, of the Establishment Fee paid to TFS Properties.

In addition to this, in the event of insolvency investors are reliant on an externally-administered Responsible Entity to act in their best interests. Such Responsible Entities may be subject to a number of conflicting interests. As a consequence, and in the absence of the establishment of systems mitigating this risk, investors may need to collectively organise appropriate representation to ensure that their interests are properly considered.

Site and silvicultural risks

Investors should be aware of the risks associated with the site and management of the Project. Key areas of risk identified by Adviser Edge are as follows.

Site selection

There is a risk that the selected land is unsuitable for an Indian sandalwood plantation. With a large area of Indian sandalwood established by TFS, the company is in an excellent position to implement site selection protocols that should ensure the selection of suitable land.

Pests and weeds

Insect damage can adversely affect yield. Weeds, especially pumpkin vine, can also affect growth rates through competition for water and nutrients, or can act as a vector to unwanted insects or diseases. TFS will monitor the plantations through frequent site visits, and will implement immediate treatments if weed invasion or pest damage exceed predetermined levels.

Plantations in the Northern Territory appear to have particularly high weed loads, which require the adoption of new management techniques to ensure that sandalwood and host tree growth are not compromised. TFS has shown an ability to adapt practices to meet new management challenges.

Infrastructure

Infrastructure risks include the factors associated with transportation, processing, and the availability of skilled labour. This poses a significant risk, given the isolation of the region. However, TFS possess a strong operational team and has developed significant regional infrastructure. TFS has also invested in Mount Romance, demonstrating its commitment to developing upstream processing facilities.

In addition to this, given the expected high-value nature of the product by weight, the location of processing facilities is significantly less important when compared to lower value commodities.

Performance risks

Yield and quality

Activities that deal with forestry are exposed to similar risks as those inherent in other agricultural production systems. Risks relevant to the plantation sandalwood industry include the impact of climatic events such as low rainfall, excessive heat and wind, and seasonal aspects such as fire and flooding. Irrigation of the plantations mitigates the impact of low rainfall and the plantations are located well away from the coastal areas that are more likely to be impacted by cyclones.

Investors should be aware that even conservative yield estimates are prone to failure due to adverse growing conditions. However, these threats can be mitigated by good site selection and management.

While recent trials have shown plantation grown Indian sandalwood yields oil, limited information remains on the yield and quality achieved in 14 to 16-year-old plantations, which is the age at which TFS anticipates harvesting the trees. As such, there is a risk that the Project plantations yield sandalwood heartwood and oil at lower levels to those estimated by TFS. This has been the case with many earlier MIS projects, although balancing this is the improved production knowledge that can be drawn on for this and future TFS managed projects.

Information risk

Given the infancy of the plantation sandalwood industry in Australia, significant information risk exists regarding the performance assumptions used to model investor returns. This risk is particularly prevalent when estimating the price of plantation-grown Indian sandalwood, as well as the heartwood yield and heartwood oil content. TFS has shown a strong commitment to monitoring and measuring sandalwood tree survival, tree growth and heartwood and oil development as the plantations age. TFS uses this information to improve its management practices and has ensured that forecasting production is more accurate now than at any time in the past.

Prices and costs

Investor returns will be directly affected by the price received for the Project resources, and the costs of harvesting and processing. While prices and costs are generally dictated by the dynamics of supply and demand, changes in certain macroeconomic factors can also have an impact. Such factors include exchange rates, interest rates, and inflation.

Investors need to be aware that these factors can both positively and negatively affect investor returns. The use of a public tender process is encouraged to ensure price transparency and to ensure that there is an appropriate level of price tension.

Marketing risks

As with any MIS project, there is a risk that the market for the Project resources will encounter a significant downturn at the time of harvest. This may be due to factors such as competition, regulation, and/or market preferences. The effect of reduced demand may affect prices, which could potentially reduce investor returns. The flexibility around the timing of the harvest, albeit relatively small, mitigates this to an extent.

Fire risk

As with all forestry plantations, there is a risk of fire on the Project plantations during the dry season. TFS has advised that it has not experienced any damaging wildfires. TFS is required to maintain adequate fire breaks. TFS insures the plantation estate on behalf of growers, who are invoiced for the cost. Given the fact that the fee structure allows TFS to recover a large proportion of deferred fees in the event woodlots are destroyed, insurance is critical to limiting downside risk associated with fire damage.

Security risk

Due to the high value of Indian sandalwood heartwood and oil, once the plantations are of a reasonable age, theft becomes a possibility, potentially diminishing investors' concerns. TFS has already started to take steps to minimise the risk of theft.

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