

TFS Sandalwood Project 2016 – Retail Investment Offer

INDEPENDENT ASSESSMENT

This report has been prepared for financial advisers only

17 February 2016

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

The Adviser Edge web site provides a service to subscribers, allowing them to view the final assessment reviews. Only subscribers are permitted access to download completed assessment reviews.

Star ratings applied to 2015/16 projects are independent of previous year's star ratings.

Licensed Investment Adviser

Barik Pty Ltd trading as Adviser Edge Investment Research is licensed as an Australian Financial Services Licensee, Licence No. 236783, pursuant to section 913B of the Corporations Act 2001. The licence authorises Barik Pty Ltd, trading as Adviser Edge Investment Research to carry on a financial services business to provide general financial product advice only, for the following classes of financial products:

- interests in managed investment schemes excluding investor directed portfolio services limited to;
- primary production schemes to wholesale clients.

Privacy Policy

Adviser Edge collects only a limited amount of personal information from its clients. Our privacy policy can be viewed at www.adviseredge.com.au This will enable you to understand your rights, our obligations and what Adviser Edge does with any information that it collects about you.

General Financial Product Advice

This advice will not take into account your, or your clients, objectives, financial situation or needs and will not be provided in respect of any other financial products. Accordingly, it is up to you and your clients to consider whether specific financial products are suitable for your objectives, financial situation or needs.

Reproduction

Adviser Edge assessment reviews cannot be reproduced without prior written permission from Adviser Edge. Each assessment review completed by Adviser Edge is held under copyright. Extracts may not be reproduced. Requests to reproduce or use an Adviser Edge assessment review should be sent to info@adviseredge.com.au

Disclosure

Adviser Edge (or any associated persons) does not have any material interest in the financial products (or product issuer advised upon) that are subject to this report. This assessment has been undertaken by Adviser Edge on an independent basis and does not constitute an investment recommendation. It is designed to provide investment advisers with a third party view of the quality of this project, as an investment option.

Adviser Edge charges a standard and fixed fee for the third party review of MIS projects. This fee has been paid under the normal commercial terms of Adviser Edge. Adviser Edge (or any associated persons) has not or does not expect to receive any further benefit or compensation as a consequence of writing this report.

Report Date

17 February 2016

Project Summary	4
Structure and Fees	5
Management	11
Site Inspection	16
Marketing	21
Investment Analysis	26
Investment Risks	33
Disclaimer	35



Adviser Edge Rating



Recommended Client Risk Tolerance

Project Details

Project Name	TFS Sandalwood Project 2016 – Retail Investment Offer
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: \$7,250 (ex. GST) per lot 12+ lots: \$6,950 (ex. GST) per lot
Ongoing Fee Structure	Two alternative fee structures (annual or annual/deferred)
Minimum Investment	One lot
Close Date for FY2016	30 June 2016
Investor Finance	Available
ATO Product Ruling	PR2016/1

Investor Returns	Annual Investment Option	Annual Deferred Investment Option
Potential Investment Returns (p.a.) – pre tax	3.8%–10.0%	5.8%–11.1%
Adviser Edge Base Case (pre & post-tax)	10.2%	11.2%

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 & Mitigation

- Sandalwood survival rates have generally improved with time but there always remains a risk that externalities may cause survival rates to fall below the expected levels. Countering this is TFS's highly competent management, site selection and use of improved seedlings.
- Project returns are sensitive to heartwood in the sandalwood trees and the oil yielded. High survival rates and strong tree growth are required to produce large volumes of heartwood. If this is achieved, investors can be confident that the heartwood will contain sandalwood oil based on recent commercial harvests undertaken by TFS.
- It is important TFS remains solvent throughout the term of the project. While the Project structure does allow for TFS to be replaced in the event of insolvency, the IP held within the business may be lost, which would be detrimental to the Project. TFS is currently in a sound financial position.
- Supply and demand dynamics at harvest time will influence financial outcomes for the Project. It is critical that TFS continues to develop new and existing markets to support higher prices in the face of burgeoning supply.

Strengths of Project

- TFS is a highly experienced manager, bringing over 18 years of sandalwood experience to the Project.
- TFS has a strong commitment to R&D and evidenced-based management, which has seen the company make constant improvement in sandalwood survival and growth rates over the past decade.
- Harvests completed in 2014 and 2015 by TFS have provided good evidence for projected oil recovery levels.
- TFS is a fully vertically integrated sandalwood company. It has recently expanded its exposure to the pharmaceutical market, an industry that is expected to have a significant role in the global sandalwood market in the future.
- There is strong existing and latent demand for Indian sandalwood, both for oil and carving.

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

- There is a secondary market for TFS project units, albeit at reduced values and on thin trading volumes.

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 and 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 2016 – Retail Investment Offer. 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 in either the NT or QLD.

The Indian sandalwood logs produced by the Project are expected to be offered for public tender, with TFS the most likely buyer. If the sandalwood is bought by TFS, it will be sold either as processed Indian sandalwood oil or heartwood to the international fragrance, carving and pharmaceutical markets. The plantation will be harvested 14 to 16 years after planting (prior to 31 December 2033).

For the 2016 Project there has been a significant change in the way in which harvest proceeds are split between investors and TFS. In previous years an investor had an initial entitlement to 100% of the net harvest proceeds, which reduced overtime if the investor elected to defer annual management fees. The minimum entitlement to harvest proceeds was 80% and the maximum 100%. Under the 2016 Project an investor commences with an 80% entitlement, which only increases if they elect to pay annual management fees in some or all of the years of the project.

To a large extent this change reflects the high percentage of investors electing to defer fees in previous projects and Adviser Edge has no issue with the adoption of this approach. Investors still have the ability to access a higher proportion of harvest proceeds and can make decisions each year as to whether the

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 (14–16 years), with TFS able 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 the value TFS places on its intellectual property.

performance of the trees warrants continued investment via annual management fees.

Proceeds from the sale of the sandalwood (excluding seed, 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, including harvesting, sales and marketing expenses, deferred fees, and TFS' entitlement to a proportion of harvest proceeds. It is expected that proceeds will be distributed following the harvest of the 2016 Project plantation, which will occur within the three-year period leading up to 30 June 2033. The precise timing of the harvest may fluctuate in order to maximise the revenue of the Project, or as a consequence of weather interrupting harvest operations. TFS has ultimate responsibility 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 2016). 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 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. Tropical Forestry Services Ltd 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 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 Establishment Fee. These funds must be deposited in the established trust account within 14 days from the Commencement Date, being 30 June 2016. Fifty per cent of the funds will be released on a quarterly basis 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 being completed.

The *Maintenance Reserve Fund* will hold the equivalent of one year's annual management fees 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 for 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. The main risk from insolvency is the loss of TFS intellectual property and operational know-how.

Fee schedule

The fees outlined in the following tables relate to an investment made on or before 30 June 2016. The fee structure for the Project involves two payment options.

These are:

- Annual investment option – an Investor pays the Establishment Fee, Upfront Annual Fee and Upfront Rent with the Application (and acquires an interest in 80% of the Gross Proceeds of Sale less any applicable deductions), followed by electing to pay the ongoing Annual Fee and Rent on an annual basis. For each year that the Investor elects to pay the Annual Fee and Rent, they will acquire an additional percentage interest in the Gross Proceeds of Sale.

If an investor pays the Annual Fee and Rent in each year, their interest will increase to 100% of the Gross Proceeds of Sale from the relevant Sandalwood Lot(s) (less deductions and allowances as set out in the Lease and Management Agreement and the Constitution).

- Annual deferred investment option – An Investor pays the Establishment Fee, Upfront Annual Fee and Upfront Rent with the Application (and acquire an interest in 80% of the Gross Proceeds of Sale), but elect (on an annual basis) not to pay the Annual Fee and Rent in any year during the life of the Project. However, deferral of the Annual Fee and Rent in Year 14 is subject to the approval of the Responsible Entity, which will be determined having regard to circumstances such as the availability of the Upfront Annual Fee and Upfront Rent.

In making the decision not to pay the ongoing Annual Fee and Rent, you will not be entitled to the corresponding additional interest in the Gross Proceeds of Sale in relation to that year. The foregone additional interest will range from 1% to 3% plus GST depending on the financial year in which the election is made.

Initial Cost to the Investor – Both payment options

Payment Type	Cost Per Woodlot (ex GST)
Application fee	
Between 1 and 11 Lots	\$7,250
12 or more lots	\$6,950
One year's annual management fee*	\$395
One year's annual lease fee*	\$132
TOTAL	
Between 1 and 11 lots	\$7,777
12 or more lots	\$7,477

* 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. As this amount (\$527 excluding GST) is technically considered a fee by the ATO, 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	\$395*	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: Year 1 & 2: 3% per year Year 3 & 4: 2% per year Year 5 to 14: 1% per year
Annual lease fee	\$132*	
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 2017 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 events for plantations in Australia are fire and wind damage, both of which are covered under the current policy taken out by TFS on behalf of investors. It should be noted that damage to plantations by disease, pests or mismanagement will not be covered by insurance.

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.

There has been a significant 16% increase in the establishment fee and annual lease fee, compared to the 2015 Project. There has also been a 5.33% increase in the annual management fee. There was no fee increase between the 2014 and 2015 Projects, and the increases need to be considered in this context. The impact of higher fees is to dampen investment returns unless there is a corresponding improvement in productivity and market conditions, which will only be known in arrears. Please refer to the Investment Analysis section of this report to examine the impact that higher fees and changes to key variables will have on financial performance.

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 spent 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, year one establishment fee of \$87,000 per hectare (\$83,400 per hectare 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.

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 around 61% of the combined establishment cost and year one and year two management fees charged by TFS is spent on the plantations. This compares to just below 70% for the 2015 Project, reflecting the 16% increase in the establishment fee. While Adviser Edge understands that there has not been an increase since 2013, the scale of the increase is beyond Adviser Edge expectations.

TFS places a significant premium on its intellectual property and dominant market position. Investors should 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 and the skills, experience and knowledge required to successfully grow Indian sandalwood. Investors should also consider that TFS uses its profits to invest in sandalwood research and development, market development and new pharmaceutical product development, all activities that will be beneficial to investors in this and other projects.

Adviser Edge continues to maintain a view 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. Notwithstanding, the sharp increase in establishment fee does place more pressure on TFS to deliver a strong investment return for investors in the 2016 Project.

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.

Annual management fees, which are payable from FY2017 onwards, have risen by approximately 5% to \$4,745 (excluding GST). The costs of management decline significantly after the early years as the sandalwood and host trees mature and fill the site. A review of the Direct Forestry Expenditure model provided to the ATO by TFS

shows that in the first four years of the Project the actual costs of management are higher than the annual fees, whereas from year five onwards the opposite holds true. This also reflects the deferred fee arrangement, with TFS taking a larger share of deferred fees in the early years and less later on. Overall, Adviser Edge considers the ongoing annual management fee to be reasonable given the complex silviculture of a sandalwood plantation, the location in a tropical environment and the need to irrigate.

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), the actual performance of the plantation 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.

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 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 continues to estimate 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. Adviser Edge expects that there will be annual improvement in harvesting efficiency, which could flow through to lower costs for investors.

Risk apportionment

Under the fee structure for the Project TFS has an initial entitlement to 20% of the Gross Proceeds of Sale, which may reduce over time depending on whether some Investors elect to pay some annual fees. This structure provides good risk apportionment, as TFS has a significant retained interest in the financial outcomes of the Project, while also providing investors with the ability to decide if the performance of the Project warrants further investment to gain a greater share of the harvest proceeds. In the event of underperformance this structure provides greater benefit to investors due to the fixed nature of annual fees.

Additional Information

Taxation

TFS has applied for and received an ATO product ruling for the Project (PR 2016/1). 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

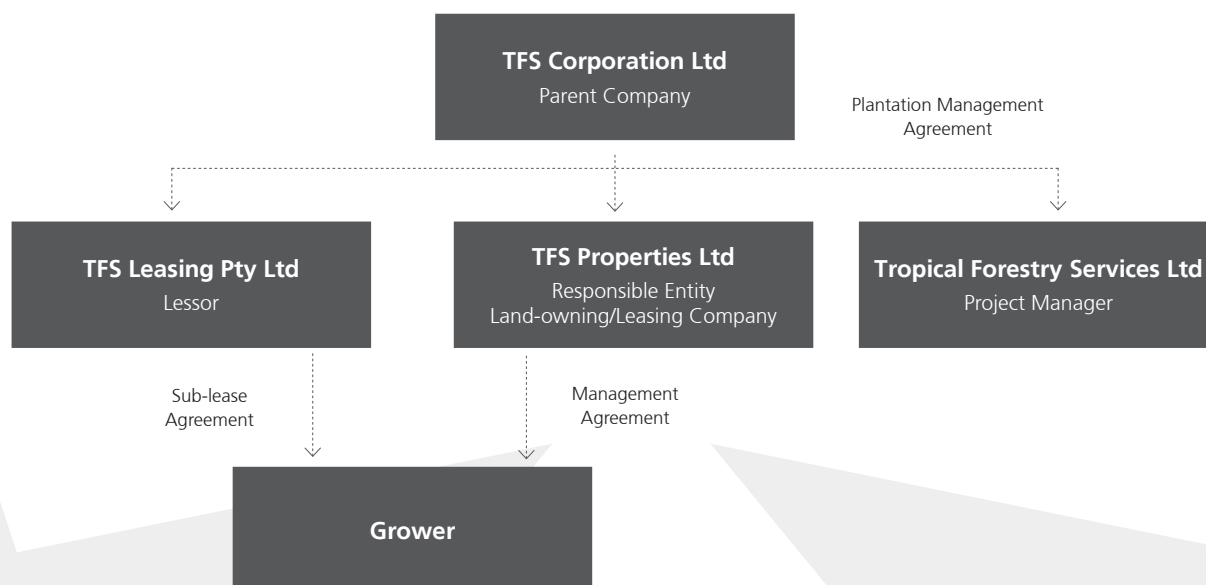
TFS will insure the trees until the end of the establishment period for 90% of their value. However, following this investors will be responsible for arranging insurance themselves if they wish to insure their Indian sandalwood investment. The RE will assist investors to acquire appropriate insurance, 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. Further, those investors that have deferred fees during the course of the investment will have a significant liability if their Woodlots are destroyed and there is no insurance in place. Please refer to the PDS to better understand this circumstance. Consequently, Adviser Edge recommends investors take up the option to insure their sandalwood lots.

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 2016.

TFS is a fully vertically integrated business that has a core focus on the production and sale of Indian sandalwood-derived products, including oil, heartwood or value-added products. The company is involved in all elements of the value chain through to retail.

TFS is a large, globally significant industry player and will have a significant influence on the future success of the industry, which it is set to dominate as the major supplier or certified plantation grown sandalwood.

TFS has been honing its management and silvicultural skills for over 15 years, aided by a singular focus on Indian sandalwood. This is a complex tree to grow and the value of the intellectual property held by TFS should not be underestimated. Adviser Edge has been reviewing the TFS sandalwood projects every year since 2003 and has seen first-hand the iterative improvements made in sandalwood survival, sandalwood growth rates and the selection of hosts. Investors in the 2016 Project will be the beneficiaries of this knowledge and experience and while the premium charged is significant, the likelihood of a good production outcome is improved as a consequence.

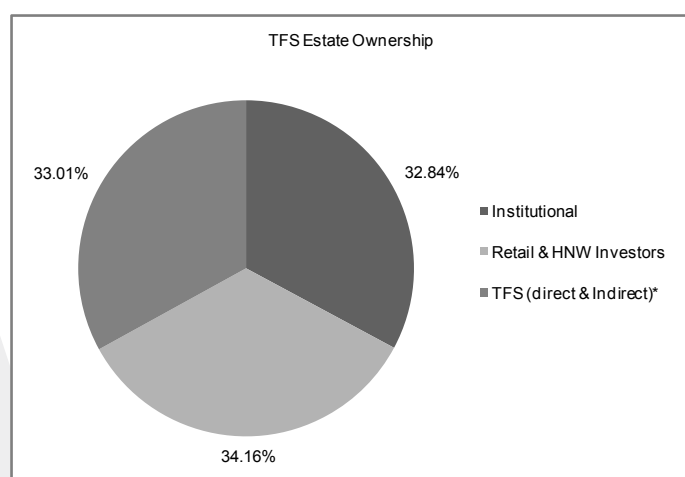
TFS now manages 10,583ha after another large planting of just over 1,500ha in 2015. Nearly all plantings took place in the Northern Territory, which is now the main operational hub of the business. TFS has its corporate head office in Perth and operations head office in Darwin.

Key Points

- One third of the TFS sandalwood estate is owned by global institutions.
- TFS has further boosted the area of sandalwood plantations it owns either directly or indirectly to 33%.
- TFS boasts an experienced operations management team, with significant levels of intellectual property held by the company.
- TFS is a fully vertically integrated business of global significance within the sandalwood industry.
- TFS continues to invest in the pharmaceutical market, which will play an important role in future supply and demand dynamics for sandalwood oil.

TFS employs close to 200 permanent employees and between 200 and 300 casual employees across its plantation, nursery and Mount Romance processing operations. Further expansion of permanent staff will be influenced by the location of new plantation regions in the NT or QLD and their proximity to existing resources.

There continues to be strong demand for the TFS Beyond Carbon institutional sandalwood investment. An additional 444ha were planted in 2015, bringing the total area now managed for global institutions to 3,475ha. Ownership of the remaining TFS managed estate is split between retail MIS investors, high net worth wholesale investors and TFS, both directly and indirectly through the deferred fee option taken up by investors in earlier projects.



* Indirect ownership through the deferred fee option for pre-2016 MIS projects.

Mount Romance continues to play an important role in the business, processing both Indian sandalwood from the ORIA plantations and native Australian sandalwood under a contract with the WA state government. Mount Romance is the world's largest distiller of sandalwood oil and has the capacity to process up to 2,000 tonnes of sandalwood per year. There appears to be ample production capacity for a number of years, most likely until the first of the large MIS plantings matures around 2022 or 2023.

Owning Mount Romance has allowed TFS to establish and develop long-term relationships with a number of international fragrance houses and cosmetics producers well in advance of having large volumes of sandalwood oil available. This is a sound strategy and one that is likely to allow TFS to manage supply and demand in the production build-up phase over the next five years.

TFS has continued to invest for long-term growth via the acquisition of the remaining 50% of shares in Santalis Pharmaceuticals (including the ViroXis business) in a cash and scrip transaction valued at \$23.4 million. The acquisition, which was funded through the issue of \$21.9 million in TFS shares and \$1.5 million in cash, provides TFS with added exposure to the large US pharmaceutical market via a range of over-the-counter (OTC) sandalwood-derived products and others in various stages of clinical trials.

This is an evolutionary step for the company, as the success of Santalis Pharmaceuticals and other pharmaceutical companies using sandalwood oil, such as Nestle-owned Galderma, is expected by Adviser Edge to have a significant bearing on the longer-term supply and demand dynamics of the sandalwood oil market.

TFS Corporation Board of Directors

Directors	Credentials
Dalton Gooding – Chairman	Experienced director, chartered accountant, senior partner in accounting firm
Frank Wilson	Founder and CEO of TFS, experienced corporate lawyer
Julius Matthys	Senior executive at BHP Billiton, commodities sales and marketing experience
John Groppoli	Experienced director, legal background, active corporate role
Gillian Franklin	Experienced director with extensive commercial cosmetics industry experience
Michael Kay	Experienced director with strong commercial experience

The TFS board of directors has had welcome period of stability following several years of change. The composition of the board is considered to be appropriate as it includes a mix of corporate, legal, sandalwood, fragrance industry and financial experience. The board has a majority of non-executive directors, which is considered important for good corporate governance. It should be noted that TFS Leasing Pty Ltd and Tropical Forestry Services Ltd have the same board of directors as TFS Corporation.

TFS Properties Ltd, the RE for the Project, now has a separate board of directors, with only two of its five directors being common with TFS Corporation et al. The TFS Properties board comprises entirely of non-executive directors, which is beneficial from a corporate governance perspective. Adviser Edge considers this board to be appropriately qualified and experienced.

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 committee is comprised of two external members and a representative of the RE. In addition, TFS employs an external Compliance Officer to monitor compliance of the RE, who reports to the Compliance Committee on the adherence to the Project's Constitution and Lease and Management Agreements.

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.

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 FY2015.

Key Financial Data – As at 30 June		
Financial Profitability	2014	2015
Revenue (\$m)	146.3	178.1
Net profit (\$m)	82.5	113.6
Profit margin (%)	56.4	63.8
ROCE (%)	16.5	16.7
ROE (%)	17.7	19.8
Market Measures	2014	2015
EPS (basic/cents)	28.9	34.6
P/E ratio	5.7	4.6
DPS (cents)	3.0	3.0
Dividend yield (%)	1.8	1.9
Dividend payout ratio	10.4	8.63
Financial Liquidity/Solvency*	2014	2015
Net working Capital (\$m)	85.5	72.7
Current Ratio	1.8	2.2
Quick Ratio	1.60	1.80
Net debt to equity ratio	15.1	27.3
Interest Cover	6.7	8.0
NTA per Share (\$)	1.17	1.33

Source: TFS Corporation Ltd, 2015.

* 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.

TFS has reported another strong result for FY2015, with revenue and net profit up 21% and 37% respectively, and a cash EBITDA of \$57.5 million. Revenue was underpinned by:

- New investor sales of 1,533ha of sandalwood plantations, including for institutional, high net worth and retail investors.
- Recurrent management fees from institutional clients.
- Sales of sandalwood oil to the European fine fragrances market.
- Sales to US and global pharmaceutical companies to support development of OTC pharmaceutical products.
- Sales of Indian sandalwood heartwood for carving and other cultural and religious uses.
- Lease fees from land owned by TFS and leased to investors.
- A weaker Australian dollar, which has boosted sandalwood oil sales revenue and revenue from Beyond Carbon, which is priced in USD.

TFS' gearing was 21% as at 30 June 2015 (net debt ÷ (total equity + net debt)), slightly up on 2014. Long-term debt continues to increase, reflecting the need to source and develop land prior to selling sandalwood plantations via one of the three financial products TFS offers. It should be noted that should a mismatch 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. TFS has shown its ability to undertake additional equity raisings to strengthen its balance sheet when required.

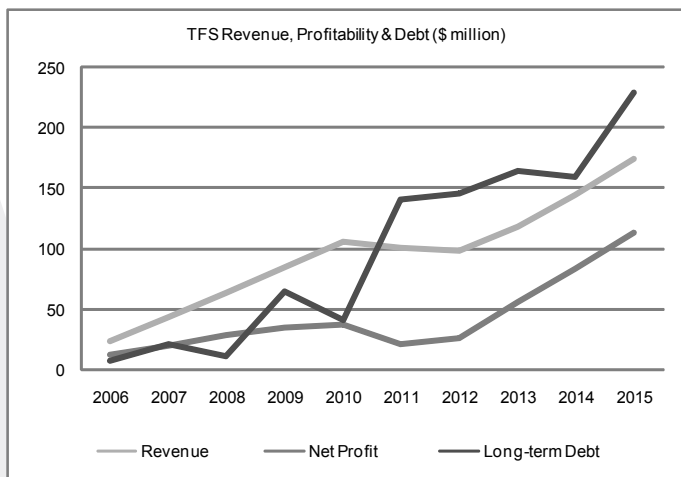
TFS has just increased its non-current debt position with the additional of US\$25 million of notes under the provisions of the existing US\$175 million of existing Senior Secured Notes. The effective coupon is 8.5%, which is significantly below the cost of TFS' existing debt, reflecting the stronger financial position of the business relative to when the Senior Secured Note transaction was completed. Funds will be applied to acquiring interests in the 2000 MIS project prior to harvest in 2016. All notes have a maturity date of 15 July 2018.

Net tangible assets were \$435 million at 30 June 2015 but do not include TFS' share of harvest proceeds for MIS projects as compensation for investors electing to defer their management fees. Similarly, the net tangible assets are unlikely to fully reflect the potential capital upside from the investment that has been made into the US pharmaceutical market, where there is enormous potential for increased demand for sandalwood oil as a base ingredient for over-the-counter products.

TFS now owns approximately 33% of the plantation estate that it manages, comprising direct interests and deferred interest in MIS revenue. A significant proportion is in MIS projects that are going to be harvested over the next decade based on escalating MIS scale up to 2008. TFS is expected to continue down the path of acquiring MIS investor interests, as this allows the company more flexibility when it comes to harvest timing and control of supply.

TFS is well-placed for another strong year in 2016. The AUD is expected to remain weak relative to the USD, which will benefit oil sales. Recurrent sales to existing investors, coupled with new sales to parties sourced by TFS, will underpin sales in 2016 and beyond.

Demand from retail investors is expected to remain muted but this will be balanced by stronger demand from high net worth investors who have a long-term investment horizon.



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 with the \$65 million raise in Q4 FY2015 and the most recent US\$25 million note issue.

TFS has shown its ability to raise equity or debt in order to fund growth. Strong recurrent revenue from institutional clients, new product sales and the ramping up of sandalwood oil and heartwood sales in the next few years are expected to underpin the business well into the future. TFS has shown itself to be a resilient business that understands the importance of vertical integration. The investments into Mount Romance and, more recently, Santalis Pharmaceutical have significant upside, allowing TFS to capture channel margin right through to retail in some instances.

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 Corporation 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 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, which was an additional US\$50 million in 2015.

Responsible entity financial requirements

ASIC has minimum financial requirements for Responsible Entities of managed investment schemes. These requirements are not designed to prevent REs from becoming insolvent. Instead, they 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.

TFS has extremely high operational competency. Sandalwood is a challenging species to grow and TFS' plantation operations team, headed by Brett Blunden and Matt Barnes, has shown an ability to achieve iterative improvement in growth rates and sandalwood survival over a long period of time. This is certainly evident in the NT, where the knowledge gleaned from 15 years in the ORIA is applied and adapted to meet a new growing environment.

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	★	★	★
Paul Castella – CEO Santalis Pharmaceuticals	★	★	
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	★	★	★
Ian Thompson – Senior Adviser	★	★	★
Johan Nortier – Processing and Maintenance Manager	★	★	★

Investors should have every confidence in TFS' ability to manage its sandalwood trees to a high standard and to ensure that funds are available when issues arise and need to be quickly and effectively managed. The company invests in research and development that has application at a commercial scale. Adviser Edge has also seen activities in the field derived from field trials undertaken over a number of years to prove efficacy and cost effectiveness. The IP held by TFS is globally significant and in Adviser Edge's opinion the silviculture management employed by TFS could not be duplicated at scale, which provides TFS with a considerable and global competitive advantage.

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 50 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

- The Northern Territory is now the main operational hub for TFS' sandalwood operations.
 - TFS is constructing a new nursery at Katherine, which will significantly increase the company's capacity to produce sandalwood and host tree seedlings.
 - Northern Territory sandalwood survival and growth rates continue to exceed those achieved in the ORIA.
 - TFS continues to evolve its sandalwood plantation silviculture through investment in outcomes focused R&D.
- Discuss the inventory management program, growth curve evolution and application of inventory output from a management perspective
 - Discuss the tree selection and breeding program and the impact that increased planting of superior seedlings is having on productivity

The Adviser Edge site inspection took place over the course of three days from 28 to 30 October 2015. The trip provided an opportunity to meet with senior operational management in Darwin and inspect the TFS plantation estate in the Ord River Irrigation Area (ORIA). A key focus of the inspection was on TFS' research and development (R&D) activities and the way in which information gained from R&D is transferred into day to day management of the plantations.

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 a number of key members of the TFS operations team, including Brett Blunden (GM, Forestry), Matt Barnes (Assistant GM), Brendan Carr (Regional Manager, WA), John Doble (Assistant Manager, WA), Michael Pattinson and Andrew Brown (R&D and Inventory Management), Kirk Hutchinson and Jenny Hurse (Senior nursery manager) and Andrew Strahely (Head of development).

The site inspection provided Adviser Edge with an opportunity to:

- View plantations across a range of age classes in the ORIA to assess growth rates, sandalwood survival and management
- Examine the way TFS transfers the knowledge gained through R&D into broadly-adopted field management practices
- Inspect the ORIA nursery and meet with senior nursery management to discuss the soon-to-be-completed Katherine nursery
- Discuss the development program for 2016, including new regions and key criteria for future properties

Adviser Edge continues to be impressed with the TFS operations team and the quality of sandalwood plantation management. Sandalwood management continues to evolve over time, reflecting the comparatively youthful nature of the industry relative to many other forestry industries here in Australia and overseas. TFS is overcoming shortcomings in knowledge through a strong financial and human resource commitment to R&D and evidenced-based adoption of new management practices.

TFS is making a significant investment in nursery operations with the development of a new nursery on the Florina Road property near to Katherine, NT. This nursery will complement the existing Packsaddle nursery in the ORIA and provide added security of seedling supply for the company. The new nursery will combine nursery practice that TFS has developed over a number of years in Kununurra with greater automation and more refined watering technology.

The new 2.4ha nursery will be commissioned in early 2016 and will likely provide some of the seedlings required for the 2016 project. When in full production the Florina Road nursery will supply over 50% of TFS' tree requirements, including sandalwood seedlings, equivalent to around 900ha of plantings each year.

TFS has continued to evolve its in-house property development capabilities, which have been instrumental in delivering properties to the plantation management division in a high quality state. Importantly, the area that is being developed effectively a year ahead of planting has increased significantly. This allows more time for the ground to settle and also ensures more effective weed control can be undertaken prior to planting.

At present the focus of new development is in the NT due to the availability of properties with large areas of suitable soil

and attached rights to extract ground water from one of three aquifers that lie underneath the Katherine region. TFS provided an overview of its development plans and the areas of focus as present. Adviser Edge is confident in TFS' site selection protocols, which have been honed over the years to ensure that unsuitable soil types in particular are not planted to sandalwood trees.

While in the ORIA, Adviser Edge met with Michael Pattinson, who is regionally responsible for the TFS inventory management program. The focus of inventory in the first two years post-planting is on sandalwood survival, whereas for trees aged five years or more the focus is on a combination of survival and tree diameter to provide a guide to site productivity. The inventory program has been instrumental in the development of a TFS growth model, which can be used to predict the likely harvest volume for a given plantation age class based on actual growth at any point in the cycle beyond five years.

In addition to the inventory program, TFS manages two progeny trials, which have recently been supplemented with new genetics from an overseas breeding program. There are approximately 30 families of trees across the two trails and all trees are measured for height, diameter and survival. Average outperformance on one growth factor (tree height) indicated that improved seedlings averaged 20% higher tree height on average and up to 60% for some individual family groupings. Overall the average outperformance relative to the control trees is approximately 130% across all families, with the top family achieving 180%.

The information from these trials informs selection of trees to be included in the TFS seed orchards, which now provide around 80% of TFS' seed requirements.

TFS has a strong competitive advantage in Indian sandalwood production but this advantage can only be sustained if TFS achieves good production outcomes for investors. The TFS research data supports Adviser Edge's visual assessment that more recent plantings are growing more strongly due to the use of higher and higher proportions of improved seedlings. Investors in the 2016 Project will benefit from the experience TFS has gained over more than 15 years of managing sandalwood and its well-evolved management systems, R&D and inventory programs that should lead to continued improvement in plantation performance over time.

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.

Over two days, Adviser Edge inspected a range of plantations established between 2000 and 2013. The inspection included the Drovers property, which was the last planting undertaken for an MIS project in the ORIA. While in Kununurra a storm cell hit the

Packsaddle plantations causing localised wind throw. Despite the strong and destructive winds, only a small number of sandalwood trees and host trees were damaged or blown over. Overall the damage would have been well below 1% of the plantation area.

The Drovers property features quite sandy soils and there are large areas of the property which have been developed but not planted due to concerns regarding soil quality and impeding barriers to growth. The property is watered solely via drip irrigation, with water drawn directly from the bordering Ord River. Sandalwood survival has been less than satisfactory on the sandier portion of the property but generally acceptable elsewhere. This property has proven more challenging than would have been expected and certainly is in stark contrast to the plantations viewed in Katherine and the Douglas Daly in 2014. Further refinement of the site selection protocols has occurred since the planting of the Drovers property.

In the ORIA the trees range from two to 15 years of age. Management for the younger trees is much more intensive, particularly with respect to weed management and pruning. Watering is either achieved via flood irrigation or drip irrigation, with both appearing to provide adequate water to meet the needs of the trees.

The flood irrigation layout has been changed, with watering now only occurring on every second row. This change in management was instigated due to concerns about the tree roots being submerged for too long a period. Despite only watering each second row there was good lateral underground movement of water, ensuring all the roots received water.

An aspect of management that caught Adviser Edge's attention during the inspection was the more active canopy management for host trees. The long-term host tree *Cassia siamea* (cassia) is now being actively height managed to reduce the impact of its canopy on sandalwood trees as a consequence of shadowing/crowding. There are also trials being undertaken to manage the form of *Dalbergia latifolia* (Indian rosewood) through dominant leader control.

The canopy management of cassia host trees is being applied more broadly and TFS' operational team is monitoring the impact on the height and growth of sandalwood trees. The team is expected to monitor and assess the pros and cons before applying this approach in other regions.

Research into heartwood development based on actual harvested timber has shown that the majority of heartwood is located in the trunk of the tree and as such the promotion of a long straight trunk with a high bole is preferable and likely to yield more heartwood. Consequently, each sandalwood tree receives a number of pruning passes during the first two years to lift the bole to around 1.5m. As the trees grow the bole height will increase to 3.5m or more. The other advantage of form pruning

is to eliminate the risk of machine damage to trees with low branches hanging out into the inter-row. The science behind this management practice appears sound.

In previous years there were limited issues with pests; however, this year there has been more pest pressure, predominantly with attacks on the sandalwood trees by borers and caterpillars. TFS monitors the pests and when the population density reaches a pre-determined level or damage is sufficient to warrant it, control measures are taken to preserve tree health.

TFS has employed an entomologist to help the management team to better understand the types of pests, their lifecycle and best times for control action to occur. The intent is to spray when best control can be achieved, using the right method (e.g. aerial versus ground misters).

Finally, WA Regional Manager Brendan Carr has instigated an infilling program in the plantation, which will see plantations with good sandalwood trees but a low host to sandalwood ratio be in-filled with new long-term hosts. Based on Adviser Edge's observations during the course of the site inspection, there appears to be a clear need for, and benefit from, a targeted infill program.

Generally the plantations in the ORIA are healthy and sandalwood trees are growing strongly. TFS continues to adapt its management to reflect in-field learning and the outcome of applied research. Survival varies across age classes, which is reflected in the inventory undertaken independently for TFS. The operational management team led by Brendan Carr appears to be doing an excellent job, albeit with sometimes imperfect knowledge due to the evolving nature of sandalwood plantation management. There was nothing seen during the course of the inspection that was cause for concern.

Regions

TFS established its first Indian sandalwood plantation in 1999 and currently manages 10,583ha 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.

Each region has access to abundant water, which is essential to meet the irrigation needs of the plantations. Each region has a similar hot tropical climate, with distinct wet and dry seasons (less pronounced in the Burdekin region).

The wet season, running from November to March, provides annual rainfall of approximately 950mm to 1,200mm. Irrigation is required during the dry season.

The availability of large areas of land in the NT makes it more likely that it will be the focus of operational activities for some time to come. Notwithstanding, water availability will remain one of the key elements of any future land transactions TFS completes.

TFS has not made a decision on where the 2016 Project will be located and it is possible that there may be more than one region represented. Adviser Edge has a preference for either the NT or ORIA, given the limited area under management in the Burdekin region. The scale of plantings for new MIS is only expected to be around 10% or less of total plantings and as such is likely to have some degree of integration with wholesale investor plantings (e.g. shared irrigation infrastructure).

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 more recently from maturing TFS plantations and a new source in Asia. TFS has established its own seed orchards, which allows for 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.

The following host trees are expected to be planted for the 2016 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. This is expected to be less of an issue as the density of sesbania planting reduces. Once strong root associations are established with the long-term host, sandalwood trees continue to grow strongly.

Adviser Edge believes that an evidence-based approach is likely to deliver better sandalwood growth rates, and reiterates the view that production risks for 2016 Growers are considerably reduced relative to earlier projects.

TFS has a strong emphasis on the introduction of improved progeny seedlings into the planting mix. Progeny trials have shown that there is a real and significant benefit from planting seedlings grown from selected seed. Early inventory measurement, supported by progeny trial data, has improved the number of seedlings outperforming the control sandalwood by around 30%. TFS expects a significant proportion of the seedlings planted in the 2016 Project will be from improved seed sources.

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.

Over the past two years there has been significant refinement in the site selection criteria for soils. Of particular focus is the exclusion of areas that have poor soil quality (e.g. aquataine soils) and/or barriers to root development (e.g. laterite rises). TFS has used its experience over the past 17 years to guide its site selection protocols, which means the likelihood of any poor areas being planted is greatly reduced.

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, provided that water can be delivered in volumes which 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 a further 8,000ha 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 Haughton 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 very 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 is evident 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 to heartwood (by removing sapwood) and stored there prior to dispatch to Mount Romance or elsewhere. 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.

TFS has made progressive changes to its processing operations, which will aid the full recovery of heartwood and allow for increasing volumes each year. There is close cooperation between the processing and harvesting operations within TFS, which is important to achieving a smooth harvest process.

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	Primarily 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, 2014 and 2015 was sold to TFS via a competitive public tender. This process ensures there is appropriate pricing tension for owners of the sandalwood. 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.

Using the 2015 harvest as a guide to the way in which a future tender process would operate is a useful exercise. The harvest of TFS Sandalwood Project No. 2 was completed in June 2015. The wood was collected, sorted and stored as logs in the TFS processing centre, available for inspection by purchasers. TFS measured and weighted the wood and calculated the estimated amount of heartwood (28.1 tonnes). The sandalwood was then marketed internationally by TFS, which also obtained an independent valuation.

TFS participated in the tender and was the ultimate purchaser of the available sandalwood, paying the equivalent of \$123,000 per tonne (\$123/kg) for 28.1 tonnes of heartwood. This was 22% higher than TFS paid for the wood harvested the previous year, which TFS bought through the 2014 tender process.

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 is expected to ensure a degree of market tension can be achieved. Further, TFS has oil supply obligations that it needs to meet, which makes its participation highly likely.

Obviously, for the tender process to work for the benefit of investors there needs to be a number of active market participants. Given the history of the industry, 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.
- 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 pharmaceutical market for Indian sandalwood continues to develop and may play an important role in supply demand dynamics in the future
- The overall market outlook for Indian sandalwood is very positive.

with respect to the cultural and religious drivers of demand and growing demand from the pharmaceutical market, Adviser Edge is confident that there will be strong demand for sandalwood when time comes to harvest the trees.

TFS will need to build demand to match the higher supply expected around the time that the 2016 project is harvested. This 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. The rising demand for whole logs in China supports the view that there is strong latent demand for sandalwood in countries where supply has been suppressed as a consequence of low supply from traditional sources.

TFS' purchase of Mount Romance has allowed the company to establish an early presence in the global sandalwood market. The company recognised the importance of developing relationships in the high value markets and in India and used Mount Romance and its access to Australian sandalwood as a means to do this. This was a very strategic and smart decision, which has not only delivered net revenue to the firm but also given the company exposure and provided a springboard for the sale of Indian sandalwood oil and whole logs.

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 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.

Key market development highlights over the past 12 months include the following.

- TFS acquired the remaining shares in Santalis Pharmaceuticals and ViroXis Corporation (collectively "Santalís") in the US. Santalis has a long-term exclusive supply agreement with TFS priced at US\$4,500/kg of sandalwood oil, which TFS has commenced supplying. The companies are well advanced in the development and commercialisation of proprietary dermatology products containing TFS' pharmaceutical-grade Indian sandalwood oil. Acquiring the remaining equity allows TFS to access 100% of the revenues generated from all new and existing products.
- Nestle-owned international dermatology company Galderma officially launched its Benzac® Acne Solutions over-the-counter acne regimen in the United States in December 2014. This product contains TFS' pharmaceutical-grade Indian sandalwood oil as the key product differentiator. Galderma is being targeted at teens and up to 50 million Americans who suffer from mild-to moderate acne. The Benzac® range of products is sold under licence and was developed by Santalis.
- There has been increased marketing activity in China, where demand for whole logs and heartwood billets is expanding at a much greater pace than anticipated. 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 appointed World Formula One driver Daniel Ricciardo as a TFS Global Ambassador (joining Adam Gilchrist). TFS will leverage Ricciardo's strong profile to help market TFS' Indian sandalwood products in the US, Europe and Asia.

While there are no specific off-take agreements in place for the Project, TFS has been active in pursuing and developing both new and existing markets for the potential supply of plantation-grown Indian sandalwood and has entered into a well-priced pharmaceutical oil supply contract. Market expansion is certainly required to ensure prices are maintained at strong levels, as sandalwood supply will increase significantly over current levels based on the plantings that have taken place over the past five years.

While there is latent demand from inelastic cultural and religious markets, the continued development of new markets, most notably for pharmaceutical-grade oil, and reinvigoration of older ones (e.g. the fragrance industry) will be critical to the long-term financial success of the Project.

Product analysis

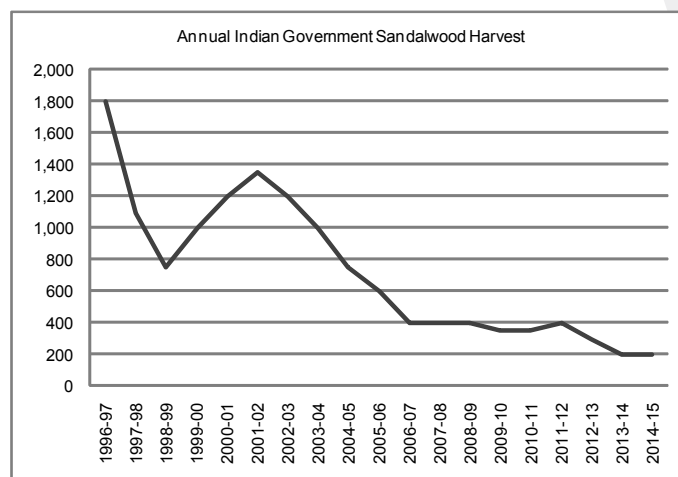
Indian sandalwood is a fragrant wood that is highly valued for its oil content, sourced from the heartwood of the tree. Sandalwood heartwood is primarily sold for the extraction of oil, or utilised for wood-carving, worship or cremation purposes. Being relatively versatile, sandalwood is utilised in 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 for sandalwood and its oil include 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 is now actively using sandalwood oil, most notably to treat skin disorders, such as human papillomavirus (HPV) and acne.

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.



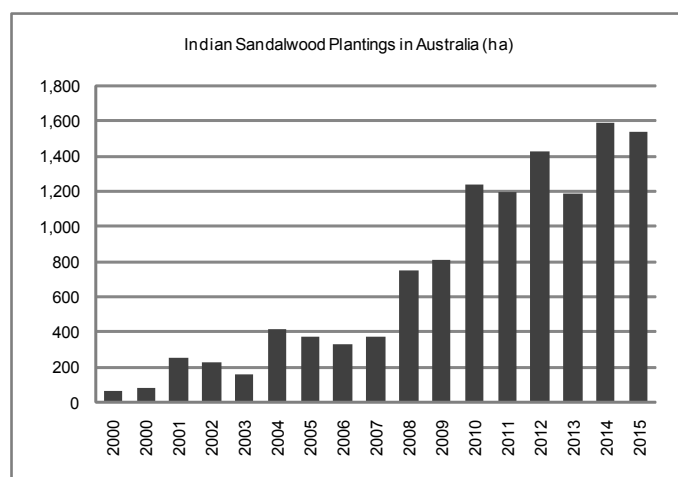
Source: H.S. Anantha Padmanabha, 2015.

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 (InI, 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 1,800 tonnes per annum, 1,600 tonne of which is illegally harvested (Padmanabha, 2015). However, there are other market participants that have indicated production levels of Indian sandalwood at 3,000 tonnes 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 and 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.



Source: Adviser Edge and TFS, 2015.

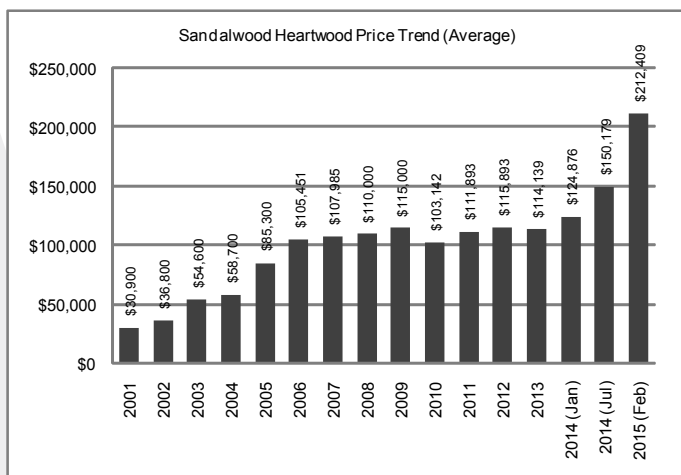
Indian sandalwood is used in a number of countries including China, India, Taiwan, Singapore, Australia, various Middle Eastern countries, Germany, Switzerland, France, the United Kingdom and the United States. Demand in western countries is predominantly driven by the fragrance industry, where Indian 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 wood carving and chewing products. It also has cultural applications in cremation, incense, and as an ingredient in pastes.

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.

From 2000 to 2015, the sale price of mature wild sandalwood in India has increased from \$30,900 per tonne to \$212,409 per tonne. This rise in sale price is due to increased demand for sandalwood and its oil. It is likely that the price of sandalwood will continue to rise due to dwindling supplies (Padmanabha, 2015). Padmanabha expresses a view that the significantly higher price

risers evident in 2014 and 2015 are unsustainable in the long term and reflect the current level of tight supply (Padmanabha, 2015). The price adopted by Adviser Edge for the purposes of modelling returns for the investment is significantly lower (refer to the Investment Analysis section of this report).



Source: H.S. Anantha Padmanabha, 2015.

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. Developing markets such as pharmaceuticals and demand expansion linked to the burgeoning Chinese and Indian middle class can be expected to further improve the outlook for sandalwood. TFS needs to focus on continued market development to maintain prices at profitable levels for investors.

Market Outlook

The expected increase in the supply of Indian sandalwood from TFS-managed plantations is expected to be mitigated by a number of factors, including long-term global economic growth, the development of new products that use sandalwood oil, and increased demand from existing users as a result of the expected larger, 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, due to Indian sandalwood's 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.

There is also a potential premium that may in the future 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 for the pharmaceutical market provides a positive outlook for the demand for Indian sandalwood.

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. The market response

to increasing the area planted to Indian sandalwood is affected by the long lead-time until harvest and the costly and complex nature of establishing plantations. 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 ready for harvest. Consequently, Adviser Edge is of the view that TFS has a long-term sustainable competitive advantage.

Adviser Edge Returns Modelling				
	Annual Investment Option ⁴		Annual Deferred Investment Option ³	
	Pre-Tax	Post-Tax ²	Pre-Tax	Post-Tax ²
Adviser Edge Base Case ¹	10.2%	10.2%	11.2%	11.2%
IRR Range ²	3.8%–10.0%	3.8%–10.0%	5.8%–11.1%	5.8%–11.1%
Median Return	7.3%	7.3%	8.7%	8.7%
Percentage of results that are break even or better	90.4%	90.4%	92.5%	92.5%
Percentage of results with an IRR of 10% or better	25.2%	25.2%	32.7%	32.7%

¹ The IRR range represents the range of results that occur within the 20th and 80th 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.

⁴ Assumes an investor pays annual fees in each year of the project giving them an entitlement to receive 100% of the Gross Sale Proceeds after costs and fees are deducted.

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 and 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 8.9% before tax when compared to the annual investment option's median return of 7.3% before tax. This is due to the higher net present value of fees paid under the annual investment option. However, investors should consider personal circumstances when determining the most suitable investment option.

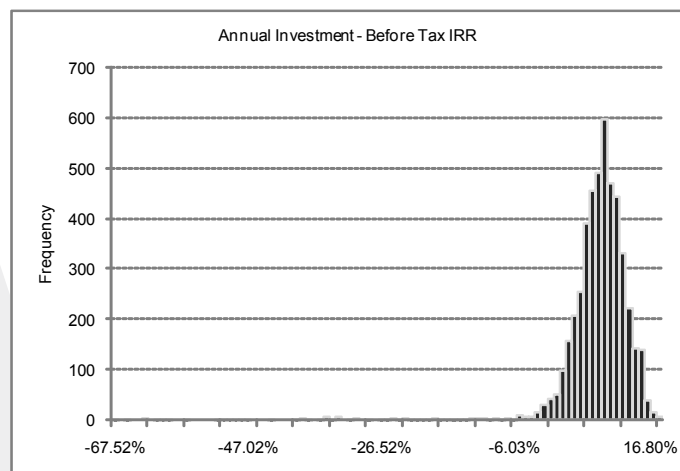
The Monte Carlo analysis demonstrates an estimated returns range of 5.8% to 11.1% for the annual deferred investment option.

This wide returns range is affected 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 7.5% before tax for the annual investment option, and 8.9% 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.

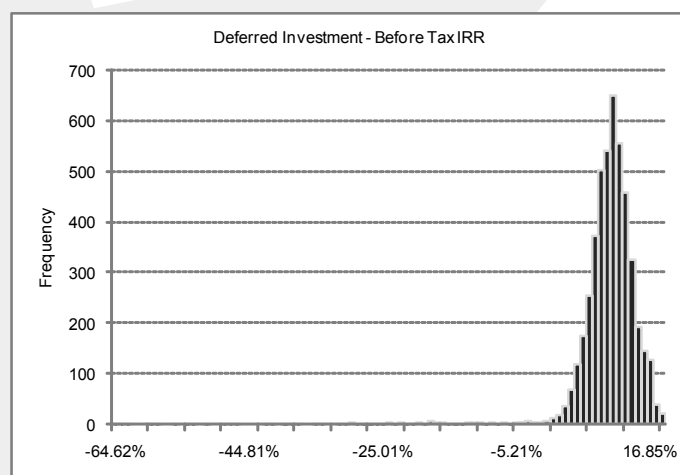
The impact of higher fees can be seen in the lower percentage of results with an IRR of 10% or better. For the 2015 Project Adviser Edge calculated that 36% of results for the annual investment option would achieve 10% or greater returns, which increased to 55.8% for the deferred fee option. For the 2016 Project the percentage of results delivering a 10% or better rate of return fell to 25.2% and 32.7% respectively. There was also a decline in the base case returns, which fell from 11.5% (annual fee option) and 12.8% (deferred fee option) to 10.2% and 11.2% respectively.

Scenario testing supports investment via the deferred fee option; however, as a decision can be made to either pay or defer fees, this decision is best made on an annual basis. This allows an investor to consider the actual performance of the plantations and prevailing market conditions prior to making a decision to pay or defer annual fees.

Pre-tax investor returns (Annual Investment Option)



Pre-tax investor returns (Annual Deferred Investment Option)



The charts above include the potential impact of a natural disaster or insolvency event, hence the long tail evident in the distribution curve. While the likelihood of natural disaster or insolvency event may be considered low, the financial impact can be quite significant. TFS has taken steps to address both issues through management in the field and via the project investment structure, to limit the likelihood of such events occurring.

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 the 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)	20 ¹	22.2 ²
Sandalwood survival rate	83%	80%
Heartwood oil content	3.70%	3.35%

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 (FY2031) and 16 (FY2033), remembering that the plantation will be established in FY2017. As leases may have a defined termination date, it is a requirement that the trees can be harvested 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.

Adviser Edge has been provided with the most recent inventory information for the TFS MIS estate. This data has been analysed to assess the annual changes in survival counts and to use as a basis for estimating the likely level of survival that could be expected for the 2016 Project.

As mentioned in previous reports, Adviser Edge has identified that there is a material lift in survival rates from the 2008 Project (planted in 2009) and onwards, with the exception of the 2013 Project planted at Drovers Run. Average survival across all age classes is 75.10% (2000 to 2014).

Comparing the larger MIS planting years of 2005 to 2007 against the 2008–10 plantings provides support for Adviser Edge's view regarding a material improvement in survival. After allowing for average annual tree losses of 1.3%, the 2005 to 2007 Projects are projected to have approximately 46% of sandalwood trees alive at 14 years of age. This compares to 74% for the 2008 to 2010 Projects. Further refinement to site selection over the past two years allows us to be confident that a survival level of 80% at

harvest in year 16 is achievable due to improved management and the use of improved seedlings.

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

- Improved site selection
- Settled and proven host species mix
- Improved 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
- Access to abundant and good quality irrigation water to meet the needs of the sandalwood and host trees during the drier months
- Skilled management

The expected final harvest survival adopted for modelling purposes is 80% at 16 years of age. Adviser Edge expects survival after the first wet season to be between 95% and 98%, with annual losses of 1% to 1.3%. These expectations are based on actual inventory data from the TFS MIS estate.

Heartwood yield

To estimate heartwood yields for modelling purposes, 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. Instead, 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 harvesting of trees by TFS over the past two years has provided additional insights into the development of heartwood in the trunk, roots and branches. This information has allowed TFS to change its harvest process to improve the cost of harvesting and reduce the processing time required to recover the valuable heartwood. It is now evident that the vast majority of heartwood is contained in the trunk of the tree, with only minimal levels of heartwood contained in branches with a diameter below 15cm.

TFS has estimated a yield of 20kg of heartwood at age 14 years, which is a lower estimate than adopted for previous projects. Consequently, Adviser Edge has also reduced its heartwood yield estimate at 16 years by 10% to 22.2kg. Key to achieving this level of production will be achieving higher sandalwood growth rates, as larger trees will produce larger volumes of heartwood, particularly as the trees age in the later part of the rotation. The use of improved seedlings will improve the confidence level of this estimate.

Adviser Edge's modelling anticipates that harvest will occur at or around 16 years. As such, Adviser Edge has adopted a heartwood yield that allows for two additional years of heartwood development. Adviser Edge is confident in making this assumption as the research, which has been peer reviewed, clearly shows that heartwood develops at a faster rate as the trees age. For modelling purposes, a base heartwood yield at 16 years of 22.2kg has been adopted.

Sandalwood oil yield

In native-sourced timber, oil yields from Indian sandalwood heartwood are typically between 3% and 8% 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. The TFS harvests conducted in 2014 and 2015, while delivering poor yields, have provided the best guide to oil recovery for the 2016 Project.

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. In its financial model, TFS has estimated oil yields to be 3.70% of heartwood weight (at 25% moisture content).

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 3.35% (the midpoint of the estimated 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. It is this knowledge that supports Adviser Edge's view that extending the harvest to 16 years has strong commercial merit.

Past performance

TFS established its first Indian sandalwood plantation in 1999, and currently has 10,333ha under management. The areas established year-to-year varies, with planting peaking in 2014 when 1,586ha were planted. There have been minimal plantings of MIS over the

past five years in response to lower market demand, due mainly to the widespread failure of MIS projects during the Global Financial Crisis (2008 to 2010).

TFS was able to transition its business to one that had a stronger focus on managing sandalwood plantations for institutional investors.

To gain a useful perspective from the historical performance of MIS plantations under TFS management it is necessary to examine the actual performance of the estate over time in the context of changes in sandalwood plantation knowledge. The performance of the earliest plantations was undoubtedly hampered by imperfect knowledge about how to manage sandalwood trees on a large-scale intensive basis.

This is best illustrated in the sandalwood survival rates for the 2000 to 2007 Projects in contrast to those established subsequently. Adviser Edge has analysed the inventory gathered by TFS over the 2012–15 period (four observation periods) and used this data to estimate survival levels in the year of harvest. Survival is highly critical as without sufficient trees there is little likelihood that total plantation volumes will match TFS' expectations.

TFS measures its plantations annually, with sampling at a much denser level than is normally the case for other plantation species. This improves the data confidence level and provides very useful information that can be used to estimate future performance.

In the early phases of the sandalwood rotation the focus is only on survival. As the trees get older TFS also measures the diameter of the trees at 20cm above ground level to enable an estimate of heartwood volume to be made. Based on these measurements, TFS has made changes to its growth model.

Overall the performance of established plantations has fallen below TFS' original expectations. Taking into account annual losses of around 1%, Adviser Edge has projected that the average sandalwood survival at harvest for the 2000–07 projects will be 54%, with 2008–12 expected to achieve an average of 73%. The best survival achieved is in the largest two projects, 2008 and 2009, indicating that factors other than scale are influencing survival rates.

Older plantations, as well as having fewer trees, are growing at rates that are much slower than the more recently established plantations. TFS has reduced its heartwood recovery estimates for older plantations to 12kg to reflect the poorer than expected growth rates. The growth rates for plantations established from 2009 onwards are much better than those observed in older plantations, but are still likely to fail to achieve the expected heartwood recovery of 22kg/tree.

More recently, established plantations have benefitted from improved site selection, with soil type in particular appearing to have the most marked influence on growth. Adviser Edge expects 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 MIS estate was affected more than the broader TFS estate in 2014, largely as a consequence of very heavy rainfall in the ORIA. 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 they are most needed, ensuring that the company can respond

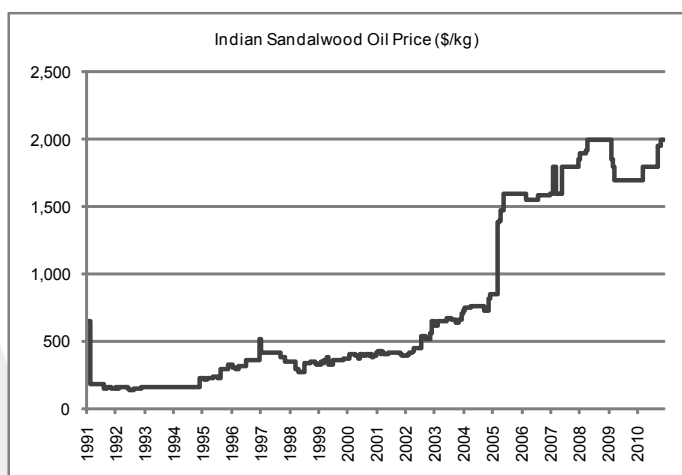
Price

Performance Assumption	TFS	Adviser Edge
Sandalwood oil price (\$/kg)		US\$1,500/t
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%

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.

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 (being two to four times estimated current supply). This is because of the projected increase in the demand for Indian sandalwood products as a result of the predicted massive growth in the Indian middle class and the emergence of new markets, some of which are developing more rapidly than previously expected.

These include:

- Pharmaceutical industry demand for oil.
- Chinese demand for carving wood.
- Demand for sustainably harvested sandalwood (e.g. in 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 TFS' sales over the past 18 months. This market appears to be developing quite quickly and with each successful registration of sandalwood-based treatments it could be expected that R&D expenditure will expand also. The upside will be a significant expansion in demand for pharmaceutical grade sandalwood oil, which will be a major factor in higher sandalwood prices.

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 global and Indian population was approximately 3.7 billion and 550 million respectively. With a current global population of around 7 billion and an Indian population of 1.2 billion, Adviser Edge would expect that even if historical supply levels were being achieved today, Indian sandalwood would still be trading at a significantly higher real price than what was being achieved in the 1970s. Also, sandalwood-derived pharmaceutical products have been gaining regulatory approval and are showing potential at retail level. Prior to 2015 there was some doubt as to the market potential of sandalwood products in the pharmaceutical market; however, the risks in this regard are now lower.

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.

There has been a significant devaluation of the Australian dollar against all major trading currencies over the past two years, bringing the currency back towards the long-term average against the benchmark USD. Given the correction that has occurred and the fact that the current AUD to USD exchange rate of around US\$0.70 is well below the 20-year average of US\$0.7705 (RBA Jan 1996 to Dec 2015). Adviser Edge feels comfortable in adopting a slightly higher exchange rate of US\$0.80 as the midpoint for modelling investment returns. The price paid for sandalwood heartwood at the farm gate will to a large extent reflect the level of oil content in the heartwood, the prevailing exchange rate and supply relative to market demand at the time of harvest.

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 estimating a price likely to be achieved for Indian sandalwood oil, and therefore heartwood logs at the time of harvest. The AUD to USD exchange rate is now trading at below the long-term average (20 years), which allows Adviser Edge to confidently adopt an exchange rate of US\$0.80 for modelling returns. There is still likely to be significant fluctuation in the exchange rate over the course of the project. Accordingly, Adviser Edge has incorporated

a relatively large real price range for Indian sandalwood prices at the time of harvest to reflect the uncertainty around these variables.

Harvesting costs

The harvesting costs for Indian sandalwood are significantly higher than for 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.

TFS has estimated harvesting costs to be \$16,000 per hectare. TFS continues to refine its sandalwood harvesting, and as such Adviser Edge expects to see some decline in the overall harvesting cost by the time the 2016 plantation is due for harvest. Notwithstanding, Adviser Edge has chosen to adopt the TFS estimate to ensure a degree of conservatism in this area.

Overall harvesting costs are not significant when the high value of the sandalwood heartwood is considered and hence changes in this variable are not expected to materially influence investment returns. Nonetheless Adviser Edge notes the steps taken by TFS to continue putting downward pressure on costs, which will ultimately be to the benefit of investors in this and earlier projects.

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 into its investment modelling the potential for RE insolvency and its expected impact, as well as the potential for destruction of the Project trees by a natural event (e.g. fire, flood, or wind).

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 has a strong balance sheet underpinned by its ownership of around one third of all sandalwood plantations it manages, but nonetheless

remains reliant on recurrent revenue from predominantly institutional sales and access to debt to fund operational expenditure. This will be the case for a number of years until the larger MIS plantations fall due for harvest. Given the expansion of land and sandalwood assets on the balance sheet of TFS and the strong recurrent investment by a number of blue chip institutional investors, 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). Nonetheless an insolvency event is likely to be deleterious to investors and needs to be incorporated into financial modelling.

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.



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.



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\$ exchange rate is also beneficial.

Sensitivities

The Project's ability to achieve key assumptions is a function of both the inherent volatility of the underlying activity but also 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.

The Project's ability to achieve these assumptions is a function of both the inherent volatility of the underlying activity but also 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.

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 harvests completed to date where information has been made available), 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 2016 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.

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.

There is a requirement for interests to be held for at least four years before any sale to a secondary market buyer can take place. There is a market for TFS sandalwood units but this generally

does not occur until around year six or beyond when the value of the trees can be more accurately assessed by a buyer. Based on Adviser Edge's knowledge of secondary market transactions, most occur at a discount to the estimated value reflecting the risk weighting a buyer places on their investment.

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. While the impact of this risk is considered high, the likelihood of it occurring is low based on the current financial position of TFS and its ability to raise equity or take on additional debt.

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 exceeds predetermined levels.

TFS has shown an ability to adapt practices to meet new management challenges. The company employs an in-house entomologist to help the plantation management division better understand the life-cycle of pests and to time treatment to achieve the best control outcome.

Infrastructure

Infrastructure risks include the factors associated with transportation, processing, and the availability of skilled labour. This poses a risk, given the isolation of the regions where TFS operates in the NT and WA. However, TFS possesses a strong

operational team and has developed significant regional infrastructure. Further, the business has shown it has the ability to retain key staff for long periods, ensuring retention of skills and knowledge. TFS' ownership of Mount Romance demonstrates 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 there have been harvests completed, the production outcomes are not considered by Adviser Edge to be reflective of the sandalwood timber yields that might be achieved in the 2016 Project due to the limited knowledge at the time the plantations were established in the late 1990s. TFS has continually refined its site selection protocols, host tree selection, weed management and irrigation techniques to improve overall productivity. Notwithstanding, in agriculture there is always risk of adverse and often uncontrollable events having an impact on production outcomes. For example the heavy rains of early 2014 slowed growth rates in plantations in the ORIA. Investors can be confident that TFS will apply its knowledge, skill and experience from more than 15 years of growing sandalwood to achieve the best outcomes possible for investors within the constraints of seasonal and site conditions.

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. The development of a growth model

by TFS using actual harvested timber statistics has improved the company's ability to predict future performance at any given stage in the rotation.

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 and wind throw risk

As with all forestry plantations, there is a risk of fire occurring on the Project plantations during the dry season and wind throw during damaging storms in the wet season.

TFS has advised that it has not experienced any damaging wildfires. TFS is required to maintain adequate fire breaks and Adviser Edge can confirm that this task is treated very seriously given the value of the sandalwood trees.

There was a wind throw event in late October 2015 on the Packsaddle plantation block, which did cause some damage, although this was estimated at below 1% overall. TFS has selected sites that are not expected to experience cyclonic activity, but there may be some minor damage from time to time as occurred with the ORIA wind throw event.

TFS insures its plantation estates 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 and wind damage in particular.

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 a security plan in place to minimise the risk of theft pre and post harvest.

Although all reasonable care has been taken to ensure that the information contained in this document is accurate, neither the Adviser Edge Investment Research nor its respective officers, advisers or agents makes any representation or warranty, express or implied as to the accuracy, completeness, currency or reliability of such information or any other information provided whether in writing or orally to any recipient or its officers, advisers or agents. Adviser Edge Investment Research and its respective officers, advisers, or agents do not accept:

- any responsibility arising in any way for any errors in or omissions from any information contained in this document or for any lack of accuracy, completeness, currency or reliability of any information made available to any recipient, its officers, advisers, or agents; or
- any liability for any director or consequential loss, damage or injury suffered or incurred by the recipient, or any other person as a result of or arising out of that person placing any reliance on the information or its accuracy, completeness, currency or reliability.

This document contains statements which reflect current views and opinions of management and information which is current at the time of its release but which may relate to intended or anticipated future performance or activities. Such statements and financial information provided have been estimated only and are based on certain assumptions and management's analysis of the information available at the time this document was prepared and are subject to risk and uncertainties given their anticipatory nature. Actual results may differ materially from current indications due to the variety of factors. Accordingly, nothing in the document is or should be relied upon as a promise or representation as to the future or any event or activity in the future and there is no representation, warranty or other assurance that any projections or estimations will be realised.

By accepting the opportunity to review this document the recipient of this information acknowledges that:

it will conduct its own investigation and analysis regarding any information, representation or statement contained in this or any other written or oral information made available to it and will rely on its own inquiries and seek appropriate professional advice in deciding whether to investigate further the business, operations and assets of the business; and

to the extent that this document includes forecasts, qualitative statements and associated commentary, including estimates in relation to future or anticipated performance, no representation is made that any forecast, statement or estimate will be achieved or is accurate, and it is acknowledged that actual future operations may vary significantly from the estimates and forecasts and accordingly, all recipients will make their own investigations and inquiries regarding all assumptions, uncertainties and contingencies which may affect the future operations of the business.

In providing this document, Adviser Edge Investment Research reserves the right to amend, replace or withdraw the document at any time. Adviser Edge Investment Research has no obligation to provide the recipient with any access to additional information or to release the results of or update any information or opinion contained in this document.



Suite 2.06, 9-11 Claremont Street,
South Yarra, VIC 3141
Telephone: +61 3 8849 0005
Mobile: +61 413 200 388