Adviser Edge

TFS Sandalwood Project 2011

INDEPENDENT ASSESSMENT

This report has been prepared for financial advisers only

8 April 2011

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 2009/10 projects are independent of previous year's star ratings.

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Report Date

8 April 2011

★★★★½

Adviser Edge Rating

Low Medium High

Recommended Client Risk Tolerance

Project Details		
Project Name	TFS Sandalwood Project 2011	
Product	Indian sandalwood timber	
Responsible Entity	TFS Properties Ltd	
Parent Company	Tropical Forestry Services Ltd	
Investment Details		
Investment Term	Approximately 15 years	
Investment Unit Size	0.167ha	
Units Available	3,100	
Application Fee	$12,500 (ex. GST) per lot (when between one and five lots are purchased)	
Ongoing Fee Structure	Two alternative fee structures (annual or annual/deferred)	
Minimum Investment	One lot	
Close Date for FY2011	30 June 2011	
Investor Finance	12 month finance available	
ATO Product Ruling	Pending	
Investor Returns	**Annual Investment Opt.**	**Annual Deferred Investment Opt.**
Potential investment returns (p.a.) – pre tax	3.60% – 14.15%	6.40% – 15.25%
Adviser Edge Base Case (pre and post-tax)	10.57%	12.06%

Investor suitability

As a general note, investment in agribusiness should represent a balance between the various potential risks and the forecast returns. 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.

Key Points:

Key Investment Risks

- MIS investors in TFS projects are subject to solvency risk. Countering this risk is TFS' sound financial position, strong equity position following a recent capital raising, and diversified income streams (retail and institutional).
- The first harvest of a TFS plantation, scheduled for 2013, will provide a true baseline on actual yield performance. However, the results of the most recent FPC trial provide supporting data for TFS' heartwood and oil yield assumptions.
- Tropical forestry is exposed to conventional agricultural risks. However, TFS has yet to experience significant events and appears to have the management plans in place to deal with such scenarios.

Strengths of Project

- TFS is in a strong financial position, with no debt following the recent capital raising. In addition, the company has diversified its cash flows into the wholesale market and manufacturing operations.
- TFS has gained significant expertise in the management of plantation sandalwood, and continues to improve on its high standards.
- Adviser Edge has a positive market outlook, with depletion of native sandalwood stands expected to compensate for increased Australian plantation production, and to maintain the current supply/demand imbalance.

Weaknesses of Project

- While the establishment fee is high, it provides TFS with greater financial stability and strength in the event of unforeseen cost increases.
- While TFS has displayed an ability to achieve high survival rates in young plantations which form the basis of productive harvests, actual heartwood and oil yields remain to be confirmed.
- Sandalwood oil pricing sourced independently has not reached full transparency relative to other global commodities. However, actual transactions completed by TFS provide greater clarity around price stability.

Other Project considerations

- A liquid secondary market has recently become available following the settlement of a wholesale transaction between TFS and a Middle East-based Sovereign Wealth Fund.

Investment Specifications	
Maximum subscription	3,100 lots (500ha)
Location	Kununurra, Western Australia
Investment unit size	0.167ha (one lot)
Number of trees per unit	Approximately 84 Indian sandalwood trees, plus host trees
Minimum application	One lot
Liquidity	Recently established secondary market will begin to provide liquidity
Insurance	Not compulsory
Investor finance provider	12-month finance available through Arwon Finance Pty Ltd

TFS Properties Limited (TFS Properties) is offering investors the opportunity to participate in the plantation Indian sandalwood industry through the offer of up to 3,100 lots in the TFS Sandalwood Project 2011. Each lot will be 0.167ha in size, and will be planted with approximately 84 sandalwood seedlings. The stocking rate aims to provide 70 trees per lot at harvest, based on an estimated survival rate of approximately 83%.

The Project involves the establishment of Indian sandalwood trees in the Ord River Irrigation Area (ORIA), near Kununurra in Western Australia. The sandalwood heartwood to be produced is expected to be sold largely to the international carving, fragrance and pharmaceutical markets. The Project has an expected term of 14 years from the planting date, which must occur before 31 December 2012.

Proceeds from the sale of the sandalwood (excluding seeds, which remain the property of TFS) will be pooled and distributed to investors on a pro rata basis, after the deduction of all relevant costs and deferred fees. It is expected that proceeds will be distributed following the harvest of the plantations at age 14 (FY2026), although TFS has indicated that up to 20% of the plantations could be harvested at age 13. The Project Agreements appear to provide some flexibility with respect to the timing of the harvest should a force majeure prevent completion of harvest at age 14, or should the heartwood and oil yields be deemed insufficient by TFS.

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 2011). 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.

Key Points

- Investors can choose from two different fee options.
- A discount on the application fee is provided for an investment in six or more lots.
- Establishment and management fees are comparatively high on a per hectare basis.

Project structure and agreements

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

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

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

In the event that the RE, TFS Properties, enters administration, the implementation of a switching fee will mean that all investors are compulsorily required to pay ongoing annual fees, regardless of which payment option they elect. This structural change to the fee arrangement is designed to facilitate change to an alternative manager in the event of the insolvency of any of the management counterparties. Adviser Edge supports the introduction of the switching fee as an investor safeguard.

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 Landgate (the Western Australian land titles office) 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 structure of the Project means that investors are reliant on the continued solvency of TFS and TFS Properties, especially in the early years of the Project term. While investors have the option of paying fees annually, they also have the option to defer these fees to harvest. This may affect TFS Properties' ongoing cash flow. It should be noted that this risk reduces as the Project term nears maturity, as ongoing obligations decrease and inherent value in the plantation increases.

While Adviser Edge prefers a Project structure less reliant on the RE, the financial position of TFS should be considered. The consequences of the Project's structural risk is outlined in the Risk and Risk Management Section of this Report, and discussion regarding the financial position of TFS and TFS Properties is contained in the Management section of this Report.

Fee schedule

The fees outlined in the following tables relate to an investment made on or before 30 June 2011. The fee structure for the Project involves two payment options. These are:

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

Initial Cost to the Investor

Application Fee	Cost Per Woodlot (ex. GST)
Between 1 and 5 Lots	$12,500.00
6 or more lots	$12,045.45

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. The application fee due per lot reduces for investors that invest in six lots or more.

Annual Fees

Payment Type	Annual Investment Option	Annual Deferred Investment Option
Annual management fee	$830*	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: FY2013–FY2014: 3% per year FY2015–FY2018: 2% per year FY2019–FY2024: 1% per year
Annual lease fee	$250*	
Selling and marketing fee	5.0% of Gross Proceeds of Sale	
Harvesting costs	Actual harvesting costs, determined at harvest. 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 2012 and thereafter annually through to 2023.
'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.

Investors that select the annual fee option will be invoiced for annual management and annual lease fees from 1 January 2012 onwards, until the last payment on 1 January 2023. 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 the annual deferred payment option, investors may elect to have the annual lease and management fees deferred and a fee calculated as a percentage of Gross Proceeds of Sale, as set out in the previous table. These investors may elect to defer annual fees on a year-by-year basis. If they decide 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 the plantation trees are permanently damaged, 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 has advised that, as long as the appropriate cover has been taken out, insurance will cover this amount. The typical destructive event is fire, with there being no referral to the cause of such an event. Significant events that are not covered include pest and cyclone damage.

Performance incentive fee

TFS is entitled to a performance incentive fee equalling 30% of the amount of any Net Proceeds of Sale that exceed $200,000 per lot. The Net Proceeds of Sale means 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.

After remaining unchanged in the 2010 Project from 2009, the application fee for the TFS Sandalwood Project 2011 has increased to $12,500 per unit (excluding GST), from $11,750 per unit (excluding GST) under the 2010 Project. This fee reduces to $12,045.45 per unit (excluding GST) when six or more units are purchased.

It is difficult to conduct a comparative analysis of the GST exclusive, per hectare application fee of $75,000 ($72,272.70 excluding GST when six or more units are purchased), as the Project is the only stand-alone MIS Indian sandalwood project in the market. As a result, Adviser Edge has compared the application fee with the estimated cost of establishing an Indian sandalwood plantation in the ORIA.

While the costs associated with establishing an Indian sandalwood plantation are high due to the complexity of management and high labour requirements, Adviser Edge believes that the cost is materially lower than the $75,000/ha charged by TFS, which incorporates a healthy profit margin for the company. However, investors in the Project are benefiting from considerable intellectual property associated with the growing of Indian sandalwood gained by TFS over the past ten years, access to an established land bank, and an established and experienced forestry team, as well as from TFS' commitment to market development and continuing research and development.

Adviser Edge believes that the application fee is high when compared to the costs of establishing an Indian sandalwood plantation. However, other benefits provided by TFS have also been considered when assessing the value of the services provided to investors. In addition to this, the healthy profit margin has been an important factor in TFS' financial stability.

Ongoing expenses for managing Indian sandalwood plantations include weed and pest control, soil nutrition, irrigation, the removal of vines and dead host species, fire management and stand monitoring. Although the initial establishment fee is higher than for the 2010 Project, the annual management fee is significantly lower at $830 (excluding GST), compared to $950 (excluding GST). With this fee also being decreased for the 2010 Project, this indicates that TFS is beginning to achieve economies of scale, reaching greater efficiencies in its management of the plantations. In addition, the annual lease fee remains unchanged from 2010. It should be noted that Adviser Edge is not aware of the average head lease cost, and therefore it is difficult to see whether the annual lease fee would cover ongoing head lease obligations in the event of manager insolvency.

The annual fees are considered appropriate when compared to the costs of land in the ORIA and the cost of ongoing management of an Indian sandalwood plantation.

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

Adviser Edge believes that one factor in deciding whether to pay the annual fee or to defer is investors' performance expectations of the Project. If investors defer the annual fees, TFS is entitled to a higher proportion of the harvest proceeds, and therefore the total fees paid are higher when the performance of the Project is higher.

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.

Adviser Edge believes that the benchmark and the level of the Incentive Fee is appropriate, particularly for the Annual Investment Option, providing added incentive for TFS to maximise investor returns.

Harvesting costs will be determined once the harvest is completed, and invoiced to growers at actual cost. TFS has estimated a current-day harvest cost $16,000/ha to produce cleaned heartwood logs at the farm gate, although it is important to note that, given the exact harvesting method is not yet known, the actual cost could vary significantly from the estimated amount.

Risk apportionment

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

The Project fee structure incorporates both a deferred fee option and an annual fee option. Adviser Edge believes that the deferred fee investment option not only provides extra incentive for TFS to perform, but also reduces investor exposure to the volatility of underlying performance factors. Consequently, the deferred fee results in an alignment of risk between both the manager and the investor. In the event that an investor elects to pay annual fees, the marketing fee in combination with the incentive fee also help to provide a degree of risk apportionment.

Additional Information

Taxation

TFS has applied for a product ruling for the Project. A product ruling is considered important as it provides a degree of certainty in relation to the taxation consequences of investing in the Project.

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

While TFS will insure the trees until the end of the establishment period for 90% of their value, 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. They will not charge a fee for doing so. Insurance will be compulsory for investors who obtain finance.

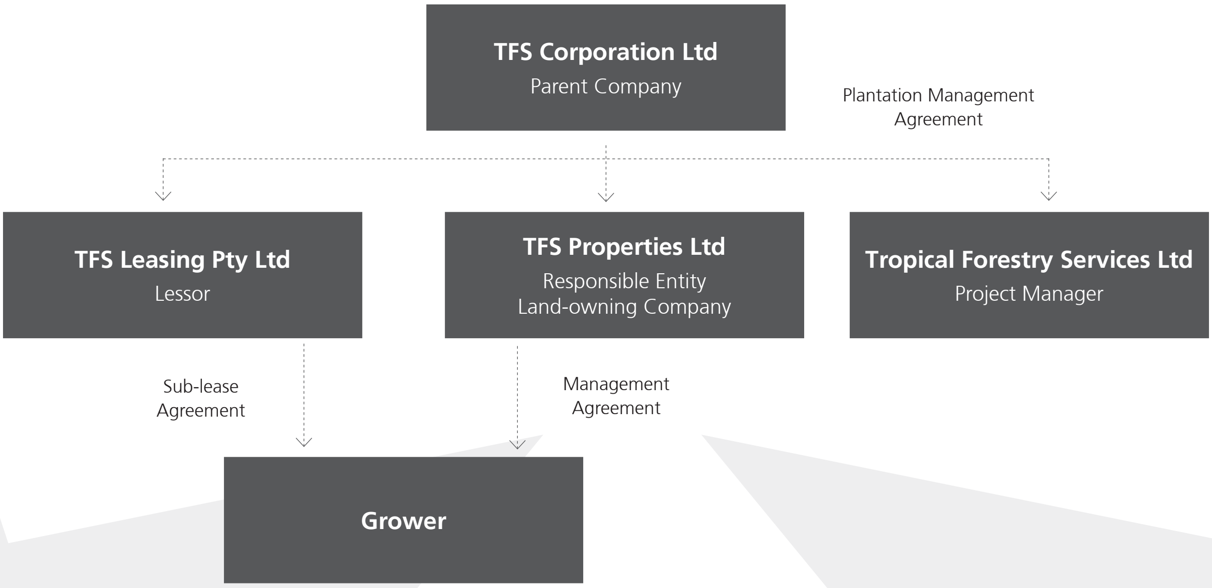
While investors' harvest proceeds are pooled, should any lots be damaged due to some unforeseen event these lots may be removed from the pool and the investors may not receive or will otherwise have a reduced entitlement to income from their investments. Insurance should help to protect investors from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

Given the high value of the sandalwood lots, it is expected that insurance will be a considerable cost over the Project term. Adviser Edge recommends that investors strongly consider the cost and benefits associated with insuring their lots.

Finance

Short term finance is available from Arwon Finance Pty Ltd to approved applicants. Interested investors should contact 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 Stock 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 2011.

TFS first established commercial plantations of Indian sandalwood on behalf of investors in 1999. Since then, TFS has grown considerably to become the largest provider of Indian sandalwood Managed Investment Schemes (MIS), now managing over 3,700ha on behalf of 3,000 individual growers and companies associated with TFS. TFS had a 30% share of the total MIS market in FY2010. While this represents a significant increase in market share due to a lack of active competitors, the actual amount raised decreased by 55% over FY2010, driven by difficult equity raising conditions and the failure of MIS companies across Australia. Over the past few years, TFS has begun to diversify its revenue streams, with a focus towards plantation management for institutional investors and the purchase of Mount Romance Australia, a sandalwood processor and essential oils producer.

TFS employs approximately 20 staff at its head office in Perth, as well as approximately 48 permanent employees and between 48 and 80 casual employees at its plantation operations in Kununurra.

In July 2008, TFS acquired Mount Romance Australia, a Western Australian sandalwood processor and essential oils business. This acquisition provides TFS with a sandalwood processing and distillation capability, and allows the company to defer capital expenditure on its planned Kununurra distillation plant. Mount Romance exports Australian sandalwood oil across the globe and has supply contracts with a number of leading industry participants. It is expected that the first commercial harvest of the Indian sandalwood will be transported to the Mount Romance facility in Albany.

Key Points

- TFS boasts a highly credentialed Board of Directors.
- TFS is in a sound financial position.
- TFS has recently increased its level of vertical integration through the acquisition of sandalwood processor, Mount Romance Australia.
- TFS has committed significant resources in the Ord River Irrigation Area.

In October 2009, TFS entered into a conditional sandalwood supply agreement with United States biotech company, ViroXis. The agreement provides for the supply of up to three tonnes of Indian sandalwood oil per annum, to be used for the development of a botanical drug, albuterpenoids to treat topical viral skin infection in adults and children. The supply agreement is conditional on ViroXis gaining regulatory approval for commercialisation of albuterpenoids. The agreement marked TFS' first commercial-scale contract within the pharmaceutical industry. While there have been no further announced developments over the past year, TFS recently advised that it had received advice from ViroXis that the human trial program was still on track.

On the 26th May 2010, TFS announced that it had entered into an Investment Management Agreement with a AAA rated US-based institution, pursuant to which TFS will manage 180ha of Indian sandalwood plantation, to be planted in FY2011. Under the deal TFS, secured an option to plant an additional 180ha p.a. for the five years to 2015, with this investment anticipated to be approximately $100 million if all options are exercised. On 6

December 2010, TFS announced that the AAA-rated US investor, which had settled its initial plantation investment of 182ha on 16 September 2010, had exercised its first option and will plant a further 182ha in FY2011. In addition, TFS recently advised that settlement has occurred with the Middle Eastern Sovereign Wealth Fund on 19 January 2011. This transaction consisted of $27 million in upfront fees, plus another $13 million to be received in annual fees, as well as conditional performance fees.

Board of Directors

The board of TFS consists of three independent directors and three executive directors. Although previously regarded as an independent director, Tim Croot is now considered to be an executive director following the provision of consultancy services to TFS' Kununurra operations in 2010.

While the board previously stipulated that it was to review its structure in order to meet the ASX Corporate Governance Principles and Recommendations, which state that the majority of the board should be comprised of independent directors, only half of the board is considered to be independent. Greater corporate governance could also be achieved through the appointment of an independent chairman, as Frank Wilson, the current chairman of the board, is also the Managing Director.

Corporate governance and compliance

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

The Compliance Committee is comprised of two external members, Chartered Accountant John O'Brien, and Robert Marusco, as well as one representative of the RE, Ronald Eacott, who is also the Chairman of the committee. In addition to this, TFS employs an external Compliance Officer, Roger Pratt, who monitors the compliance of the RE and then reports to the Compliance Committee on the its adherence to the Project's Constitution and Lease and Management Agreements. Roger Pratt is a director of management consulting firm Grosvenor Corporate Management.

Adviser Edge has reviewed corporate governance documents supplied by TFS, and believes that TFS has adopted acceptable corporate and financial management procedures.

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

Financial performance

The following table presents the key financial data for TFS for the financial years FY2009 and FY2010.

Key Financial Data* – As at 30 June		
Financial Profitability	2010	2009
Revenue ($m)	108.1	86.4
Net profit ($m)	37.1	34.8
Profit margin (%)	34.3	40.3
ROCE (%)	22.8	22.0
ROE (%)	19.0	25.8
Market Measures	2010	2009
EPS (basic/cents)	16.98	18.40
P/E ratio	4.9	6.4
DPS (cents)	4.75	4.0
Dividend yield (%)	5.7	3.6
Dividend payout ratio	0.28	0.23
Financial Liquidity/Solvency	2010	2009
Net working Capital ($m)	51.0	51.1
Current Ratio	1.75	2.04
Quick Ratio	1.57	1.81
Net debt to equity ratio	0.23	0.20
Interest Cover	15.7	16.8
NTA per Share ($)	0.77	0.60

Source: TFS Corporation Ltd, Annual Report 2010.
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.

The Managed Investment Scheme (MIS) industry has been under intense pressure, with the collapse of both Great Southern and Timbercorp drawing adverse publicity to the whole sector. In addition, the additional collapses of Forest Enterprises Australia, the Rewards Group and Willmott Forests have further undermined confidence in the sector. This, coupled with the onset of the Global Financial Crisis, has led to a fall in demand for all MIS products, with sales across the industry dropping by around 82% in FY2010. TFS accounted for some 30% of all MIS sales over FY2010.

Although TFS has begun to actively diversify its earnings, it is still partially reliant on MIS sales to generate revenue, although it has significantly grown its non-MIS institutional sales in FY2010. MIS sales in FY10 were 306ha, which is significantly lower than the previous year's result of 677.5ha and resulted in a 37% fall of MIS-related revenue. Assisting TFS in meeting its sales targets was 782ha worth of sales to non-MIS institutional investors , an increase of 144% on the previous year.

TFS has been actively reducing its revenue exposure to retail MIS sales by targeting non-MIS institutional sales to overseas investors. This provides greater diversification of TFS' sources of cash. It is also good to see institutional confidence in TFS' business. TFS will continue to be reliant on raising capital from this and other sources to meet its operating cash flow requirements.

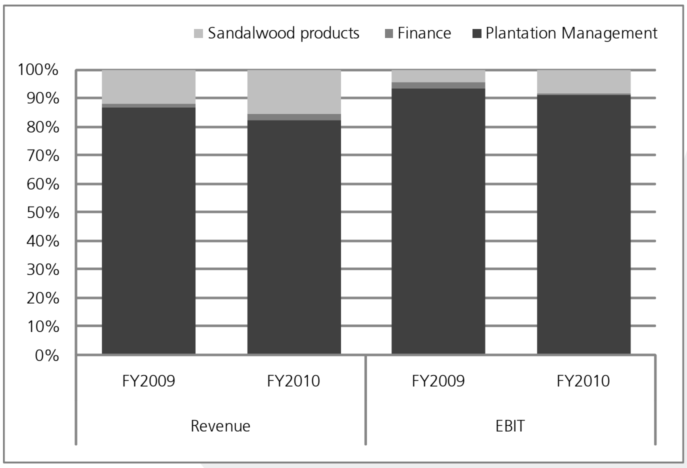
In spite of these lower MIS sales, TFS' overall net profit has grown by 6.5% to $37.1 million on the back of strong growth in sales revenue of around 25%. Part of this growth in sales is due to land sales executed by TFS, while the remainder of revenue growth can be attributed to the new non-MIS product offered by TFS (revenues growth of 144%), as well as the rebound in the Mount Romance Australia sandalwood and oil production business (revenue growth of 62%).

FY2010 produced the second year of sales of TFS' new product targeting institutional investors. This non-MIS product targets institutional investors looking to invest in the growing of trees, the trade of trees in the secondary market, and the sale of Indian sandalwood oil. This 'wholesale' product differs from the normal MIS product in that investors own both the land and the trees as opposed to just the trees, reducing the capital expenditure requirement of TFS in regards to land acquisition. With the successful planting of 782ha for institutional investors during FY2010, TFS saw a 123% increase in non-MIS institutional plantation sales.

FY2010 saw the further integration of Mount Romance Australia into the broader TFS Group. Mount Romance is a sandalwood processor and distributor. The purchase increases the company's level of vertical integration in the industry by diversifying its operations into the processing and distillation of sandalwood. Mount Romance exports Australian sandalwood oil across the globe and has supply contracts with many leading industry participants. It provides TFS with the capability to process its own Indian sandalwood plantations as the trees approach harvest in FY2012. Over the past few years, TFS has begun to diversify its business model to the point where traditional MIS sales represent 27% of total cash revenues. The remaining 73% of revenues is comprised of a combination of revenue at Mount Romance Australia (19%), the wholesale product, and recurring income from previous plantation project contracted management fees.

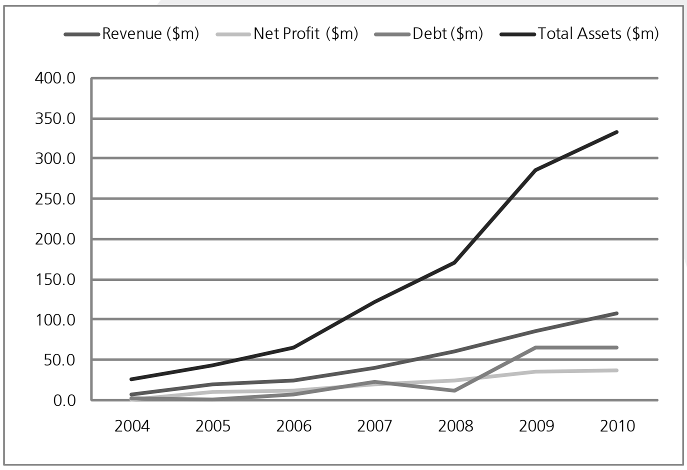
Operating cash flow was reported at -$25.1 million for FY2010 down from $16.2 million in FY2009. The operating cash flow result essentially reflects a temporary timing mismatch between when a sale to a wholesale investor is reported and when settlement and transfer of land titles occur. This temporary mismatch is expected to be resolved through the course of FY2011 as the subdivision of land at the Kingston Rest property is completed and title to portions of the Kingston Rest property are transferred to investors.

TFS segment breakdown (%)



In May 2009, TFS entered into a joint venture with the United Arab Emirates-based Emirates Investments Group (EIG). Subsequently, a jointly owned company, Gulf Natural Supply (GNS), has been established, with TFS owning 49%. Under the agreement, GNS will be granted the exclusive distribution of TFS and Mount Romance products into the Middle East, North Africa, and Pakistan. The key features of the deal include an agreement for TFS to supply up to 25% of its annual harvest, as well as a commitment from EIG to establish a minimum of 200ha of new sandalwood plantations in Australia annually at a cost equivalent to that of MIS projects. This will provide TFS with a secure level of cash flow as well as access to key markets. When fully executed, the joint venture will make TFS the world's largest producer, processor and distributor of Indian and Australian sandalwood oil.

TFS – Financial performance (2004–2010)



As the TFS-managed projects approach harvest, the liquidity risk associated with being reliant on ongoing MIS sales diminishes over time as cash flow from deferred fees is generated. TFS' first harvest is expected to occur around FY2014. However, it should be noted that TFS has dramatically increased its MIS sales since FY2006, with these younger plantations accounting for the majority of TFS' overall estate.

Accordingly, with such a large plantation estate to manage over a long period of time, it is important that TFS maintains a robust financial position to ensure that it has the financial resources to meet its ongoing obligations. TFS' financial position has been significantly improved through a recent capital raising of $37.9 million, of which $27.4 million was raised through an institutional placement, with another $10.5 million raised through a fully underwritten rights issue. The raised funds will be used to repay all current debt facilities, including the $20 million debt facility maturing on 30 April 2011, and $10 million of shareholders' loans. This leaves the company in a debt-free position with surplus funds to be used for business development and working capital, allowing the company to now focus on operational performance.

The new debt-free status of the company means there is renewed capacity for TFS to raise debt finance if, and when, required in the future. This is viewed positively by Adviser Edge.

Adviser Edge has reviewed TFS' financial performance and believes that the company is in a solid financial position. The diversification away from reliance on the retail MIS market to institutional investment provides added security to future cash flows. While operating cash flows throughout FY2010 were disappointing, this essentially reflects a temporary timing mismatch between when a sale to a wholesale investor is reported and when settlement and transfer of land titles occur. This temporary mismatch is expected to be resolved through the course of FY2011 as the subdivision of land at the Kingston Rest property is completed and title to portions of the Kingston Rest property are transferred to investors.

With the ability to further access debt and equity markets, improvements in income earned from its Mount Romance operation, and institutional MIS sales, TFS has the ability to manage its liquidity position over the Project term. Nonetheless, TFS will need to be adept in its financial management should there be a deterioration in any one of these sources. TFS has recently demonstrated this ability, with the recent capital raise providing evidence of this.

TFS Properties Ltd (Responsible Entity)

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

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

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

Responsible entity financial requirements – Consultation paper 140

ASIC has released a consultation paper proposing an amendment to the financial requirements of responsible entities. If these amendments are made policy (expected to be March 2011), responsible entities will be subject to a number of additional obligations. While these changes are not designed to prevent responsible entities from becoming insolvent, these changes are designed to limit the risk that a responsible entity becomes insolvent as a result of assuming liability for the debts of others and to provide some level of assurance that, if the responsible entity does fail, there is sufficient money available for the orderly transition to a new responsible entity or to wind up the scheme.

Adviser Edge is of the view that, while these changes will improve the financial position of responsible entities, it will not necessarily prevent the failures of some forestry MIS managers 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. Furthermore, for projects with ongoing fees, responsible entity solvency can be affected if a significant number of investors or, a single large investor, default on their obligations .

While the Project does have an ongoing fee structure option, there is still a risk around the deferred fee option and the effect on working capital requirements for the Project. Whilst 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, 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.

Tropical Forestry Services Ltd (Project Manager)

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

Key Operational Personnel – Tropical Forestry Services Ltd			
Key Personnel	Credentials	Industry	MIS
Frank Wilson – CEO/ Executive Chairman	★	★	★
Malcolm Baker – General Manager, Forestry Operations	★	★	★
Chris Done – Senior Forester	★	★	★
Glenn Taylor – Head of Plantations	★	★	★
Matt Barnes – Head of Development	★	★	★
Kirk Hutchinson – Head of Technical Services	★	★	★

Adviser Edge is confident of TFS' ability to manage the Project to the highest possible standard, which is demonstrated by the company's strong commitment to resourcing in the ORIA and the strength, both in size and quality, of the management team.

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 Expert		
Name	Company	Focus
Peter Kimber	Kimber Environmental Services	Sandalwood silviculture
Anantha Padmanabha	H.S Anantha Padmanabha	Market and pricing

Peter Kimber of Kimber Environmental Services (KES) has considerable experience in the development and management of plantation Indian sandalwood, having worked on trials in the species with the Western Australian Forests Department (now the Department of Conservation and Land Management (CALM)) during the 1980s. His knowledge has been instrumental in developing the complex silvicultural methods used in Indian sandalwood plantations. As the Principal Forestry Consultant to TFS since 2000, Mr Kimber has a first class honours degree in forestry and is a member of the Institute of Foresters, Australia.

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

- Indian sandalwood is a complex species to grow and requires a host species to thrive.
- The plantations will be irrigated with water sourced from Lake Argyle, a highly secure water source.
- TFS has been proactive in securing land for plantation development in the ORIA and has a significant land bank.

As part of its due diligence, Adviser Edge conducted a comprehensive inspection of the TFS-managed sandalwood projects located in the Ord River Irrigation Area (ORIA) on 11 and 12 October 2010. This inspection provided an opportunity to assess the growth in plantations since the previous inspection in 2009, meet with key operational and management personnel, and inspect the company's Kingston Rest property, which is being developed for institutional investors.

Over the course of the inspection, Adviser Edge met with all senior management personnel, plus orchard managers and R&D Project staff. Over the course of two days, Adviser Edge inspected all age classes managed by TFS. In addition to this, Adviser Edge was also able to make a comparison of TFS-managed plantations with other plantations being managed in the ORIA.

The overall impression gained from this inspection is that TFS continues to improve on its already high quality management standards. New plantation establishment was excellent and well in advance of peers. Survival rates were high across both sandalwood and host trees, and weed control across younger plantations was in line with what Adviser Edge considers to be industry best practice. Undoubtedly, TFS has become the benchmark for sandalwood silviculture and irrigation management.

In recent years TFS has instigated a policy of having plantation managers live on-site at the plantations. Having plantation managers and senior management living on the plantations appears to be highly beneficial, with personnel being more intimately attached to the plantations, enabling rapid response when any issues arise. The reliance on irrigation water makes this a very pertinent point.

In instances where small areas of recently established plantations were not meeting required standards, TFS had implemented remedial plans. For instance the infilling of pot hosts ensured that sandalwood trees were not stressed unnecessarily. This was in stark contrast to other plantations viewed in the ORIA, where in some instances large areas of recently-established sandalwood trees were under stress as a consequence of poorly timed or missing infilling programs. The ability to focus on quality at operational level is one benefit of having a healthy margin within the pricing structure of the investment.

There has been no material change to the mix of host species, reflecting the benefits to new investors of the knowledge TFS management has gained from over a decade of sandalwood plantation management in the ORIA.

TFS has progressed to being very outcomes-focused/evidence-based with regards to its research and development programs. Currently the R&D focus is in two key areas: host tree silviculture and destructive trials of aged sandalwood trees.

TFS' work is directed at gaining a better understanding of host tree silviculture, with reference to improving sandalwood growth. Examples include deep watering of sesbania, topping cassia for better light penetration, and sourcing better seed for rosewood trees. In addition to this, TFS has gained collaborative support from the Forest Products Commission (FPC) to undertake destructive sampling of mature sandalwood trees. TFS has also instigated the ongoing measurement of trees contained in permanent sample plots located throughout the plantations, which is helping the company to develop a workable growth curve for Indian sandalwood in the future.

This work will further advance the knowledge associated with heartwood and sandalwood oil yields. At the time of completing this report the outcomes of the testing being undertaken at TFS' Mount Romance facility were not known but will be reported if materially relevant.

In addition to the ORIA inspection, Adviser Edge also had an opportunity to visit and inspect the development works that have been completed or are underway on the TFS-owned Kingston Rest property, which is located approximately 60km north of Kunnunurra. The first plantations have been developed on behalf of two international investment houses, following more than a year of intensive infrastructure development. The plantations are comparable to any ORIA plantations regarding early growth, sandalwood survival and weed control.

Certainly, like the ORIA plantations, the use of drip irrigation has allowed TFS to deliver excellent early outcomes, which sets the trees up well for mid- and long-term growth.

In summary, investors should have the utmost confidence that TFS will manage their plantations to a very high standard. This does not take away from the risks associated with the Project, including growth rates or heartwood and the level of oil that can be extracted. However, it does reduce the likelihood that poor silvicultural management will affect outcomes. New investors definitely stand to benefit from the accumulated experience that TFS has gained over the last ten years. There is clear visual improvement in growth rates across age classes, which reflects TFS' increased knowledge and experience. Notwithstanding, TFS needs to continue towards the development of a quantitatively based yield curve for the species.

Region

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

At approximately 16°S latitude, the ORIA experiences a hot tropical climate with a wet season from November through to March, with approximately 94% of its 800mm average annual rainfall falling during this period. As the Project will be irrigated from the highly reliable Lake Argyle, annual rainfall levels are less relevant than for other regions.

The mean monthly minimum and maximum temperature ranges between 24°C and 39°C in the wet season, and 15°C to 39°C in the dry season. (BOM, 2009) Although vulnerable to tropical cyclones, the ORIA is a reasonable distance from the ocean, and most cyclones can be expected to have reduced in intensity by the time they reach Kununurra.

TFS established its first Indian sandalwood plantation in 1999 and currently manages approximately 3,700ha of plantations in the ORIA.

Species and varieties

The species to be grown in the Project is *Santalum album* (Indian Sandalwood), which is 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 throughout existing seed sources in the ORIA, with the majority of the provenances originating from the Western Australian Conservation and Land Management (CALM) plantations, which were established during the 1980s and 1990s, as well as from maturing TFS plantations. TFS has established its own seed orchards, which allow TFS to conduct provenance trials focused on identifying and bulking-up selected provenances with desired traits such as volume and heartwood and oil yield.

TFS has refined its host species mix over a number of years, with actual host tree performance in earlier Projects being a strong factor in the mix of hosts selected for the 2011 Project. Adviser Edge believes that an evidence-based approach is likely to deliver better sandalwood growth rates, and reiterates the view that production risks for 2011 growers are considerably reduced relative to previous projects.

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.

The sandalwood seedlings are planted in the same row and in close proximity to the short-term or pot host, Alternanthra nana. The short-term hosts are planted close to the Indian sandalwood seedlings to ensure that strong root associates are formed in the early stage of the plantation. The short-term hosts have served their purpose by the time the tree is around four years old, and the root volume of the Indian sandalwood tree will expand and form root associations with the long-term hosts after three to four years. The main medium-term host is Sesbania formosa (Sesbania), while Acacia trachycarpa may also be used. Indian sandalwood generally experiences a minor shock at three years of age as the sesbania host naturally dies off and the Indian sandalwood becomes more reliant on the long-term host, predominantly Cathormiom umbellatum (cathormiom), as well as Dalbergia latifolia (Indian rosewood) and Cassia siamea (cassia). However, once strong root associations are established with the long-term host, growth is expected to pick up again.

Cassias are considered to be good hosts, with minimal mortality. However, fairly vigorous growth means that they need to be pruned, beginning in the second year and up to four times over the rotation, to minimise competition with the Indian sandalwood tree.

TFS has made significant progress in host species selection and seed orchard capabilities. This is demonstrated by the improvement in the growth and uniformity of the TFS plantations over the years. It is expected that further significant advancement will occur as results from current research and development activities become available.

Site selection

TFS has a land bank of approximately 2,050ha available for planting. Much of this land is anticipated to be used for institutional sales, with the sites for the 2011 MIS Project likely to be located within the ORIA. Generally, sites are selected on

Cununurra Clay soils, which are free draining and with good moisture holding characteristics. Topography needs to be flat or slightly undulating to minimise the risk of water-logging and, where flood irrigation systems are used, to minimise the costs of plantation establishment.

Sourcing new land continues to be a challenge for TFS. However, the company has been proactive in seeking suitable sites, ensuring that the land selection criteria are not compromised in the search for new areas. TFS is currently investigating the suitability of Indian sandalwood to the Carlton Plain region, with detailed due diligence being conducted on 4,000ha of suitable land on the Carlton Hill property. However, it is unlikely that the 2011 Project will be located outside the Ivanhoe Plains.

Further bolstering its land bank, TFS announced in September 2010 that it had entered into a joint venture partnership with the Miriuwung Gajerrong (MG) Corporation, providing it with access to an additional 1,000ha in the ORIA. Of this, 400ha forms part of the new Ord Stage 2, with preferential selection on the remaining 600ha.

Adviser Edge is confident in TFS' ability to secure suitable land for the Project.

Site development program

Sites will be laser levelled and planting lines ripped to a depth of 0.5m to promote drainage across the plantation sites, and to eliminate the compacted soils created by previous agricultural activities. Laser levelling ensures that sites are adequately drained in a way that prevents erosion or water-logging issues. Deep ripping is considered to be especially important on blocks that have previously experienced high levels of compaction. This can occur after the use of harvesting machinery on wet soils, such as in sugar plantations, and may require amelioration. Following cultivation, mounding takes place with raised beds formed at approximately 1.8m intervals.

Planting is generally carried out in the coolest part of the year, between April and September, in order to minimise stress on the seedlings. The use of temporary drip irrigation extends the planting season, as water can be constantly applied and thus reduce stress on the seedlings.

The plantations are expected to grow rapidly in the first few years, with material differences in growth across the early plantings based on whether the trees were planted early or late in the planting season.

Site maintenance

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

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

One of the risks to Indian sandalwood plantations is attack by corellas, and ongoing vigilance of this pest is required. In addition, the native cathormiom host species is susceptible to pest attacks. Vines are also an issue, requiring manual labour for their removal.

The site development and ongoing management plans employed by TFS are comprehensive, and appear to be in line with industry best practice.

Irrigation

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.

Drip irrigation is used on sandier sites unsuitable for flood irrigation, and is also used to increase survival rates in young plantations. On sites that have been developed using drip irrigation, but are suitable for flood, TFS will revert to flood irrigation after five years in order to decrease irrigation costs and encourage root growth between rows. Drip irrigation is more expensive to develop and maintain, although there are significant advantages to the system. As the water is delivered directly to the Indian sandalwood and host species trees, the drip irrigation system makes it difficult for weeds to become established, particularly in the inter-row spaces. This reduces the costs associated with weed management, and better utilises water resources. The trickle system also provides a more efficient way of delivering water to the plantation, and eliminates water going onto unplanted access rows.

The plantation will be irrigated when soil moisture levels, which are measured using soil moisture probes and soil pits, reach a pre-determined low level. The irrigation water is supplied from Lake Argyle, a storage dam located 55km south of Kununurra.
The dam was constructed in the 1970s to provide a reliable

source of water for 70,000ha of farmland in the region. To date, 14,000ha have been developed under Ord Stage 1, with 8,000ha of land being developed under Ord Stage 2 and approval for a further 6,000ha also being progressed.

The irrigation source for the Project is considered to be highly reliable. The Project should benefit from a mix of drip irrigation, which enables strong early growth and high survival rates, and flood irrigation, which is expected to encourage early root association with long-term hosts.

Harvesting and processing

TFS expects to harvest the majority of trees at age 14 (FY2026), although up to 20% of the plantations may be harvested at age 13. TFS will determine the exact timing of the harvesting operations.

It is expected that trees will be harvested by the removal of the entire tree from the ground using mechanical equipment to maximise the recovery of the butt and large roots, which are expected to be of high value. As harvesting is not expected for a number of years, TFS has not yet finalised its harvesting procedures, although the company is currently investigating and testing various methods.

The acquisition of Mount Romance, one of the world's largest distillers of *Santalum spicatum* (Australian sandalwood), has provided TFS with significant intellectual property regarding harvesting and processing. TFS has commissioned an initial scoping study into the harvesting and processing of plantation-grown Indian sandalwood, which will be led by Mount Romance General Manager Peter Wilson. Investors in the Project are likely to benefit from the expected ten years' experience that will have been derived from TFS' commercial Indian sandalwood harvests in the region by 2025.

Adviser Edge is of the view that the addition of Mount Romance to TFS' corporate structure will increase its capacity to develop appropriate harvesting and processing infrastructure for the Indian sandalwood produced as part of the Project.

Market Overview	
Product type	Indian sandalwood heartwood
Primary use	Fragrance oil, mouth fresheners, incense, natural medicine, carvings and pharmaceuticals
Key target market	France, Taiwan, Hong Kong, India, USA, UK and China
Major competitors	India, East Timor, Indonesia
Product sales agreements	Not in place for this Project

Key Points

- The sandalwood produced under the Project is likely to be sold by Mount Romance to a number of newly-developed markets for the product.
- It is difficult to obtain accurate information on the sandalwood industry, meaning that future prices are difficult to estimate.
- Although India is the largest sandalwood producer, native stocks and production under government control continue to decline.
- Australia is expected to become the largest sandalwood producer in the world once early managed investment scheme plantations reach maturity between 2015 and 2020.

Marketing strategy

TFS anticipates that the timber produced from the Project will be sold as cleaned heartwood logs at the farm gate. The sale of the logs will be overseen by the Project Compliance Committee.

The integration of Mount Romance Australia, a specialist Australian native sandalwood processor and distributor, has made TFS a fully vertically integrated sandalwood producer, processor and marketer. Mount Romance provides TFS with an established sales network, strong customer relationships, and intellectual property relating to the processing and distillation of native sandalwood. Mount Romance has over 10 years' experience in the manufacture of Australian sandalwood oil, and supplies pure sandalwood oil to many of the major fragrance houses in the world, including Christian Dior and Estée Lauder. This experience is expected to be invaluable when TFS' Indian sandalwood plantations are ready to be harvested and its product marketed.

TFS has entered into a conditional sandalwood supply agreement with United States biotech company, ViroXis, for the supply of up to three tonnes of Indian sandalwood oil per annum, to be used for the development of the botanical drug albuterpenoids, for skin conditions. The agreement marked TFS' first commercial-scale contract within the pharmaceutical industry. ViroXis is also developing similar products for the retail market, and is hopeful of a product launch by the end of 2011. TFS also holds supply agreements with French essential oils company Albert Veille, and international soaps and cosmetic company Lush Ltd.

TFS has been active in pursuing both new and existing markets for the potential supply of plantation-grown Indian sandalwood. The acquisition of Mount Romance places TFS in a strong position to develop markets for the Indian sandalwood that will be produced from this Project and other projects on behalf of investors.

Product analysis

Indian sandalwood is a fragrant wood that is highly valued for its oil content, sourced from the heartwood of the tree. While the majority of the wood is sold for the extraction of this oil, some is also utilised for carving purposes. Being relatively versatile, sandalwood is utilised in a number of industries and in a range of products. The most common use for sandalwood oil is in the fragrance industry, with the mouth freshener industry (i.e. chewing tobacco) recently becoming a source of demand. Other uses include woodcarving, as an incense constituent, an additive in soaps and toiletries, and as an important ingredient in Indian and Chinese natural medicines. The pharmaceutical industry has also recently shown interest in the use of sandalwood oil.

While there are several different species of sandalwood, Indian sandalwood is the most prized in terms of oil quality and fragrance value. There is only one other species of sandalwood that is comparable in terms of oil and yield characteristics, which is *Santalum yasi*, a tree native to Fiji.

Market overview

Globally, India dominates the supply of sandalwood, accounting for around 95% of global production, nearly all of which is sourced from native stands. Due to the high value of the wood, much of the Indian sandalwood harvested in India is done so illegally, with a much smaller proportion harvested officially. As a result of the high level of wood illegally harvested, the Indian government has reduced its official annual harvest from around 5,000 tonnes in the 1970s to a level of only 400 tonnes in 2009, in an attempt to promote sustainability. Sandalwood is now considered an endangered species in India. While it is difficult to determine, the total annual Indian harvest (legal and illegal) is estimated at around 2,000 tonnes.

Although India has traditionally dominated the global sandalwood market in terms of exports, the restricted domestic production, coupled with increasing local demand, has reduced the level of sandalwood oil and timber available for export, with the government imposing a varying annual export quota. This has also been an issue for the other significant sandalwood producer, Indonesia (2%–3% of global production), which is tackling issues of over-exploitation with a similar approach.

As well as India and Indonesia, sandalwood also occurs naturally in Australia, with Australian sandalwood native to Western Australia

(*Santalum spicatum*), and Queensland (*Santalum lanceolatum*). The sustainable harvest of these native stands (mainly *Santalum spicatum*) has allowed Australia to supply around 40% of world sandalwood exports. (ABARE, 2009) While Australian sandalwood is considered to be an inferior substitute for Indian sandalwood, the depressed supply out of India and Indonesia has meant that merchants have been compelled to source this species, among others, to satisfy their requirements.

The United States, the United Kingdom and Europe are considered to be the largest markets for sandalwood oil, with large fragrance and perfumery companies accounting for the majority of this volume. The United States is the biggest market for sandalwood oil outside India. Demand from Asia has increased in recent years, with China emerging as a major market for sandalwood oil and other products since sandalwood imports were legalised in 1999.

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 aromatic characteristics, it attracts a premium heartwood and final oil price.

The establishment of Indian sandalwood plantations in Australia has been significant in recent years, with over 5,000ha of plantations established since 1997. The majority of these plantations have been established under managed investment schemes (MIS), and are located in the ORIA region of Western Australia, with a small proportion located in far north Queensland. As these plantations approach maturity, it is anticipated that the Australian industry will account for a substantial share of global production, with a large proportion to be exported.

Market outlook

With the Indian and Indonesian governments expected to further restrict or at least maintain the annual harvest quota of native Indian sandalwood stands, it is likely that the imbalance between supply and demand currently present in the market will be exacerbated, possibly leading to further price increases. Although plantation development is being encouraged in these countries, a lack of resources and political issues are likely to limit private forestry development.

With the value of sandalwood oil being increasingly recognised, the number of industries that utilise sandalwood products continues to grow, boosting the level of demand for sandalwood. This, coupled with restricted supply, is cause for a relatively positive outlook.

The availability and price of substitute products will also play a role in determining market conditions into the future. As a result of demand outstripping the supply of Indian sandalwood, many buyers have sourced heartwood from other sandalwood species to fulfil their requirements. The possibility of synthetic substitutes could also play a role in determining future demand, although suitable synthetic substitutes have not been developed to date.

Australia's Indian sandalwood estate will begin to be harvested around 2013, with Australia forecast to become one of the world's largest producers and exporters of Indian sandalwood heartwood and oil by 2022. It is anticipated that the 2025 heartwood harvest could be more than 12,000 tonnes of heartwood, providing a potential yield of almost 400 tonnes of sandalwood oil. Global demand is currently estimated at around 8,000 tonnes per annum. However, due to the lower oil content of plantation grown sandalwood at 15 years of age, the global demand could be as high as 13,000 tonnes per annum. (Padmanabha, 2010)

Mitigating the impact of the expected increase in global supply of Indian sandalwood are the expected continuation of Indian government export quotas, the increase in global economic growth, the development of new products that use sandalwood oil, and an increase in demand from existing users as a result of the expected increased, and more consistent, supply of sandalwood oil.

The export quotas imposed by the Indian government are also likely to be maintained in order to secure all Indian production for the local market. This will free up many lucrative export markets for the growing Indian sandalwood industry in Australia, and the fact that India's sandalwood market will probably require imports to make up the supply imbalance will also provide an opportunity.

The fact that native Australian sandalwood has been exported from Australia for several years will be of benefit to the domestic Indian sandalwood industry as plantations approach maturity. The product development expertise obtained from the Australian sandalwood industry will be of great assistance in the development of value-added products and export markets.

The versatile properties of sandalwood oil are becoming increasingly known, with sandalwood oil recently being recognised as a valuable constituent in the pharmaceutical industry. In October 2009, ViroXis Corporation in the United States signed a conditional contract with TFS Ltd for the supply of sandalwood for development of the drug albuterpenoids, a treatment for viral skin infections in humans. ViroXis cited the history of human use in natural medicines and the oil's good safety profile as benefits of the product. The drug is yet to be approved by the Food and Drug Administration (USA), but if approved and subsequently recognised as being beneficial, demand for the oil will most likely increase in the long-term.

Based on information provided by TFS about its activities in the development of new markets for use in end products, particularly in the pharmaceutical market, it is likely that there will be a significant expansion in the market for Indian sandalwood oil in the long term.

Although the outlook for Indian sandalwood markets is relatively positive, Adviser Edge believes that sandalwood companies, particularly TFS, must continue to explore and develop markets to help mitigate any potential downward price pressure that may occur in the future due to increased supply of heartwood from maturing plantations.

Adviser Edge Returns Modelling				
	Annual Investment Option		Annual Deferred Investment Option[3]	
	Pre-Tax	Post-Tax[2]	Pre-Tax	Post-Tax[2]
Adviser Edge Base Case[1]	10.57%	10.57%	12.06%	12.06%
IRR Range[2]	3.60% – 14.15%	3.60% – 14.15%	6.40% – 15.25%	6.40% – 15.25%
Median Return	9.40%	9.40%	11.15%	11.15%
Percentage of results that are break even or better	89.23%	89.23%	94.45%	94.45%
Percentage of results with an IRR of 10% or better	46.19%	46.19%	59.06%	59.06%

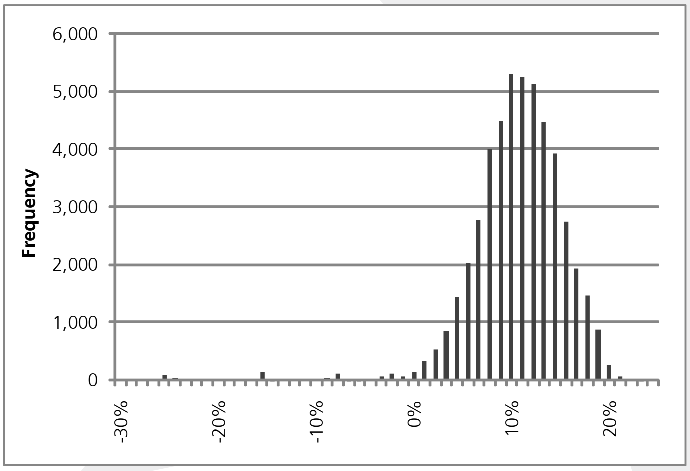
[1] The IRR range represents the range of results that occur within the 20th and 80th percentile in the simulated model. The range is based on Adviser Edge's modelling of potential outcomes for the Project using Monte Carlo simulations. These are subject to a number of limitations, which are discussed 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.

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.

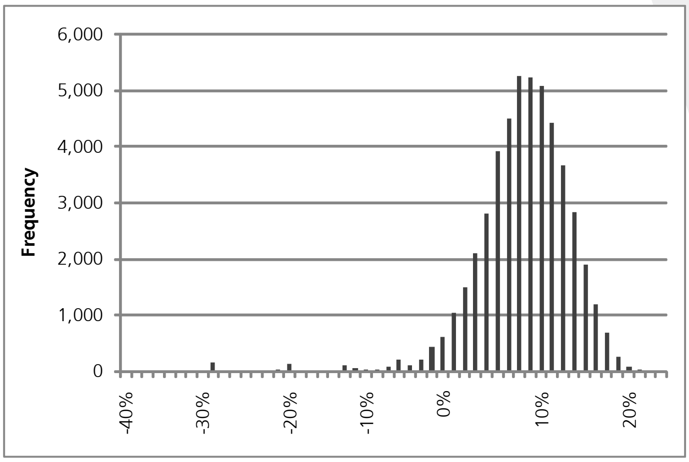
Returns modelling undertaken by Adviser Edge suggests that the annual deferred investment option provides a higher median return of 12.06% before tax when compared to the annual investment option's median return of 10.57% before tax. This is due to the higher net present value of fees paid under the annual investment option, as discussed in the Fee Analysis section of this report. However, investors should consider personal circumstances when determining the most suitable investment option. The Monte Carlo analysis demonstrates an estimated returns range of -100% to 28.65% for the annual deferred investment option, with 60% of values returns falling between 6.40% and 15.25%.

This wide returns range is largely caused by the modelling of the potential impact of manager insolvency or a natural disaster event. Ignoring the risk of manager insolvency or a natural disaster increases the median return to 9.75% before tax for the annual investment option, and 11.35% for the annual deferred investment option. This reflects the skewed nature of modelled returns when such an event is included, and is caused by the low probability of an insolvency or natural disaster event occurring, but the high impact associated with such an event. The following graph illustrates the distribution of returns that resulted from Adviser Edge's analysis.

Pre-tax investor returns (Annual Deferred Investment Opt.)



Pre-tax investor returns (Annual Investment Option)



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

Key Investment Analysis Performance Assumptions

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

Yield

Performance Assumptions	TFS	Adviser Edge
Age at harvest	14	14
Heartwood yield – age 14 (kg/tree)	27.5kg	25.5
Sandalwood survival rate	83%	80%
Heartwood oil content	3.15%	2.50%

TFS has indicated in the PDS that it intends to harvest the sandalwood plantations at age 14 (FY2026). However, TFS has also indicated that up to 20% of the plantations may be harvested at age 13 (FY2025).

TFS has forecast heartwood yields per tree of 25kg, 27.5kg and 30kg at ages 13, 14 and 15 respectively. Based on a forecast survival rate of 83% through until harvest, and an initial planting density of 505 sandalwood trees per hectare, this results in a forecast yield of 11,527kg/ha of heartwood, assuming that 100% of the plantations are harvested at age 14.

TFS has indicated that it may harvest a portion of the plantations (no more than 20%) at age 13. This will enable the testing of oil yields, and will also allow adaptation of management techniques prior to harvest in order to increase oil yields if required. This may include inducing stress on the sandalwood trees, which anecdotally may then promote heartwood formation and oil production. Based on TFS' harvest estimates, harvesting 20% of trees at age 13, and the remainder at age 14, would result in a yield of 11,316kg/ha of heartwood.

Yield estimates provided by TFS have been based largely on data derived from a plantation in the ORIA belonging to the Western Australian Forest Product Commission (FPC). This plantation has been used as these are the only trees of a suitable harvesting age that are available for analysis. Heartwood development has been found to occur in plantation-grown trees in the ORIA from age five onwards. TFS believes that the yield estimates may be conservative due to the relatively poor soils on which the FPC plantation is located compared to the Cununurra Clays on which the TFS trees are planted.

Based on the knowledge that sapwood is converted to heartwood when it is five years old, the heartwood core of a 10-year-old tree is expected to be the same diameter as the whole tree was at age five. The Independent Expert has stated that, based on an expected basal area of 16cm at age 14, it can be expected that the bole will contain 22.6kg of heartwood, with a further 20% of marketable heartwood in the butt and roots of the tree, giving an estimated 27kg of heartwood in the average 14-year-old tree.

TFS anticipates that the heartwood will achieve an average sandalwood oil content of 3.15%. This estimate is based on data derived from an analysis of the 14-year-old experimental FPC plantation, where it was found that this was the average oil content. While this oil yield is considered to be commercially viable, further testing will be conducted on older trees at TFS' Mount Romance facility to verify these estimates.

Further strengthening the oil yield assumptions is the recent announcement of the outcome of a trial conducted by the Forest Products Commission in conjunction with TFS. Ninety trees from four FPC trial plots within the ORIA were harvested in August 2010, and were subject to an extensive investigation into heartwood and sandalwood oil yield. The results of the trial showed that the mean oil yield per tree was 1.2kg, which represents a mean oil yield of 4.9% based on a mean heartwood yield of 25kg per tree. This is significantly higher than TFS' assumption of 3.15% for modelling purposes, which is based on a previous FPC trial. Although these results are preliminary and are subject to an independent audit, they are considered to be statistically relevant and a good indicator of final results.

The results of the most recent FPC trial provide quantitative and statistically relevant data supporting heartwood and oil yield assumptions for plantation grown Indian sandalwood. However, the harvested trees upon which the trial was based are significantly older than the trees will be at TFS' expected plantation harvest date (15 years old), which may result in oil yields which are lower than the 4.9% achieved for the older FPC trees. The FPC trial results increase the probability that TFS can achieve its stated aim to produce an average oil yield of 3.15% at age 15.

Adviser Edge has adopted a slightly conservative heartwood yield per tree compared to TFS. Based on the results of the two trial harvests in the ORIA, Adviser Edge has assumed a heartwood yield of approximately 25.5kg per tree at age 14, with a survival rate through until harvest of 80%.

While TFS has demonstrated considerable improvement in the silviculture of Indian sandalwood, including significant improvements in sandalwood survival rates, there is still limited information available to verify heartwood yields across large plantations. Current yield estimates are based on samples of individual trees, and it is yet to be demonstrated that these yields can be achieved with the estimated stocking rates at harvest. As a result, Adviser Edge has applied a degree of conservatism when assessing potential investor returns.

TFS has demonstrated an ability to grow Indian sandalwood and achieve high survival rates. However, there remains a degree of uncertainty associated with forecasting heartwood yields, and as a result Adviser Edge has adopted a conservative heartwood yield for investment modelling purposes.

Past performance

TFS established its first Indian sandalwood plantation in 1999, and has since planted over 3,500ha. The trees planted in 1999 are forecast to be harvested in 2013.

In June/July 2007, TFS harvested 17 trees from its oldest plantation, Stockroute; at this time the trees were eight years old. The trial harvest indicated that heartwood production had initiated in all of the sampled trees, with a range of between 3.52kg and 32.8kg of heartwood produced per tree, and an average of 12.85kg. Detectable traces of oil were present in 15 of the sampled trees, with two of the trees yet to develop oil. Interestingly, these two trees had some of the highest heartwood yields. Oil yields ranged from 0% to 2.84%, with an average yield of 0.68%, which was encouraging given the age of the plantations.

TFS has not conducted any further destructive sampling of trees since 2007. However, TFS is currently developing non-invasive measurement tools that will allow a significantly large sample group to be measured and analysed. It will be important to continue actively sampling heartwood and oil yields, in order to determine the appropriate silvicultural regimes to maximise the saleable heartwood and oil content.

TFS has provided Adviser Edge with survival counts for past plantations. Survival counts are initially conducted once the trees are one year old. TFS has consistently improved survival rates since establishing its first plantations in 1999. Survival counts for early plantation years were as low as 25%, although this has improved dramatically for later plantations, where survival counts are up around 80% to 90%. It should be noted that, while the survival counts for early plantations are low, they are considered to be favourable when compared to other sandalwood managers in the region.

In addition to this, while yields on early projects are expected to be below initial forecast, it is expected that prices will exceed original forecasts, with TFS expecting these early projects to meet targets.

While it is difficult to fully assess the past performance of TFS due to the age of the plantations, it is clear that the company remains the leading manager of plantation Indian sandalwood in Australia.

Price

Performance Assumption	TFS	Adviser Edge
Farm-gate heartwood price ($/kg)	A$68/kg	A$40.12/kg
Sandalwood price inflation	3.03%	2.9%
Estimated harvesting cost ($/ha)	A$16,000/ha	A$16,000/ha
Cost inflation	3.03%	2.9%

TFS has estimated a farm-gate price of approximately A$68/kg for cleaned heartwood logs. This price estimate is based on the Indian auction price of over $100,000 per tonne of heartwood. In order to account for the difference in oil content between wild sandalwood and plantation sandalwood, the price estimate assumes an average oil content of 5% for the wild-grown heartwood sold at auction and 3.15% for the plantation-grown heartwood, and accounts for the INR/AUD exchange rate.

The market for Indian sandalwood has limited transparency, due to its size and the level of illegal trade. As a result, it is difficult to determine an accurate current price level at which large volumes of native Indian sandalwood are trading. The British publication *The Public Ledger*, which provides frequent coverage of the Indian sandalwood oil market, reports that the price for premium Indian sandalwood oil has ranged between US$1,700/kg and US$2,000/kg over the course of 2010.

The Independent Expert, Anantha Padmanabha, states in his Expert Sandalwood Marketing Report, that prices in the regulated Indian market are lower than the prices achieved in the international market, which are currently trading at an average of A$125,000 per tonne of heartwood, and around A$2,500/kg of Indian sandalwood oil.

It is expected that the price for plantation grown Indian sandalwood heartwood will be lower than that grown in the wild, due to an expected lower oil content. The oil content is expected to be lower for plantation grown heartwood due to the young age of the tree at harvest, 14 years, compared to the average age of wild grown Indian sandalwood sold at auction of 50 to 60 years. The average oil content for Indian sandalwood sold at auction in India is estimated at between 4.0% and 5.5%.

A significant determinant of the price of the Indian sandalwood is the quantity of heartwood oil. The opaque nature and size of the sandalwood market makes it difficult to estimate prices. While Adviser Edge has used more conservative price estimates in assessing potential returns from the Project, TFS has provided a range of information which supports strength in sandalwood demand in the future, despite the expected supply increases.

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.

As previously stated, there is limited information regarding sales prices of large volumes of Indian sandalwood oil, due to the opaque nature of the market. In addition to this, it is unclear whether plantation-grown Indian sandalwood will sell at a discount or a premium to native oil. Adviser Edge has adopted a base price of US$1,500kg of Indian sandalwood oil, and assessed a large range of prices in the returns modelling process. While this price is lower than prices currently being reported, Adviser Edge believes that a level of conservatism needs to be applied. Based on current plantings, forecast heartwood volumes and forecast extraction rates, Adviser Edge believes that when the Project is harvested, supply from Indian sandalwood plantations in Australia may exceed the current estimated global oil supply by up to two times. While current global oil supply is expected to significantly increase by the time that the Project is harvested, it is also expected that the market for Indian sandalwood will expand with new sources of demand. This is demonstrated by the supply agreements entered into by TFS, as well as the developments in the pharmaceutical industry, a relatively new market for Indian sandalwood oil.

In addition to this, given the forecast market dominance of Australian plantation-grown Indian sandalwood, there is expected to be an inverse relationship between yield and price. If yields fall below forecasts, it is expected that the sandalwood oil price would increase commensurately.

While there continues to be a risk to the potential supply/demand dynamics at harvest, Adviser Edge believes that it is prudent to use more conservative price assumptions when assessing potential returns from the Project.

A base farm-gate price of A$40.12/kg for cleaned heartwood logs has been estimated by Adviser Edge. This is based on an oil price of US$1,500/kg, a forecast long-term USD/AUD exchange rate of 0.82, and a heartwood oil content of 2.50%. The estimated price also accounts for the relevant processing and transportation costs.

Given the limited data surrounding oil yields for plantation-grown Indian sandalwood, Adviser Edge has adopted a conservative oil yield of 2.50%. The 14-year old trees were grown under various silvicultural regimes, and were grown on supposedly poorer soils than those to be used for the Project. While it is believed that increased heartwood volumes will be achieved under the current regime, it is not known how improved growing conditions, and therefore reduced stress on the sandalwood tree, will affect oil yields. This is an area in which knowledge is expected to greatly improve over the next five years, as TFS' early plantations mature and begin to be harvested.

Adviser Edge has assumed zero real price inflation for the sandalwood oil. While price of Indian sandalwood oil has experienced significant appreciation over the past 20 years, this sort of appreciation is not expected to be sustainable, and increased supply from plantation-grown Indian sandalwood should counter a decrease in supply from native stands.

While the market fundamentals for Indian sandalwood appear to be strong, the Indian sandalwood market is notoriously opaque and price information is significantly limited. In addition to this, the relatively small size of the market means that the Indian sandalwood price could become volatile when new supplies become available to the market. Accordingly, Adviser Edge has used a lower price assumption, which is based on a more conservative oil yield. In addition to this, a zero nominal price increase assumption has also been used. Adviser Edge has incorporated a relatively large variation in Indian sandalwood prices when determining an indicative IRR returns range.

Harvesting costs

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

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

Other assumptions

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

In assessing the likelihood of an insolvency event, Adviser Edge has taken into account TFS Limited's balance sheet, its ability to generate future cash flow, and its access to capital. TFS is in a sound financial position with very low net debt levels, but has a reasonably high reliance on investment capital raisings for future cash flows. As such, Adviser Edge has applied a relatively low default rate in its investment modelling.

The Project is structured in such a way that, in the event of the insolvency of the Responsible Entity, it is possible that a replacement RE will be appointed, given the incorporation of an annual fee. However, given the heavy reliance on the experience of TFS in the sandalwood industry, any insolvency is expected to have a significant negative impact on Project outcomes.
The impact of an insolvency event diminishes where the insolvency event occurs at a later stage in the Project's term, due to the increased value of the Project resource (the standing trees).

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

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

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

Sensitivities

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

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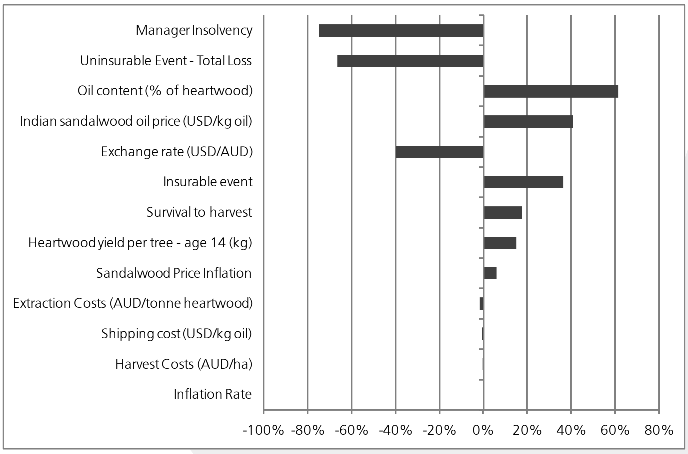
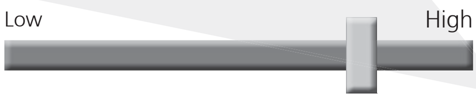
IRR sensitivity



Project returns are highly sensitive to heartwood oil yields, which are expected to significantly impact 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, which impacts 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 a manager insolvency event and fluctuations in the prevailing AUD/USD exchange rate.
As previously discussed, while the likelihood of an insolvency event is low, the potential consequences are considered high.

Yield

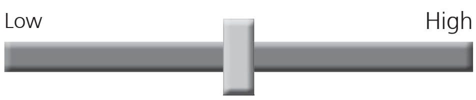


Yield risk is considered to be high, due to a number of factors. The complexity of the silvicultural regime means that there is a risk surrounding survival rates. In addition to this, the Australian industry is in its infancy, and there is yet to be a commercial harvest of plantation-grown Indian sandalwood in Australia. There is a risk that the plantations will not achieve the anticipated heartwood or oil yields.

Price

There are two main risks associated with the price estimates used to model Project returns. Firstly, the opaque nature of the Indian sandalwood market makes it difficult to get an accurate understanding of current prices for wild-grown Indian sandalwood sold in large volumes. Secondly, it is not known at what discount, if any, plantation grown sandalwood will sell compared to native sandalwood.

Costs

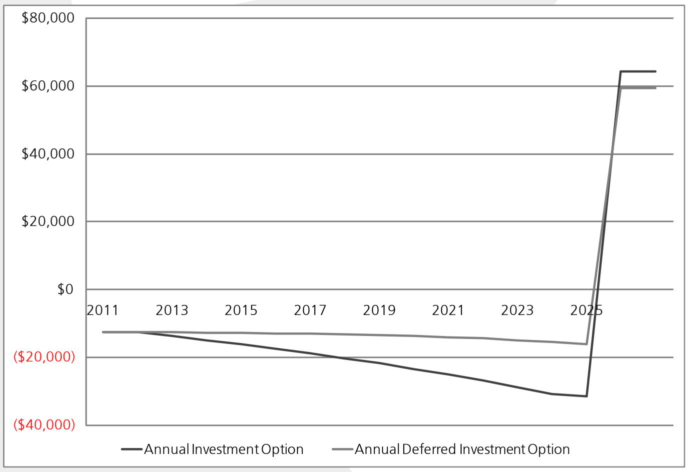


Investors in the Project are directly exposed to the costs associated with harvesting the sandalwood. While there is limited information to support the estimated cost of harvesting and extraction, given the relatively low cost compared to the high value of the commodity, the variances in harvesting costs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

Pre-tax Cash Flow per Unit

The TFS Sandalwood Project 2011 aims to generate investor returns through the establishment, growth and sale of Indian sandalwood heartwood. The Project has a target term of 14 years from establishment, after which time the final harvest should occur. A preliminary harvest may occur in Project year 13, at which time up to 20% of the plantation may be harvested. However, TFS intends to harvest 100% at age 14, and Adviser Edge has adopted this figure for modelling purposes. An indicative cumulative pre-tax cash flow for the different fee options is presented in the following chart. These cash flows have been calculated using the performance assumptions adopted by Adviser Edge, as previously discussed.

Cumulative pre-tax cash flow per unit



Post-Tax Potential

The post-tax returns earned by an investor will depend on the investor's marginal tax rate when harvest returns are received. The post-tax IRR range provided by Adviser Edge assumes that the investor maintains the same marginal tax rate of 46.5% throughout the investment term.

However, it is likely that an investor's tax status will change over the life of the Project. A change in tax status may result from a change in circumstance for the investor, or a change in tax policy administered by the Australian government. It is important that investors are aware of how these changes may affect the Project's post-tax performance.

Adviser Edge recommends that investors consult with qualified specialists who understand how changes to an investor's tax status may affect investment returns.

Investors in the TFS Indian Sandalwood Project 2011 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.

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

Should the Project be wound up for any reason, it is expected that consideration for the interests will be subject to significant discounts due to the relative risk associated with the time to maturity and the ongoing costs of management. However, the establishment of a secondary market for interests in TFS sandalwood Projects mitigates the risk of interests being sold at a loss.

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

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

Site and silvicultural risks

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

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, and the company's land bank, 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 can also affect growth rates through competition for water and nutrients, or can act as a vector to unwanted insects or diseases. TFS will monitor the plantations through frequent site visits, and will implement immediate treatments if weed invasion or pest damage exceed predetermined levels.

Infrastructure

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

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.

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.

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 macro-economic 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.

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.

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