



Growing & Harvesting Machine Ready To Roll

TFC stands for Tropical Forestry Services. It was founded in 1997 and listed on ASX in December 2004, code 'TFC'. The company has steadily garnered over 30 years of forestry knowledge and skills to create, manage and partly own the largest area of Indian Sandalwood plantations in the world.

TFC is vertically integrated, from nurseries, planting and maintenance to managing cropping and processing timber into Sandalwood oil. This is guided by extensive in-house research and conservative financing from internal, Managed Investment Schemes (MIS) and large global investors.

Sandalwood is special: Valued for its fragrance, medicinal and spiritual uses for millennia, Indian Sandalwood sources are rapidly diminishing. Alternative sources are few and inferior. The Western Australian government initiated some planting in the Ord River Irrigation Area about 1982. Since 1999 this has been progressively developed and extended by TFC with significant improvements in genetics, survival and yield. Planted areas have risen five-fold, to over 6,500ha. The acquisition and improvement of a processing facility has given TFC full control of quality oil production.

TFC survived the demise of several timber companies from other MIS schemes that did not deliver value to Growers. It was (and will continue to be) underpinned by the rising price of Sandalwood in contrast to pulp prices, but it also ensured that each scheme's sales funded their planting and growth, while funding its own growth conservatively from capital raisings. Post the MIS collapse, TFC paid off debt with new capital and sought wholesale funding globally — a success that now provides strong growth despite TFC also rebuilding its name in MIS based on strong investment fundamentals.

TFC has expanded its plantation footing from WA into NT and Queensland. It is now preparing for its first harvest, in the last quarter of 2013. We expect this to confirm its research findings as to yield, quality and costs. If sale prices of the oil achieve the prices TFC expects, its FY14 profits should swell and MIS Growers will be well rewarded. That should set TFC up for continuing strong growth and yield in the years ahead as it builds and harvests its own plantations and adds even more value to those it manages for its many MIS and its international wholesale investor clients globally.

Action: Buy for Growth; has Risk

Website: www.tfsltd.com.au

ASX code:	TFC
Closing Price, 26/3/13	\$ 0.545
Market Capitalisation:	\$ 152 million
52 Week High:	\$ 0.62
52 Week Low:	\$ 0.32
Sector:	Forest Products
S&P/ASX Index:	All Ordinaries Index
Quoted Shares on Issue:	279.62 million
First Listed (at 20 cents) :	4 December 2004

Summary of Fundamentals

Year-end June	FY11A	1H12A	FY12A	1H13A
EBIT	42.25	15.00	43.06	13.06
NPAT, \$m	20.17	5.96	25.88	4.82
EPS, ¢	8.33	2.15	9.26	1.72
P/E Ratio, x	6.54	12.67	5.89	15.84
Dividend, ¢	3.5	-	-	-
Yield, %	5.8%	-	-	-
Franking	100%	-	-	-

Share Price Chart — From IPO to 26 March 2013



Directors

Chairman & CEO	Frank Wilson
Non-Executive Directors:	
Ronald Eacott	Adam Gilchrist
Julius Matthys	Stephen Atkinson



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Overview — of Scale, of Sandalwood and of TFC

Scale of Activities and some Key Figures

Plantation sizes are given in hectares (ha). One hundred ha = one square kilometre; One acre = 0.4047 ha.

TFC's operations now cover over 6,500 ha. Of these, TFC owns directly 641 ha; its Managed Investment Scheme ('MIS') investors own 3,316 ha of which TFC has an indirect interest in 708 ha due to having partially financed certain Growers' investment obligations; wholesale investors, typically global institutions, hold 2,554 ha (900 ha yet to settle).

MIS 'Growers' can buy one or more lots of land, each being one unit of the trust. TFC's MIS lots have mostly been 1/6 ha, some 1/2 ha or 1/10 ha, recently 1/12 ha.

TFC has some 5,000 shareholders. Its MIS schemes (16 operating and one now being launched) have some 4,000 investors. The first was established in 1999. TFC also has a number of wholesale investors, who invested in 2,554 ha of plantations from 2009 to 2012. MIS investors took up interests in some 1186 ha in those four years. Directors of TFC have interests in 196 ha.

TFC plants Indian Sandalwood (*Santalum album*) trees regularly in rows, with 'host' trees taking alternate rows and spaces between the Sandalwood trees, which hemi-parasitically latch onto and derive nutrients through the hosts.

TFC is currently planting Indian Sandalwood at an average 500 trees per ha ('sph'). This stocking density can fall towards 420 with insect attack or disease as time progresses. In earlier years, planting was less dense and failure was more common, leaving the MIS projects with averages from 165 to 499 sph, with reserves created in some cases. The MIS investors at June 2012 held 19,543 units covering 3,405 ha with 3291 ha planted and the TFS2012 Project to be planted by 30 June 2013. The planted area had 1,406,000 trees, an average of 427 sph.

Valuations of MIS and TFC assets are based on expected tonnes of 'heartwood' or sap-containing inner wood per tree, its expected yield in kilos of quality oil and the expected price of oil. Such gross receipts are offset for Growers by estimated 5% sales and marketing charges and estimated harvest and processing charges. Each of the output figures is conservatively based on TFC's sampling and research studies. The net result is discounted to the expected date of harvesting and sales at rates of 15% to 17% pa.

On this basis, the combined Grower interests in all MIS at 30 June 2012 was \$555m at an oil price of \$2,441 per kilo. This notional current market value was considered by the responsible entity (TFC group) to be sensitive to variation as follows:

A 5% fall /(Rise) in AUD to USD	\$32.84 million
A \$100 per kg oil price Rise / (Fall)	\$17.78m
A 10% More /(Less) yield in heartwood oil	\$43.4m.

Why Sandalwood?

Indian Sandalwood is one of the world's most valuable hardwoods, selling for over A\$100,000 per tonne of heartwood (Tamil Nadu Forestry Department Auctions). Renowned for centuries for its fragrant and medicinal properties, Indian Sandalwood has a wide range of uses in the global fragrance, incense, worship, carving and pharmaceutical industries. Its history as a tradeable commodity spans thousands of years. Sandalwood oil is a globally important ingredient in fine fragrances, cosmetics and toiletries, incense sticks, and for medicinal purposes (Chinese medicines and aromatherapy) and the wood is used for high quality carvings.

Sandalwood trees are hemi-parasitic, making cultivation highly specialised. This factor, together with its strong demand in Asia, India, the Middle East and in the global fragrance industry, has led to illegal harvesting of wild trees and severe deforestation of *Santalum album* in its native environments of South India, Indonesia and Timor.

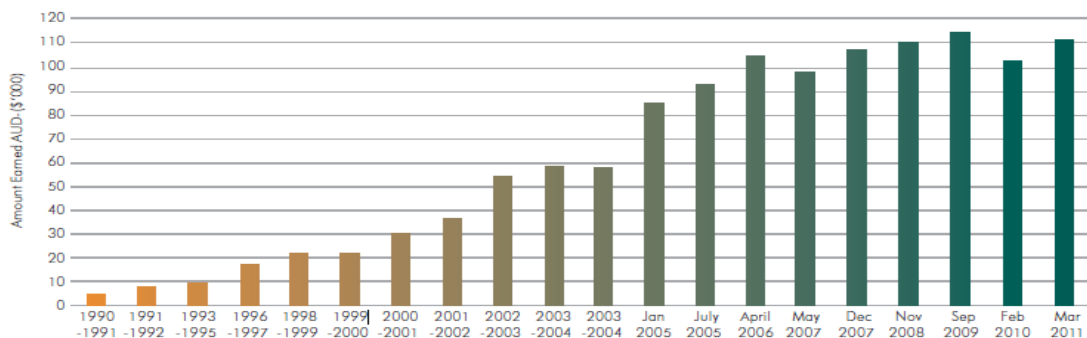
Sandalwood has well entrenched worldwide markets and particularly so in the fast growing economies of India and China where it has long been valued for its fragrance and medicinal qualities as now in some Western and global



markets. Importantly, it not only has fragrance but acts as a fixative to prolong the effect of most perfumes and scents and is thus particularly useful in the worldwide perfume and cosmetics industry. Science is also now uncovering the bases of its medical qualities, which may yield further particular value as anti-microbial and anti-inflammatory agents. In fact, a pharmaceutical range of products for the treatment of skin disorders is commencing clinical trials, which could raise demand for TFC products — see page 14.

There are some 29 varieties of Sandalwood, but the now native 'Indian' tree *Santalum album* produces by far the highest yields of oil with the finest qualities. Believed to have originated in Timor, its growth there, in Indonesia and other parts of South and South East Asia has been less successful. In India, protected by government export controls and with little if any cultivation, the market price has risen for years with demand far outstripping limited supply. The price of Indian Sandalwood's heartwood has risen at a compound rate of over 16.7% per annum since 1990.

Sandalwood Auctions in India: Price Trend (Average)



Source: TFC Sandalwood Project 2013 Product Disclosure Statement

While the other 27 Sandalwood species are of minor commercial interest, the Australian native, *Santalum spicatum*, has a wide territory, believed to range over 161 million ha or 1.6 million sq km, mainly in the southern arid areas of WA, but only very sparsely. The trees have been used by Australia's indigenous peoples for thousands of years.

Sandalwood was one of Australia's leading exports from the mid 1800's, notably from Albany on the south-west of WA. Tonnes of Sandalwood were sent to China each year to produce incense for Buddhist worship. In the 1920's wood harvests peaked at over 14,000 tonnes. The Western Australian Government passed legislation to limit harvests to sustainable levels. These controls still continue.

Sandalwood was first distilled in Australia in 1875. By 1916 crude commercial production of Sandalwood oil began. Scientific control and systematic production has significantly improved the quality of distilled oil over the last century. Improving processing and adding quality controls can raise the concentrations of Santalols, key chemical components used to classify the quality of Sandalwood oils. Sandalwood oil was used for medicinal treatments in countries including Britain, France, Belgium and Japan, as an oral antiseptic and a treatment of venereal disease. However, with the widespread use of antibiotics, commercial production of Sandalwood oil was discontinued in 1963.

As TFC's plantations grew in size and began to mature, it became strategically important for TFC to own its own oil processing operations. An Albany-based company Mt Romance Australia Pty Ltd started making Sandalwood oil in 1997. Following an R&D programme it began to produce high quality commercial yields and to market to the cosmetics, fragrance, aromatherapy and therapeutic markets. TFC acquired the Mt Romance group in 2008.

Meanwhile, the WA Government continued to enforce quotas on harvesting *Santalum spicatum*, currently at 1,400 tonnes pa, mostly sourced from the south-west corner of WA and from pastoral leases generally to the north of the Goldfields. Some plantations have been established.

The attractions of the Indian species of Sandalwood, with a far higher oil yield than the Australian species, are clear. Importantly, the Indian, *album*, variety requires a semi-tropical and wet habitat and TFC now appears pretty uniquely competent to grow it satisfactorily. TFC has also been able to improve its processing capacity and efficiency, build end customer relationships and test and enhance its product quality. The experience at its Albany plant in processing, double distilling and blending a variable range of *spicatum* supplies into oil, refined to high quality, will give it a substantial technology edge for processing its own trees, as the less variable as well as higher oil content of *album* will enable the current plant to process more trees as well as produce more oil per tonne of Sandalwood input.

Outline of TFC, its History, Capabilities & Connections

The massive work done over many years to develop the Ord River Irrigation Area (ORIA) of north-east Western Australia and the success of government trials of the plantation growth of Indian Sandalwood there drew the attention of established Perth solicitor Frank Cullity Wilson, who came from a leading timber family.



Mr Wilson founded TFC in 1997 with colleagues from the Perth corporate, agricultural and forestry community and engaged a team of WA Government foresters who had gained years of Sandalwood growing experience on the ORIA.

TFC's first planting was in 1999 and it now manages the largest area of Indian Sandalwood plantation in the world, with over 6,500 hectares planted, for TFC itself, its retail (MIS) and its institutional ('Beyond Carbon') investors.

The company listed on the Australian Stock Exchange in an IPO in December 2004 with an initial \$31m market capitalisation. It has since then raised further capital on a number of occasions by rights issue, placements and SPPs.

Since ASX listing, TFC has launched 16 MIS projects, with one currently on offer. Following the global financial crisis (GFC) and the failures of most other MIS operators, TFC recognised the need to raise funding from global institutional sources. It began to market its Beyond Carbon scheme and to develop relationships with overseas investors. This successfully led to raising funding from the US in 2009/10. Funds have since been raised from a number of investors including a US Endowment Fund, European investors and a Middle Eastern Sovereign Wealth Fund.

TFC has three joint ventures. In 2009 it took 50% in Northern Development Corporation Ltd with an experienced land development group, and 49% in Gulf Natural Supply Co. with UAE-based Emirates Investment Group to assist Sandalwood Oil distribution and Beyond Carbon activities in the Middle-East.

In July 2008 TFC acquired the Albany-based Sandalwood processor and oil distributor, Mt Romance Holdings Pty Ltd and its subsidiaries. From 1999 Mt Romance has been the world's leading processor and international marketer of Australian Sandalwood oils, with, mostly bulk, sales revenues averaging some \$18 million in the last few years.

With Mt Romance, since 2008 TFC has been able to develop and exploit a full in-house capability for scientific analysis of samples from its plantations as well as a test bed for processing methods to create the highest quality oils from Sandalwood. Since the acquisition it has produced a steady supply of Sandalwood oil products for the global market, exporting oil to the USA, Middle East, China, India, Europe and the UK, while also market testing batch quantities of Indian Sandalwood.

TFC will commence the first commercial harvest of its Indian Sandalwood plantations in late calendar 2013.

Ahead of this harvest, TFC signed forward supply agreements for some of its Indian Sandalwood resources. Agreements in place include with leading global cosmetics company Lush. Mt Romance is of course already an established supplier of Sandalwood oil to the global fragrance and pharmaceutical industry and we understand that further sales and off-take agreements have been canvassed in these markets. TFC believes that the pharmaceutical sector will become an important driver of future demand for Indian Sandalwood in addition to demand from historical markets in China, India and the Middle East.

Plantations — Size, Ownership and Funding

TFC manages over 6,500 ha of established Indian Sandalwood plantations across Northern Australia including

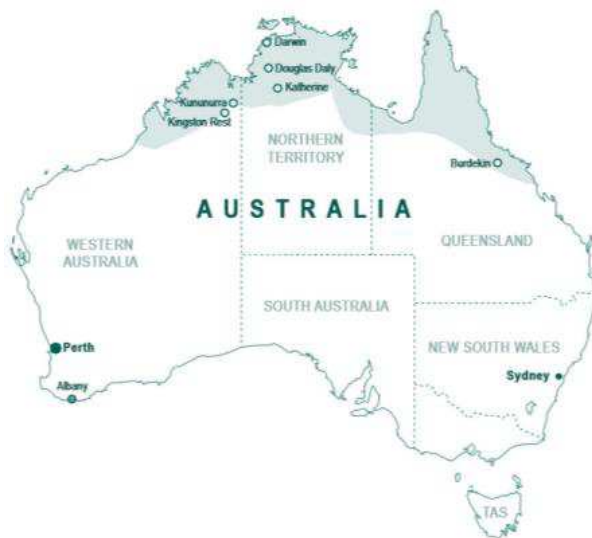
- 5,551 hectares in and around the ORIA in the East Kimberly region of W.A. (Kununurra, Kingston Rest)
- 670 hectares in the Burdekin region of Queensland
- 290 hectares in the Douglas Daly region of the Northern Territory.

TFC owns a further 3,560 ha of undeveloped land — 3,300 ha in the Northern Territory near Katherine, 150 ha near Kununurra and 110 ha in Queensland. The Kununurra land is intended for the 2013 MIS project, while the balance is principally earmarked for Beyond Carbon investors.

Northern Australia provides optimal growing conditions — fertile land with abundant irrigation or natural rainfall and a sub-tropical climate. TFC selects suitable properties outside cyclone and flood prone regions and with free draining soils of high quality.

Adding to its initial plantations, TFC had acquired a further 517ha near Kununurra by 2006 and in 2007 acquired its Kingston Rest property not far from Kununurra, with 2,000ha and a very substantial reservoir. By 2008 tree survival rates were rising well with better seedling quality, after planting care and maintenance and the use of more suitable varieties of host trees. Subsequently, planting, growth and survival rates increased further, with added benefits from genetics and operational improvements. In 2010 Kingston Rest became Australia's largest private irrigation project, completed on time and budget with investors fully committed.

In FY12 TFC planted the Burdekin and Douglas Daly lands and a further 438 ha at Kununurra and Kingston Rest, a total of 1,398 ha for Beyond Carbon investors. It also planted 88 ha for MIS investors (a 2012 project balance) and retained 22 ha for itself — a record planting for the year of 1,508 ha and indicative of future planting capacity.



Locations of TFC Operations

On the left, Albany is shown, south of Perth, with TFC's plantation sites in tropical northern Australia. Shown in more detail below, Kununurra and Kingston Rest are in WA while recent land purchases are at Douglas Daly and Katherine in the Northern Territory and near Burdekin in Queensland.



TFC's Ownership and its Income Potential from Established Plantations

Holdings & TFC Income Flows	TFC direct	TFC in MIS	MIS investors	Beyond Carbon Invs.
Hectares owned/planted	641	735 (1)	3,316 (incl 735 (1))	2,554 (900 to settle)
Land Purchase & Establishment of Plantations			Establishment fees Some interest (2)	Initial margin on sales & plantation assets
Annual Management		More indirect ownership via deferred fee arrangements	Annual managt & maintenance fees; Lease revenue	Annual management & maintenance fees
'Value-add' Processing, Marketing & Distribution NB: This is all future Income that will commence once harvesting starts	Value-add margins on all/third party processing & marketing benefits	as for TFC	Margin on buying wood from Growers at market prices; then value-adding & on selling production; Normal marketing fees	Oil processing fees; Performance fees for greater than 'single-digit' returns; Marketing & Distribution fees

Notes: (1) TFC is entitled to the proceeds from 735 ha (22%) of Growers' holdings under the deferred management fee arrangement. (2) If the Grower elects leverage financing.

A key difference between MIS and Beyond Carbon is that TFC retains its freehold or leasehold interest in land used by MIS investors, and thus is free to re-use the land after the Grower receives the relevant harvest income. But TFC acquires and sells the relevant land parcels to Beyond Carbon investors, who retain it after a harvest. Another point is that MIS Growers receive the net proceeds of marketing cleaned logs (which TFC may buy at market prices to process), whereas TFC may only process the Sandalwood into oil at the option of the Beyond Carbon investor.

MIS as a Funding Model for TFC

From the outset, TFC recognised that plantation forestry was long-term and capital intensive. In the 1990's the Federal Government as part of its Plantations 2020 forestry vision encouraged agricultural & forestry investment schemes to build activity in the sector, and allowed investors to claim deductions on the investment costs.

The Income Tax Assessment Act 1997 introduced a Division on 'Forestry managed investment schemes'. In the boom years, MIS schemes raised substantial funds. TFC found this a valuable funding source, which it supplemented with its own capital raisings, notably in its IPO and subsequently. However, the GFC (global financial crisis) froze the previously buoyant sentiment on such schemes. It also contributed to significant commodity price falls. Several leaders in the field collapsed. TFC had to find other sources of funding to continue its expansion. Fortunately, and deliberately, it had safeguarded initial income from project sales to fund its planting and subsequent maintenance costs. Others with over-reliance on continuing sales had fewer reserves. With conservatism, bank support and capital issues, TFC bridged its capital gap until it launched Beyond Carbon to attract global institutional funds.



Managed Investment Scheme ('MIS') Activity

TFC has launched Managed Investment Schemes since 1999 and now operates a total of 16 projects with one more launched recently. From 2003 to 2008 the number of schemes in operation rose from six to twelve, with their total value of net assets or trust funds rising from \$18.3m to \$205.8m at 30 June in those years. The faster and cumulative growth over the last four years is shown in Table 1 below.

MIS PROJECTS, CUMULATIVE	at 30 June				
Number of Schemes Operating		13	14	15	15+1
MIS Accounts, \$'000 (Growers' Funds)		FY09	FY10	FY11	FY12
Profit pre tax		72,259	85,209	80,755	112,154
Lease & Mgt Fees Rec'd		3,612	6,093	7,186	7,371
Fees paid to RE/Assocs		3,612	6,093	7,186	7,371
Net increment in value		23,737	60,268	70,471	104,178
Total Net Assets at 30 June		264,729	347,125	427,568	539,541
Valued on oil price A\$/kg		2,095	2,112	2,345	2,441
Useful Plantation Area					
Area leased by Investors, ha		2,960	3,203	3,294	3,405
MIS Units on Issue					
Units held by investors		16,142	17,639	18,185	19,543
Plus, held by TFC & Associates		1,346	1,524	1,593	1,671
(not included in MIS accounts)					
Trees					
Number of Sandalwood Trees, '000		972	1,256	1,351	1,406
Sensitivity					
Changes in Profit and Equity \$'000					
5% Fall in AUD to USD / (Rise)		8,388	11,966	16,822	21,030
\$100/kg oil price Rise / (Fall)		8,006	11,332	14,346	17,233
10% More heartwood oil yield / (Less)	NA	NA		33,647	42,058

Table 1 — MIS Schemes Operating

Further details on MIS projects can be seen in Tables 3 and 4 on page 13 (Embedded Value) and TABLE 5 on page 17 (Summary of All Projects), Appendix 1.

Hypothetical details of Growers' investments year by year and possible outcomes are shown in Table 2 below and discussed in the text.

The MIS Model and its Implications for an Integrated Industry Leader

Table 2 shows our estimates of possible outcomes from successful completion of the current MIS Project 2013. It is based on PDS figures of likely typical initial and annual payments from Growers to the RE (Responsible Entity - a licensed subsidiary of TFC, acting as trustee). These are shown in the third column in \$ per lot and in the fourth as \$'000 assuming the complete MIS is subscribed — a funds inflow of approx. \$31m by mid 2013.

MIS Project 2013 - Approx investment by growers, net of GST						
		Payments @ \$ 6,000/lot+fees		Discount	Value Today for	
Year	FY	per lot	MIS total	12.14%	One Lot	Total MIS
0	2013	6,500	31,200	100.000	6,500	31,200
1	2014	0	0	89.174	0	0
2	2015	500	2,400	79.520	398	1,908
3	2016	515	2,472	70.912	365	1,753
4	2017	530	2,544	63.235	335	1,609
5	2018	546	2,621	56.389	308	1,478
6	2019	563	2,702	50.285	283	1,359
7	2020	580	2,784	44.841	260	1,248
8	2021	597	2,866	39.987	239	1,146
9	2022	615	2,952	35.658	219	1,053
10	2023	633	3,038	31.798	201	966
11	2024	652	3,130	28.355	185	887
12	2025	672	3,226	25.286	170	816
13	2026	692	3,322	22.548	156	749
14	2027	713	3,422	20.107	143	688
15	2028	0	0	17.930	0	0
16	2029	0	0	15.989	0	0
17	2030	0	0	14.258	0	0
(Calculated per lot for subscriptions to 12 or more lots)						
Totals: one lot & MIS		14,308	68,678		9,763	46,860
End value, net, p.v.		68,479	328,700	Per yr 17	9,764	46,867
Gross amounts, total, relevant to TFS, \$'000:						
Net present value @ discount of		12.14%	17.00%	15.00%	10.00%	
Initial grower payments		31,200	31,200	31,200	31,200	
Typical annual receipts, npv		1,908	1,753	1,815	1,983	
5% sales & marketing fees		561	273	366	779	
Harvest & processing costs		903	439	589	1,253	
Total oil output value, \$'000		42,444	20,634	27,662	58,893	

Table 2 — MIS Project 2013

These figures are discounted to the present value at four rates: **12.14%** being the apparent break-even rate of cash flows to the Growers over the entire project, based on figures derived from the MIS Product Disclosure Statement ('PDS'); **17%** being the likely discount rate TFC might use in computing future values for itself and for the Growers, based on the annual reports of the company and previous MIS projects and allowing for its assessment of risk uncertainties; **15%** as a target rate that has been used by TFC, and **10%** as a base that might be found adequately attractive to investors if and when uncertainties are reduced by proof in successful harvests and product sales.

Below 'year 0 to 17' the total Grower outlays are shown, again in \$ per lot and for the entire MIS in \$'000, with on the next line the likely end value or net receipts to the Growers and the entire MIS based on the sales values and costs indicated in the PDS. Sandalwood is to be sold for the Growers as cleaned logs. Harvesting and selling costs are indicated in the PDS.

At the foot of the table the main items of interest to TFC are shown — initial receipts to the MIS account, annual receipts typified by the discounted value of those in the second year, the present value of costs and income at the end of the project, being the 5% sales and marketing fees, harvesting and processing fees (typically \$16,000 and \$60,000 per ha), and the guide to the potential oil output sales value if all the logs were purchased and processed into oil by TFC, using guide



values of wood at \$100,000 per tonne and of oil at \$2,500 per kg. MIS initial or annual fees are expected to equate roughly to TFC's establishment costs of the plantation and to its annual maintenance costs, with no doubt a profit margin. Likewise the harvest, processing, sales and marketing fees cover work likely to be largely outsourced by TFC but under its control. Finally, a significant part of the potential value of oil sales can be expected to be retained by TFC as processing and sales margins on the basis that it will have the capacity to process those logs into oil and sell the oil at a fair margin over the log value.

To the extent that these hypothetical MIS estimates are substantiated by the long-term results, they indicate that:

1. The 2013 MIS Growers, subject to the risks involved, might anticipate a long-term return in the order of 12% pa, ignoring tax impacts. Tax impacts are expected to be an important attraction to MIS Growers, at least initially.
2. If all lots being offered in the MIS project are sold to investors there should be a ~\$31m fund inflow, available to TFC once planting is completed, to offset the costs of preparing and planting 400 ha, with annual maintenance income as the trees grow. At harvest, TFC should earn margins on the fees arising and have the opportunity to buy the logs to feed through its oil processing plant, enhancing its downstream sales, profit and market position.
3. On the project concluding successfully and subject to crop rotation or leaving the land fallow for a period, TFC will again have 400 ha of land with irrigation ready for a new plantation. Through this process and courtesy of the cash flows at all business stages, it should be able to build its IP and research, its planting and processing competence, its MIS funding experience and connections, its Sandalwood oil sales and end market leadership.
4. Through using other peoples' capital and rewarding them appropriately, TFC should enhance its forestry and agribusiness expertise, improving returns from its own properties while building its capital and capacity to add to its own and managed plantations. A good business model!

'Beyond Carbon' — Institutional Appetite for Direct Agribusiness Investment

The example above of the MIS Project 2013 is an indication of the capital sharing and sourcing approach of TFC. Its move into the global wholesale market was forced by the demise of MIS projects after the GFC, as noted earlier. But it was a good move in its own right as large investors globally are seeking long-term, unlisted, infrastructure projects. Whether it be the Future Fund, overseas 'Sovereign Funds' or other large institutional funds or family offices, there is interest in larger, longer, investments not subject to the shorter term pressures of stock markets.

Such players also have a particular interest in agriculture, due to changing world dynamics and demand. In Australia, very large land holdings are in private hands and major investors globally are involved. In the case of TFC, while its speciality is not a foodstuff it has the twin advantages of a market demand that is widespread, well established and discriminating, and a commodity supply that is scarce, dwindling and ill organised. Surprisingly, we have not yet found evidence of significant competitors to TFC and from all accounts any prospects for a revitalised Sandalwood production in India or Indonesia appear far off. So TFC appears to have maybe up to 15 years advantage over other players. It is growing trees that are proven to be suited to the northern tropical areas of Australia, and its markets are not so large as to attract a great deal of competition provided it can supply them adequately. It has every opportunity to become a key player controlling its niche.

A global sales team was developed in 2008. TFC has since then attracted a number of global wholesale investors. These include a middle eastern sovereign fund and a leading US institution. Each has already made two investments. TFC's CEO, Head of Global & Retail Products, and others regularly visit and present to major potential investors. The 'Beyond Carbon' name for TFC's global investment drive does not indicate any specific carbon credit computations but highlights the congruence of TFC's sustainable, 'green' and community conscious activities with criteria for enlightened socially responsible investment today.

The benefits from Beyond Carbon investors to TFC may be fewer than those from MIS projects as TFC stands to make fewer margins along the way and wholesale investors do not seek financing and are less likely to seek early release from their investment. However, wholesale investors tend to provide larger slabs of capital, typically buy the land outright and may seek further investment, which conserves TFC's capital and may lead to faster growth. Although their involvement is private whereas successful MIS projects can create a valuable public record, a satisfied wholesale investor is quite likely to make a recommendation to another with useful effect.

Wholesale investor support has already been behind some of TFC's recent land acquisitions, as well as it earlier filled a funding gap when MIS interest dried up. We see TFC making every effort to expand it.

Oil Processing, Quality & Composition, Sustainability at TFC

Oil Processing at Mt Romance and Quality Assurance

Once Sandalwood is harvested the bark and leaves are removed and the trees are sorted into roots, butts and logs. This wood is then chipped to specification to increase the surface area for oil extraction.



Acquired for \$26.8m in July 2008 (\$11m in cash and equity and the assumption of \$17.6m of debt), the Albany Mt Romance facility is the world's largest 'state of the art' distiller of Sandalwood oil. Its 14 stills can process 2,000 tonnes pa of Indian Sandalwood logs or 1,200 tpa of Australian Sandalwood logs, of which it has recently been processing only 600 to 700 tpa. This contributed \$16.3m revenue, \$2.95m EBITDA and \$2.3m of pre-tax profit in FY12, down on the two prior years (EBITDA ~\$5.3m) due to an even more short supply. The easier to process Indian Sandalwood logs not only permit more wood input but give much higher oil yield.

As Sandalwood is a natural product a number of variables can affect its oil yield and quality. Like wine, subtle differences can be found between trees grown in different locations, climatic conditions and soil types. Every batch of wood arriving at Mt Romance undergoes laboratory analysis to determine the quantity and nature of all constituents. This helps direct the wood into the appropriate product stream and prepare blending batch instructions so that on full distillation the highest quality of pure Sandalwood oil is produced to clients' individual preferences.

Using steam distillation, oil is extracted from the wood chips. Each batch of oil undergoes Gas Chromatography testing and is scrutinized by TFC's odour panel to ensure the Sandalwood oil meets specifications. A Certificate of Analysis and a Material Safety Data Sheet is provided for each shipment to confirm its purity and composition.

Standard procedures manuals govern all processes. Controls are run on all oil samples, through all processes, to ensure methodology remains optimal. External lab analyses are also used regularly to confirm the accuracy of internal data. Retention samples are kept for at least seven years. Repeat orders can then be closely matched to specifications of previous orders. Pre-Shipment Representative Samples are also provided for client approval.

Sales are typically on long-term contracts to leading companies around the world, including the USA, Europe, the Middle East, India and China. Customers include Givaudan, Lush, Aveda, Hermes, IFF, Estée Lauder and Shiseido and many private companies in India, China and Taiwan.

Chemical Composition of Sandalwood Oils

Heartwood from mature Indian Sandalwood has roughly double the oil content of wild Australian Sandalwood trees and is of higher quality with broader and deeper end markets. Australian Sandalwood is slow-growing and suited to arid climates, while Indian Sandalwood can be harvested in 15 years under irrigation making it more commercially viable. Although all Sandalwood oils contain similar components, in the two main commercial species the concentrations of these components are different, creating two similar but quite distinctive oils.

Indian Sandalwood oil's main constituents are sesquiterpenes, dominated by the two primary sesquiterpene alcohols, alpha-Santalol and beta-Santalol, which contribute to a well established anti-inflammatory and anti-microbial function.

The commercial distillation at Mt Romance of harvest quantities of Indian Sandalwood from Ord River done by TFC was reported in *Perfumer & Flavourist*, Vol.36, December 2011. It showed high percentages of the alpha and beta Santalols, complying comfortably with ISO specifications. The alpha Santalol was 47.1% and beta-Santalol 19.3%.

Sustainability and ISO accreditation at TFC

TFC's business naturally puts it in the category of 'green' and suitable for environmentally sensitive investors. For both sustainability and economic reasons it appears committed to the highest environmental and ethical standards in all aspects of its business. Plantations are grown on land that has previously been used for agricultural or horticultural production. As the first ORIA land owner to recycle its water, TFC won the 2006 State Regional Water Award. In 2011 subsidiary Mt Romance won the Platinum Award by the Water Corporation for its Water Efficiency Management Plan — by-products and waste bluegum chips are used in the boiler and water is extensively recycled.

TFC plantations and plant have ISO accreditation (14001 Environment, 9001 Quality and 4801 Quality, Health & Safety). TFC aims at best practice in climate, community & biodiversity, producing organic, sustainable, quality-controlled Indian Sandalwood. It makes high quality oils with good Santalol levels and established therapeutic benefits. It uses renewable energy and water recycling. Driven by research and quality control it benefits from over 16 years of experience in both Sandalwood growth and extraction.

TFC was rated in March 2013 by Oekom Research AG, one of the world's leading ratings agencies and providing criteria for European asset managers currently handling €520 billion. Oekom has helped shape the rapidly growing global focus on sustainable and responsible investment since 1993. TFC has achieved a 'Prime Corporate Responsibility' rating pre-qualifying the company as an attractive proposition for ethical and sustainable investors. It is one of only seven companies in its industry globally to have been awarded a Prime rating.



The Sandalwood Oil Supply and Demand Imbalance

Demand Growth is Expected

Global demand for Indian Sandalwood heartwood is currently estimated at around 24,000 tonnes per annum —

Cremation	1,473	Home Worship	6,186	Perfumes & Attars	3,568	Temples	6,279
Handicrafts	138	Mouth Fresheners	5,661	Pharmaceuticals	676	<i>all figures tonnes pa</i>	

Source: TFC / Incipient Capital Group (2012)

- Demand for natural products using Indian Sandalwood is expected to rise significantly
- New medical applications are being researched and developed by TFC's partner ViroXis and by others (it has been suggested that annual demand for pharmaceuticals may multiply several times by 2020)
- Demand for Indian Sandalwood for cremation and other religious purposes in India and China is expected to remain strong. There are some 940 million Hindus in India with a mortality rate of approx. 6-7 million pa
- The Indian middle-class is expected to grow from 50 to 580 million by 2025, an increase in purchasing power
- Consumption of Pan Masala mouth fresheners, which include Sandalwood oil, has been growing at 10-15% pa and this is expected to continue, especially in India
- There is potential opportunity to service an additional 15,000 tonnes of annual demand from lower value products (eg. incense sticks and soaps) that currently source substitutes due to a lack of supply.

Supply Figures are Very Opaque

It is hard to find widely accepted figures for Indian Sandalwood supplies because most of the supply is currently illegally sourced. However, it has been estimated by Anantha Padmanabha, a forestry consultant with over 35 years experience in forestry in India and Consultant to TFC, that the annual official harvest of Indian Sandalwood in India is approx. 400 tonnes. In its studies for TFC, Incipient Capital Group (see above) reported that industry discussions suggested auctioned wood only represented 5-25% of total market. Illegal production is vastly higher than official statistics. There appears to be little evidence of significant production outside India, whether from native or plantation-based trees.

So — Mind The Gap!

These supply figures appear to be quite out of line with the estimates of demand. We question whether the official prices quoted for Indian Sandalwood represent the overall average price, given that the official harvest has fallen so far from an already low ~1,750 tonnes in 1996. We hazard that the illegal, 'black market' or alternative supplies from other countries may be larger than the figures suggest, or maybe that part of the demand is being, and might continue for a period to be, satisfied by alternative, synthetic or degraded / diluted product.

TFC notes that Australian Sandalwood sells for approx. \$14,000 per tonne, one eighth of the price of Indian Sandalwood. We have yet to see what price significant and rising annual amounts of Australian plantation-grown Indian Sandalwood will achieve.

Clearly the markets are in some disarray and a successful advent of reliable, quality and growing oil supply from TFC is likely to prove significantly disruptive to pricing, market usage and demand. However, prices for oil have been achieved from sample batches at between US\$2,500 and US\$4,000 per kilo. Oil price forecasting could be hazardous!

Some initial forward sales from the first harvest of Kununurra grown Indian Sandalwood oil have already been made by TFC at \$4,000 / kg, representing a ~60% premium to prevailing spot prices. This at least is a very good start.

It illustrates the big supply / demand imbalance — a most unusual opportunity for a competent new producer of an old and established product that appears to have growing markets but no other large and competent competitor and has a 16 year head start on any new entrant.



TFC's Engine Room and its Drivers

The Board of Directors, Management and Staff, Alignment of Interests

Frank Wilson LLB, Chairman & Chief Executive Officer. The driving force in the history of the TFC group, he was appointed founding Chairman in March 2000. He was previously the managing partner of law firm Wilson & Atkinson for 16 years. He is a governor of the University of Notre Dame. At the time of TFC's 2012 Annual Report he held 16.20% of TFC issued capital and 186.7 ha of interests in TFC MIS projects.

Non Executive Directors:

Ronald Eacott was appointed in March 2000. Currently MD of a reprographic company, he was a State Manager of Boral for 18 years, also of Union Steel and of Elders in New Zealand. He held 1.73% of TFC issued capital and 4.83 ha of interests in TFC MIS projects.

Adam Gilchrist was appointed in July 2011. In 2008 he had retired from an outstanding career in Australian cricket. Since June 2010 he has been involved in the promotion of Sandalwood-based products. He is active in various public and community roles. He held 0.76% of TFC issued capital and 1.3 ha of interests in TFC MIS projects.

Julius Matthys was appointed in December 2011. An experienced senior executive with BHP Billiton, his roles have included global Iron Ore and Aluminium marketing, managing the Worsley Alumina refinery joint venture and VP External Affairs WA. He held 1.20% of TFC issued capital and 1.3 ha of interests in TFC MIS projects.

Stephen Atkinson was appointed in July 2012. He had been a founding director and shareholder, responsible for provision of legal advice in the establishment and running of the TFC group. He was previously a partner of law firm Wilson & Atkinson and in 2002 he established a sport management consultancy. He held 1.38% of TFC issued capital and 1.5 ha of interests in TFC MIS projects.

Together these Directors held approximately 21.3% of TFC issued capital at 3 September 2012 and 195.6 ha of interests in TFC MIS projects.

The Board deliberately split the roles of Chairman and CEO in 2011. Mr Wilson resigned as a Director of TFC in November 2011 following the July 2011 appointment of Richard Alston to the Board as Chairman. Mr Wilson continued to act as CEO and was reappointed to the Board in June 2012. He was again appointed Chairman in November 2012 following Mr Alston's resignation in October 2012.

Over the last two years there have been several other changes in the Board and attempted Requisitions by a prior director for a Meeting to change the Board. We will not canvass these matters here. However, given their prominence and likely impact on the share price, we note that a Board review of all related matters can be seen by going via TFC's website www.tfsltd.com via shareholders/media-investor-and-public-relations to ASX or directly to www.asx.com.au/asxpdf/20121220/pdf/42c2xcxlr8y9c7.pdf — Shareholder Update 20/12/2012, a ten page pdf containing an 8-page letter signed by all Board members.

There is a very close alignment of interest between investors in TFC and the MIS and Beyond Carbon investors: TFC has a significant interest of over 20% in all its plantations and owns its oil processing facilities, whilst directors and key management currently own over 20% of TFC's issued capital and a significant area of its plantations.

We have met a number of the senior managers and staff of TFC. It appears well founded with expertise and initiative across all functions. It has a number of well educated and trained foresters and has experienced management across operations, research, sales and finance. Total headcount is approaching 150, in Perth, Albany, Kununurra and other plantation sites. Contractors work as required for maintenance and harvest and may number from 20 to 150.

First Harvest Yields and Prices - a Watershed even if it may Initially Underwhelm

While yields in the initial harvest starting late this calendar year are expected to be lower than originally forecast in 1998, the pricing to be achieved is expected to be considerably higher. Advancements in TFC's silviculture techniques used in its later plantations are expected to result in progressively and significantly higher yields going forward.

TFC is entitled to around 40% of the FY14 harvest. We believe that the total harvest crop may be small as early plantings were less successful, but prices should be well ahead of initial guidance. We have tried to estimate the harvest from the likely 160 ha cropping area, the density of trees of some 140sph and their reduced size compared with recent plantings (a make-up area was planted later and may not be harvested until 2015-16). Given that progressively since 1999 TFC's rate of tree growth has far improved with better stock, hosts, management and soils, we estimate it may only produce in the order of 200 to 250 tonnes of heartwood. This should not disappoint: it may not create a step change in cash flow and profits, but this will be the first commercial harvest and different in kind from earlier test harvests. It will be proof of concept. TFC can then compute and begin to disclose its future growth.



Looking at both tree survival and tree growth rates (some of which we have seen in the field) we have reason to expect a very large change in output as the years go by. This build-up of output over time has its benefits: Mt Romance should be able to handle both its Australian Sandalwood and its new Indian Sandalwood. The market (and hence price) impact will be gradual. We expect TFC to be able to place all oil produced and at satisfactory prices. The year by year growth of plantation heartwood availability should allow market activity and process expansion to match. TFC's substantial R&D/process capability is able to 'value-add' products to suit end markets' and customers' needs. Its experience and extensive network of customers should assist it to establish off-take agreements and expand business into new markets, notably in medical applications, a field which it has been addressing — see page 14.

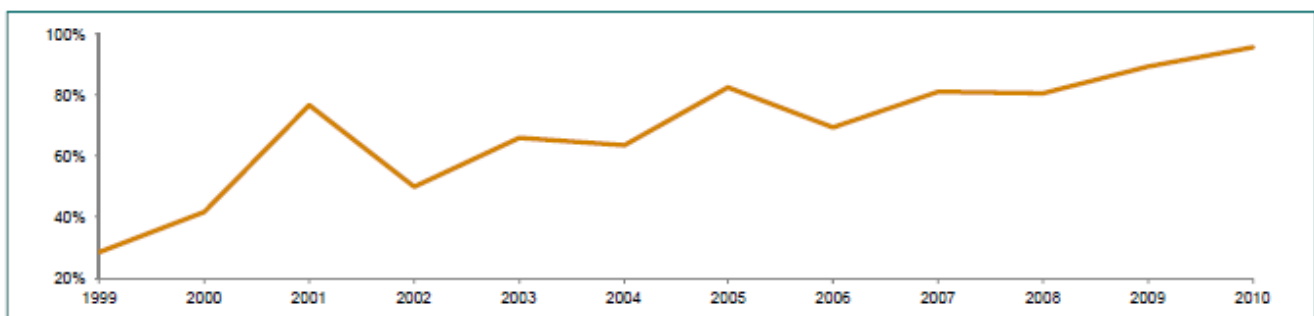
Survival Rates of Trees in TFC's Plantations

Sandalwood plantations need expert management and meticulous maintenance for optimal tree growth and harvest yields. Maintenance includes consistently arranging optimal irrigation and choosing the best hosts for trees at their various growth stages, managing control of pests and disease, pruning of host trees and occasionally Sandalwood trees, fire management, weed control, irrigation, and avoiding any rising ground water levels or windstorm damage.

TFC's plantation operations have been fine-tuned over many years to maximise their yield and embedded value. Key factors include its expert team of horticultural and forestry managers; extensive research undertaken to develop appropriate hosting and cultivation processes; careful selection of land to account for climate, access to water, soil type and available infrastructure. Silviculture techniques are constantly refined, resulting in a greater survival rate of trees and rising oil yields. It appears that attempts by other commercial operators to establish Indian Sandalwood plantations have had limited success in Australia and overseas. Tree survival rates have risen very well, shown below.

Survival rates of TFC's Indian Sandalwood plantations over time

Source: TFC



TFC carried out re-planting to make up for tree losses in its early years, under commitments to Growers to ensure a tree mortality rate below 25% at the end of a project's first year. Any possible future costs are not considered material.

Capital, Ownership of Plantations, Value Accretion

Balanced and Significant Capital Sources Aid Value Accretion to TFC

Long term financing is matched to the long term nature of cash flows. The only debt, the US\$150m senior secured notes, expire in June 2018. Its subscription was encouraged by its 55.5m warrants exercisable into ordinary shares at \$1.28 by June 2018. As income from oil sales is based on their US\$ price, the US\$ notes provide a natural hedge.

TFC's Beyond Carbon program has uncovered, not unexpectedly, significant demand from wholesale institutional investors in Indian Sandalwood plantations, offering on-going sources of capital and earnings growth.

With the demise of other MIS operators, TFC now has a virtual monopoly in Australian MIS sales. It expects demand to rebound given the unique and sustainable nature of the projects. The first harvest will be a crucial test of this and TFC expects it will reassure MIS Growers. The recycling of TFC's capital invested in its early plantations as they are harvested will help it invest in new plantations with the more favourable yield and growth character now developed. We do not anticipate capital requirements on shareholders unless a particularly attractive opportunity arises.

Research and Development Activities

TFC's purpose built nursery at Kununurra has the capacity to produce over 500,000 seedlings per season. Genetic selection and testing of Indian Sandalwood stock has been ongoing, as has testing and development of host trees.



TFC's focus on research with the full involvement of operations staff has shown it how to grow large trees that have big heartwood volume and oil yield. Improvements in yield can be expected past year 15. Processing techniques are also important to oil yield and quality. Apart from many continuing studies made by boring core samples from trees, TFC has done five destructive harvests, two in 2010 and three in 2011. These cover 170 trees from nine blocks in the ORIA. The trees were aged from 11 to 23 years. A further harvest from a private Grower is underway.

These destructive harvest tests show that —

- 'Total Merchantable Mass' of heartwood is closely related to 'Diameter over Bark'; the Age and Yield of heartwood are also closely related. By combining these relationships, TFC can predict quite closely the actual from the predicted heartwood content, for trees aged between 11 and 20 years.
- Sandalwood oil yield has been found to be between 2.9% and 5.9% and all ISO test parameters, such as Santanol levels, specific gravity, refractive index, solubility, optical rotation and acid value are comfortably within or near the mean of ISO specifications.
- Tests on 15-year old trees in various plantations show that Diameter over Bark is greater in the later planted of TFC's plantations — a clear confirmation that its improving techniques for selecting, planting and maintaining trees are paying off in creating larger trees that should yield more oil. Older trees progressively have improved characteristics and higher mean oil yields per tree.

TFC continues this work but is also starting to combine its extensive soil data from its inventory work to produce a soil model. This should progressively identify what soil characteristics matter to Sandalwood and its hosts, enable optimal management practices to be employed on new sites and produce an expected yield model based on the soil from new and existing sites. Separate to this research and probably equally important is the genetic breeding and cultivation work based on TFC's nursery, and its experiments, both large scale and on a test basis, of various hosts and their impact on Sandalwood growth. TFC's discarding of some hosts used in its early years, the improved performance of its Sandalwood using other hosts, and the relatively very rapid growth of the latest plantation areas, notably those at Kingston Rest, was evident to the author during an extended visit to the Company's sites in late January 2013.

Future Expansion Prospects

TFC anticipates that it will be the dominant producer of Indian Sandalwood by 2020 (total current global demand is estimated to be 24,000 tonnes of heartwood per annum). Global demand is forecast to significantly exceed supply.

TFC estimates that replicating its current market position would require some 17 years of investment and require extensive intellectual property and expertise. TFC has developed patented hosting techniques to limit sapling mortalities. It is also difficult to access commercial quantities of quality Indian Sandalwood seed.

TFC has a significant land bank of 3,560 hectares for future planting and sales to MIS and wholesale investors. The Mt Romance processing facilities have capacity to process 2,000 tpa of heartwood into oil before simple expansion. For major expansion, new facilities embodying TFC's and other new technology may later be constructed at Kununurra.

Possible Growth and Valuation Scenarios

Trees owned by TFC

TFC has to date earned revenues and profits by selling MIS schemes to Growers and to Beyond Carbon investors. This is a lumpy income depending on investment demand. It has not yet been fuelled by factual investment returns based on its own actual harvest successes. But yet it has generated profits and dividends. TFC has also been able to plant its own trees alongside those of its investment clients. Long-term, and starting in a small way in 2013-14 TFC stands to earn the full benefits on harvesting its own trees, and a substantial part of the Growers' trees in which it has gained an interest by providing finance. See Table 6 on page 18. Such new income is likely to rise year by year in future. If the hypothetical figures of MIS valuations and potential processing throughput on harvesting prove fair indications, the revenue and margin volumes may in time outstrip past earnings. TFC, being the experienced player and calling the tune, should be able to recycle much of such income into new trees for its own long-term benefit.

Embedded Value in the MIS Projects

Table 3 overleaf shows the operating MIS projects and their growth of estimated net asset value. It may be noted that (a) the valuation of each Project is reviewed each year and has typically increased. This is due partly to the values that have pertained to Indian Sandalwood heartwood auctions or, more recently, Indian Sandalwood oil prices. But the greater part of the increases relate to the growth of the trees towards maturity and harvesting.



(b) the total net asset value of all MIS projects has grown by over twenty times during the nine years shown. This is partly due to the above factors but also significantly due to the rising amounts of new acreage planted — see the cumulative areas shown towards the foot of the table. It may be recalled that as TFC's plants, hosts, planting and maintenance methods have improved, so the future years of recent plantations should show stronger value growth, subject to any changes in sales prices.

Table 3 - Showing TFC's MIS projects, their individual and combined net assets at each year end, and planted area growth

Progressive Numbers, Size and Value of MIS projects and their total Net Assets / Trust Funds - also indicating related MIS Sales / Establishment Fees in their first & second years																					
Jun-30	Schemes	Net Assets, \$'000	No. 1	No.2	2000	2002	2003	Gold 2003	2004	Prem. '04	2005	2006	2007	2008	2009	2010	2011	2012	Valued (1)		
2003	6	18,286	6,246	2,063	3,988	3,810	1,789	390											60,000		
2004	8	25,060	6,983	2,743	4,988	3,298	3,004	1,153	783	2,108									68,000		
2005	9	43,147	7,347	3,380	6,141	4,108	3,891	1,846	1,864	6,033	8,537								93,000		
2006	10	74,172	8,856	4,131	7,505	5,195	4,682	2,219	2,243	5,542	13,849	19,950							105,000		
2007	11	127,024	11,883	5,943	9,703	6,818	5,142	2,021	2,330	6,431	16,331	28,519	31,903						98,390		
2009	13	264,729	14,816	4,581	11,702	7,645	7,583	3,026	3,952	14,179	18,862	41,399	45,440	56,619	34,925				2,095		
2010	14	347,125	17,543	5,597	13,597	8,653	8,704	3,228	4,954	16,647	22,117	46,680	53,507	81,806	49,054	15,038			2,112		
2011	15	427,568	17,665	5,979	16,658	9,644	9,842	3,759	5,452	15,873	24,800	57,716	62,567	97,167	74,256	20,919	5,271		2,345		
2012	16	539,541	21,519	7,293	20,128	12,150	12,072	4,600	6,650	19,400	30,284	73,805	76,947	119,321	91,151	31,635	6,462	6,124	2,441		
Cumulative Area (in ha) under MIS			68.8	101.8	151.8	201.3	249.1	273.1	303.4	405.5	579.5	930.5	1,463.0	2,252.5	2,903.8	3,202.8	3,291.1	3,404.9			
The Assets are valued on the basis outlined in the MIS accounts on the TFC website (tfsldt.com). This includes discounted estimates of future gross sales prices, as shown in the far right column:																					
Values, (1), are: In years 2003-'08, Tamil Nadu Indian Sandalwood Heartwood Sales average price, A\$/tonne; In subsequent years, the Public Ledger price for Indian Sandalwood oil, in A\$ per kg.																					
Note that the numbers in the first and second years of new MIS schemes approximately match TFC's revenue from Establishment Fees plus early Lease and Management Fees, with timing differences.																					
Subsequent years' numbers reflect revaluations from cost to the estimated net present value of likely, discounted, future receipts (typically higher).																					

Embedded Value in the TFC Group

There is irregularity in the flows of revenue and profit through the TFC accounts, due to lumpiness of sales under MIS projects and to wholesale investors and other variables. This makes it hard to estimate future profits and earnings per share. But Table 4 below reveals a strongly positive trend across most business segments through 2004—2012.

Table 4 - TFC Revenue, EBITDA and Pre-tax Profit, shown by segment, Financial Years 2004 to 2012 & half-years

Revenues	Year ended 30 June / Half-yea	2004	2005	2006	2007	2008	2009	2010	2011	1H12	2012	1H13
Plantation Management												
Establishment Fees		5,059	16,574	23,842	34,746	49,478	60,247	55,481	43,470	20,095	51,226	763
Land Sales								13,305	13,190			
Plantation Sales									442			
Lease & Management Fees	Combined in Establishment Fees				2,395	3,060	3,613	6,093	9,304	3,349	10,257	5,031
Accrued Income Recognition					2,768	4,574	8,494	11,131	14,012	11,992	17,970	12,383
Interest - External		2,402	106	44	60	186	485	543	579	1,682	3,018	1,221
Interest - Inter segment								2,198	4		4,654	
Gain on Revaluation of Plantation			2,911	3,362	3,934	2,077	8,029	8,005	5,957	7,572	10,153	14,592
Gain on Settlement of Trade Debtor											10,314	
Other				85	137	575	1,098	957	1,299	1,049	1,285	1,239
Total Segment Revenue		7,461	19,591	27,332	44,040	59,950	81,966	97,713	88,257	45,739	108,877	35,229
Sandalwood Products												
Product sales							11,299	18,289	18,809	7,257	16,288	7,961
Other - Internal											599	292
Finance												
Interest - External		651	677	726	740	2,116	1,442	2,688	3,975	2,451	4,898	2,222
Sales of Agricultural Produce					290	1,392	145			676	1,429	
Total Segment Revenue		8,112	20,267	28,058	45,070	63,458	94,852	118,690	111,041	56,123	132,091	45,704
Inter Segment Revenue								-2,198	-4		-5,253	-292
Total Group Revenue		8,112	20,267	28,058	45,070	63,458	94,852	116,492	111,037	56,123	126,838	45,412
EBITDA												
Plantation Management							48,941	56,438	23,704	17,215	51,192	12,683
Sandalwood Products							3,362	5,371	5,215	1,088	2,947	1,251
Finance							1,899	2,805	4,101	2,134	4,945	2,265
Agriculture							27			523	1,168	-8
Combined EBITDA							54,229	64,614	33,020	20,960	60,252	16,191
Inter Segment Revenue									-4		-5,253	-292
Total Group EBITDA							54,229	64,614	33,016	20,960	54,999	15,899
Pre-Tax Profit												
Plantation Management		3,515	13,696	16,487	27,281	32,658	45,687	47,998	18,063	8,026	33,864	3,626
Sandalwood Products							2,133	4,469	4,339	655	2,288	1,001
Finance		-17	559	369	3	851	1,137	262	3,003	2,129	3,920	2,211
Farming / Agriculture					-352	546	26			523	1,168	-8
Inter Segment Revenue									-4		-5,253	-292
Share of Net Profits of Associates									60	117	19	101
Net Pre-Tax Profit		3,498	14,255	16,856	26,931	34,055	48,983	52,729	25,461	11,450	36,006	6,639

It is clearly critical for TFC to keep launching MIS schemes to build its estates and maintain establishment income. Obviously Beyond Carbon schemes are another key to building TFC's profits and value. The EBITDA and pre-tax profit figures above also show contributions to date from financing Growers and from oil processing operations.



Oil processing has so far been from Australian Sandalwood, which attracts lower prices and is harder to refine than Indian Sandalwood oil, which is likely to steadily become the larger product. There should be considerable long-term upside for processing sales and profits. This would require some capital but that is not expected to be a heavy burden, even if some or all the Mt Romance activities might be moved to a state-of-the-art system, there or at Kununurra.

The provision of finance is useful in marketing an MIS project as many investors seek some funding help. However, when the potential returns from using TFC capital to support new acreage and build its own plantations are weighed in a progressively more positive light as first harvesting approaches, there seems little doubt that, allowing for risk, that is a better use of capital than financing MIS Growers, particularly at current interest rates, if alternative funding can be arranged for them. After review, TFC is aiming to sell down its Grower loan book, assisted by its adviser Moelis.

Embedding More Value

In August 2012 the TFC Board initiated a comprehensive strategic review of the Company, its assets and businesses with the objective to review all options to enhance shareholder value. The review includes an assessment of TFS' operations, capital management initiatives, potential privatisation and other corporate options. Investment bank Moelis & Company was appointed to assist the Board with the review. Results are expected early April 2013. We note that an unsolicited private equity proposal was received in April 2012, later withdrawn. Given TFC's upcoming first harvest and unique industry position it would not surprise to see interest emerge again. It is important for the shareholders that underlying value through such a period of change is realistically understood and recognised in the share price.

Medical Applications for Sandalwood Oil and TFC's Biotechnology Joint Venture

Extensive research has been conducted into the use of Indian Sandalwood for the treatment of skin conditions.

In 2011, TFC entered into partnership with ViroXis Corporation Inc. (www.viroxis.com), a US bio-pharmaceutical company focused on developing and commercialising botanical pharmaceuticals derived from Sandalwood oil. After a successful FDA-approved investigator-sponsored Phase 2b study that found Santalum album oil safe and effective for treating human papilloma virus (warts) when administered topically, in March 2011 ViroXis received FDA approval through an Investigational New Drug (IND) application to advance commercial Phase 2 clinical trials using Australian-sourced Indian Sandalwood oil. In December 2012 ViroXis announced that the first patient was enrolled in the 180-patient trials testing three strengths of the treatment. Results of this study should be known by the end of 2013.

TFC has the following agreements with ViroXis:

- An exclusive supply agreement for pharmaceutical quality Indian Sandalwood oil at premium prices
- The option to acquire up to 10% interest in ViroXis for US\$1.5m, expiring November 2018
- The partners have set up a 50/50 joint venture company Santalis Pharmaceuticals, Inc., based in San Antonio like ViroXis, to pursue commercial developments with OTC (over the counter) Sandalwood applications
- To maintain its 50% stake in Santalis, TFC can annually elect to underwrite up to \$1.5m pa of product development costs, for five years, reimbursable from future Santalis revenues.

ViroXis estimates that in the long term a global HPV common warts market could use up to 240 tonnes pa of oil supply. Such a volume would be likely to test the supply of future oil, enhancing pricing achieved for the remainder of TFC's plantation estate. On 16 January 2013, Santalis announced that its first commercial product, for acne treatment, had completed a 50-patient open label phase 2 clinical trial. Results published in the December 2012 Journal of Drugs in Dermatology showed the acne treatment kit highly effective in reducing lesion counts, with minimal side effects. The kit will be available directly, and later through private label distribution partners and finally OTC (over the counter).

Being botanically-based, future products of Santalis (and ViroXis) might have an easier and faster path through FDA and other regulations, but investors should recall that biotech development is typically long-term and high risk.

Guidelines towards FY13 and FY14 Results

At least \$65m of Beyond Carbon sales are expected to settle in FY13. The FY13 MIS project aims to sell a maximum of around \$32m by 30 June 2013, though this will not all be accounted as revenue until fully planted. Uncertainties arise from the delayed settlement of a Beyond Carbon investment, noted in the FY12 and 1H13 accounts and audit report. This is independent of but follows an earlier Beyond Carbon failure to settle. In that case, TFC took back the plantation and on favourable terms gained from the event although it required capital. In its 1H13 report, TFC now recognises that the procuring of long-term wholesale capital from global investors remains challenging and typically involves complex and often protracted negotiations. However, it is working to expand its distribution channels and sales team and notably with its foundation investors to exercise their options for new product and with several new ones to take up to 700 ha. Specifically, it remains confident of the outstanding Beyond Carbon settlement.



In FY13 the Mt Romance facility should show Sandalwood product revenue and profit growth above the FY12 levels and potentially in FY14 at record levels. With the expected reduction of the MIS funding activities of TFC's finance subsidiary Arwon Finance, interest revenue will fall by FY14, but the net profit impact will be small and some \$30m capital will be released. Subject to the performance of TFC and MIS offers and in particular the size and success of the first harvest (refer to the comments on page 10), FY14 should see further growth in revenues and profit.

No dividend has been declared since FY11 due to the timing of proceeds from certain wholesale investments and the more conservative accounting policies earlier adopted around recognition of sales — now attributable only to the extent that planting has been completed. The impact of this treatment may be less in future. In FY12 TFC recognised \$43.4m revenue from Beyond Carbon investors and \$7.8m from MIS investors, the total up 17.8% on FY11. Any uplift in existing plantation value is a non-cash item. Cash earnings per share have tended to be significantly lower than overall earnings per share for this reason. In FY12 cash earnings (typically considered a basis for deciding a dividend payout) were 2.0¢ compared with 9.3¢ overall earnings — in FY 11 they were respectively 6.0¢ and 8.4¢. For FY13, TFC has given guidance of cash EBITDA of some \$35m, up 45% on FY12. We offer no specific forecast.

Sensitivity and Risk

Sensitivity Figures

Please consider the figures given on pages 2 and 6 and in Table 1 on page 6. There is very high sensitivity of both profits and equity values to changes in basic assumptions. Investors may be familiar with a 5% rise in the AUD to USD rate hitting profits, but the impact here is unusually high. Likewise product yield obviously impacts profit and equity values. For TFC a 10% change in heartwood yield could have the impact of a 20% move in the AUD / USD rate and more than a 25% impact on profit. Variability of tree diameter, merchantable mass and heartwood yield — and so saleable oil yield — could be a multiple of 10% from inspection of the results of TFC's five destructive harvest tests.

More subjective still at present is the sensitivity of profit and equity to the Sandalwood oil price. A \$100/kg change in the price was, in TFC's 2012 Annual Report, then estimated to impact profit and equity by \$2.884m. Profit was some \$26m and equity almost \$270m. The oil price for small quantities of Indian Sandalwood oil, produced naturally in India, was in the order of \$2,500/kg and continuing its steady rise. But the price offered for TFC's new Indian Sandalwood grown in Australian irrigated plantations may be different. If it was only \$2,000/kg it could have an impact near \$15m — not a large difference for TFC's equity but over half its FY12 profit (depending on volume). Of course, with trees grown under regulated conditions and processed into oil in the professional manner of Mt Romance, with supply below demand the price might even be higher (as for ViroXis) and the profit would benefit accordingly.

Some Notable Areas of Risk

Risks apply for any corporate investment. In the case of TFC, the additional risks applicable to agriculture also apply. Weather conditions, pests and disease are part and parcel of crop investment. It may be noted for TFC that its plantations are in the tropical areas of northern Australia, not in flood-prone areas but selected for water availability and sited sufficiently inland to mitigate risks of damage by cyclones, which tend to weaken as they pass over land. TFC's experience to date has shown Indian Sandalwood relatively resistant to typical pest and disease problems, which have been controlled by light use of specific insecticides when required.

Like other timber resources, Sandalwood growth is a long-term project. Compared with others, it has advantages and lower risk in that it is a niche product that has not been extensively cultivated elsewhere and is not expected to see intense competition from new estates nor new natural exploitation. In fact exploitation has already occurred and has significantly driven up prices, unlike in the case of timber, pulp and paper. This is countered by the pioneering nature of TFC's plantations which, despite some preliminary forward price commitments, have not yet been exposed to the market, creating heightened uncertainty.

TFC has a strong practice of research and development and has clearly accumulated substantial competence and IP, not only over its 15 years of cultivating and growing trees but from the earlier experience of foresters over a similar period of pioneering work in the ORIA. With its ownership of Mt Romance processing and analytical IP and previous trials, there are solid grounds for expecting its estimates and forecasts of timber heartwood and oil yields to prove realistic once harvesting begins. It can also be expected, as shown in those trials, that performance and yield will improve markedly from the early harvest results as later plantings and growth have been progressively enhanced.

Thus physical risks appear to have been reduced and addressed. This leaves the market price, acceptance and demand as the major imponderables pending the initial and perhaps the first few harvests. Again, TFC is in a good position having already, through Mt Romance, been a significant producer and marketer of (Australian) Sandalwood oil to the fragrance industry and others for a number of years. We note that it takes some fifteen years for TFC to recycle its biological investments and so it is vital for it to continue to attract MIS and Beyond Carbon investors.



Conclusion

Over sixteen years TFC has built a global leadership in sustainable Indian Sandalwood plantation management and processing. It is vertically integrated with proven expertise across cultivation, plantation, processing, distillation and marketing. It has a strong research focus and established long term funding sources matched to the maturities of its plantations. It is very well positioned to capitalise on the favourable global supply and demand dynamics for Sandalwood and is on track for its initial harvest late this year.

TFC's Board and management are both experienced and committed, with a 20% ownership stake. It has inherent "locked-in" value with over 20% ownership in the current plantation assets. It already has additional land holdings in prime agricultural areas and the experience to develop and deploy them to best practice and commercial effect.

Investors in TFC, and its MIS and Beyond Carbon projects, should consider the areas of risk described above. But we also note that at a share price of 54.5 cents the market capitalisation of TFC is some \$152m and some 56% of its \$273.7m net asset value given in the half-year accounts at 31 December 2012. It compares with net tangible asset backing of 64 cents, totally discounting the entitlement of TFC to deferred fees funded for MIS Growers. The market has been applying a heavy discount to published valuations. We expect that a reasonably successful first harvest could much reduce that discount. Further harvests, of later planted and improved trees, should progressively diminish remaining concerns and verify the strength of TFC's unique, vertically integrated, scientific and sustainable model.

We see the current share price as more than adequately discounting TFC's heightened risks and expect that on a reasonably successful initial harvest the price should rise towards net assets of around a dollar. We like TFC's integrated business model, its niche leadership position and improvements made in plant selection and management. We recommend TFC for its substantial long-term growth prospects, albeit with extra risks until good harvests ensue.

Important Information

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Appendix 1

Table 5 — Summary of MIS Projects Extant in February 2013, with the Current MIS 2013 Project

MIS PROJECTS SUMMARY, 2012	No. 1	No.2	2000	2002	2003	Gold 2003	2004	Prem. '04	2005	2006	2007	2008	2009	2010	2011	2012	2013
Size of Lots in MIS scheme, ha	1/6	1/6	1/6	1/6	1/6	1/6	1/10	1/10	1/2	1/2	1/6	1/6	1/6	1/6	1/6	1/12	1/12
Area leased by Investors, ha	68.8	33	50	49.5	47.8	24	30.3	102.1	174	351	532.5	789.5	651.3	299	88.33333	113.8	400
Units/Lots held by investors	413	198	300	297	287	144	303	1021	348	702	3195	4737	3908	1794	530	1366	4800
Plus, held by Manager & Assocs	242	12	173	360	129	105	76	50	6.8	44.2	11	289	5	98	70	0	0
Unit Lot size, ha	0.167	0.167	0.167	0.167	0.167	0.167	0.100	0.100	0.500	0.500	0.167	0.167	0.167	0.167	0.167	0.083	0.083
Stocking Average, sph	265	193	362	239	312	267	374	334	349	423	385	437	499	431	335	335	420
Trees per unit/lot	44	32	60	40	52	44	37	33	175	212	64	73	83	72	56	28	35
Check total / no of trees above	1.01	0.94	0.63	0.50	0.71	0.58	0.80	0.96	0.94	1.00	1.00	1.00	1.00	1.00	1.00	Not Avail	N.A
Heartwood tns/Lot @22.5kg/tree	0.99	0.72	1.36	0.90	1.17	1.00	0.84	0.75	3.93	4.76	1.44	1.64	1.87	1.62	1.25	0.63	0.79
A Gross value/Lot @ \$100,000/tonne	99,370	72,375	135,750	89,625	117,076	100,047	84,150	75,150	392,625	475,989	144,215	163,870	187,277	161,732	125,460	62,712	78,750
B Less 5% sales & marketing fee, \$	4,969	3,619	6,788	4,481	5,854	5,002	4,208	3,758	19,631	23,799	7,211	8,193	9,364	8,087	6,273	3,136	3,938
C Net sales value per Lot, \$	94,402	68,756	128,963	85,144	111,223	95,045	79,943	71,393	372,994	452,189	137,005	155,676	177,913	153,646	119,187	59,576	74,813
D Harvest & processing @76,000/ha	12,661	12,667	12,667	12,667	12,658	12,667	7,600	7,600	38,000	38,000	12,667	12,667	12,666	12,667	12,667	6,331	6,333
E Grower net receipts, \$/Lot	81,741	56,090	116,296	72,477	98,565	82,378	72,343	63,793	334,994	414,189	124,338	143,010	165,247	140,979	106,520	53,245	68,479
F End value of All Lots, \$'000	33,759	11,106	34,889	21,526	28,288	11,862	21,920	65,132	116,578	290,761	397,260	677,437	645,787	252,917	56,456	72,732	328,700
G cf Net Value 30 June 2012, \$'000	21,519	7,293	20,128	12,150	12,072	4,600	6,650	19,400	30,284	73,805	76,947	119,321	91,210	31,635	21,519	6,124	0
Receipts in financ'l years (approx)	FY14-FY15	FY15-FY16	FY16-FY17	FY18-FY19	FY19-FY20	FY20-FY21	FY20-FY21	FY21-FY22	FY21-FY22	FY22-FY23	FY23-FY24	FY24-FY25	FY25-FY26	FY26-FY27	FY27-FY28	FY28-FY29	FY29-FY30
Potential Oil output in kg/unit	31.3	22.8	42.8	28.2	36.9	31.5	26.5	23.7	123.7	149.9	45.4	51.6	59.0	50.9	39.5	19.8	24.8
H Oil value/unit @ \$2,500/kg	78,254	56,995	106,903	70,580	92,198	78,787	66,268	59,181	309,192	374,841	113,570	129,048	147,481	127,364	98,800	49,385	62,016
Potential oil output, all Lots, \$ '000	32,319	11,285	32,071	20,962	26,461	11,345	20,079	60,423	107,599	263,138	362,855	611,298	576,355	228,492	52,364	67,460	297,675

Notes:

These are hypothetical figures and NOT discounted, based on successful progressive completions of all Projects and attainment of the timber volumes, heartwood yields, oil yields and respective prices shown.

The Grower's expected gross value of timber per Lot at harvest, at \$100,000/tonne, is shown at **A**. From this will be deducted a 5% sales and marketing fee shown at **B**, giving the net sales value per Lot at **C**.

From the net sales value will be deducted harvest and processing costs, shown here per Lot at **D** as \$76,000 per hectare, to give the net receipts of the Grower, in \$ per Lot, at **E**.

The totals of these net Growers' receipts are shown for each Project at **F**, in thousands of dollars.

This expected net end value for all the lots (line **F**) is greater for each project than its net asset value **G** in the MIS Project annual reports for 30 June 2012, reflecting additional value-add expected towards maturity.

We note that TFS will share in the fees and charges at **B** and **D**, and will also receive the value from Lots held by any group subsidiaries as indicated on line 4, 'Plus, held by Manager & Assocs'.

We note that the end value of all Lots is a substantial figure - in particular for the large projects of 2008 and 2009 - \$677m and \$645m. This, even when discounted in double digits, will be very significant.

Both TFC and the Growers will favour early harvests in order to receive the proceeds earlier; conversely, they will be motivated, all being well, to let the trees live longer as yields should improve with further growth.

Harvests may well take place over two or several years for the above reason and to accomodate harvesting and processing capacities and cash / profit / capital / market considerations.

It may be noticed that the oil values(at **H**) on these hypothetical figures tend to be close to but often less than the Grower net receipts based on wood values (at **E**): more due to the assumptions than reality.

As well as the size of the end values of the Projects, as noted particularly for 2008 and 2009 Projects, the hypothetical projected size of oil output in the years ahead totally eclipses TFC's recent \$16-18m oil revenues.

These figures, hypothetical and not discounted though they are, give an indication of the possible latent value growing on the plantations for the future benefit of MIS, Beyond Carbon and TFC investors.



Appendix 2

Table 6 — TFC Consolidated Results for the Years ended 30 June

TFS Corporation Ltd - consolidated results for the years ended 30 June											
	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
Total revenue from services (\$'000)	6,880	5,384	8,112	13,964	19,718	33,461	52,538	63,859	74,880	66,405	61,483
Revenue from products sales (\$'000)							129	11,299	18,289	18,809	16,283
Gain on tree valuation/deferred revenue (\$'000)				5,521	5,382	6,735	6,642	16,503	19,085	19,995	28,122
Other revenue (\$'000)				783	1,011	1,194	4,150	3,190	4,239	5,828	10,635
Earnings before interest & tax (\$'000)				14,824	15,493	24,698	36,450	52,124	51,784	29,493	50,168
Net profit after tax (\$'000)	2,328	1,255	2,397	9,588	10,630	16,606	24,143	34,838	35,154	20,166	25,878
Earnings per share (basic) (cents)				6.84	6.73	10.42	13.09	18.40	16.98	8.36	9.29
Return on shareholders equity (% pa)				32.84	30.72	31.31	23.11	25.79	18.00	8.33	9.62
Dividend per ordinary share (cents)				2.00	2.10	3.40	4.00	4.25	4.75	3.50	0.00
Dividend franking (% pa)				100	100	100	100	100	100	100	100
Dividend payout ratio (%)				32.92	31.22	33.18	31.03	23.33	30.72	47.98	0.00
Financial ratios											
Net tangible assets per share (cents)				18.50	21.90	32.73	55.52	60.04	63.04	63.67	66.10
Net interest cover (times)				39.14	33.83	17.07	15.22	16.77	13.43	6.40	2.92
Net Debt / equity ratio (%)				3.83	12.88	25.59	-5.00	19.79	24.12	-1.17	33.98
Current asset ratio (times)				2.45	2.23	1.48	2.69	2.06	1.75	3.66	5.62
Balance sheet data as at 30 June											
Current Assets (\$'000)	4,071	4,263	5,748	14,462	22,461	43,597	60,068	100,227	119,118	178,437	175,341
Non-current assets (\$'000)	14,880	17,458	20,773	30,262	44,751	82,231	110,720	185,615	214,776	287,861	316,514
Total assets (\$'000)	18,950	21,721	26,521	44,724	67,212	125,828	170,788	285,842	333,894	466,298	491,855
Current liabilities (\$'000)	2,396	2,447	2,983	5,909	10,076	29,388	22,365	49,064	68,100	48,804	31,188
Non-current liabilities (\$'000)	7,089	7,739	9,312	9,616	22,533	43,395	43,971	101,694	70,453	175,393	191,177
Total liabilities (\$'000)	9,484	10,186	12,296	15,524	32,609	72,783	66,336	150,758	138,553	224,197	222,965
Net Assets (\$'000)	9,466	11,535	14,225	29,200	34,603	53,045	104,452	135,084	195,341	242,101	268,890
Shareholders' equity											
Share capital (\$'000)	4,678	5,488	6,831	14,640	14,712	16,890	39,665	43,014	77,688	115,687	117,760
Reserves (\$'000)	847	847	980	686	686	4,014	14,971	15,453	9,229	8,584	17,040
Retained profits/(acc. losses) (\$'000)	3,941	5,199	6,864	13,873	19,204	32,142	49,816	76,617	108,424	117,830	134,090
Total shareholders equity (\$'000)	9,466	11,535	14,225	29,200	34,603	53,045	104,452	135,084	195,341	242,101	268,890
Other data as at 30 June											
Company status											
Fully paid shares (000's)	Pre IPO	Pre IPO	Pre IPO	157,839	158,007	162,065	187,278	191,272	227,361	276,453	279,622
Number of shareholders				894	988	2,752	2,988	3,938	4,961	5,073	4,977
Share price:											
— years high (cents)				54	51	116	133	152	123	107.2	90
— years low (cents)				22	35	35	70	67.5	80	74.8	37
— close (cents)				43	40.5	88	115	118	84	88.5	49.5
Market Capitalisation (\$'000)				67,871	63,993	142,617	215,370	225,701	190,983	244,661	138,413

Sandalwood Seedlings in the Nursery



Sandalwood Trees in the Plantation



Distilling Sandalwood Oil

