

TFS SANDALWOOD PROJECT NO.2

ANNUAL FINANCIAL REPORT
FOR THE YEAR TO 30 JUNE 2005

MANAGER'S REPORT

The Directors of Tropical Forestry Services Ltd (ACN 080 139 966), the Manager for TFS Sandalwood Project No.2 ("the Project"), present their report together with the financial statements of the Project for the period ended 30 June 2005.

Directors

The names of the Directors of Tropical Forestry Services Ltd during the period and at the date of this report are:

Frank Cullity WILSON
Graeme Eric SCOTT
Stephen Lee ATKINSON
Ronald Lionel EACOTT
Blaine David KIDD
Julius Luke MATTHYS
Thomas Nash CULLITY

Principal Activities

During the period the principal activity of the Project was the management of a Sandalwood plantation.

Change of State of Affairs

There was no significant change in the state of affairs of the Project.

Results of Operations and Likely Developments

The Project made a profit for the financial year ended 30 June 2005 of \$637,120 (2004: \$679,935).

This is due to the increment in the valuation of the sandalwood trees.

The plantation was established in 2000 and is now 5 years old.

The price of Sandalwood continues to rise at the Indian auctions in Tamil Nadu and at the latest auction in July 2005, the price had risen to \$US68,000 per tonne on average.

This compares with an average price per tonne of \$US60,000 at the same auctions in January 2005.

An extract from a report on the Plantation by our independent expert forester, Mr Peter Kimber follows:

Present State of the Plantation

TFS 2 was planted in two different configurations with two different long-term host mixtures. The northern-most third of the Plantation has the long-term hosts and the sandalwood planted in different rows. The hosts in this area are alternate rows of *Cassia Siamea* and *Cathormium Umbellatum*. This part of the Plantation is by far the most successful and would be up to expected growth rates and tree size if it were not for the earlier depredations of *Phytophthora* root rot. It is, nevertheless, good and getting better.

The southern two-thirds of the Plantation was planted as an intimate mixture of sandalwood and the long-term host *Cathormium*. While the short-term *Sesbania Formosa* hosts were still alive, the sandalwood trees flourished. When they died out late in the second year (as was expected), the *Cathormium* long-term hosts were stunted and unthrifty due to their having been heavily shaded by the *Sesbania*, and were quite incapable of hosting the sandalwood. As a result, the sandalwood trees declined alarmingly. Fortunately, the land on which the Plantation had been established previously carried a crop of *Leucena Leucocephala* trees, used for cattle fodder. *Leucena* is a prolific producer of seed that lies dormant in the ground. With the cultivations that were made to maintain the Plantation, *Leucena* seed was brought to the surface and germinated. Most of the southern part of the Plantation is now hosted by *Leucena* and is recovering reasonably well. Patches where *Leucena* failed to germinate were very open and permitted the remnant *Cathormium* hosts to slowly recover. By June 2003 they were large enough to provide some sustenance to the parasitic sandalwood.

In summary, a lot of management expertise and energy has gone into correcting poor Plantation design and in controlling *Phytophthora* root rot over the past two years. The effort has been largely successful, but the sandalwood trees remain somewhat smaller than would be expected at 4 years of age.

Management Activities

The Plantation was irrigated on a number of occasions throughout the year and experimental infrastructure was established in an adjacent block of the Plantation in order to determine the relationship between the level of moisture in the soil and the growth rates of the tree crop. Data collected from this during the 2004 dry season will provide guidelines as to the optimal time to irrigate the Plantation. These will be applicable to TFS 2. Irrigation furrows between the rows of trees were maintained three times during the year using a "go-devil" – a set of opposed plough discs which cultivates to create a mound of soil with a furrow on either side, through which irrigation water can flow.

Sandalwood trees were pruned for the second time of three planned prunings aimed at creating branch-free boles up to 2.5 metres high.

Two aerial applications of the fungicide "Agriphos 600" at the rate of 20 litres of chemical per hectare were made at 6 month intervals in an attempt to render the sandalwood trees resistant to the root-rotting fungus Phytophthora which had earlier caused severe defoliation and a worrying level of mortality. Control of the disease has been good with the exception of the eastern edge of the Plantation where the outlets from the water supply channel have leaked making the Plantation permanently wet a few metres in from the channel.

An aerial application of 100 kilograms per hectare of the fertiliser Diammonium Phosphate (DAP) was made in an attempt to assist the sandalwood to recover from the setbacks they had suffered from Phytophthora and a lack of hosts over the past 18 to 24 months.

Conclusion

This Plantation is recovering after a difficult start and although the trees are somewhat below optimum size for their age, we hope that these trees will continue to recover and measurements are being taken on a regular basis to objectively assess their development.

Balance of Interests

As at 30 June 2005, the balance of lease interests held by Growers is 198 (30 June 2004: 198).

Interests Held by Manager and Related Parties

At 30 June 2005, no lease interests are held by the Manager and 60 lease interests are held by Related Parties.

Environmental Regulations

The Project is not subject to any significant environmental regulations under any State, Commonwealth or Territory Law.

Fees Paid to the Manager and Associates

Fees of \$68,387 were paid to Tropical Forestry Services Ltd, Manager of TFS Sandalwood Project No.2, for provision of its services during the period ended 30 June 2005 (period ended 30 June 2004: \$67,787).

Insurance of Officers of the Company or Auditors

No indemnities have been given or insurance premiums paid, during or since the end of the financial year, for any person who is or has been an officer or auditor of the Manager or the Project, other than the following.

The company that is related to the Manager has paid premiums to insure each of the directors against liabilities for costs and expenses incurred by them in defending any legal proceedings arising out of their conduct while acting in the capacity of director of the Manager. The cover included professional indemnity as well as directors and officers insurance. The total amount of the premium paid was \$66,550.

MANAGER'S REPORT (CONTINUED)

Auditor's Independence Declaration

The auditor's independence declaration for the year ended 30 June 2005 has been received and can be found on page 16 of the financial report.

For and on behalf of the Directors of Tropical Forestry Services Ltd:

A handwritten signature in black ink, appearing to read 'G. Scott', with a stylized flourish at the end.

Graeme Eric Scott

Perth, 7 October 2005



Independent Auditor's Report

To the Members of TFS Sandalwood Project No.2

Scope

The financial report and directors' responsibility

The financial report comprises the statement of financial position, statement of financial performance, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for TFS Sandalwood Project No.2 (the Project), for the year ended 30 June 2005.

The directors of the responsible entity are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Audit approach

We have conducted an independent audit of the financial report in order to express an opinion on it to the members of the Project. Our audit has been conducted in accordance with Australian Auditing Standards to provide reasonable assurance whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal controls, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001, including compliance with Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Project's financial position, and of its performance as represented by the results of its operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

Independence

We are independent of the Project, and have met the independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001

In accordance with ASIC Class Order 05/83, we declare to the best of our knowledge and belief that the auditor's declaration set out on page 16 of the financial report has not changed as at the date of providing our audit opinion.



Independent Auditor's Report

To the Members of TFS Sandalwood Project No.2 (CONTINUED)

Audit Opinion

In our opinion, the financial report of TFS Sandalwood Project No.2 is in accordance with:

- (a) the Corporations Act 2001, including:
 - (i) giving a true and fair view of the Project's financial position as at 30 June 2005 and of its performance for the year ended on that date; and
 - (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and
- (b) other mandatory financial reporting requirements in Australia.



RIX LEVY FOWLER
Chartered Accountants



PHILLIP RIX FCA, A.S.I.A.
Partner

DATED at PERTH this 7th October 2005

TFS SANDALWOOD PROJECT NO.2
STATEMENT OF FINANCIAL PERFORMANCE
FOR THE YEAR TO 30 JUNE 2005

	NOTE	2005 \$	2004 \$
REVENUE FROM ORDINARY ACTIVITIES			
Establishment fees		-	-
Lease & management fees		68,387	67,787
Interest received		-	-
Net increment in net value of sandalwood trees		637,120	679,935
		<u>705,507</u>	<u>747,722</u>
EXPENSES FROM ORDINARY ACTIVITIES			
Accounting fees		1,500	-
Audit fees		2,000	-
Bad / Doubtful debt expense		-	-
Bank charges		-	-
Filing fees		650	-
Leasing expenses		26,812	24,076
Management fees		41,575	43,711
Reimbursement of expenses by Manager		(4,150)	-
		<u>68,387</u>	<u>67,787</u>
NET OPERATING INCOME FROM ORDINARY ACTIVITIES		<u>637,120</u>	<u>679,935</u>

The Statement of Financial Performance should be read in conjunction with the accompanying notes.

TFS SANDALWOOD PROJECT NO.2
STATEMENT OF FINANCIAL POSITION
AT 30 JUNE 2005

	NOTE	2005 \$	2004 \$
CURRENT ASSETS			
Cash	2	-	-
Receivables	3	7,413	5,874
Other	4	46,427	46,427
TOTAL CURRENT ASSETS		53,840	52,301
NON CURRENT ASSETS			
Sandalwood Trees	5	3,379,800	2,742,680
Other	4	371,414	417,840
TOTAL NON-CURRENT ASSETS		3,751,214	3,160,520
TOTAL ASSETS		3,805,054	3,212,821
CURRENT LIABILITIES			
Payables	6	7,413	5,874
Unearned Income	7	46,427	46,427
TOTAL CURRENT LIABILITIES		53,840	52,301
NON CURRENT LIABILITIES			
Unearned Income	7	371,414	417,840
TOTAL NON-CURRENT LIABILITIES		371,414	417,840
TOTAL LIABILITIES		425,254	470,141
NET ASSETS		3,379,800	2,742,680
GROWERS' FUNDS			
Undistributed income reserve	8	3,379,800	2,742,680
EQUITY		3,379,800	2,742,680

The Statement of Financial Position should be read in conjunction with the accompanying notes.

TFS SANDALWOOD PROJECT NO.2
 STATEMENT OF CASH FLOWS
 FOR THE YEAR TO 30 JUNE 2005

	NOTE	2005 \$	2004 \$
CASH FLOWS FROM OPERATING ACTIVITIES			
<u>Inflows</u>			
Receipts from growers		27,261	15,486
Interest received		-	-
<u>(Outflows)</u>			
Payments to suppliers		(27,261)	(15,486)
Bank charges		-	-
	10(b)	0	-
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES			
Payment for establishment of plantations		-	-
CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES			
Other		-	-
Net increase / (decrease) in cash held		0	-
Cash at beginning of financial year		-	-
Cash at end of financial year	10(a)	0	-

The Statement of Cash Flows should be read in conjunction with the accompanying notes.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR 30 JUNE 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Accounting

The financial report is a general purpose financial report which has been prepared in accordance with the Project's constitution and the requirements of the Corporations Act 2001, which includes applicable accounting standards. Other mandatory professional reporting requirements (Urgent Issues Group Consensus Views) have also been complied with.

The financial report has been prepared in accordance with the historical cost convention, except for Sandalwood trees (which are self-generating assets), which are recorded at net market value.

(b) Revenue Recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Project and the revenue can be reliably measured. Specific revenues are recognised as follows.

Operations revenue:

- Sandalwood Lot sales (Establishment Fees) are recognised as revenue on acceptance of the application by the Responsible Entity.
- Lease and Management Fees are recognised as revenue in the period to which they relate.

(c) Sandalwood Trees

Sandalwood trees are measured at their market value at each reporting date. The net market value is determined as being the net present value of expected future cash flows (discounted at a risk adjusted rate).

Net increments or decrements in the market value of the Sandalwood trees are recognised as revenues or expenses in the Statement of Financial Performance, determined as:

- (i) the difference between the total net market values of the trees recognised as at the beginning of the period and the total net market values of the trees recognised as at the reporting date; less
- (ii) costs incurred during the reporting period to acquire and plant Sandalwood trees.

Costs incurred in maintaining or enhancing trees are recognised as expenses when incurred. Therefore, those costs are not included in the determination of the net increment in net market values.

(d) Income Tax

Under current legislation, the scheme is not subject to income tax provided the Growers are presently entitled to the income of the Project.

Unrealised gains and losses on investments which are regarded as income, are transferred to Growers' funds and are not distributable and assessable until realised. When income is realised, tax will be paid by the growers at the marginal rates of tax that exist under the relevant tax legislation at the date of realisation.

(e) Cash and Equivalents

For the purposes of the Statement of Cash Flows, cash and cash equivalents includes cash on hand and in banks, and short-term deposits at call.

(f) Receivables

Receivables are recognised and carried at original invoice amount, or the amount due less a provision for any uncollectible debts. An estimate for doubtful debts is made when collection of the full amount is no longer probable.

(g) Payables

Liabilities for creditors and other amounts are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received. Payables to related parties are carried at the principal amount.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR 30 JUNE 2005 (CONTINUED)

(h) Unearned Income

Prepaid Lease and Management Fees are recognised on a straight line basis over the term of the project as this is considered to closely approximate the value of the service provided. The unearned portion is deferred and recorded as unearned income.

(i) Goods and Services Tax

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Taxation Office. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of the expense. Receivables and payables in the Statement of Financial Position are shown inclusive of GST.

(j) Adoption of Australian Equivalents to International Financial Reporting Standards

The responsible entity is preparing and managing the transition to Australian Equivalents to International Financial Reporting Standards (AIFRS) effective for the financial years commencing from 1 January 2005. The adoption of AIFRS will be reflected in the scheme's financial statements for the year ending 30 June 2006. On first time adoption of AIFRS, comparatives for the financial year ended 30 June 2005 are required to be restated. The majority of the AIFRS transitional adjustments will be made retrospectively against retained earnings at 1 July 2004.

The responsible entity's management are assessing the significance of these changes and preparing for their implementation. The impact of the alternative treatments and elections under AASB 1: First Time Adoption of Australian Equivalents to International Financial Reporting Standards has been considered where applicable.

The directors of the responsible entity are of the opinion that there are no material differences in the accounting policies on conversion to AIFRS. Users of the financial statements should note, however, that the amounts disclosed could change if there are any amendments by standard setters to the current AIFRS or interpretation of the AIFRS requirements changes from the continuing work being performed by the responsible entity.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2005 (CONTINUED)

	NOTE	2005 \$	2004 \$
2. CASH			
Cash at bank		-	-
3. RECEIVABLES			
Outstanding fees (i)		7,413	5,874
Less: Provision for doubtful debts		-	-
		<u>7,413</u>	<u>5,874</u>

(i) Outstanding fees represent moneys receivable from growers for the cost of establishment of the plantation. No interest has been charged on amounts due.

4. OTHER ASSETS

Current

Prepayments (i)		46,427	46,427
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Non Current

Prepayments (i)		371,414	417,840
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(i) prepayments represent lease and management fees paid to the manager in advance of the period in which the lease and management services are to be provided.

5. SANDALWOOD TREES

at cost of establishment (still to be planted at balance date)		-	-
at net market value (planted at balance date)		3,379,800	2,742,680
		<u>3,379,800</u>	<u>2,742,680</u>

(a) Physical quantity of sandalwood trees planted and owned

Number of sandalwood trees		9,511	9,511
Area under lease (planted)		33.0	33.0
Area under lease (to be planted)		0.0	0.0
Growers in project (units)		198	198

(b) Nature of Asset

Investors in the TFS Sandalwood Project No.2 who are referred to as "Growers" subscribed for Sandalwood Lots of size one-sixth of a hectare each upon which Sandalwood trees have been established.

The Sandalwood plantation is situated at King Location 385, approximately 8 kilometres from the Western Australian township of Kununurra.

The land upon which the Sandalwood plantation is located is owned by the Responsible Entity. Growers lease the land from the Responsible Entity for the duration of the Project. The Project will continue in operation until the date on which the last of the Growers has been advised that the produce of the Sandalwood crop from each leased area which is leased by the Grower has been harvested and that the relevant Lease and Management Agreement has been terminated but in any event, not later than 30 June 2015.

The net market value of the Sandalwood trees has been determined in accordance with a Directors' valuation in accordance with the AASB's to reflect the market value of plantation.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2005 (CONTINUED)

NOTE	2005 \$	2004 \$
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(c) Significant Assumptions

Significant assumptions made in determining the net market value of the trees are:

- 100% of the trees will be harvested and sold in 2014/2015;
- the price of Sandalwood is constant in real terms;
- the costs expected to arise on harvest are constant in relative terms; and
- the pre-tax average real rate at which the net cash flows have been discounted is at 17% per annum

Cash flows exclude income taxes and are expressed in real terms.

6. PAYABLES

Trust funds payable to manager (i)	7,413	5,874
GST payable	-	-
Other	-	-
	<u>7,413</u>	<u>5,874</u>

(i) Trust funds payable to the manager represents the sum of monies payable by growers to the manager under the lease and management agreement yet to be paid across. No interest in payable on outstanding amounts.

7. UNEARNED INCOME

Current

Prepaid lease & management fees	<u>46,427</u>	<u>46,427</u>
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Non Current

Prepaid lease & management fees	<u>371,414</u>	<u>417,840</u>
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8. TRUST FUNDS

Undistributed Income

The undistributed income reserve contains realised and unrealised income and expenses that are not yet assessable/deductible.

Opening balance	2,742,680	2,062,745
Net operating income	637,120	679,935
Closing balance	<u>3,379,800</u>	<u>2,742,680</u>

9. DISTRIBUTION PAID

No distributions were payable or paid during the period.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2005 (CONTINUED)

	NOTE	2005 \$	2004 \$
10. STATEMENT OF CASHFLOWS			
(a) Reconciliation of cash			
Cash balance comprises:			
Cash at bank		-	-
(b) Reconciliation of net operating income to net cash flows from operating activities			
Net operating income		637,120	679,935
Adjustments:			
(Increase) / decrease in net receivables		(1,539)	(5,874)
(Increase) / decrease in prepayments		46,426	46,427
(Increase) / decrease in market value of sandalwood trees		(637,120)	(679,935)
Increase / (decrease) in GST payable		-	-
Increase / (decrease) in accounts payable		1,539	5,874
Increase / (decrease) in unearned income		(46,426)	(46,427)
Net cash inflow / (outflow) from operating activities.		-	-

11. RELATED PARTY DISCLOSURE

(a) Manager

The Manager of the TFS Sandalwood Project No.2 is Tropical Forestry Services Ltd, whose immediate and ultimate holding company is TFS Corporation Limited.

(b) Directors of the Manager

The Directors of the Manager during the period were:

Frank Cullity WILSON
Graeme Eric SCOTT
Stephen Lee ATKINSON
Ronald Lionel EACOTT
Blaine David KIDD
Julius Luke MATTHYS
Thomas Nash CULLITY

(c) Fees paid or payable to the Manager

The Manager receives all Establishment, Lease and Management Fees which have been paid by the Project during the period.

The Manager provides Sandalwood plantation establishment and management services for TFS Sandalwood Project No.2 and carries out the custodial and administrative functions.

Transactions between TFS Sandalwood Project No.2 and Tropical Forestry Services Ltd result from normal dealings with that company as the Project's Manager.

(d) Holdings of Directors and Director Related Entities

A total of 60 lease interests are held by Directors or parties related to Directors on the same terms and conditions as other Growers. No amount is outstanding at year end.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2005 (CONTINUED)

12. AUDIT

Rix Levy Fowler are the auditors of the Project and the Project's Compliance Plan.

13. SEGMENT INFORMATION

The Project operates in one industry segment, being investment activities and in one geographical segment, being Australia.

14. SUBSEQUENT EVENTS

Since 30 June 2005, there has not been any matter or circumstance not otherwise dealt with in the financial report that has significantly affected or may significantly affect the Project.

15. FINANCIAL INSTRUMENTS

(a) Interest Rate Risk

Interest rate risk is the risk that a financial investment's value will fluctuate as a result of changes in market interest rates. The Project's exposure to interest rate risk is as follows:

Financial Assets

Cash	\$0
Weighted average debit interest rate (p.a.)	0%
Weighted average credit interest rate (p.a.)	3.00%
Interest rate type	Variable

The Project had no other financial assets or financial liabilities with exposure to interest rate risk as at balance date.

(b) Credit Risk

Credit risk represents the risk that a counterparty will fail to perform contractual obligations under a contract. The Project's only credit risk exposure relates to debtors who comprise the receivable balance at 30 June 2005. A provision for doubtful accounts is recognised when collection of the full nominal amount is uncertain.

(c) Net Fair Value

The Project's financial assets and liabilities included in the Statement of Financial Position are carried at their net fair value. Refer to Note 1 for the methods and assumptions adopted in determining net fair values for Sandalwood trees.

**DIRECTORS' DECLARATION
FOR THE YEAR TO 30 JUNE 2005**

In accordance with a resolution of the Directors of Tropical Forestry Services Ltd, I state that:

In the opinion of the Directors:

- (a) the financial statements and notes of the Project are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the scheme's financial position as at 30 June 2005 and its performance, as represented by the results of its operations and its cash flows for the period ended on that date; and
 - (ii) complying the Accounting Standards and the Corporations Regulations; and
- (b) there are reasonable grounds to believe that the scheme will be able to pay its debts as and when they become due and payable.

On behalf of the Board
Tropical Forestry Services Ltd



GRAEME ERIC SCOTT
DIRECTOR

Dated: this 7th day of October 2005



To the Board of Directors of the Manager of TFS Sandalwood Project No.2

Auditor's Independence Declaration

This declaration is made in connection with our audit of the financial report of TFS Sandalwood Project No.2 for the year ended 30 June 2005 and in accordance with the provisions of the Corporations Act 2001.

We declare that, to the best of our knowledge and belief, there have been:

- No contraventions of the auditor independence requirements of the Corporations Act 2001 in relation to this audit;
- No contraventions of the Code of Professional Conduct of the Institute of Chartered Accountants in Australia in relation to this audit.

Yours faithfully

Rix Levy Fowler
Chartered Accountants

PHILLIP RIX FCA, A.S.I.A.
Partner

DATED at PERTH this 7th October 2005