

TFS SANDALWOOD PROJECT NO.2

ANNUAL REPORT
FOR THE YEAR TO 30 JUNE 2008

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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 2008.

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
Ronald Lionel EACOTT
Blake William MYLES
Ian MacKenzie MURCHISON
Ian Ross THOMPSON
Tim CROOT

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 2008 of \$478,899 (2007: \$1,361,027).

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

The plantation was established in 2000 and is now 8 years old.

Due to the decline in the supply of Indian Sandalwood in India, only small quantities of heartwood have been sold at recent auctions. Consistent price growth has been the result of the growing imbalance between the supply and demand that characterises the Indian Sandalwood market.

The price of Indian Sandalwood has continued to increase at a compounded rate of 21% over the last 16 years. At the latest auction held by the Tamil Nadu Forestry Department, 108 tonnes of heartwood was sold for an average price of \$107,985 per tonne (December 2007).

Expert Forester's Report

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

TFS Sandalwood Project No 2 is situated on King Location 254 and the area it covers is designated compartment 83A

This plantation was established in the year 2000 using two distinct configurations of sandalwood and its hosts. The northernmost one third of the plantation has alternating rows of sandalwood and the long-term host *Cassia siamea* and this part of the plantation is healthy and vigorous.

The remaining two thirds was planted as an intimate mixture of sandalwood, the short-term host *Sesbania* and the long-term host species *Cathormion*. Unfortunately this long-term host is very intolerant of shading, and the dense growth of *Sesbania* suppressed it, to the point of death in some areas. The *Sesbania* died out when the plantation was 3 years old and the sandalwood was left with few effective hosts. As a consequence it stagnated and became unthrifty. An immediate attempt was made to replant at least some of the areas with infills of Indian rosewood (*Dalbergia latifolia*) which is a tough and successful host. This was partially successful in correcting the situation but success was limited by a dense volunteer growth of the tropical leguminous tree *Leucena* that proved to have no hosting qualities. The area had previously been used for growing this tree for cattle feed. *Leucena* is a prolific seed producer, and the seed lies dormant in the soil for many years. The cultivation and irrigation provided for the sandalwood plantation stimulated it to germinate in vast numbers.

MANAGER'S REPORT (CONTINUED)

Over the past year the plantation manager has killed all the *Leucena*, felled all the dead stems by chainsaw, and mulched them in situ to a coarse woody ground cover. Recently this part of the plantation was replanted with the long-term host species *Dalbergia latifolia* and *Cassia siamea* and this operation has been to date a total success. The remaining original *Cathormium* hosts have also responded to the treatment and are now providing sustenance to the sandalwood. There remains a reasonable stocking of sandalwood trees which should shortly respond to the much improved host status of the plantation. Removing the *Leucena* shade has exposed some sandalwood to sunscorch to which it is prone on the northwest facing part of its bole. Susceptible trees have been treated using a white clay-based spray to protect the bole from the sun.

Standard operations that have been carried out over the year include irrigation, weed control, and maintenance of water supply channels, drains for the removal of irrigation water and access tracks.

As sandalwood plantations increase in age the frequency of irrigation decreases to a cycle of 6 to 7 weeks at age 5 years, and this is how often TFS 2 is now watered throughout the dry season. At each irrigation water is flooded from the water supply channel via valves and guided into the furrows that run between the rows of trees over a period of about 24 hours after which the excess water is drained away.

Regular weed control has involved one to two passes of a slasher between the tree rows, done as soon as the soil surface has dried out after the wet season. Weeds within the tree rows were controlled by herbicide sprays applied through side nozzles. Periodically during the dry season creepers that threaten to smother the smaller trees have been manually removed. This tends to be an on-going problem as birds eat the fruit of the most problematic creeper – stinking passionfruit - and bring the seeds into the plantation from the bush.

Maintenance of the water supply channels and drains consisted of the removal of silt and periodic spraying to control weed growth. Maintenance tracks have been graded at the end of the wet season and their verges have been sprayed periodically to control weed growth.

In summary, this plantation has been vastly improved over the past year.

Auditor's Independence Declaration

The auditor's independence declaration for the year ended 30 June 2008 has been received and can be found on page 21 of the financial report.

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



Frank Cullity Wilson

Perth, 14th day of January, 2009

Independent Audit Report

To the Members of TFS Sandalwood Project No.2

We have audited the accompanying financial report of TFS Sandalwood Project No.2, which comprises the balance sheet as at 30 June 2008, and the income statement, statement of changes in equity and cash flow statement for the year ended on that date, a summary of significant accounting policies and other explanatory notes and the directors' declaration at the year's end.

Directors Responsibility for the Financial Report

The directors of the manager are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Act 2001. This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1, the directors also state, in accordance with Accounting Standards AASB 101: Presentation of Financial Statements, that compliance with the Australian equivalents to International Financial Reporting Standards (IFRS) ensures that the financial report, comprising the financial statements and notes, complies with IFRS.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report and the remuneration disclosures in the directors' report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Independence

In conducting our audit, we followed applicable independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.

Auditor's Opinion

In our opinion:

- a. The financial report of TFS Sandalwood Project No.2 is in accordance with the Corporations Act 2001, including:
 - i. giving a true and fair view of the project's financial position as at 30 June 2008 and of their performance for the year ended on that date; and
 - ii. complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001; and
- b. The financial report also complies with International Financial Reporting Standards as disclosed in Note 1



BENTLEYS
Chartered Accountants



RANKO MATIĆ
Director

DATED at PERTH this 14th day of January 2009

TFS SANDALWOOD PROJECT NO.2
 INCOME STATEMENT
 FOR THE YEAR TO 30 JUNE 2008

	NOTE	2008 \$	2007 \$
REVENUE			
Establishment fees		-	-
Lease & management fees		77,348	69,707
Other income:			
Net increment in net value of biological assets		478,899	1,361,027
		<u>556,247</u>	<u>1,430,734</u>
EXPENSES			
Audit fees		1,075	1,825
Bad debt/ Provision for impairment of receivables		3,300	-
Leasing expenses		35,773	28,132
Management fees		41,575	41,575
Reimbursement of expenses by Manager		(4,375)	(1,825)
		<u>77,348</u>	<u>69,707</u>
NET PROFIT		<u>478,899</u>	<u>1,361,027</u>

The Income Statement should be read in conjunction with the accompanying notes.

TFS SANDALWOOD PROJECT NO.2
BALANCE SHEET
AT 30 JUNE 2008

	NOTE	2008 \$	2007 \$
CURRENT ASSETS			
Cash and cash equivalents	2	-	-
Trade and other receivables	3	3,000	19,107
Other	4	46,427	46,427
TOTAL CURRENT ASSETS		<u>49,427</u>	<u>65,534</u>
NON CURRENT ASSETS			
Biological assets	5	5,971,402	5,492,503
Other	4	232,133	278,560
TOTAL NON-CURRENT ASSETS		<u>6,203,535</u>	<u>5,771,063</u>
TOTAL ASSETS		<u>6,252,962</u>	<u>5,836,597</u>
CURRENT LIABILITIES			
Trade and other payables	6	3,000	19,107
Unearned Income	7	46,427	46,427
TOTAL CURRENT LIABILITIES		<u>49,427</u>	<u>65,534</u>
NON CURRENT LIABILITIES			
Unearned Income	7	232,133	278,560
TOTAL NON-CURRENT LIABILITIES		<u>232,133</u>	<u>278,560</u>
TOTAL LIABILITIES		<u>281,560</u>	<u>344,094</u>
NET ASSETS		<u>5,971,402</u>	<u>5,492,503</u>
GROWERS' FUNDS			
Undistributed income reserve		5,971,402	5,492,503
EQUITY		<u>5,971,402</u>	<u>5,492,503</u>

The Balance Sheet should be read in conjunction with the accompanying notes.

TFS SANDALWOOD PROJECT NO.2
 STATEMENT OF CHANGES IN EQUITY
 FOR THE YEAR TO 30 JUNE 2008

	NOTE	Undistributed Income \$	Total \$
		<u> </u>	<u> </u>
Balance at 1.7.2006		4,131,476	4,131,476
Profit for period		1,361,027	1,361,027
Sub-Total		<u>5,492,503</u>	<u>5,492,503</u>
Distributions provided for or paid		-	-
Balance at 30.6.2007		<u>5,492,503</u>	<u>5,492,503</u>
Balance at 1.7.2007		5,492,503	5,492,503
Profit for period		478,899	478,899
Sub-Total		<u>5,971,402</u>	<u>5,971,402</u>
Distributions provided for or paid		-	-
Balance at 30.6.2008		<u>5,971,402</u>	<u>5,971,402</u>

The Statement of Changes in Equity should be read in conjunction with the accompanying notes.

TFS SANDALWOOD PROJECT NO.2
 CASHFLOW STATEMENT
 FOR THE YEAR TO 30 JUNE 2008

	NOTE	2008 \$	2007 \$
CASH FLOWS FROM OPERATING ACTIVITIES			
<u>Inflows</u>			
Receipts from growers		54,763	20,450
<u>(Outflows)</u>			
Payments to suppliers		(54,763)	(20,450)
	8(b)	<u>-</u>	<u>-</u>
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES			
Payment for establishment of plantations		-	-
		<u>-</u>	<u>-</u>
CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES			
Other		-	-
		<u>-</u>	<u>-</u>
Net increase / (decrease) in cash held		-	-
Cash at beginning of financial year		-	-
Cash at end of financial year	8(a)	<u>-</u>	<u>-</u>

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 2008

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial report covers the TFS Sandalwood Project No.2. The TFS Sandalwood Project No.2 is a Managed Investment Scheme registered in Australia.

Basis of Preparation

The financial report is a general purpose financial report that has been prepared in accordance with Australian Accounting Standards, including Australian Accounting Interpretations and other authoritative pronouncements of the Australian Accounting Standards Board and the Corporations Act 2001.

Australian Accounting Standards set out accounting policies that the AASB has concluded would result in a financial report containing relevant and reliable information about transactions, events and conditions to which they apply. Compliance with Australian Accounting Standards ensures that the financial statements and notes also comply with International Financial Reporting Standards. Material accounting policies adopted in the preparation of this financial report are presented below. They have been consistently applied unless otherwise stated.

The financial report has been prepared on an accruals basis and is based on historical costs, except for Sandalwood trees (which are biological assets), which are recorded at net market value. This report does not take into account changing money values or, except where stated, current valuations of non current assets. Cost is based on the fair values of the consideration given in exchange for assets.

Accounting Policies

(a) 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. All revenue is stated net of the amount of goods and services tax (GST). The following specific revenue recognition criteria must also be met before revenue is recognised.

Operating revenue:

- Timber Lot sales (Establishment Fees) are recognised as revenue on acceptance of the application by the manager. The directors of the manager are of the view that this recognition policy most appropriately reflects the timing in which the probability of the economic benefits flows to the entity based on commitments made by investors and costs expended to date.
- Lease and Management Fees are recognised as revenue in the period to which they relate.

(b) Biological assets

Sandalwood trees are measured at the Manager's Director's assessment of 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 Income Statement, 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.

(c) 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.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR 30 JUNE 2008 (CONTINUED)

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.

(d) Cash and Cash Equivalents

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

(e) Trade and other Receivables

Trade 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. The amount provided for is the portion of deemed uncollectible after the value of trees as security has been taken into account. Bad debts are written off as incurred. Amounts due from growers are recognised and carried at the amount stated in the loan agreement plus accrued interest, less any principal repayments received.

(f) Trade and other 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, whether or not billed to the consolidated entity. Payables to related parties are carried at the principal amount. Interest is recognised as an expense on accruals basis. Deferred cash settlements are recognised at the present value of the outstanding consideration payable on the acquisition of an asset discounted at prevailing commercial borrowing rates.

(g) 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.

(h) 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 Balance Sheet are shown inclusive of GST.

Cash flows are presented in the cash flow statement on a gross basis, except for the GST component of investing and financing activities, which are disclosed as operating cash flows.

(i) Impairment of Assets

At each reporting date, the economic entity reviews the carrying values of its tangible and intangible assets to determine whether there is any indication that those assets have been impaired. If such an indication exists, the recoverable amount of the asset, being the higher of the asset's fair value less costs to sell and value in use, is compared to the asset's carrying value. Any excess of the asset's carrying value over its recoverable amount is expensed to the income statement.

(j) Financial Instruments Recognition and Initial Measurement

Financial instruments, incorporating financial assets and financial liabilities, are recognised when the entity becomes a party to the contractual provisions of the instrument. Trade date accounting is adopted for financial assets that are delivered within timeframes established by marketplace convention.

Financial instruments are initially measured at fair value plus transactions costs where the instrument is not classified as at fair value through profit or loss. Transaction costs related to instruments classified as at fair value through profit or loss are expensed to profit or loss immediately. Financial instruments are classified and measured as set out below.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR 30 JUNE 2008 (CONTINUED)

Derecognition

Financial assets are derecognised where the contractual rights to receipt of cash flows expires or the asset is transferred to another party whereby the entity is no longer has any significant continuing involvement in the risks and benefits associated with the asset. Financial liabilities are derecognised where the related obligations are either discharged, cancelled or expire. The difference between the carrying value of the financial liability extinguished or transferred to another party and the fair value of consideration paid, including the transfer of non-cash assets or liabilities assumed, is recognised in profit or loss.

Financial instruments are initially measured as cost on trade date, which includes transaction costs, when the related contractual rights or obligations exist. Subsequent to initial recognition these instruments are measured as set out below.

Classification and Subsequent Measurement

Financial assets at fair value through profit and loss

Financial assets are classified at fair value through profit or loss when they are held for trading for the purpose of short term profit taking, where they are derivatives not held for hedging purposes, or designated as such to avoid an accounting mismatch or to enable performance evaluation where a group of financial assets is managed by key management personnel on a fair basis in accordance with a documented risk management or investment strategy. Realised and unrealised gains and losses arising from changes in fair value are included in profit or loss in the period in which they arise.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are stated at amortised cost using the effective interest rate method.

Held-to-maturity investments

These investments have fixed maturities, and it is the company's intention to hold these investments to maturity. Any held-to-maturity investments held by the company are stated at amortised cost using the effective interest rate method.

Available-for-sale financial assets

Available-for-sale financial assets include any financial assets not included in the above categories. Available-for-sale financial assets are reflected at fair value. Unrealised gains and losses arising from changes in fair value are taken directly to equity.

Financial Liabilities

Non-derivative financial liabilities are recognised at amortised cost, comprising original debt less principal payments and amortisation.

Fair value

Fair value is determined based on current bid prices for all quoted investments. Valuation techniques are applied to determine the fair value for all unlisted securities, including recent arm's length transactions, reference to similar instruments and option pricing models.

Impairment

At each reporting date, the company assesses whether there is objective evidence that a financial instrument has been impaired. In the case of available-for-sale financial instruments, a prolonged decline in the value of the instrument is considered to determine whether an impairment has arisen. Impairment losses are recognised in the income statement.

(k) Comparative Figures

When required by Accounting Standards, comparative figures have been adjusted to conform to changes in presentation for the current financial year.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR 30 JUNE 2008 (CONTINUED)

Critical Accounting Estimates and Judgements

The directors of the Manager evaluate estimates and judgements incorporated into the financial report based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events and are based on current trends and economic data obtained both externally and within the group.

Key Estimate – Biological Asset valuation

As referred to in Note 1(b) and Note 5, as required under the accounting standards the directors of the manager make an estimate as to the market value of the standing sandalwood trees held by the scheme. The carrying value of the sandalwood trees at year end is shown in Note 5. The market value is calculated as the net present value of expected future cashflows. The estimates used in calculating the expected future cashflows include assumptions on yields in terms of survival rates of trees, and heartwood and oil content of the trees, as well as assumptions as to the future price of the heartwood logs. All estimates are based on the best information currently available and where there is any doubt the scheme uses the more conservative estimates.

Key Estimate and Judgement – Provision for Impairment of Receivables

The entity assesses the likelihood of any impairment of the entity's receivables at each reporting date by evaluating those payments that are in arrears and making a judgement as to the likelihood of that receivable not being paid based on all knowledge available of the debtor. When recovery is assessed as doubtful, the entity estimates by how much the security held by the company against the receivable will be insufficient to adequately cover the debt and records a provision accordingly. The total provision for impairment of receivables at year end is shown in Note 3.

The financial report was authorised for issue on 14 January 2009 by the board of directors of the manager.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2008 (CONTINUED)

	NOTE	2008 \$	2007 \$
2. CASH AND CASH EQUIVALENTS			
Cash at bank		-	-
3. TRADE AND OTHER RECEIVABLES			
Outstanding fees (i)		6,300	19,107
Less: Provision for impairment of receivables		(3,300)	-
		<u>3,000</u>	<u>19,107</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)		<u>46,427</u>	<u>46,427</u>
Non Current			
Prepayments (i)		<u>232,133</u>	<u>278,560</u>
 (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. BIOLOGICAL ASSETS			
Sandalwood trees at cost of establishment (still to be planted at balance date)		-	-
Sandalwood trees at net market value (planted at balance date)		<u>5,971,402</u>	<u>5,492,503</u>
		<u>5,971,402</u>	<u>5,492,503</u>
(a) Physical quantity of sandalwood trees planted and owned			
Number of sandalwood trees		9,282	9,282
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 an associate of the Manager. Growers lease the land from the Manager 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 2008 (CONTINUED)

(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 between 15%-17% per annum

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

	NOTE	2008 \$	2007 \$
6. TRADE AND OTHER PAYABLES			
Trust funds payable to manager (i)		3,000	19,107
GST payable		-	-
Other		-	-
		<u>3,000</u>	<u>19,107</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 is 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>232,133</u>	<u>278,560</u>
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Represents lease and management fees received in advance of services provided.

	NOTE	2008 \$	2007 \$
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8. CASH FLOW INFORMATION

(a) Reconciliation of cash

Cash balance comprises:

Cash at bank		<u>-</u>	<u>-</u>
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(b) Reconciliation of net operating income to net cash flows from operating activities

Net operating income		478,899	1,361,027
Adjustments:			
(Increase) / decrease in net receivables		16,107	(9,801)
(Increase) / decrease in prepayments		46,427	46,427
(Increase) / decrease in market value of sandalwood trees		(478,899)	(1,361,027)
Increase / (decrease) in GST payable		-	-
Increase / (decrease) in accounts payable		(16,107)	9,801
Increase / (decrease) in unearned income		(46,427)	(46,427)

Net cash inflow / (outflow) from operating activities.		<u>-</u>	<u>-</u>
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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR TO 30 JUNE 2008 (CONTINUED)

9. 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 and Key management

The Directors and key management of the Manager during the period were:

Frank Cullity WILSON – Executive Chairman
Ronald Lionel EACOTT - Director
Blake William MYLES - Director
Ian MacKenzie MURCHISON – Director
Ian Ross THOMPSON – Executive Director
Tim CROOT – Director
Quentin MEGSON – Chief Financial Officer

(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.

(e) Key management compensation

No compensation has been paid by the scheme directly, or its Manager to key management personnel

10. AUDIT

Bentleys are the auditors of the Project and the Project's Compliance Plan. During the year the auditors received remuneration in relation to the project of \$1,075 (2007: \$1,825)

11. SEGMENT INFORMATION

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

12. SUBSEQUENT EVENTS

Since 30 June 2008 the Australian dollar exchange rate with the United States dollar has declined substantially. As this exchange rate is used as part of the calculation of the value of the biological assets this would have a material positive impact on the value of those assets of approximately \$2.4m (on a pre tax basis) as at the date of this report..

No other events have occurred since balance date that has significantly affected or may significantly affect the Project.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR TO 30 JUNE 2008 (CONTINUED)

13: FINANCIAL RISK MANAGEMENT

(a) Financial risk management

The project's financial instruments consist mainly of deposits with banks, and accounts receivable.

(i) Treasury risk management

The executive chairman and chief financial officer of the Manager regularly analyse financial risk exposure and evaluate treasury management strategies in the context of the most recent economic conditions and forecasts. The overall treasury risk management strategy is to assist the project in meeting its financial targets, whilst minimising potential adverse effects on financial performance.

(ii) Financial risk exposures and management

The main risks the project is exposed to through its financial instruments are interest rate risk, liquidity risk, foreign currency risk, credit risk, and agricultural risk.

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.

Liquidity risk

The project manages liquidity risk by monitoring forecast cash flows and ensuring that adequate unutilised borrowing facilities are maintained.

Foreign currency risk

The project is exposed to fluctuations in foreign currencies in relation to its valuation of biological assets and specifically the company owned sandalwood plantations.

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 2008. A provision for impairment is recognised when collection of the full nominal amount is uncertain.

Agricultural risk

The project is exposed to agricultural risks in relation to the establishment and maintenance of its sandalwood plantations. These risks are managed by ensuring appropriate qualified staff (including foresters and agronomists etc) are employed to undertake and monitor the agricultural activities. Those activities are underpinned by manuals that have been developed to mitigate many of the risks attributable to the plantations.

Price risk

The project is exposed to commodity price risk in relation to its valuation of biological assets and specifically the company owned sandalwood plantations.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2008 (CONTINUED)

(b) Financial instruments

(i) As at 30 June 2008 the project had not entered into any derivative financial instruments, foreign exchange contracts, interest rate swaps or similar contracts.

(ii) Net fair values

The Project's financial assets and liabilities included in the Balance Sheet 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.

(c) Sensitivity Analysis – Interest rate risk, Foreign currency risk, Price risk

The entity has performed a sensitivity analysis relating to its exposure to interest rate risk, foreign currency risk and price risk at balance date. This sensitivity analysis demonstrates the effect on the current year results and equity which could result from a change to these risks.

Interest rate sensitivity

At 30 June 2008, the effect on profit and equity as a result of changes in the after tax interest rate, with all other variables remaining constant would be as follows:

	2008 \$	2007 \$
Change in profit		
- increase in interest rate by 1% point	-	-
- decrease in interest rate by 1% point	-	-
Change in equity		
- increase in interest rate by 1% point	-	-
- decrease in interest rate by 1% point	-	-

Foreign currency risk sensitivity analysis

At 30 June 2008, the effect on profit and equity as a result of changes in the after tax value of the Australian dollar to the US Dollar, with all other variables remaining constant would be as follows:

	2008 \$	2007 \$
Change in profit		
- improvement in AUD to USD by 5%	(218,850)	(203,223)
- decline in AUD to USD by 5%	218,850	203,223
Change in equity		
- improvement in AUD to USD by 5%	(218,850)	(203,223)
- decline in AUD to USD by 5%	218,850	203,223

Price risk sensitivity analysis

At 30 June 2008, the effect on profit and equity as a result of changes in the after tax price risk, with all other variables remaining constant would be as follows:

	2008 \$	2007 \$
Change in profit		
- increase in sandalwood oil price by \$100/kg	206,240	189,491
- decrease in sandalwood oil price by \$100/kg	(206,240)	(189,491)
Change in equity		
- increase in sandalwood oil price by \$100/kg	206,240	189,491
- decrease in sandalwood oil price by \$100/kg	(206,240)	(189,491)

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2008 (CONTINUED)

14. PROJECT DETAILS

The registered office of the project is:
254 Adelaide Terrace
Perth WA 6000

The principal places of project are
Head Office
254 Adelaide Terrace
Perth WA 6000

Plantation
King Location 385, Packsaddle Road
Kununurra WA 6743

15. CHANGES IN ACCOUNTING POLICIES

The following Australian Accounting Standards have been issued or amended and are applicable to the project but are not yet effective. They have not been adopted in preparation of the financial statements at reporting date.

AASB Amendment	Standards Affected	Outline of Amendment	Application Date of the Standard	Application Date for the Group
AASB 2007-3 Amendments to Australian Accounting Standards	AASB 5: Non current assets held for sale and discontinued operations. AASB 6: Exploration for and evaluation of minerals AASB 102: Inventories AASB 107: Cash flow statements AASB 119: Employee benefits AASB 127: Consolidated and separate financial statements AASB 134: Interim financial reporting AASB 136: Impairment of assets AASB 1023: General insurance contracts. AASB 1038: Life insurance contracts	The disclosure requirements of AASB 114: Segment Reporting have been replaced due to the issuing of AASB 8: Segment Reporting in February 2007. These amendments will involve changes to segment reporting disclosures within the financial report. However it is anticipated there will be no direct impact on recognition and measurement criteria amounts to be included in the financial report.	1 January 2009	1 July 2009

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2008 (CONTINUED)

15. CHANGES IN ACCOUNTING POLICIES CONT

AASB 8 Operating Segments	AASB 114: Segment Reporting	As above	1 January 2009	1 July 2009
AASB 2207-6 Amendments to Australian Accounting Standards	AASB 1: First time adoption of AIFRS AASB 101: Presentation of financial statements. AASB 107: Cash flow statements AASB 111: Construction contracts AASB 116: Property, plant and equipment AASB 138: Intangible assets	The revised AASB 123: Borrowing Costs issued in June 2007 has removed the option to expense all borrowing costs. This amendment will require the capitalisation of all borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. However, there will be no direct impact to the amounts included in the financial group as they already capitalise borrowing costs related to qualifying assets.	1 January 2009	1 July 2009
AASB 123 Borrowing costs	AASB 123: Borrowing costs	As above	1 January 2009	1 July 2009
AASB 2007-8 Amendments to Australian Accounting Standards	AASB 101: Presentation of Financial Statements	The revised AASB 101: Presentation of Financial Statements issued in September 2007 requires the presentation of a statement of comprehensive income and makes changes to the statement of changes in equity,	1 January 2009	1 July 2009
AASB 101	AASB 101: Presentation of Financial Statements	As above.	1 January 2009	1 July 2009

All other pending Standards issued between the previous financial report and the current reporting dates have no application to the project.

**DIRECTORS' DECLARATION
FOR THE YEAR TO 30 JUNE 2008**

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 2008 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



Frank Cullity Wilson

Dated: this 14th day of January, 2009

To The Board of Directors

**Auditor's Independence Declaration
under Section 307C of the Corporations Act 2001**

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 2008 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 the audit;
- no contraventions of the Code of Professional Conduct of the Institute of Chartered Accountants in Australia in relation to the audit.

Yours faithfully



BENTLEYS
Chartered Accountants



RANKO MATIĆ
Director

DATED at PERTH this 14th day of January 2009