

TFS SANDALWOOD PROJECT NO.2

ANNUAL REPORT
FOR THE YEAR TO 30 JUNE 2009

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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 2009.

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, Financial Position and Likely Developments

The Project made a profit/(loss) for the financial year ended 30 June 2009 of (\$1,390,589) (2008: \$478,899). The net assets of the project have decreased by \$1.39m to \$4.58m (2008: \$5.97m).

The decrease in value was primarily due to a re-estimate of survived tree numbers based on recent tree counts.

The plantation was established in 2000 and is now 9 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.

Due to the low quantities of auctioned heartwood, the valuation of the plantation for the current year has been derived by obtaining the current Indian sandalwood oil price as obtained from the "Public Ledger" publication and applying that price to expected oil yields within the plantation trees. The equivalent Australian dollar Public Ledger price for Indian sandalwood oil as at 30 June 2009 was A\$2,095 per kg (2008: A\$2,122).

Scheme Property

At 30 June 2009 there were 198 units held by investors in the project. In addition to this, the manager or its associates held 12 units in the equivalent project which have not been reflected in these statements. There were no units issued in the project during the year, and there were no units transferred from an investor to the responsible entity or its associate.

The net assets of the scheme at 30 June 2009 were \$4.58m. This primarily consists of the valuation of the sandalwood trees held by investors. The valuation is based on a discounted cashflow formula for the expected tree value at harvest applied to the estimated survived tree count in the plantation.

During the year fees of \$71,679 were received from investors and paid to the responsible entity or its associates.

Expert Forester's Report

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

The TFS No.2 plantation is situated 20 kilometres north of Kununurra on King Location 254, being part of the extensive Ivanhoe Plain. The plain is an ancient floodplain of the Ord River and the soils are dark coloured clays. Their suitability for growing Indian sandalwood has been demonstrated over the 23 years since the first sizeable trial plot was established in 1986.

MANAGER'S REPORT (CONTINUED)

The southern part of the plantation where the original permanent host species, *Cathormion umbellatum* had been suppressed due to heavy shading by the short-term *Sesbania* host, continued to be rehabilitated by infilling gaps with seedlings of the long-term host species *Cassia siamea* and Indian rosewood (*Dalbergia latifolia*) to replace the *Cathormion* hosts that had died. Gaps were first spot sprayed with herbicide to kill the weed growth, then tree seedlings were planted in the weed-free spots over the period August to October 2008. To ensure the early survival of the newly planted seedlings the period between irrigations was temporarily reduced to ensure they stayed moist as temperatures increased later in the year. Survival level was good. Those *Cathormion* hosts that did survive have now recovered from their early set-back in life and have developed into heavy-crowned flourishing trees that are at last performing their hosting function.

The entire plantation was fertilized from the air in September 2008.

Weed control over the whole plantation was commenced as soon as the ground was dry enough to bear the weight of a tractor by slashing and mulching the access rows between the trees. This operation had to be repeated in September 2008 and again in March and May 2009. Weeds growing within the rows of trees were controlled by manually spot spraying herbicides in July, September and November 2008 and again in April 2009. Vines became a threat to smothering the trees in parts of the plantation and were controlled by manually stripping them from the trees and pulling them up by the roots.

The last few dead *Leucena* trees remaining from the poisoning operation were sawn, removed from the plantation and crushed by machine to form mulch.

Irrigation was continued throughout the dry season at a more frequent interval than normal for a plantation of this age in order to ensure the survival of the infilled host seedlings.

The great improvement in the health and vigour of this plantation reported by me last year has continued and is a credit to the plantation manager.

Environmental Management

The project's operations are subject to significant environmental regulations under the laws of the Commonwealth and State.

The directors of the Manager have considered the recently enacted National Greenhouse and Energy Reporting Act 2007 (the NGER Act) which introduces a single national reporting framework for the reporting and dissemination of information about the greenhouse gas emissions, greenhouse gas projects, and energy use and production of corporations. At the current stage of development, the directors have determined that the NGER Act will have no effect on the project for the current or subsequent financial year. The director will reassess this position as and when the need arises.

Auditor's Independence Declaration

The auditor's independence declaration for the year ended 30 June 2009 has been received and can be found on page 20 of the financial report.

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



Frank Cullity Wilson

Perth, 9th day of October, 2009

Independent Auditor's 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 2009, 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.

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 registered scheme's financial position as at 30 June 2009 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 9th day of September 2009

TFS SANDALWOOD PROJECT NO.2
 INCOME STATEMENT
 FOR THE YEAR TO 30 JUNE 2009

	NOTE	2009 \$	2008 \$
REVENUE			
Establishment fees		-	-
Lease & management fees		71,679	77,348
Other income:			
Net increment in net value of biological assets		(1,390,589)	478,899
		<u>(1,318,910)</u>	<u>556,247</u>
EXPENSES			
Audit fees		3,125	1,075
Doubtful /bad debts expense (recovery)		(3,300)	-
Leasing expenses		30,104	35,773
Management fees		41,575	41,575
Reimbursement of expenses by Manager		175	(1,075)
		<u>71,679</u>	<u>77,348</u>
NET PROFIT		<u>(1,390,589)</u>	<u>478,899</u>

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

TFS SANDALWOOD PROJECT NO.2
BALANCE SHEET
AT 30 JUNE 2009

	NOTE	2009 \$	2008 \$
CURRENT ASSETS			
Cash and cash equivalents	2	-	-
Trade and other receivables	3	-	3,000
Other	4	46,427	46,427
TOTAL CURRENT ASSETS		<u>46,427</u>	<u>49,427</u>
NON CURRENT ASSETS			
Biological assets	5	4,580,813	5,971,402
Other	4	185,707	232,133
TOTAL NON-CURRENT ASSETS		<u>4,766,520</u>	<u>6,203,535</u>
TOTAL ASSETS		<u>4,812,947</u>	<u>6,252,962</u>
CURRENT LIABILITIES			
Trade and other payables	6	-	3,000
Unearned Income	7	46,427	46,427
TOTAL CURRENT LIABILITIES		<u>46,427</u>	<u>49,427</u>
NON CURRENT LIABILITIES			
Unearned Income	7	185,707	232,133
TOTAL NON-CURRENT LIABILITIES		<u>185,707</u>	<u>232,133</u>
TOTAL LIABILITIES		<u>232,134</u>	<u>281,560</u>
NET ASSETS		<u>4,580,813</u>	<u>5,971,402</u>
GROWERS' FUNDS			
Undistributed income reserve		4,580,813	5,971,402
EQUITY		<u>4,580,813</u>	<u>5,971,402</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 2009

	NOTE	Undistributed Income \$	Total \$
		<u> </u>	<u> </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>
Balance at 1.7.2008		5,971,402	5,971,402
Profit for period		(1,390,589)	(1,390,589)
Sub-Total		<u>4,580,813</u>	<u>4,580,813</u>
Distributions provided for or paid		-	-
Balance at 30.6.2009		<u>4,580,813</u>	<u>4,580,813</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 2009

	NOTE	2009 \$	2008 \$
CASH FLOWS FROM OPERATING ACTIVITIES			
<u>Inflows</u>			
Receipts from growers		35,420	54,763
<u>(Outflows)</u>			
Payments to suppliers		(35,420)	(54,763)
	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 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial report covers the TFS Sandalwood Project No.2. The TFS Sandalwood Project No.2 is an investment scheme for sophisticated investors.

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.

The financial statements are presented in Australian dollars which is the project's functional and presentation currency.

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:

- 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.

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.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR 30 JUNE 2009 (CONTINUED)

(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 2009 (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 2009 (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.

Key Judgement – Environmental issues

Balances disclosed in the financial statements and notes thereto are not adjusted for any pending or enacted environmental legislation and the directors understanding thereof. At the current stage of the company's development and its current environmental impact the directors believe such treatment is reasonable and appropriate.

The financial report was authorised for issue on 9 October 2009 by the board of directors of the manager.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2009 (CONTINUED)

	NOTE	2009 \$	2008 \$
2. CASH AND CASH EQUIVALENTS			
Cash at bank		-	-
3. TRADE AND OTHER RECEIVABLES			
Outstanding fees (i)		-	6,300
Less: Provision for impairment of receivables		-	(3,300)
		-	3,000
 (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
Non Current			
Prepayments (i)		185,707	232,133
 (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)		4,580,813	5,971,402
		4,580,813	5,971,402
(a) Physical quantity of sandalwood trees planted and owned			
Number of sandalwood trees		6,361	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 2009 (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	2009 \$	2008 \$
6. TRADE AND OTHER PAYABLES			
Trust funds payable to manager (i)		-	3,000
GST payable		-	-
Other		-	-
		-	3,000
		-	3,000

(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

46,427 46,427

Non Current

Prepaid lease & management fees

185,707 232,133

Represents lease and management fees received in advance of services provided.

	NOTE	2009 \$	2008 \$
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8. CASH FLOW INFORMATION

(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

(1,390,589) 478,899

Adjustments:

(Increase) / decrease in net receivables

3,000 16,107

(Increase) / decrease in prepayments

46,427 46,427

(Increase) / decrease in market value of sandalwood trees

1,390,589 (478,899)

Increase / (decrease) in GST payable

- -

Increase / (decrease) in accounts payable

(3,000) (16,107)

Increase / (decrease) in unearned income

(46,427) (46,427)

Net cash inflow / (outflow) from operating activities.

- -

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR TO 30 JUNE 2009 (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 \$3,125 (2008: \$1,075)

11. SEGMENT INFORMATION

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

12. SUBSEQUENT EVENTS

No 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 2009 (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 2009. 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 2009 (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 2009, 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:

	2009 \$	2008 \$
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 2009, 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:

	2009 \$	2008 \$
Change in profit		
- improvement in AUD to USD by 5%	(171,756)	(218,850)
- decline in AUD to USD by 5%	171,756	218,850
Change in equity		
- improvement in AUD to USD by 5%	(171,756)	(218,850)
- decline in AUD to USD by 5%	171,756	218,850

Price risk sensitivity analysis

At 30 June 2009, 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:

	2009 \$	2008 \$
Change in profit		
- increase in sandalwood oil price by \$100/kg	163,955	206,240
- decrease in sandalwood oil price by \$100/kg	(163,955)	(206,240)
Change in equity		
- increase in sandalwood oil price by \$100/kg	163,955	206,240
- decrease in sandalwood oil price by \$100/kg	(163,955)	(206,240)

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2009 (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

DIRECTORS' DECLARATION FOR THE YEAR TO 30 JUNE 2009

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 2009 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 9th day of October, 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 2009 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 9th day of September 2009