"Anyone taken as an individual is tolerably sensible and reasonable, but as a member of a crowd, he at once becomes an [idiot]." - **Friedrich von Schiller (modified)**

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COMPANY: TFS Corporation Limited / Quintis | ASX: TFC / QIN
INDUSTRY: Indian Sandalwood

On March 22, 2017, we published our investment opinion (the "Report") on TFS Corporation Ltd. / Quintis (ASX: TFC / QIN) ("TFS" or the "Company"), which claims to manage the world's largest commercial Indian Sandalwood plantations. On March 27, 2017, TFS issued a response to an ASX query (the "Response") about its customers and previous disclosures.

We find the TFS Response wholly inadequate. Not only did TFS fail to address many of the key points raised in our Report, but TFS made the startling new admission that its supposedly largest customer had yet to purchase sandalwood from the Company in 2017. Coupled with the shocking resignation of Managing Director Frank Wilson, TFS's tepid Response enhances our conviction in our investment opinion. Apparently, we are not alone in thinking so.

On March 28, 2017, **Moody's** revised **its rating outlook on TFS's credit from stable to negative**, based on factors including the difficulty of replacing earnings lost from its biggest customer, TFS's ability to maintain continued institutional investment to support its revenue and cashflow, and volatility in the wake of management turnover.

Moody's downgrade of its rating outlook, Wilson's resignation and TFS's Response all increase our conviction in our investment opinion. Accordingly, we continue to value TFS's equity at AU$ 0.00.

1) Frank Wilson Resigns: Surfstitch 2?

On March 27, Frank Wilson, the founder, former CEO, and largest shareholder, **resigned** as Managing Director of TFS. Wilson said he had been "approached by a well-funded, credible party" that was looking to take control of the Company. Wilson claimed he resigned to focus fully on this proposal.

The Company, however, confirmed in a later announcement, that it had not received any formal or informal takeover proposals, it was not aware of the identity of any unnamed suitor, it had not received any specific information in relation to the terms and conditions of any offer, and it was **not "guaranteed that an offer will ultimately be submitted**."

We have little confidence that Wilson can interest any private equity buyer to assist him in a takeover of TFS. First, the timing does not make sense. Wilson stated that he had "recently" been "contacted by a well-funded party with what I believe to be a serious approach." But if Wilson and a buyer had been in discussions last week, why would any buyer stick around after finding out that TFS's biggest customer has stopped buying the Company's products? Unless this mystery buyer received insider information (and knew about this startling development before other investors), the buyer found out about the lost sales yesterday like every other shareholder. We find it hard to believe a buyer would maintain interest in a Company which failed to disclose that its supposed largest customer had stopped buying its products.

Second, even if a buyer was interested in some of the assets, we think that it could wait and scoop up such assets in the near future, not only for a cheaper price, but unencumbered by TFS's voluminous baggage. Any suitor looking to buyout TFS shares would also inherit the Company's staggering debts and potential liabilities. With Moody's swift change to a negative rating outlook on the Company's debts, TFS already seems to be losing the faith of the capital markets we believe it requires to survive. We think a smart buyer would simply wait until the Company is in a distressed situation, and then negotiate with creditors to cherry pick its best assets without inheriting the vast amount of baggage that TFS is now carrying.

Third, if the buyer is serious about partnering with Wilson, it may think twice after Wilson announced a potential takeover to the market. To us, Wilson's resignation announcement seemed intended on driving up the price of TFS shares. But this is exactly the opposite of what a private acquirer would want. Serious private equity firms and strategic partners want to buy cheap and sell high. Why would any buyer want someone to reveal their intentions to the market, driving up the price of shares before it made its bid?

Fourth, if the proposed buyout was legitimate, why was it necessary for Wilson to resign? In management led takeovers, management is free to recuse itself from the negotiations (to prevent conflicts of interest), focus on running the company, and allow independent directors to negotiate with an appointed representative of the prospective acquirers. Management teams around the world negotiate proposed takeovers of their companies without leaving their day job. Why couldn't Wilson?

The closest analogue we can find to this situation is Surfstitch Group Ltd. (ASX: SRF). In February 2016, Surfstitch missed earnings guidance and its share price plunged almost 40% to lows of AU$ 1.07. The retailer's CEO, Justin Cameron, resigned two weeks later and said he was pursuing a privatization bid with private equity investors.

Cameron's resignation announcement looks almost identical to Frank Wilson's.

QUINTIS
SANDALWOOD ALBUM

28 March 2017

QUINTIS LTD
ABN 97 092 200 854

Resignation of Managing Director

Quintis (ASX:QIN, 'the company') advises that last night (27 March 2016) it received a resignation letter from Quintis Managing Director Frank Wilson. Mr Wilson has indicated that he has received an offer to potentially partner with an unnamed international corporation to present a proposed change of control transaction to the Company board. He has informed the board that he intends on exploring this opportunity (both with the unnamed corporation and, potentially, other third parties) further and has resigned as a director with immediate effect.

The Company notes that it has not received any formal or informal proposal from either Mr Wilson or the potential party/ies he intends on engaging with, nor has it received any specific information in relation to what the potential terms and conditions may be if an acquisition proposal is submitted, nor is it guaranteed that an offer will ultimately be submitted.

Quintis has retained legal and financial advisers to assess any proposal lodged by Mr Wilson and/or other related or unrelated parties in the future.

SurfStitchGroup

FOR IMMEDIATE RELEASE - ASX ANNOUNCEMENT 10 MARCH 2016

SurfStitch Group Company Update

Sydney, Australia – SurfStitch Group Limited (ASX: SRF) today advises that Group CEO and Managing Director, Mr Justin Cameron has submitted an email to the Chairman stating his resignation from all positions with the Group with immediate effect. The Company understands Mr Cameron is pursuing an opportunity relating to a potential acquisition of the Company in conjunction with private equity.

The Company stresses that it has not, to date, received any formal or informal proposal from, nor has it had any discussions with, private equity in relation to any potential acquisition of the Company. Furthermore, the Company has not received any specific information from Mr Cameron in relation to what the possible terms and conditions may be of any potential acquisition proposal. However, the Board of Directors has formed an Independent Board Committee to consider and respond to any proposal that the Company may receive.

Any proposal received by the Company would be assessed on its merits and in the context of maximising shareholder value as it would in the ordinary course. However, it is important that shareholders note that there is no certainty that any proposal or approach from any party may be forthcoming.

Sources: https://wcsecure.weblink.com.au/pdf/QIN/01842520.pdf; http://www.asx.com.au/asxpdf/20160310/pdf/435qm7b9vtkg9q.pdf

Following Cameron's announcement, Surfstitch's shares jumped 24% to a high of AU$1.45. Yet no bid from Cameron ever materialized. Beset by controversy and volatility, Surfstitch's share price fell 86% in the four months after Cameron's resignation.

Surfstitch (ASX: SRF) Stock Chart

Source: Bloomberg

In our view, the parallels are obvious. Both Cameron and Wilson tendered shock resignations after their respective companies' share prices had plummeted on disappointing performance. Both men stated they were leaving to pursue a takeover of their respective companies. Both companies' share prices rallied on the possibility of a buyout. Yet both men failed to offer any details about the proposed acquisition. We think that TFS's stock will experience a similar decline because we doubt that Wilson can successfully entice a well-financed partner to back a legitimate bid.

2) Phantom Chinese Buyer

We cannot help but wonder whether Wilson's resignation was prompted by the startling revelations in TFS's Response. In September 2016, TFS announced that it completed its first shipment under a "**five-year agreement to supply 150 tonnes per annum of processed heartwood to China**" to **Shanghai Richer Link**. This is roughly the equivalent of USD 25 million per year, making Shanghai Richer Link by far TFS's biggest customer.

In our Report, we opined that TFS's announcements of massive pre-sales to Shanghai Richer Link were highly misleading because evidence indicated that its exclusive Chinese customer was incapable of fulfilling such a contract. Rather than a large commodities importer capable of spending USD 25 million per year on sandalwood, Shanghai Richer Link appears to be a tiny importer with no website, minimal operations, tiny revenues, almost zero profits and a small cash balance insufficient to purchase sandalwood in bulk. We believe that TFS has deliberately misled investors by announcing a giant contract in which it claimed to have pre-sold 150 tonnes of sandalwood per year into China given the paltry operations and tiny assets of its exclusive Chinese customer.

It looks like we were right, because TFS admits in its Response that "**Shanghai Richer Link has not yet requested any shipments in 2017**."[1] This startling admission corroborates our own due diligence and our opinion that this supposedly massive contract is largely illusory. When we called Shanghai Richer Link and asked them about TFS, at first the representative was confused, then said "**we don't do that business anymore**."

This is frankly unbelievable. TFS claims to have "forward sold" 750 tonnes of sandalwood to Shanghai Richer Link, and then admits, when Glaucus pointed out this contract was illusory, that its customer has not yet ordered any sandalwood from the Company in 2017. Investors and regulators should not lose sight of the fact that TFS admits in

[1] TFS Response, p. 5.

its Response that Shanghai Richer Link is its **biggest sandalwood customer**, **which was supposed to account for 59% of the Company's forward sandalwood sales**.

Customer Name	Product	Annual Volume(kg)
Galderma	Oil	611
Lush Cosmetics	Oil	1,000
Young Living	Oil	1,200
Medinext General Trading	Oil (Equivalent)	1,110
Shanghai Richer Link	**Oil (Equivalent)**	**5,550**
Shanghai Richer Link As % of High Value Indian Sandalwood		***59%***

Note 1: Volume for Galderma is based on the Company's disclosure that it supplied 1,222kg of oil in two years following the signing

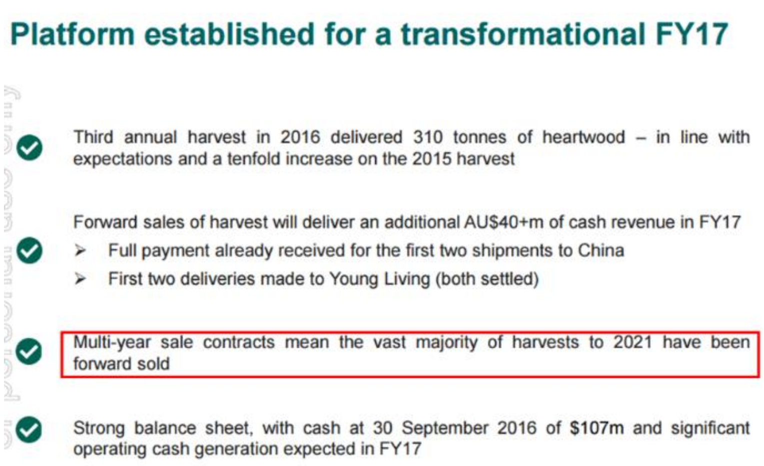
Note 2: Volume for Lush Cosmetics is based on the minimum annual number

Note 3: Assume the oil yield of 3.7% when converting Wood to Oil

Source: Company response and bond prospectus

We are not Australian securities lawyers, but doesn't a company have a duty to disclose if its biggest customer has ceased purchasing its products?

In 2016, the Company announced that it had pre-sold its upcoming harvests for 2016 and 2017, half of which were supposedly pre-sold to Shanghai Richer Link (its only Chinese customer). Since then, TFS has promoted its business by reminding investors of such pre-sales, presumably as evidence of strong demand for the Company's core product:



Source: Q1 FY17 Result Presentation

http://www.asx.com.au/asxpdf/20161130/pdf/43dblj08lwcmnw.pdf

It is reasonable to assume that bond issuers, project level investors (retail MIS and institutional financiers), and shareholders relied on the Company's promise that its upcoming harvests were pre-sold. But TFS only now admits, after being caught by Glaucus, that its supposedly biggest customer has not placed any orders in 2017.

How can Australian regulators or investors be comfortable with a Company that fails to provide any meaningful disclosure to the market when the customer which supposedly accounts for 59% of contracted sandalwood sales stops buying the Company's products?

TFS then concludes with the pathetic excuse that it "believes that its ability to achieve this guidance is not dependent on further sales to Shanghai Richer Link as any wood not sold to Shanghai Richer Link will be sold to alternative customers."[2] But TFS has been trying to contract with buyers for years – are investors supposed to believe that TFS will magically replace its biggest customer overnight?

This is not even the first time that TFS, in our opinion, has made highly misleading statements about the value of newly-signed contracts. In August 2014, according to Australian media reports, TFS announced a deal with Galderma which it claimed would be worth "**half a billion dollars**." Shares of TFS rose 20% in the weeks after the announcement. Despite TFS's hype machine, the contract turned out to be small, generating only AU$ 6.9 million in revenues in the two years following its signing.[3] In its Bond Prospectus,[4] the Company even admitted that sales to Galderma declined in FY 2016, a far cry from the AU$ 500 million expected value promised by TFS at the time of signing.

We believe, based on Shanghai Richer Link's anemic balance sheet, minimal revenues, tiny profits, and paltry operating business, that TFS's biggest customer was **never** in a position to buy 150 tonnes of sandalwood per year from the Company. We think it was highly misleading to announce to the market that TFS had pre-sold USD 25 million of sandalwood to a customer with only AU$ 228,352 in cash on its balance sheet and no operating website.

We also believe that it was highly misleading for TFS not to update the market when its biggest customer had ceased purchasing sandalwood from TFS. Whether TFS's failures violated any Australian securities laws is not for us to decide, but we fail to see how any investor can have confidence in the honesty and integrity of a Company which conceals such material information and repeatedly makes what we think are obviously misleading statements about the value of its contracts and its customers.

a. Tax Evasion by Chinese Importers of Sandalwood

In addition to its illusory contract with Shanghai Richer Link, a media report from a Chinese broadcaster, published on March 23, 2017, announced that Chinese customs officials cracked a smuggling operation which was evading taxes on the import of sandalwood from Australia.

The media report included a shot of the TFS logo, and as TFS now admits, one of its employees was interviewed as part of the broader investigation.

Source: http://news.cctv.com/2017/03/23/ARTIFj3453vRHOxqZY2M8ve9170323.shtml

In its Response, TFS admits that allegations of tax evasion by Chinese importers came to its attention in December 2016, prompting the company to hire an external law firm to review the matter. Although TFS claims that neither TFS nor its employee has been charged by Chinese authorities, there is a larger issue. Given that TFS claims that China is its largest market, why didn't TFS disclose the investigation until now?

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[2] TFS Response, p. 5.
[3] TFS Bond Prospectus, p. 4.
[4] TFS Bond Prospectus, p. 67.

To us, this is just another example of untrustworthy behavior. In our view, TFS only discloses bad news when it gets caught. The government of TFS's largest export market launched a sweeping investigation of smuggling sandalwood into China, but TFS only admits that its employee was interviewed when its logo appears in a Chinese news report about a crackdown on sandalwood smuggling. Similarly, TFS announced a sweeping contract with its biggest customer to sell 150 tonnes of sandalwood per year, but only discloses that the same customer has not placed any orders in 2017 when Glaucus exposes the customer as a tiny, borderline-distressed commodities importer without the cash flows or balance sheet to buy sandalwood in such quantities.

If TFS only admits to bad news when it gets caught, what else is it hiding?

3) Ponzi-Like Marketing Materials

In our Report, we highlighted marketing material by a German institutional bank named Jaederberg & Cie ("JC"), which characterizes itself as an asset partner of TFS, in which JC offered project level investments in TFS's vintages from as early as 2010. Inexplicably, JC's marketing materials promise that investors in TFS's plantations will be paid **cash dividends starting two years after the initial investment, with a full payback of the initial investment promised within seven years of the investment date**. There is no possibility that any of such payments can come from the harvesting of sandalwood, because the trees are not ready to be harvested until at least 15 years after planting. **The only source of such future payments must come from funds raised from future investors (or the capital markets)**. We concluded that, to us, this looks like a Ponzi scheme, because investors are promised quick, above-average investment returns which **in practice will be paid not from the sale of a product but from cash raised from future investors**.

In its Response, TFS tries to throw JC under the bus, despite admitting a "longstanding relationship" with the German bank. TFS claims that it "does not, and has not, been involved in either the production of prospectuses and marketing materials (apart from providing permission to use a Quintis corporate video and images) for Jäderberg & Cie's investment funds or the structuring of the funds."[5]

First, investors should note that TFS is being cute. In its Response, it claims that it was not involved in the production of the marketing materials or structuring of the funds, but fails to deny that it **reviewed them or that it had the authority to give final approval for the structure of the investment offerings or the content of the marketing materials**.

Second, only Australian (and potentially German) regulators have the subpoena power to determine if TFS truly was not involved in the production of such documents or the structuring of such investments, but for our part, we have our doubts.

JC claims on its website to have raised at least AU$ 30.6 million for TFS so far, possibly more depending on the popularity of its more recent offerings. Are we to believe that JC raised such sums of money without TFS reviewing any of the underlying investment documents or the proposed structure of the payback periods?

JC Capital Raising

AUD mm	JC Indian Sandalwood 1	JC Indian Sandalwood 2	JC Eagle Park 4	JC Indian Sandalwood 5	**Total**
Initial Investment	15	13	2.6	N/A	**30.6**

Source: JC Marketing Material

To us, it seems highly unlikely that a firm like JC, which describes itself as an asset partner of TFS, could raise such sums for TFS from investors without TFS having knowledge of, or involvement in, the structuring of the investment offerings or the marketing materials.

Third, TFS fails to address the very issue at hand, because even if TFS throws JC under the bus, it could still be liable. JC's marketing documents promise investors quick, above-average investment returns which **in practice will not be paid from the sale of sandalwood but from cash raised from future investors**. Paying off old investors with

[5] TFS Response, p. 5.

money raised from new investors is the hallmark of a Ponzi scheme, and was exactly the pattern of behavior of other failed Australian agricultural managed investment schemes such as Great Southern. Even if TFS was not involved in crafting such promises (which we doubt), by presumably accepting funds raised by JC, **TFS most certainly benefitted from them**.

As a result, we believe that TFS and JC are still obligated to fulfill such promises, which means that they are obligated to raise more money in the coming years to make payments to investors who subscribed to offerings through JC.

Ultimately, we highly doubt that TFS can wash its hands of Ponzi-like marketing materials which contributed over AU$ 30 million to its coffers by claiming ignorance of the details of such offerings.

4) Incipient Capital: Undisclosed Related Party is the Source of Key Price and Demand Forecasts

In our Report, we pointed out that the key component of TFS's marketing presentations to potential investors in its plantations is a study by **Incipient Capital** forecasting the future demand for sandalwood. In its 2016 presentation to investors, this study was the **only source** of TFS's critical demand forecast. Yet TFS fails to disclose that Incipient Capital was an undisclosed related party with many connections to the Company. TFS's response is three-fold.

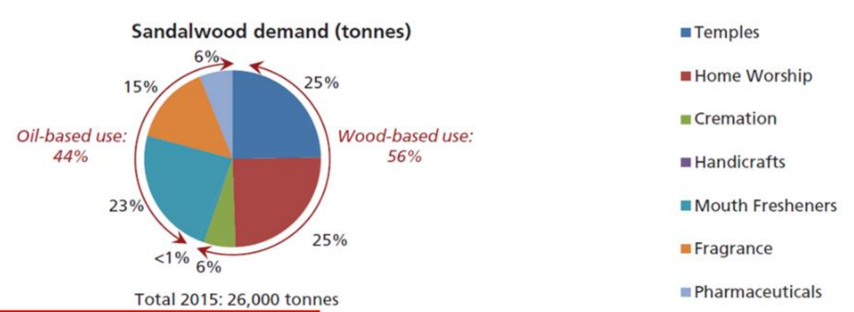
First, TFS complains that we failed to mention a more recent study done by McKinsey on the global sandalwood market. But this is ridiculous considering that until its Response, TFS has never, to our knowledge, mentioned the McKinsey study by name in any of its public documents.[6]

Even today, TFS refuses to release the full study. How can Glaucus, or any investor, address a study which TFS refuses to distribute or which even the identity of the author was until recently a secret? The details of the McKinsey study are crucial to evaluating the conclusions cherry-picked by the Company in its Response. For example, did TFS pay for the study? Market studies paid for by companies tend to promulgate a view which is positive for such companies. What other assumptions went into McKinsey's market estimate? Until we know, how can any investor assess the study's value?

Second, TFS is trying to downplay its reliance on Incipient Capital, but investors should not let the Company get away with such sleight of hand. Incipient Capital was the **only source** of TFS's critical demand forecast in its 2016 presentation to investors. It was also **the only source** in TFS's bond prospectus of demand forecasts. Incipient Capital's study is ubiquitous in TFS marketing materials, and TFS should not be able to dismiss its importance.

Market for Indian Sandalwood

Indian Sandalwood has been used for over 2,500 years and was declared a royal tree in India in 1792. Its valuable heartwood can be traded in logs or distilled into and traded as Indian Sandalwood oil. In a 2012 report, Incipient Capital Group Limited ("Incipient Capital") estimated that the annual global demand for Indian Sandalwood in 2015 would be 26,000 tonnes. The graph below shows the estimated market demand for Indian Sandalwood in 2015 by end-market.



Source: Incipient Capital Group Limited (2012)

Source: TFS Senior Secured Notes Offering Memorandum
Date: 7/20/2016

[6] TFS had previously mentioned a study by "one of the world's leading management consulting firms," but until the Response, we did not see any Company disclosure which indicated that the study was conducted by McKinsey.

Third, TFS claimed in an earlier response to Bloomberg that by the "legal definition," Incipient Capital is not a related party. But this is nonsense: by any definition, common sense or legal, we think it is obvious that Incipient Capital is a related party. To review, TFS consistently cited Incipient Capital in its marketing materials without disclosing that:

- Incipient Capital was the lead manager in raising $194 million in financing for TFS from 2009 to 2012.
- Incipient Capital's co-founder and non-executive director, from 2009-2016, was the CEO of a JV 49% owned by the Company and fully acquired in 2014.
- Incipient Capital's co-founder was also the founder and director of Wise-owl, an Australian market research firm which has put out positive analyst coverage on TFS, placing a **buy rating** on the stock.

How is Incipient Capital not a related party when Phillip Shamieh is a partner of the firm **and, at the same time, serves as the CEO of TFS JV/subsidiary Gulf Natural Supply?** According to his LinkedIn page, he worked simultaneously for both TFS and Incipient Capital from 2009 through January 2016 (the same period when TFS was citing the critical study). Isn't that a textbook related party?

Not only do such conflicts of interest undermine the credibility of the Incipient Capital study, but we believe it is materially misleading for TFS to present critical forecasts to potential investors without disclosing that the source is a related party that works and raises money for TFS.

5) Forecasted Cash Flows Based on Ludicrous Assumptions

The valuation of sandalwood trees is highly sensitive to a few key inputs, including future market price, yield and survivability. Given the length of time between planting and harvest, these inputs are inherently difficult to forecast. In our Report, we opined that TFS has used the long production cycle and esoteric sandalwood market to propagate ridiculously favorable assumptions to investors regarding the future profitability of its plantations. It continues to raise money without accountability because nearly all of its trees have yet to be harvested, but accountability is coming.

a. Unrealistic Price Forecasts

The market for Indian sandalwood is thinly-traded and highly opaque, which we believe TFS exploits to mislead investors with absurdly optimistic forecasts regarding the future price of sandalwood.

i. Import Data

In our Report, we highlighted import data available from Indian customs records which shows that sandalwood oil is being imported at prices lower than the US$ 4,500 per/kg frequently mentioned by TFS. In the Response, the Company criticizes our data source as relying on "unknown shipping documentation compiled by a third party and placed on a free website." But this is exactly the point: our Indian customs data is an **independent source**, and therefore, we believe, far more valuable than self-serving projections by TFS.

Our Report highlights the Indian customs data because TFS admits that India is a key market for its sandalwood. But if essential sandalwood oil is being imported today into India at lower prices than TFS is forecasting when it values its plantations, then it undermines not only the Company's forecasts but also the gains it recognizes every year on the value of its biological products.

But TFS's Response further undermines its price forecasts, because with the apparent cessation of sales to its largest customer, TFS is admittedly having trouble selling its products. TFS claims that the size of the sandalwood market will **increase to twelve times its current size** by 2025 (with TFS projecting that it will supply 75% of the demand).[7] If TFS is having trouble selling its products now, when supply is scarce, why should investors believe that prices will increase (or stay high) when TFS floods the market with sandalwood in the future? We believe that over time, a glut of supply will force the price of sandalwood down, making returns on future harvests far lower than TFS is projecting and rendering the value of TFS's plantations far lower than the Company is prepared to currently admit.

[7] FY 2016 Full Year Results Presentation

ii. TFS Artificially Inflates the Price of Sandalwood and Prevents Market Price Discovery

In its Response, TFS **fails to address one of the more critical components in our Report**

Since 2014, each year, the Company has **purchased MIS-owned sandalwood harvests at auction**. These hectares are managed by TFS but owned by its retail and institutional investors. In theory, MIS-owned trees were supposed to be sold at auction after harvest. Instead, TFS raises money from the capital markets to buy the harvested trees. In one case, it foolishly bragged that it paid 10% above the next highest bidder at auction. In 2016, the Company admitted that it raised AU$ 60.5 million from the equity markets to purchase 221 hectares of MIS plantations from retail investors due to be harvested over the next five years. In our view, this is Ponzi-like behavior. **TFS is using funds raised from new investors to buy out previous investors**. In doing so, the Company is bidding up the price of sandalwood at auction, thereby artificially inflating the price of the thinly-traded commodity to justify its own ludicrous price forecasts.

The Company claims it wants to increase exposure to sandalwood, but we suspect that it is purchasing older plantations to prevent sandalwood from hitting the open market in significant volume, thereby preventing the establishment of a market price for sandalwood; which we suspect would be well below the price used in the Company's forecasts. Our suspicion is that the Company is terrified of trees hitting the open market at an equilibrium price lower than TFS's forecasted price, which would not only undermine the Company's future promises of profitability and returns for investors, but would also force the Company to incur dramatic write downs in the valuation of its existing plantations.

We are limited to the data available in the public forum, but a regulator with subpoena power could examine TFS's internal email correspondence with respect to such purchases. It could also subpoena documents in connection with such auctions, including whether TFS was over-bidding at such auctions to drive up the quoted price of sandalwood.

b. Dubious Yield and Survivability Assumptions

In our Report, we highlighted that TFS's reported "profits" (from non-cash gains) and its marketing materials are both based on highly dubious assumptions regarding the heartwood yield and survivability of its sandalwood trees.

We noted that academic studies project yields between 4.0 – 6.8 kg per tree. In FY 2011, TFS told investors to expect a yield as high as 30 kg per tree, as high as seven times the yield projected by such academic research. We also pointed out that in 2016, TFS admitted that its **actual yields on harvested trees** were 3.1, 4.9, and less than 9.7 kg per tree (for 2014, 2015 and 2016 harvests, respectively), far below the Company's current forward projection of 19.8 kg per tree. Actual survival rates from FY 2014 through FY 2016 were 32%, 38%, and 70%, respectively, which also came in far below the Company's forecast survival rates of 80-90%. In addition, the Company alerted investors in FY 2016 that 9 of its first 12 vintages (75%) were not growing in line with the yield curve.

TFS's Response is basically that survival rates and yields have improved since its earlier plantations and that improvements in the process of sandalwood planting (and maintenance) will result in better outcomes. But this misses the point.

Our point is that TFS should be using the yield and survivability it has actually achieved to value its plantations (and to market to shareholders, creditors and project-level investors), not its self-serving forecasts, which have little basis in either academic studies or TFS own results.

We believe that TFS's financial statements should project an expected yield of ~10 kg per tree, which would be double the reported yield from academic studies and even greater than the Company's maximum yield on prior harvests. In our opinion, just this simple revision of its yield estimates to a more realistic assumption would cause TFS's scheme to unravel. First, the Company would be forced to take a write down on the value of its biological assets, a hit to its income statement which would correct for ludicrous previous upward re-evaluations. Second, the Company would have to correct misleading cash flow forecasts in its marketing material, which rest on such overly rosy assumptions. This would make it much harder to raise money for new vintages. In our opinion, the loss of investor confidence from this change in TFS's forecasts would effectively cut off TFS from the capital markets.

Valuation

Moody's downgrade of its rating outlook, Wilson's resignation and TFS's Response increase our conviction in our investment opinion. Specifically, TFS has now admitted that it failed to disclose that its biggest customer has not ordered any sandalwood in 2017, despite the fact that TFS claimed to have pre-sold USD 25 million of sandalwood to this customer per year for the next five years. We believe it should dramatically undermine investor confidence in TFS that the Company failed to disclose such a material development until Glaucus caught it red handed.

Nor can it inspire investor confidence that TFS essentially disclaims all involvement with JC, its long-time partner, which was, in our opinion, disseminating Ponzi-like marketing materials to investors. Are investors, creditors and regulators really to believe that JC raised AU$ 30 million for TFS using marketing documents and investments structures that were not reviewed or authorized by TFS?

TFS is already heavily levered, burns cash at a torrid pace, and cannot function without access to the capital markets. As a result, its debts are mounting, and its interest payments are becoming a larger and larger burden. TFS reported AU$ 555 million in total financial liabilities as of 1H FY 2017.

AU$ '000	2010	2011	2012	2013	2014	2015	2016	1H '17
Total Financial Liabilities	67,281	140,842	146,503	164,154	245,332	349,393	456,153	555,342
Cash EBITDA	44,268	16,533	23,780	51,804	51,400	57,533	62,162	7,574
Interest Payment	2,938	3,757	9,756	16,248	19,141	19,617	31,211	15,418
Interest Payment as % of Cash EBITDA	7%	23%	41%	31%	37%	34%	50%	204%

Source: Company Public Filings

In FY 2016, TFS's annual interest payments were AU$ 31 million, accounting for 50% of the Company's reported *cash EBITDA*. Such leverage is concerning because of the Company's long wait until it can harvest meaningful amounts of sandalwood. The only way that the Company can continue to pay interest on its debt is with new borrowing or project level financing, creating a vicious cycle.

Every investor should do their own homework. For our part, we calculate that TFS's liabilities far exceed the value of its sandalwood plantations, and that once investors come to realize the misleading nature of TFS's disclosures, TFS will struggle to access the capital markets.

With Moody's revision of its outlook on TFS's debt to negative, this process has already begun. Without the capital markets, we highly doubt that the Company will be able to fully repay its current investors, let alone continue to operate for the benefit of shareholders. We believe that TFS will likely follow Timbercorp and Great Southern into ignominy and failure. Accordingly, we continue to value TFS's equity at AU$ 0.00.

DISCLAIMER

We are short sellers. We are biased. So are long investors. So is TFS. So are the banks that raised money for the Company. If you are invested (either long or short) in TFS, so are you. Just because we are biased does not mean that we are wrong. We, like everyone else, are entitled to our opinions and to the right to express such opinions in a public forum. We believe that the publication of our opinions about the public companies we research is in the public interest.

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