

## QUINTIS SCHEMES

### PROPOSAL FOR 2003 to 2009 SCHEME GROWERS

#### SUMMARY

Growers are at risk. Title to your trees depends upon:

- rent continuing to be paid or credited under a series of leases;
- a liquidator not being appointed, as a liquidator can terminate leases if not challenged. Growers need to be ready for this possibility.

Growers should change responsible entity (**RE**) to protect themselves, but the change should be in a way which does not prejudice any recapitalisation of Quintis or the Noteholders.

#### BACKGROUND

##### (a) Overview

The company responsible for any managed investment scheme is called the “responsible entity” (**RE**). An RE requires an Australian Financial Services Licence from ASIC and has duties to scheme members / investors.

The current RE of all the Quintis managed investment schemes is Sandalwood Properties Ltd (**Quintis RE**), formerly TFS Properties Ltd, a wholly owned subsidiary of Quintis Ltd.

It is RE of the following schemes:

- The 2002 TFS Sandalwood Project (**2002 Scheme**);
- The 2003 to 2009 TFS Sandalwood Projects, including the 2004 Premium Sandalwood Project (**2003 to 2009 Schemes**); and
- The 2010 to 2015 TFS Sandalwood Projects (**2010 to 2015 Schemes**).

Primary Securities Ltd (**Primary**) is a professional RE licensed to operate any forestry scheme (and other types of scheme or named schemes). Primary is the RE for many trusts and schemes and is often the manager of its schemes. More information about Primary can be obtained from its website: [www.primarysecurities.com.au](http://www.primarysecurities.com.au).

Primary has extensive experience in restructuring distressed agricultural managed investment schemes. When the RE of a scheme is in receivership, MIS investors need to change the RE to protect their interests.

The only party that can effectively protect MIS investors is one:

- without legal or commercial conflicts with creditors, banks and institutional investors; and
- with the unique skills and experience in distressed agricultural MIS.

Primary considers that it is the most eligible professional RE in Australia for this role and has the required reputation, and track record to maximise outcomes for Growers and the schemes.

Primary would consent to appointment as RE to all Schemes under certain conditions.

(b) **The Quintis Group**

The Quintis Group was placed in voluntary administration on 20 January and receivers were appointed on 23 January 2018. KordaMentha (Scott Langdon, John Bumbak and Richard Tucker) are the Administrators. McGrathNicol (Shaun Fraser, Jason Preston and Robert Bauer) are the Receivers.

(c) **Who controls the Quintis RE?**

It is not entirely clear who controls the insolvent Quintis RE, or the RE functions of the Quintis RE.

The letter sent to all Growers on 23 January 2018 was from the Administrators (KordaMentha) and not the Receivers (McGrathNicol), though they appear to be working together.

KordaMentha say that they are formulating proposals for ongoing trading during the administration period. This implies that the Administrators continue to control the RE and the Quintis operating company and Sub-Manager, while the Quintis Sandalwood Lots are most likely held by the Receivers.

In Primary's experience, the conflicts of interest and duty cannot be managed by administrators, receivers or liquidators controlling an RE function.

(d) **The Schemes**

The Quintis RE does not manage the plantations or carry out maintenance and marketing services itself. All maintenance and marketing services are sub-contracted to another Quintis subsidiary Quintis Forestry Limited (**Quintis Sub-manager**). In the past, so we understand, maintenance and marketing services under these sub-management agreements have been performed at Kununurra by a staff of about 500.

The assets of the Schemes are mainly trees. The value of the biological assets of the 2003 to 2009 Schemes is about \$500 m<sup>1</sup>.

One quarter of the Sandalwood Lots (and therefore one quarter of the trees) in the 2003 to 2009 Schemes are owned by companies in the Quintis group. In some of the Schemes, Quintis holds as many as 50% of the Sandalwood Lots. Therefore any RE needs to represent and be seen to be representing Growers as a whole, including Quintis in its capacity as a Grower.

The Sandalwood Lots on the 2002, 2003 and 2005 Schemes are only on land owned by Quintis. However, the Sandalwood Lots of the other schemes is on land which is owned by Quintis and also on land that is leased from third parties. It is for this reason that Primary is of the view that the Receivers may want to keep the Schemes operating because their continuation will enable them to maintain value of the trees on third party land.

(e) **Conflicts and issues involving the Quintis RE**

There are issues and conflicts with the Quintis RE continuing to be controlled by Quintis and/or by Receivers, and potentially, liquidators:

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<sup>1</sup> Based on the June 2017 financial statements for Quintis Ltd, and reducing the price to take into account the most recent published sale of heartwood for the 2002 Scheme.

- Except for the most recent communications from the Administrators and for the 2002 Scheme, since April 2017, the Quintis RE has stopped reporting to Growers about forestry matters, maintenance, harvest and sale, except for the 2002 Scheme, and (if other collapses are any guide) the Receivers are unlikely to provide any reporting in these matters on a Scheme by Scheme basis;
- The Quintis RE has not provided financial statements for the Schemes since the 2016 financial statements, and Receivers customarily seek an exemption from providing financial reports to Schemes;
- The Quintis RE has not provided assurance to Growers that rent under head-leases is being paid, or that their property rights continue to be secure. Our experience with receivers where land is owned by the company in receivership is that the receivers prefer to sell land and trees together and terminate all leases – this may be an issue for the 2002, 2003 and the 2005 schemes where all plantations are on Quintis land. Where land is leased, the RE should be monitoring the payment of rent to ensure that the interest of Growers is being protected. If rent is not being paid, then the Growers should be alerted so that action can be taken if necessary (as Primary did for the Gunns 2000 and 2001 schemes).
- When products are sold, the main purchaser of products to date has been a company in the Quintis group. Assuming that this continues to occur (as is likely), there will always be questions (and even risks) that sales are not at an arm's length price;
- The sub-manager is in receivership or administration and an externally controlled RE is unlikely to consider whether or not to terminate the related party sub-management agreement or not from the perspective of Growers, or consider alternative sub-managers.
- The Quintis RE has not been, and the Receivers will not be, representing Growers in relation to any recapitalisation discussions, notwithstanding the fact that the Growers own more than 75% of the trees and Quintis looks after maintenance and marketing services. Growers need a seat at the table to ensure that their interests are being protected.
- Receivers can be difficult in relation to money which belongs to Growers. Receivers claimed priority to proceeds of sale of produce in one of the collapsed pine schemes. Receivers, administrators and liquidators usually claim a lien against schemes for payment of all work they or their consultants do for the maintenance, preservation or sale of the Schemes, such as carrying out a valuation or reading the Scheme Constitution or communicating with Growers. In this regard our experience with the Willmott Forests 1995-1999 scheme was that these costs included legal fees for trying to block the appointment of a new RE supported by Growers.

Growers need to take steps to replace the Quintis RE, and do so now.

(f) **Conflicts and issues involving Sandalwood Growers Co-op Ltd**

There are also issues and conflicts with the Grower group Sandalwood Growers Co-op Ltd (**SGC**). SGC at first appeared to be a body representing Growers but it has recently emerged that SGC is controlled by or heavily influenced by Frank Wilson of the previous Quintis management (that has failed) and is proposing to offer a competitive management and marketing function to replace Quintis and its 500 employees.

Frank Wilson has effectively announced that if Huntley Management Ltd is appointed RE of the 2002 Scheme, the RE will terminate the Quintis sub-management agreement and appoint SGC as manager for all Schemes. He does not give any details as to how this would be funded.

Growers need to be very cautious of any proposal to terminate the Quintis Sub-manager for the following reasons:

- The Quintis Group is still seeking to recapitalise, that is, to bring in additional funds, and Primary's view is that the chances of a successful recapitalisation are likely to have improved because of the receivership, as many previous class actions, put options and other claims against the corporate group will now be close to worthless.
- By effectively appointing SGC to manage, Growers are being drawn in and used in an ongoing fight for power between Frank Wilson and the Noteholders. The more conservative course of action would be to appoint an RE which currently believes that the Growers' best interests are not to mount a war against the Noteholders.
- Growers have little or no information about the maintenance and marketing resources and plans of SGC. These plans would be very difficult to formulate when it is not known what scale will be required, that is, how many schemes will contract to use SGC.

In general, Primary is concerned about former executives of insolvent forestry MIS companies looking to take control of the Schemes they formed. They usually have high personal and commercial interests, including loans and other obligations. This is another conflict that has to be resolved.

Supporting SGC and Huntley Management Ltd at this time involves risks that do not need to be taken by Growers.

***Growers need to be represented and advised by an independent RE without such commercial interests and conflicts.***

## **RISKS FOR GROWERS**

### **(a) The risk that rent is not being paid**

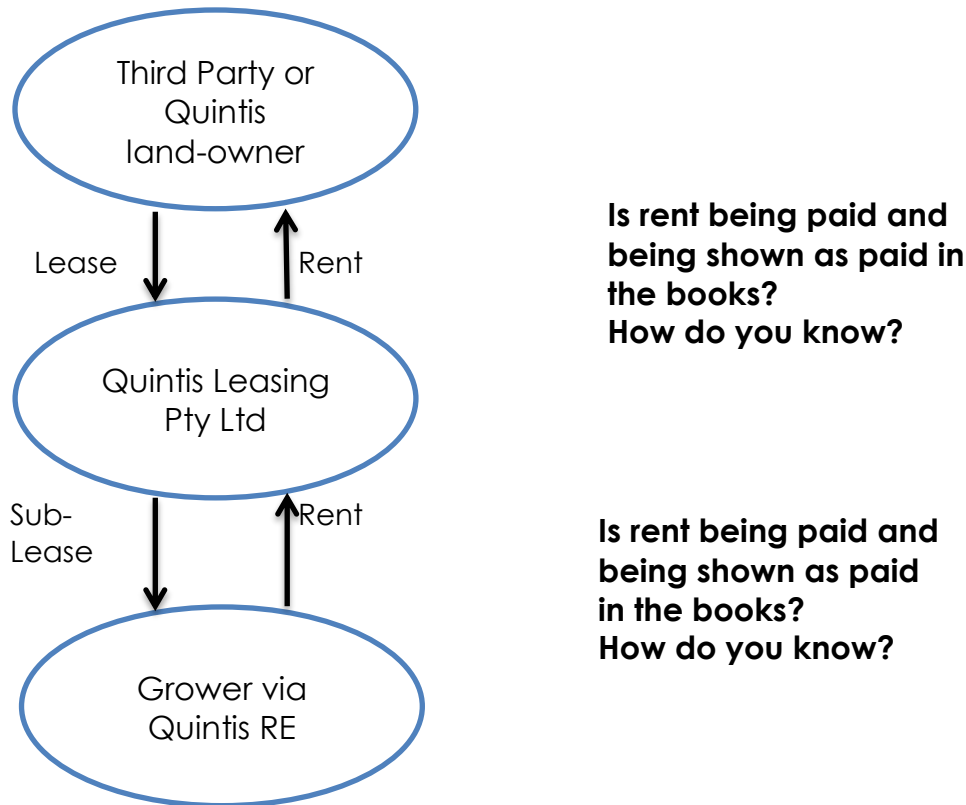
Growers' interests are derived from their sub-leases. In each Scheme, there is a series of leases and sub-leases starting with the land-owner, either a Quintis company or a third party owner.

Growers are not being adequately informed in relation to the status of all these leases. For example Growers have no idea if rent is being paid (and shown as being paid in the books) under every head-lease and sub-lease. Refer to the chart below.

When Gunns collapsed, the Growers in the 2000 and 20001 Schemes were told by the Receivers that no rent had **ever** been paid by the RE under head-leases **on land owned by Gunns**. Primary had to negotiate this issue and arrange funding to pay the rent for Growers.

***An independent RE should be in place now monitoring the payment of rent for Growers on every head-lease and sub-lease and arranging funding to ensure that rent is being paid or is being entered as paid through to the Quintis land-owning company or third party owner.***

If rent is being paid but liquidators are appointed to Quintis, a liquidator is unlikely to continue to pay rent. An independent RE would then be in a position to try and organise funding from Growers so that no lease went into default. We co-ordinated a funding of rent from Growers to rescue the Gunns 2000 and 2001 schemes.



(b) **The risk of lease disclaimer by a liquidator**

If the Noteholders decided that a recapitalisation was not going to occur, or for some other reason it wanted to terminate the Administration, then a liquidator would most likely be appointed to the Quintis land-owning and leasing companies.

If that occurs, the liquidator has the power to disclaim (or terminate) leases (in its capacity as lessor). In this case, the disclaimer notice might be served on Quintis Leasing Pty Ltd and possibly also on each Grower.

The disclaimed lessee (i.e. the Grower) loses their trees and becomes an ordinary creditor in a multi-million dollar liquidation which could not be recapitalised. They are likely to receive nothing from their investment if this occurs.

Disclaimer can be set aside if Growers can show sufficient prejudice. An application to set aside disclaimer must be lodged within 14 days and requires co-ordination and speed.

**Only by having an independent RE (already in place) can Growers be co-ordinated and ensure that proceedings to set aside disclaimer are commenced in time to protect their leases in these circumstances.**

On behalf of Growers in Willmott Forests 1995-1999 Scheme, Primary (for Growers) sued the liquidators to stop disclaimer and negotiated a settlement which resulted in the Growers buying the land and preserving their interests in the scheme.

## **FIRST OPTION TO CHANGE RE ON A BENIGN BASIS**

### **(a) Growers call a meeting to replace the Quintis RE.**

This requires 5% of scheme members in terms of value convening a meeting with resolutions to remove and replace the RE. This is the main method by which Primary has been appointed in the past, though Primary has also been appointed by Courts twice.

Primary now wishes to start the meeting process.

Usually, such a meeting is also accompanied by resolutions to amend the Constitution.

Obtaining the required majority to support such a resolution is sometimes difficult with more than 50% of the eligible Growers in terms of value having to be present at the meeting (in person or by proxy).

In the circumstances where rescues have been successful in the past, this has resulted from organisation and cohesion, for example from an adviser group with their clients.

A complication of Grower action is that due to the structure of the Schemes, significant voting interests are held by Quintis and so some of the Schemes are effectively controlled by the Receivers.

According to the Registers, the precise proportion of Sandalwood Lots owned by Quintis in the 2002 and the 2003 to 2009 Schemes is as follows:

2002	50%
2003	43%
2004	53%
2004(P)	26%
2005	23%
2006	42%
2007	48%
2008	14%
2009	13%

If the Quintis RE is removed as RE of the 2002 and the 2004 Schemes, it could always call another meeting and put another RE back in. Hence, it is better to avoid this outcome and choose an RE that for the time being (and subject to certain conditions) intends to work with the Administrators / Receivers and not terminate any sub-management agreements. This is why we say this option is benign.

The Quintis RE and its associates are not able to vote on a resolution if they are interested in that resolution or matter other than as a member. The Quintis RE and its associates are likely to remain interested in any issues or matters relating to a resolution to remove the Quintis RE or appoint a new RE or in amendments while a Quintis company controlled by Administrators is the RE, sub-manager and lessor and the resolution affects that interest. Once the Quintis RE is removed, this conflict rule will no longer apply, and the Quintis entity holding Sandalwood Lots will be able to vote in relation to any resolution.

(b) **What is the meeting process to see Primary appointed?**

Initially, Primary needs 5% of Growers in each of the 2003 to 2009 Schemes to authorise the convening of a meeting. This is what we are now seeking in sending this proposal. We will then focus on the remaining schemes.

(c) **What amendments are needed to the Constitution?**

Given that the Quintis RE is insolvent, the Constitution for each Scheme needs to be amended to give Primary greater powers and provide for other eventualities, such as provided for in the amendments summarised in the attached Authority to convene a meeting.

These will of course be explained in great detail in the Explanatory Memorandum with the notice of meeting when that is sent out to Growers for the Scheme.

The resolutions include provision for optional fees and costs of Primary. This is a cheaper option for Growers than the existing fees and 5% marketing commission.

Signing the authority does not bind you to support the amendments at the meeting when it is convened, it merely enables the meeting to be convened.

(d) **Duties as RE**

If appointed as a RE, Primary would permit the current Quintis sub-manager to continue for the time being because our current view is that this may be in the best interest of Growers. Changing the RE means that Growers have a representative overseeing Quintis.

We would carry out the following duties:

- Inspect the plantations and operations (including an inventory and survival analysis) and report to Growers on each Scheme and its value.
- Provide updated financial statements of the Schemes.
- Ensure that third party lease rent is being paid by the Administrators / Receivers and Grower rights are appropriately protected, and keep Growers informed of these matters. Growers are not being informed of these matters.
- Represent Growers at negotiations in recapitalisation of Quintis if that was appropriate.
- Take control of Grower money (via a custodian where applicable), collect fees (if any) and keep accounts.
- Monitor and oversee operations.
- Monitor and oversee the marketing of sandalwood products from the schemes to ensure fair market value is achieved in any sale.

(c) **Paying for the costs**

We see the cost of any work we do as being paid from the following sources:

- Initially from Primary's own funds, pending recovery from other sources
- Borrowings

- Grower voluntary contributions (as per the orders).

Primary is in a powerful position to assist because it has a number of registered multi-class trusts including Primary Loan Board and Primary Investment Board, and can cost effectively issue Product Disclosure Statements on a Scheme by Scheme basis for funding purposes, or to assist with the recapitalisation, if required. This mechanism was used successfully for Willmott Forests 1995-1999 Project to enable Growers to assist with funding the acquisition of the land from the liquidators of Willmott Forests Ltd.

If Quintis were recapitalised, Primary would take the role of representing Growers, monitoring the Quintis sub-manager and reporting to Growers.

## **SECOND OPTION TO CHANGE RE**

### **(e) Application to Court for appointment of a Temporary RE**

The fastest way to change RE is for a Grower or ASIC to apply to the Court for the appointment of a temporary RE (s601FP).

Once appointed, the temporary RE would have to call a meeting of members of the scheme within 3 months to confirm the appointment (s601FQ(1)) or appoint another RE if desired by the Growers.

The Court may make any orders it considers necessary upon appointment of a temporary RE (s601FP).

If members of a Scheme do not appoint a permanent RE, the temporary RE may apply to the Court for that Scheme to be wound up (s601FQ).

## **THIRD OPTION: DO NOTHING: HIGH RISK**

Primary has spoken to one of the Administrators who informed Primary that he and the Receivers prefer that there be no change of RE until a recapitalisation can be completed. A successful recapitalisation of Quintis cannot be guaranteed.

### **(a) The risk of waiting for recapitalisation**

If Quintis is not recapitalised, Growers will get no warning of the decision, and could suddenly be placed in a position of grave danger as explained above under the heading "RISKS FOR GROWERS".

Growers need their own RE in place now, and the Constitution of the Scheme amended ready for this eventuality, so that the RE can protect their interest with contingent funding mechanisms and powers in place.

Primary stands ready to support and protect Growers in whatever circumstances and has the skills and experience to do so.

Other risks in waiting for a recapitalisation include:

- The inherent conflict in the Administrators and Receivers' position remains if the Quintis RE is retained as the RE of the schemes during the administration process;



- There will be no entity independently representing either the schemes' or Growers' interests in any negotiations (recapitalisation, Deed of Company Arrangement, whatever is being discussed or planned – Growers will not have a seat at the table).

If a recapitalisation is possible, it is likely to be better managed through the appointment of an RE to all Quintis schemes whilst the process is underway. It is unlikely that the appointment of a new RE would materially affect the prospects of a recapitalisation, particularly if the RE was mindful to continue with the current sub-management arrangements.

If the appointment of a temporary RE was a material factor in the negotiations, it would suggest that the Quintis RE and the Quintis Group are affected by the inherent conflict between the interests of creditors, Growers and Quintis itself. The independent management of the schemes should not factor into the terms of the recapitalisation of the corporate Quintis group.

### **CONCLUSION: WHAT SHOULD GROWERS DO?**

- Avoid SGC (Sandalwood Growers Co-op Ltd), and do not appoint Huntley Management Ltd as RE. Picking a fight with the Administrators, Receivers and Noteholders involves unnecessary risks and costs for Growers.
- **Change the RE** to Primary **now** to protect your interest in the Scheme if the recapitalisation does **not** occur, and also if it **does** occur, as you need an independent RE without conflicts, particularly when the buyer of your heartwood is Quintis. It is within the power of Growers to change RE.
- Email Primary ([admin@primarysecurities.com.au](mailto:admin@primarysecurities.com.au)) if you would like to be considered for our Grower committee, and tell us something about yourself, your holding and which Scheme(s) you are in.

If you favour the cautious approach Primary proposes, then complete the Authority for each Scheme you are a member of, and send it to Primary.

The Authority authorises Primary staff to convene meetings of the 2003 to 2009 Schemes to remove the Quintis RE, appoint Primary as RE, and put in place amendments to the Constitutions to protect Primary and your trees.

Details as to how to send the Authority are on the Authority.



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