

ASX Release

27 August 2019

Subject: Ernst & Young report in response to Bonitas Document

On 6 August 2019, Bonitas Research LLC (Bonitas) selectively released a document about the financial position of the Rural Funds Group (ASX: RFF) (Document). Rural Funds Management Limited (RFM), as responsible entity for RFF, released a response on 7 August 2019 rejecting claims made in the Document. Furthermore, RFM engaged Clayton Utz to instruct an expert to independently investigate the matters raised and assess RFM's rejection of each of the claims made in the Document.

The independent investigation conducted by EY concludes that the assertions contained within the Document are not substantiated. Further, EY have corroborated the response provided by RFM on 7 August 2019. The full report prepared by EY is attached.

RFM has instructed Clayton Utz to commence action against Bonitas Research LLC for its deliberate and malicious publication of the Document, which RFM contends constitutes misleading and deceptive conduct in Australia in respect of RFF securities.

About Rural Funds Group (RFF)

RFF owns a diversified portfolio of high quality Australian agricultural assets. RFF's investment objective is to generate a stable income stream derived from leasing its assets to suitable counterparts and capital growth through any appreciation in the value of those assets. RFF is a stapled security, incorporating Rural Funds Trust (ARSN 112 951 578) and RF Active (ARSN 168 740 805), trading under the ASX code 'RFF'. Rural Funds Management Ltd (RFM) is the responsible entity of RFF.

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**Independent
Investigation Report
- Analysis of Bonitas
Research LLC
Document**

Rural Funds Management

26 August 2019

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Kym Fraser
Partner
Clayton Utz
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Independent Investigation Report - Analysis of Bonitas Research LLC Document

Dear Kym

At your request, we have conducted an analysis of certain assertions made publicly by a short seller, Bonitas Research LLC ("Bonitas"), on 6 August 2019 in respect of Rural Funds Group ("RFF") and the response by Rural Funds Management Limited ("RFM"), as responsible entity for RFF on 7 August 2019.

Our engagement was performed in accordance with our engagement letter dated 7 August 2019 ("Engagement Letter"). Our procedures were limited to those described in that letter, detailed within this Report and those provided in your letters of instruction dated 7 August 2019, 9 August 2019 and 23 August 2019 ("Instructions").

As outlined in our Engagement Letter and within this Report, our Report is based on information and Instructions provided by you. We have not conducted an audit. However, we have utilised information provided by management and where available, agreed this to third-party information.

Neither this report nor any part of it may be published or distributed other than for the specified purpose without obtaining the written consent of Ernst & Young, unless disclosed in accordance with any law or by order of a Court of competent jurisdiction.



Ernst & Young

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1. Executive summary

1.1.1 This executive summary must be read in conjunction with the detailed findings as set out in this report.

1.1.2 We have been engaged by Clayton Utz to:

- (a) Independently investigate specific allegations made by Bonitas to the market on 6 August 2019 ("Bonitas Document"), detailed in Section 3.1.3, to determine whether the allegations contained therein are substantiated; and
- (b) Independently determine whether the responses provided by RFM to the allegations as set out in RFM's Response to the Bonitas Document made in respect of RFF to the ASX on 7 August 2019 ("RFM Response") are corroborated.

We received the above instructions from Clayton Utz on 7 August 2019 and subsequent instructions on 9 August 2019 and 23 August 2019 ("Instruction Letter" or "Instructions").

1.1.3 Based on our independent investigation and procedures outlined below, the assertions contained within the Bonitas Document are not substantiated. Further, based on our inspection of the RFM Response and the procedures undertaken as specified in this report, we observe that the RFM's Response to the Bonitas Document is corroborated by the observations in this report.

1.2 Independent Investigation Procedures Performed and Findings

1.2.1 Based on the procedures we have performed and outlined in detail in Section 3.2 and Section 4, we make the following observations:

Table 1 Allegation Matrix: Summary of assertions, work performed and factual findings

Bonitas Assertion	Procedures Performed and Information Relied On	EY factual findings	Conclusion
Revenue recognition for rental income			
Evidence suggests that RFF reported profitability had included A\$28+ million of fabricated rental income paid to RFF by its two largest third-party lessees and RFF had "artificially inflated its reported financial performance..." Refer section 4.2	We obtained executed rental agreements (including variations where relevant) for the almond properties with the lessees referenced and agreed the methodology for determining rent to these executed rental agreements. We also agreed the amounts invoiced to cash received.	We observed all payments received for rental income from almond properties for financial years 2016, 2017, 2018 and for the half-year ended 31 December 2018 agreed to underlying rental agreements and cash received.	Bonitas assertion is not substantiated as the rent received and recognised in the financial statements agrees to the relevant accounting working papers, the executed rental agreements, invoices, and amounts received by RFF. Refer to findings.
	We obtained management's assessment of the classification of the leases as operating leases under the accounting standards.	Management did not have contemporaneous documentation that they were able to provide for the assessment as operating leases under the accounting standards. However, documentation was subsequently prepared by Management to support their	

Bonitas Assertion	Procedures Performed and Information Relied On	EY factual findings	Conclusion
		judgements. We have not assessed the conclusions reached by Management.	
Acquisition of J&F			
RFF's largest nefarious transaction appeared as an undisclosed dividend recapitalisation of RFM's newly acquired cattle asset, J&F Australia Pty Ltd ("J&F"), which included a A\$30 million special cash dividend paid to RFM financed by borrowings backstopped by RFF's A\$75 million financial guarantee to J&F and dividend afforded with cash from equity raises and bank borrowings. Refer section 4.3	EY obtained the underlying relevant Share Sales Agreement, Share Buy-Back Agreement and loan agreements to understand the purpose of the \$30m paid by J&F to RFM. EY obtained the documentation pertaining to the financial guarantee provided to J&F by RFF and understood the terms of this arrangement.	EY observes that RFM received payment of A\$30m from J&F as part of J&F's buy-back of shares, which were subsequently cancelled by J&F.. The share buy-back was a step that was contemplated as part of the required transaction steps. EY observes that RFF receives a guarantee fee in return for providing the financial guarantee to J&F.	Bonitas allegation is not substantiated as the A\$30m payment received by RFM was in return for J&F's buy-back of shares and equivalent to the amount that RFM outlaid in its acquisition of the shares in J&F. Refer to findings.
RFF Management continues to tell investors that RFM's sole form of compensation for managing RFF's assets under management is ~1% fee per annum. Refer section 4.4	EY obtained the relevant management services agreement between RFF and RFM, which outlined the management fee and agreed the fees paid.	EY observes that RFM is entitled to a total 1.05% for management fees in accordance with the explanatory memorandum issued on the formation of RFF. EY recalculated the total management fees received for the year ended 30 June 2018 based on the adjusted total asset value under management disclosed and note that this was calculated to be consistent with the percentage disclosed.	
Conflict of interest and other matters raised against RFM			
RFF Management controls and operates both boards of RFF and RFM. Refer section 4.4	EY performed an ASIC search on current and former RFF management and RFM Directors to identify other directorships and shareholdings.	EY observes that RFF, being a Trust does not have a board of directors. EY observes that one of the RFF management team is also an RFM Board member.	Refer to findings.

Bonitas Assertion	Procedures Performed and Information Relied On	EY factual findings	Conclusion
Fair value of assets disclosed			
<p>Fair value of assets disclosed</p> <p>RFF Management overstated RFF's net assets by 100% and RFF's true net assets figure was only A\$268 million as of December 31, 2018, which would put RFF in breach of its recently increased minimum A\$400 million net asset loan covenant.</p> <p>Refer section 4.5</p>	<p>EY interviewed staff to understand the accounting policy in measuring fair values, obtained and agreed external valuations to underlying general ledgers, understood the basis for any directors' valuations used and agreed accounting records to the financial statements.</p>	<p>In executing our procedures, we observed the following:</p> <ol style="list-style-type: none"> 1. No increment or decrement is recorded where directors' valuations rather than external valuations were relied on by Management. A discounted cash flow (DCF) was utilised by Management to assess whether any changes to underlying assumptions previously used in external valuations were required. 2. In the half-year ended 31 December 2018 financial statements, a change in the allocation of the fair value to the identifiable assets determined by external valuers was made by management. 3. The external valuers' reports used to prepare the financial statements inclusive of the periods between 30 June 2017 to 30 June 2018 for the three properties contained an incorrect allocation of the water allotments (and as a result an incorrect allocation of value of water) due to transfers between the properties. We have agreed the total water allocation available to the three properties and the total fair value attributed for the three properties on a collective basis and no differences were noted. 	<p>Bonitas allegation is not substantiated as the values recorded are supportable through external valuations obtained.</p>

Bonitas Assertion	Procedures Performed and Information Relied On	EY factual findings	Conclusion
Disclosures pertaining to the loan to 2007 Macgrove project			
<p>\$14.5m loan to 2007 Macgrove Project (related party) not found on 2007 Macgrove balance sheet.</p> <p>Refer section 4.6</p>	<p>EY obtained a reconciliation performed by Management of Table E2 and the general ledger mapping for the 31 December 2018 half-year financial statements. EY traced the schedules to the general ledger.</p>	<p>The related party loan was disclosed in table E2 of the 31 December 2018 half-year financial statements. The balance of \$14.5m disclosed was an error and should have been \$0.008m. This error did not affect the balances disclosed in the Consolidated Statement of Financial Position.</p> <p>EY observed that the error was confined to table E2 of the 31 December 2018 half-year financial statements and did not affect the the Consolidated Statement of financial Position.</p>	<p>Bonitas allegation is not substantiated as RFF's Consolidated Statement of Financial Position did not contain a \$14.5m loan to 2007 Macgrove Project. Table E2 of the 31 December 2018 half-year financial statements contained an error which was confined to Table E2 only.</p>
Resignation of Andrea Lemmon			
<p>Suggestions that David Bryant's former Company Secretary Andrea Lemmon, abruptly resigned in August 2018 after 21 years of working with David Bryant since RFM was founded in 1997.</p> <p>Refer section 4.7</p>	<p>EY interviewed Andrea Lemmon. In addition, EY reviewed documents provided by the company outlining the succession plan and timing of Andrea Lemmon's departure.</p>	<p>No matters noted.</p>	<p>Bonitas allegation is not substantiated as Andrea Lemmon's departure was orderly with planning commencing in 2015.</p>

2. Key Matters

2.1 Mandate

- 2.1.1 In accordance with our Instruction Letter we have been engaged to:
- (a) Independently investigate specific allegations made within the Bonitas Document detailed in Section 3.1.3, to determine whether the allegations contained therein are substantiated; and
 - (b) Independently determine whether the responses provided by RFM within the RFM Response are corroborated.
- 2.1.2 In accordance with the requirements of APES 215 – Forensic Accounting Services (“APES 215”), we confirm that EY is independent in this matter.

2.2 Purpose of this report

- 2.2.1 This report has been compiled solely to provide you with our findings in respect of the independent investigation we performed in accordance with our instructions dated 7 August 2018 and subsequent instructions dated 9 August 2019 and 23 August 2019.
- 2.2.2 Our report, or any part of it, may not be published or distributed without obtaining our prior written consent, which has been provided in respect of disclosure to the ASX and potentially to the Australian Securities & Investments Commission. Our report (or similar) may be disclosed in accordance with any applicable law or by order of a Court of competent jurisdiction.
- 2.2.3 The specified purpose for which our report is prepared is to conduct an independent investigation of the assertions within the Bonitas Document in accordance with our Engagement Letter.
- 2.2.4 Specifically, this Report provides our findings of our independent investigation into the assertions made within the Bonitas Document which was issued on 6 August 2019.
- 2.2.5 Our report may be relied upon by Rural Funds Group only pursuant to the terms of our engagement letter dated 7 August 2019. We disclaim all responsibility to any other party for any loss or liability that the other party may suffer or incur arising from or relating to or in any way connected with the contents of our report, the provision of our report to the other party or the reliance upon our report by the other party.

2.3 Time period

- 2.3.1 Our independent investigation related to the Bonitas Document assertions covering the financial year 30 June 2016 to half-year 31 December 2018, and consideration of matters which may be raised by Management in the financial statements and disclosures for the year-ending 30 June 2019 (“The Period”). Any events or transactions that occurred outside of The Period, which we refer to in this report, were included for information purposes only.

2.4 Restrictions and limitations

- 2.4.1 We draw your attention to the limitations inherent in this report.
- 2.4.2 EY have not conducted an audit of RFF. However, we have utilised information provided by management and agreed this information to the general ledger where relevant, and independently verified all information relied on by EY, having regard to the completeness and consistency of the information provided.

2.4.3 We have included information that we obtained verbally in this report. Unless expressly indicated otherwise, we cannot verify that such information obtained is credible or truthful. In performing our independent investigation, nothing has come to our attention to indicate that the information we obtained verbally is not credible or truthful.

2.4.4 If additional or new information is brought to our attention subsequent to the date of this Report which would affect the findings detailed below, we reserve the right to amend and qualify our findings accordingly.

2.5 Conduct of this assignment

2.5.1 We have made all the inquiries which we believe are appropriate. No matters of significance that we regard as relevant to our observations have, to our knowledge, been withheld.

2.5.2 The Engagement Partner has complied with the requirements of APES 215, the professional code of practice of CPA Australia and the Institute of Chartered Accountants in Australia and New Zealand.

2.6 Fees for this assignment

2.6.1 The fees received or receivable in relation to this assignment are based upon agreed hourly rates for time incurred.

3. Overview of Engagement

3.1 Background

- 3.1.1 RFM manages over A\$1 billion of agricultural assets including six funds for which RFM is the responsible entity.
- 3.1.2 RFM's largest fund, RFF, is an ASX-listed REIT which owns a portfolio of diversified agricultural assets including almond and macadamia orchards, commercial-scale poultry farms, premium vineyards, water entitlements, cattle and cotton assets. These properties are subject to leases.
- 3.1.3 Allegations and the corresponding page and paragraph references which were made within the Bonitas Document include:
- (a) "Evidence suggests that RFF's reported profitability had included A\$28+ million of fabricated rental income paid to RFF by its two largest third-party lessees." (see page 1, paragraph 2 and repeated at pages 1, 2, 7, 8, 9, 10, 11, 12, 13, 14, 20.)
 - (b) RFF had "artificially inflated its reported financial performance..." (see page 1, paragraph 2 and repeated at pages 7, 8, 9, 10, 11, 12, 13, 14, 15, 16.)
 - (c) "Dividend afforded with cash from equity raises and bank borrowings." (see page 14, heading).
 - (d) "RFF Management overstated RFF's net assets by 100% and that RFF's true net assets figure was only A\$268 million as of December 31, 2018, which would put RFF in breach of its recently increased minimum A\$400 million net asset loan covenant." (see page 1, paragraph 3 and repeated and discussed at pages 14, 15, 16, 17.)
 - (e) "RFF's largest nefarious transaction appeared as an undisclosed dividend recapitalisation of RFM's newly acquired cattle asset, J&F, which included a A\$30 million special cash dividend paid to RFM financed by borrowings backstopped by RFF's A\$75 million financial guarantee to J&F." (see page 1, paragraph 5 and repeated at pages 4, 19, 20, 21, 22, 23, 24, 25, 30.)
 - (f) "RFF's 1H'19 results disclosed that it was owed A\$14.5 million from an RFM related party macadamia lessee which inexplicably did not appear on the lessee's balance sheet." (see page 1, paragraph 5 and repeated at pages 3, 4, 19, 20, 26, 27, 28, 29.)
 - (g) "RFF Management continues to tell investors that RFM's sole form of compensation for managing RFF's assets under management is ~1% fee per annum." (see page 3, paragraph 4 and repeated at pages 5, 18, 20.)
 - (h) "RFF Management controls and operates both boards of RFF and RFM." (Page 3, paragraph 5 and repeated at pages 8, 18.)
 - (i) "...David Bryant's former Company Secretary Andrea Lemmon, who abruptly resigned in August 2018 after 21 years of working with David Bryant since RFM was founded in 1997." (page 25 Bonitas Report).

3.2 Procedures performed

- 3.2.1 Our analysis was mainly based on analysis of records, meetings with management and other information which RFM provided to us.
- 3.2.2 The procedures we performed comprised the following:
- (a) Interviews with Management
 - (b) Recommendation of electronic records preservation
 - (c) Inspection of accounting policies
 - (d) Inspection of audited financial statements and disclosure notes
 - (e) Inspection and interrogation of the general ledger and underlying records, including third-party documentation where appropriate
 - (f) Background searches of publicly available information (directors, companies, directorships)
 - (g) Tracing underlying books and records to third-party documentation, where appropriate.
- 3.2.3 Our detailed procedures in respect of each of the assertions made by Bonitas have been detailed in each key focus area, within Section 4.
- 3.2.4 As our procedures do not constitute either a reasonable or limited assurance engagement in accordance with Standards issued by the Australian Auditing and Assurance Standards Board, we do not express any conclusion and provide no assurance on the conclusion or any other part of this report.

4. Detailed Procedures and Observations

4.1 Bonitas Research LLC Document

- 4.1.1 A number of allegations were raised in the Bonitas Document, as outlined in Section 3.1. There are some that are linked and therefore we have addressed these collectively as key focus areas where appropriate.
- 4.1.2 We detail our procedures performed and factual findings with respect to each of the key focus areas below:
- (a) Revenue Recognition for Rental Income
 - (b) Acquisition of J&F
 - (c) Conflict of Interest and other matters raised against RFM
 - (d) Fair Value of Assets disclosed
 - (e) Disclosures pertaining to the Loan to 2007 MacGrove Project
 - (f) Resignation of Andrea Lemmon.

4.2 Revenue Recognition for Rental Income

- 4.2.1 Bonitas have alleged that RFF overstated its reported rental income received from both Select Harvest Limited ("SHV") and Olam Orchard Australia Pty Ltd ("Olam").
- 4.2.2 Bonitas have alleged that rental income for financial years ended 30 June 2017, 2018 and for the half-year ended 31 December 2018 has been overstated by A\$28+ million. In formulating this amount, Bonitas stated that they compared rental expense disclosed by the third parties in their financial statements to rental revenue disclosed by RFF.
- 4.2.3 In the RFM response, RFM asserted that the Bonitas reading of the accounts of third-party lessees is mistaken.

Procedures Performed and Information Provided

- 4.2.4 EY were provided with the following documents and information which we relied on in forming our assessment of the assertions raised:
- (a) Rental agreements between RFF and SHV
 - (b) Rental agreements between RFF and Olam
 - (c) Management reconciliation of rental income
 - (d) Rental invoice schedules
 - (e) Bank statements.
- 4.2.5 EY performed the following procedures:
- (a) Interviewed Management to understand the process for calculating amounts invoiced to SHV and Olam.
 - (b) Obtained the rental agreements in place for all Almond properties between RFF & SHV and RFF & Olam in force for financial years 2016, 2017, 2018 and during

the half-year ended 31 December 2018 and agreed the methodology used by Management to calculate rental income to the signed rental agreements.

- (c) Traced any underlying inputs required to determine the rental income due to RFF to supporting documentation provided by Management.
- (d) Reconciled the rental income to the general ledger, invoices issued to SHV and Olam, bank statements and RFF's financial statements.
- (e) Agreed schedule of issued invoices to payments received by reconciling to underlying bank statements for rental income from SHV and Olam.
- (f) Assessed Management's classification of the arrangements as operating leases.

EY Factual Findings

- 4.2.6 EY observed that rental income from SHV and Olam reflected in RFF's financial statements for The Period was consistent with RFF's general ledger for the corresponding periods.
- 4.2.7 EY agreed the payments received from SHV and Olam in respect of rental income referred to in section 4.2.6 to RFF's bank statements as paid and received.
- 4.2.8 EY agreed the methodology used to determine the quantum of rental income referred to in section 4.2.6 to signed rental agreements between SHV and RFF and Olam and RFF. To the extent that inputs were required in the calculation (such as capital expenditure) we agreed this to values disclosed in the financial statements.
- 4.2.9 EY observed the Bonitas Document asserts that rental income disclosed by RFF in financial years 2017 and 2018, and for the half year ended 31 December 2018, exceeds the rental expense disclosed in the financial statements of SHV and Olam. Whilst our procedures did not extend to counterparty accounting treatment, and therefore make no comment on the lessees' accounting treatment, we note the following as a general observation with regard to lessee accounting.
- 4.2.10 It is not unexpected that lessees may elect to capitalise expenditure incurred in respect of the properties on the basis that they are costs incurred in developing agricultural produce, particularly if the almond trees are not yet considered mature. On that basis, it is plausible that there are differences in lease rental expense and lease rental income between different parties.

Assessment of the classification of the leases

- 4.2.11 EY observes that the recognition of rental revenue for the almond properties tested is premised on Management's assessment that the leasing arrangements with third parties are operating leases in accordance with relevant Australian accounting standards and pronouncements, including AASB 117 Leases. Specifically, bearer plants are considered to be property plant and equipment under the accounting standards and require an assessment separately from the land on which they are attached.
- 4.2.12 Contemporaneous documentation to support Management's lease classification analysis and conclusions made at the date the leases were entered into was not available during our engagement. However, following our information request, Management provided us with summary documentation of their assessments for the two properties we selected to test. Based on these assessments, Management have noted that due to the risks retained by RFF on the trees as well as the expected future rental returns, they believe that the classification as an operating lease is appropriate.
- 4.2.13 EY has not concluded on or confirmed the accounting treatment in respect of the classification of leases. We note that whilst the assumptions used by Management and in turn the conclusions reached appear supportable, this is a highly judgemental and complex area.

- 4.2.14 To the extent that the arrangement had been determined to be a finance lease, the resultant recognition would be split between interest revenue and recovery of the assets. The total cash received would not change and this has been tested as part of our procedures.

4.3 Acquisition of J&F

- 4.3.1 Bonitas have alleged that a A\$30m special dividend was paid to RFM by J&F, funded by J&F's working capital facility for which RFF provided a A\$75 million financial guarantee.
- 4.3.2 Bonitas have alleged that shortly after RFM acquired J&F, RFM directed J&F to immediately borrow A\$30 million against RFF's A\$75 million guarantee to pay the A\$30 million to RFM.
- 4.3.3 In the RFM Response, RFM asserted that the ending capital structure of J&F and the guarantee were exactly as described to investors in the equity raising document and the member meeting documentation provided in July 2018. The guarantee was considered fair and reasonable by an independent expert and due to its related party nature, approved by RFF unitholders. RFM did not benefit from a \$30m special dividend, rather it received an amount of \$30m as a result of selling its shares to J&F by way of a share buy-back.

Procedures Performed and Information Provided

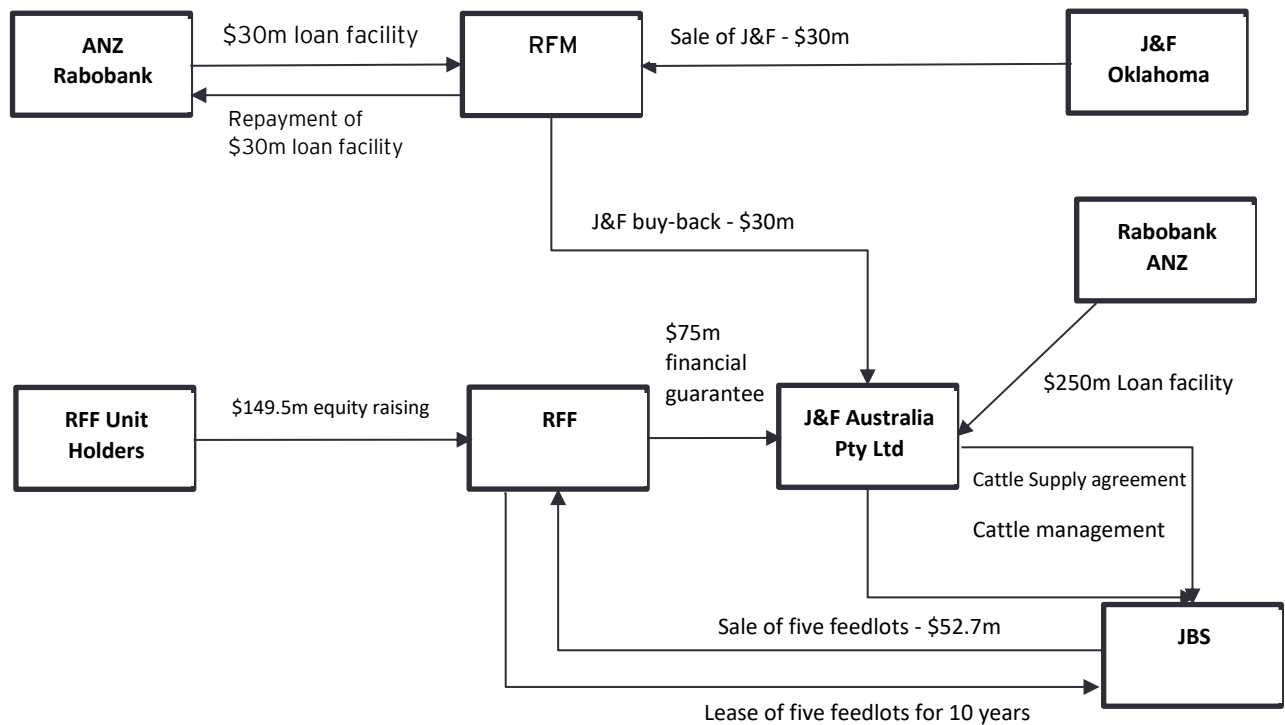
- 4.3.4 EY were provided with the following documents and information which we relied on in forming our assessment of the assertions raised:
- (a) J&F Australia Pty Ltd Share Sales Agreement
 - (b) J&F Australia Pty Ltd Share Buy-back Agreement
 - (c) A\$30 million ANZ (and Rabobank) Loan facility Agreement
 - (d) A\$250 million Syndicated Loan Agreement
 - (e) Bank statements
 - (f) A\$75 million financial guarantee between RFF and J&F Australia Pty Ltd.
- 4.3.5 EY performed the following procedures:
- (a) Verified RFM's acquisition of J&F to the executed Share Sales Agreement and transfer of funds from ANZ to J&F Oklahoma Holdings Inc.
 - (b) Verified J&F's buy-back of shares to the executed Share Buy-Back Agreement and J&F bank statements
 - (c) Verified RFF's repayment of amounts drawn down on the A\$30 million ANZ (and Rabobank) loan facility to RFF bank statements
 - (d) Verified the existence of an executed financial guarantee of A\$75 million between RFF and J&F

EY Factual Findings

4.3.6 RFM received payments totalling A\$30,693,936 from J&F between 13 and 20 September 2018 as proceeds from J&F's share buy-back of 28,288,560 of J&F shares, which were subsequently cancelled by J&F. This was one of the contemplated steps required as part of the acquisition by RFM of J&F and RFF's acquisition of five cattle feedlots from JBS Australia Pty Ltd ("JBS").

4.3.7 A summary of the transaction and relevant entities is presented below in Figure 1:

Figure 1 Summary of acquisition of J&F



4.3.8 Overall transaction summary:

- RFM acquired 100% of the equity in J&F on 23 August 2018.
- The acquisition was initially funded through a A\$30m loan facility with the ANZ (and Rabobank) and a A\$250 million Syndicated Loan Facility, with a term of two years, to cover J&F's existing debt of A\$209 million at the time of the acquisition.
- RFF provided a financial guarantee to J&F which was required as security for the A\$250 million Syndicated Loan Facility.
- RFF raised A\$149.5 million in equity. The Syndicated Loan Facility required RFF to raise a minimum of A\$135 million through equity raising.
- RFF purchased five cattle feedlots from JBS and executed a 10-year lease back to JBS for the same feedlots.
- In addition, a Cattle Sales and Purchases agreement was executed between J&F and JBS. This requires J&F to purchase and own cattle until they have achieved the desired weight. At this point, the cattle is to be sold to JBS at cost plus margin. A Cattle Management Services agreement was also executed between

J&F and JBS whereby JBS is required to manage J&F's cattle until they achieved the desired weight.

- 4.3.9 RFM acquired 100% of the ordinary shares in J&F on 23 August 2018 for a total price of A\$30,693,936 from J&F Oklahoma Holdings Inc. Total payments of A\$30,693,936 were made to J&F Oklahoma Holdings Inc between 13 and 20 September 2018 for the acquisition.
- 4.3.10 RFM's acquisition of J&F was funded through a A\$30 million loan facility executed between RFM and ANZ (and Rabobank), from which A\$27,230,138 was drawn down and transferred by the ANZ directly to J&F Oklahoma Holdings Inc. RFM also transferred cash of A\$3,463,798 to J&F Oklahoma Holdings Inc. (total payment of A\$30,693,936).
- 4.3.11 On acquisition of J&F, J&F held debt of A\$209 million. RFM executed a separate Syndicated Loan Facility of A\$250 million, A\$209 million of which was drawn down to pay out J&F's current debt providers.
- 4.3.12 RFM (J&F) was subject to the following pre-conditions in order to draw down on the A\$250 million Syndicated loan facility:
- (a) RFM as responsible entity for RFF has received or will receive no less than \$135m from an equity capital raising
 - (b) A financial guarantee for A\$75 million of the syndicated loan facility.
- 4.3.13 RFF completed an equity raising of A\$149.5 million in August 2018.
- 4.3.14 RFF executed a financial guarantee of A\$75 million to J&F in return for a financial guarantee fee for a period of 10 years.
- 4.3.15 Following RFM's acquisition of J&F, J&F executed a share buy-back of all but five of its ordinary shares. RFM received from J&F payment of \$30,693,936 as part of the share buy-back.
- 4.3.16 A\$27,320,138 of the proceeds from the share buy-back were used to repay the A\$30 million ANZ (and Rabobank) facility in full (amount drawn down was A\$27,320,138).
- 4.3.17 EY observes that via the A\$75 million financial guarantee, RFF is exposed to some risk of the J&F asset acquired by RFM. EY also notes that RFF receives compensation for this risk through the financial guarantee fee that it receives from J&F. RFF owns the feedlot upon which J&F's cattle is managed. J&F's cattle is managed by JBS throughout the life of the cattle (refer Section (f)).
- 4.3.18 RFF's risk exposure noted in section 4.3.17 is also mitigated by J&F's insurance cover on J&F's feedlot cattle held with Arthur J. Gallagher & Co (Aus) Limited. EY sighted the annual Notice of Insurance which provided cover for A\$272 million of feedlot cattle for the period 13 August 2018 to 13 August 2019 and covers all risk of mortality and Government slaughter. EY also sighted the annual Notice of Insurance covering the period 13 August 2019 to 13 August 2020, which provided cover for A\$247 million.
- 4.3.19 EY observes that the ending capital structure of J&F and the financial guarantee provided by RFF to J&F are consistent with the equity structure proposed and described on page 21 of the Retail Offer Booklet issued by RFF on 13 July 2018 and the Notice of Meetings and Explanatory Memorandum issued by RFF on 23 July 2018.

4.4 Conflict of Interest and other matters raised against RFM

- 4.4.1 Bonitas have alleged that the transactions between RFM and RFF have not been at arms-length and have asserted that RFM has received compensation in excess of the fees for

assets under management of 1% per annum. In addition, they have asserted that RFF Management controls and operates both boards of RFF and RFM.

- 4.4.2 In the RFM response, RFM have stated that as responsible entity of RFF, it charges a management fee of 1.05% of the adjusted gross asset value of RFF. RFM is also entitled to be reimbursed for expenses incurred in performing its duties as responsible entity of RFF.
- 4.4.3 In addition to the assertion that RFF Management controls both RFF and RFM, RFM noted that it is the responsible entity of RFF and holds an Australian Financial Services licence authorising it to operate RFF. RFF does not have a board of Directors. This structure is common amongst Australian REITs and other managed investments.

Procedures Performed and Information Provided

- 4.4.4 EY were provided with the following documents and information which we relied on in forming our assessment of the assertions raised:
- (a) Explanatory Memorandum issued on the formation of RFF
 - (b) Constitution of RFF.
- 4.4.5 EY performed the following procedures:
- (a) Obtained supporting contractual agreements which outlined the performance and management fees to which RFM was entitled to earn from RFF and the basis for this fee
 - (b) Recalculated the fee recorded as an expense in the 30 June 2018 period and investigated any variances
 - (c) Performed an ASIC search on current and previous Directors of RFM and compared the results to the related party disclosures in RFF's financial statements
 - (d) Performed an ASIC search on current and previous Secretaries of RFM and compared the results to the related party disclosures in RFF's financial statements
 - (e) Performed an ASIC search on all Directors and Secretaries (current and previous) for J&F, JBS, RFM, SHV and Olam to determine if any common positions are held between these entities.

EY Factual Findings

- 4.4.6 EY notes that in accordance with the explanatory memorandum issued at the time of the formation of RFF, RFF agreed to pay 1.05% to RFM for management fees. This is less than the total entitlement under the terms of the RFF constitution which allows up to 2% fees to be paid. In addition, reimbursement of reasonable expenses is allowed.
- 4.4.7 Based on the 30 June 2018 financial statements, the total management fee paid was A\$6.263 million. This is approximately 0.97% of the average adjusted total asset value in RFF (utilising the 30 June 2017 adjusted total asset value and the 30 June 2018 adjusted total asset value). EY observes that Management raises invoices monthly based on the assets under management at the date of invoicing and therefore discrepancies arise due to the timing of acquisitions and disposals during the period. Raising invoices monthly is normal practice for asset managers and therefore discrepancies are not unusual.
- 4.4.8 Management has represented that the management fee is the only compensation that RFM receives from RFF. Management has also represented that any payments to RFM other than the management fee relate to reimbursable costs incurred by RFM on behalf of RFF (i.e. payment for RFF management which are employed by RFM).

4.4.9 EY have performed an ASIC search on the Directors and Secretaries (both past and present for the entities outlined to determine if any common positions). Based on this search, we observe the following:

- (a) As disclosed in the financial statements of financial years 2016, 2017, 2018 and the half-year ended 31 December 2018, Michael Carroll is a current Director for both SHV and RFM. RFM Management confirm that procedures are in place to manage this potential conflict and advised that Michael Carroll did not participate in any negotiation between RFM and SHV regarding the leases between SHV and RFM.
- (b) In addition, it was noted that David Bryant and a current Director of Olam are both current directors of Cotton JV Pty Ltd, a 50:50 joint venture between Queensland Cotton Corporation Pty Ltd (a subsidiary of Olam) and RFM. This joint venture is disclosed in the 30 June 2018 financial statements of RFF.

4.5 Fair Value of Assets disclosed

4.5.1 Bonitas have alleged that on the basis of the discrepancies in the rental income and other transactions noted, RFF Management overstated RFF's net assets by 100% and that RFF's true net assets figure was only A\$268 million as of 31 December 2018, which would put RFF in breach of its recently increased minimum A \$400 million net asset loan covenant.

4.5.2 In the RFM Response, RFM asserted that the statement was incorrect and that all asset values recorded in RFF accounts are accurate, appropriate, supported by independent valuations and reviewed by its auditor, PricewaterhouseCoopers.

Procedures Performed and Information Provided

4.5.3 EY were provided with the following documents and information which we relied on in forming our assessment of the assertions raised:

- (a) External valuations were obtained for the period between 30 June 2015 and 31 December 2018 for the following properties: Kerarbury Aggregation; Moorall & Steak Plains; Tocabil; Yilgah & Collaroy; and Macadamia properties
- (b) Allocation calculations performed by Management for the periods between 30 June 2016 and 31 December 2018 and relevant consolidation ledgers
- (c) Board papers for valuations presented to the board between 30 June 2017 and 31 December 2018
- (d) Reconciliations of the allocations performed from the general ledger to the audited financial statements.

4.5.4 EY performed the following procedures:

- (a) Assessed the appropriateness of management's allocations of external valuations in accordance with accounting policies of RFF
- (b) Agreed Management's allocation of fair value to the underlying general ledger
- (c) Agreed the general ledger allocations to the financial statements
- (d) Where directors' valuations were used during the period, we obtained an understanding from management as to the basis of the directors' valuation.

EY Factual Findings

- 4.5.5 We inspected the underlying valuations and allocations used by Management. In doing so, we make the following observations:
- 4.5.6 The external valuations prepared were by qualified valuers and signed for each of the respective years. We observed that not all valuers who signed the valuations sighted the relevant properties - **generally only one valuer visited each of the respective properties.**
- 4.5.7 Management have advised that they obtain external valuations at a minimum every 2 years. To the extent that the date of the valuation is not the year end date, the **valuation is increased by the capital expenditure over the period**, as this is assessed to be the fair value of the additional expenditure. EY notes that this is consistent with the information provided by Management.
- 4.5.8 The valuation method used to measure the properties is a discounted cash flow ("DCF") method based on the current rental arrangements. Management advised that they do not use a vacant possession calculation. They have represented that the valuations do not take into account any potential produce, as they are measuring the rent received and expenditure required to obtain the rent under the arrangements. Based on the procedures performed, EY observed that management utilise the value determined by the DCF prepared by the valuers.
- 4.5.9 In accordance with Australian Accounting Standards, water licences are an intangible asset under AASB 138 *Intangibles* (AASB 138). Generally, **water licences are held at cost rather than at fair value as there is not considered to be an active market.** This is consistent with the accounting policies of RFF which is extracted below from the 30 June 2018 financial statements:
- "RFF owns permanent water rights and entitlements which are recorded at historical cost less accumulated impairment losses. Such rights have indefinite life and are not depreciated. The carrying value is tested annually for impairment as well as for possible reversal of impairment. If events or changes in circumstances indicate impairment, or reversal of impairment, the carrying value is adjusted to take account of impairment losses."*
- 4.5.10 EY agreed that any uplift of fair value determined for water rights was not recorded in the underlying statement of financial position for The Period. In addition, in determining the allocations utilised by management in any of the financial years, management reduced the total external valuation value available to allocate amongst other assets by the fair value attributable to the water right.
- 4.5.11 Management identified inconsistencies with the water allocations between some properties (Tocabil, Yilgah and Moorabool) in the build-up of the external valuers' report. Based on interviews with Management, this is on the basis that water allocations have been transferred between the properties for use. All properties are within the same geography and therefore this appears reasonable. Therefore, in assessing the appropriateness of the valuations, EY has assessed the allocations of fair value water value on an aggregated basis for these properties.
- 4.5.12 It was observed by EY in undertaking our procedures, that there was a change in determining the appropriate allocation of value to assets in the 31 December 2018 financial statements. Management utilise a variety of techniques to allocate the fair value determined by the external valuer. This may include attribution of value based on other evidence or cross checks performed by the valuer. In the 31 December 2018 financial statements, management identified that there was a significant increase in the price per mega litre for water based on recent transactions and therefore market transactions for allocating water was not considered reliable based on how the properties were used. On

this basis, management assessed that it was more appropriate to value water licences in the current period based on "use", that is in respect of the current leased properties.

- 4.5.13 EY notes that management have assessed that this was not a significant judgement that required disclosure within the financial statements on the basis that the overall valuation determined by the valuer was still the basis for the allocation. EY observes that AASB 13 Fair Value Measurement requires qualitative disclosures for any unobservable inputs that might impact the measurement of fair value for various assets. Whilst this is an area of judgement, EY would expect that the allocation methodology utilising the underlying rental income received, should be disclosed as this is a key input in determining the fair value of the underlying assets by the external valuer.
- 4.5.14 In addition, management advised that in preparing the financial statements for the 30 June 2019 period, they identified that there had been an incorrect application of AASB 116 *Property Plant and Equipment* ("AASB 116") to some assets as a result of changes to the accounting standards application for "bearer plants" in prior financial reporting periods. That is, in accordance with the principles of AASB 116, the revalued balances of the "bearer plants" (i.e. Almond and Macadamia trees) should be depreciated. As a result of this, management have applied the criteria in AASB 108 and determined that this was an error and a restatement was prepared. This restatement results in amendments being posted to the 30 June 2018 financial statements previously reported.
- 4.5.15 In applying the criteria in AASB 116:
- (a) Depreciation is recorded based on the effective lives of the plants and recorded within the determination of net profit after tax
 - (b) At the date of the revaluation, the asset value is adjusted and the accumulated depreciation is eliminated against the gross carrying amount of the asset
 - (c) The bearer plants are revalued to the value determined and allocated based on external valuations. Any revaluation increment is recorded within the statement of comprehensive income.
- 4.5.16 There is no net impact on the fair value of the biological assets recorded in the statement of financial position nor the total comprehensive income disclosed in the consolidated statement of comprehensive income. However, the amendments will result in changes to both depreciation and revaluations disclosed both in the profit and loss and other comprehensive income.

4.6 Loan to 2007 Macgrove Project

- 4.6.1 Bonitas have alleged that the 31 December 2018 half-year financial statements disclosed that it was owed A\$14.5million from an RFM related party which did not appear on the Lessee's balance sheet.
- 4.6.2 In the RFM Response, RFM noted that there was an error in Note E2 of the financial statements which Bonitas had referred to. In this respect the table incorrectly listed a loan to the 2007 Macgrove Project of A\$14.463m. RFM asserted that the correct figure was \$0.008m and no other changes were noted in the financial statements.

Procedures Performed and Information Provided

- 4.6.3 EY were provided with the following documents and information which we relied on in forming our assessment of the assertions raised:
- (a) Interim financial statements for RFF for the half-year ended 31 December 2018

(b) Consolidation used for preparing the Interim financial statements including mapping.

4.6.4 EY performed the following procedures:

(a) Agreed current and non-current receivables disclosed in the half year ended 31 December 2018 financial statements for RFF to the general ledger provided by Management

(b) Recalculated Note C4 and Note E2 based on the information in the general ledger.

EY Factual Findings

4.6.5 EY notes that based on our procedures, the disclosure for Note E2 should have been as follows ("Correct Balance"):

Table 2: Note E2 (Related Party Disclosure)

Debtor	Correct Balance '000s	Disclosed Balance '000s*	Difference '000s
RFM Farming	151	151	-
Rural Funds Management	-	-	-
RFM Macadamias	37	37	-
Cattle JV (including finance lease receivable)	15,233	15,233	-
RFM 2007 Macgrove Project	8	14,463	14,455
Cotton JV	142	142	-
J&F Australia Pty Ltd	428	428	-
RFM Poultry	49	49	-
Total	16,048	30,503	14,455

*As disclosed in RFF's 31 December 2018 half-year financial statements

4.6.6 EY agreed the correct balances to the general ledger balances used to prepare the financial statements.

4.6.7 EY verified that the error reflected in the 31 December 2018 half-year financial statements was confined to note E2 (i.e. the error did not impact the statement of financial position as this had been disclosed correctly). EY recalculated the balance disclosed in the statement of financial position based on the general ledger and noted no errors.

4.7 Resignation of Andrea Lemmon

4.7.1 Bonitas have alleged that "...David Bryant's former Company Secretary Andrea Lemmon, who abruptly resigned in August 2018 after 21 years of working with David Bryant since RFM was founded in 1997." It is inferred by Bonitas that this is on the basis that she was aware of the alleged activities asserted in the Bonitas document.

4.7.2 In the RFM Response, RFM stated that Andrea Lemmon advised David Bryant of her plan to retire in 2015. Andrea Lemmon and other RFM staff then planned and managed her succession over a two-year period preceding her retirement in October 2018.

Procedures Performed and Information Provided

4.7.3 EY were provided with the following documents and information which we relied on in forming our assessment of the assertions raised:

(a) Internal communications memo dated 16 October 2017

(b) RFF ASX announcement - Andrea Lemmon retirement.

4.7.4 EY performed the following procedures:

(a) Interviewed Andrea Lemmon

(b) Sighted internal communications regarding Andrea Lemmon's planned retirement

(c) Sighted RFF ASX release regarding Andrea Lemmon's retirement.

EY Factual Findings

4.7.5 EY interviewed Andrea Lemmon on 21 August 2018 who informed us of her orderly wind-down to retirement in October 2018. Andrea Lemmon confirmed to us that during 2015, she communicated her intention to retire within the next three years to RFF Management, including David Bryant. In addition, during 2015 to 2017, she had numerous discussions regarding an exit and succession plan with RFF Management.

4.7.6 David Bryant issued an internal notification to RFF Management advising of Andrea's intention to retire by 31 December 2018, dated 16 October 2017. EY have sighted this memo.

4.7.7 RFF issued an ASX release on 31 August 2018 informing the market that Andrea Lemmon would retire in October 2018 and that Emma Spear was appointed as Company Secretary effective 31 August 2018.

5. Glossary

5.1.1 Throughout this document, unless otherwise stated, the following references apply. These references serve to clarify this report and are not intended to be authoritative.

Reference	Description
APES 215 - Forensic Accounting Services	Document that sets out the standards for provision of quality and ethical forensic accounting services
Australian Accounting Standards	Financial reporting standards applicable to entities in the private and public sectors of the Australian economy
Bonitas	Bonitas Research LLC
Bonitas Document	Document containing assertions made by Bonitas on RFF dated 6 August 2019
Engagement Letter	Engagement Letter between Clayton Utz and EY dated 6 August 2019
Instructions	Instructions contained within the Engagement Letter and subsequent letters dated 9 August 2019 and 23 August 2019
J&F	J&F Australia Pty Ltd
JBS	JBS Australia Pty Ltd
Management	Management of RFF (Used interchangeably with RFF Management)
Olam	Olam Orchards Australia Pty Ltd
Report	This report
RFF	Rural Funds Group
RFF Management	RFM team responsible for the management of RFF
RFM	Rural Funds Management Limited
RFM Response	RFM's Response to the Bonitas Document made in respect of RFF to the ASX on 7 August 2019
SHV	Select Harvests Limited
The Period	Financial year 30 June 2016 to half-year 31 December 2018, and consideration of matters which may be raised by Management in the financial statements and disclosures for the year-ending 30 June 2019.

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ED None

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