

HD (SWTFC) Ferret's Stock Watch: TFS CORPORATION LIMITED

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SANDALWOOD INDUSTRY LOOKING HEALTHIER WITH TECHNOLOGY

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TFS Corporation had a really tough start around Kununurra in the Pilbara of WA and it's been about a decade to see it become a viable industry.

Your Ferret some years ago visited Kununurra and its environs and caught Barramundi in the Ord River.

At one stage, investing in a sandalwood plantation was looked up as courting financial disaster but then suddenly growing sandalwood trees seemed a great proposition although investors had to overcome the realisation that the trees take about 12 or 15 years to grow and become specially prized wood and **oil** for the fragrance industry.

TFS Corporation now has about 7,600 hectares of Indian Sandalwood (*Santalum album*) trees established in the tropical north of Australia of which TFS has an effective ownership of about 2,400 hectares.

TFS plantations are owned and managed on behalf of shareholders and both retail and institutional investors.

Through the **acquisition** of renowned distiller Mt Romance, TFS can also offer organic Sandalwood **oil** (*Santalum spicatum*) to buyers in the global fragrance market.

TFS Corporation is a Western Australian **company** listed on the Australian Securities Exchange (ASX Code - TFC).

With over 15 years of experience in both the cultivation of Indian Sandalwood and the distillation of WA Sandalwood **oil**, TFS has consolidated its position in the global Sandalwood industry - from soil to **oil**...

Critical to the TFS success is its commitment to sustainability.

At TFS we work towards best practice in climate, community & biodiversity to deliver long-term returns to investors, the **company** and the globe.

In June, TFS Corporation reported a downturn in profit over a nine months period.

Directors explained it was the result of the cyclical nature of TFS' product sales, there is typically a heavy bias in TFS's earnings profile towards the end of each financial year and the results in the first nine months of the year usually bear little relevance to the full year result.

The results for the nine months ending 31 March 2014 are consistent with this trend.

TFS reported NPAT for the nine months to 31 March 2014 of \$1.8m compared with NPAT of \$3.5m against the previous corresponding period, a decrease of 47%.

The result for the period was impacted by the following: Revenues increased by 15% to \$71.9m from \$62.5m in the previous period.

This increase was largely attributable to the recognition of \$12.9m of establishment fees and land sales.

The former relates to the previous financial years Management Investment Scheme and wholesale sales of \$10.1m.

Establishment fee revenue is recognised in proportion to the establishment work performed at balance date. Revenue from land sales relates to \$2.8m arising from the **sale** of plantation land, none of which occurred in the previous period;

* The plantations either owned by the Group or under management totalled approximately 7,600ha at March 31, 2014. This represents an increase of 16% from the plantations under management at March 31, 2013 and this was the key driver of the higher plantation and operating costs recorded in the period of \$28.8m (2013: \$23.2m); and

* Notwithstanding the increase in activities and plantation assets, salaries and corporate administration expenditure increased by 3% from \$20.4m to \$20.9m for the nine month period ending 31 March 2014.

SHARE PRICE MOVEMENTS

Shares of TFS Corporation yesterday slipped 3.5c to \$1.86. Rolling for the year is \$1.96 and low 42.5c. Dividend is 3c to yield 1.6 per cent. Earnings per share is 19.37c and price earnings ratio is 9.68. The **company** has 196 **million** shares on issue with a market cap of \$42.5 million

For the year ending June 30, 2013 the **Company** achieved a net profit after tax of \$55.7 **million**, an increase of 115.4% against that reported in the previous corresponding period.

Based on the strength of this result the Directors re-established the payment of a dividend, with a fully franked dividend of 3 cents paid on November 8, 2013.

The improved result for the 2013 financial year and the reinstatement of dividend payments is a confident signal that TFS is now well into a positive transition phase where TFS will emerge in the near future as a major global producer of Indian Sandalwood **oil**

Chairman Patrick O'Connor told shareholders that Indian sandalwood **oil** is a globally important ingredient in fine fragrances, cosmetics and toiletries, Indian consumer products and medical purposes.

The wood is also used for high quality carvings and artefacts and religious worship in Hindu and Buddhist faiths.

The significant milestone in confirming the full value potential for your **company** will be achieved through the actual experience of price and volume off-take for the finished products, being predominantly TFS Santalum album **oil**.

The **company's** strategy has been and will be to develop the target markets that will have the ability to achieve premium pricing with growing volumes.

The **Company's** work in this regard through its 50% owned US based joint venture, Santalis Pharmaceuticals Inc, continues to develop a suite of dermatological products based on TFS Santalum album **oil**. In addition, work with TFS' partner, ViroXis Corporation, in pharmaceutical product development, specifically the viral skin disease treatments, continues with clinical studies currently underway.

The clinical studies and work of Santalis Pharmaceuticals in the development of high value end markets for TFS Santalum album **oil** is exciting and we believe will create significant value for TFS Corporation.

The fertile plains of the Ord River Irrigation Area around Kununurra in Western Australia are being transformed by plantations of Indian sandalwood, Santalum album

It is the largest commercial production of Indian sandalwood in the world.

In more than 60% of the total farming area around Kununurra, about 3500 hectares, sandalwood has supplanted food crops such as melons, pumpkins, legumes, chick peas, bananas, and many other crops.

Thankfully, the plantations of mango trees still exist. However even these weren't totally spared and many were ripped out to make way for more sandalwood. Many farmers thought they could make a substantial profit out of this non-food crop, but they may have been fooled.

There are two main commercial plantations, Integrated Tree Cropping, (ITC), a subsidiary of Elders Forestry Ltd, and Tropical Forestry Services (TFS), as well a small number of privately owned commercial plants.

In 2009, TFS was heralding sandalwood as a plantation crop that would benefit the whole community and the environment, claiming best practice in climate, community and biodiversity and offering to protect the **company's** long-term returns while protecting the planet.

In a tense meeting of growers, Elders sold all of its sandalwood managed investment schemes to an unknown **company** called Santanol.

The firesale of \$70 **million** was passed by the growers in a vote, due to the lack of any alternative.

One industry spokesperson said: "Unfortunately for growers, the deal is grossly unfair and plantation assets are being offloaded by Elders at a firesale price."

Elders refused to disclose the identity of the financial backers of Santanol saying instead it was "a significant global investment house".

The growers have 1700 hectares planted in comparison to only 40 hectares belonging to Elders Forestry.

Only four years ago Elders Agribusiness bought into the collapsed management schemes Timbercorp and Great Southern, claiming that Elders had a future in timber and plantation industry.

Elders is now in the process of selling all its assets and is unlikely to have any business activity in forestry after this year.

BACKGROUND

TFS, a Western Australian public **company**, was founded in the late 1990s to establish the first Indian sandalwood plantation in Australia.

It began with a 1200-hectare crop in 1999 and now has 700 individual growers in 12 different projects.

Its first harvest is due this year but growers and investors have taken an enormous gamble as no one can predict how much the crop will earn.

TFS bought Mt Romance Ltd, Australia's largest distillery of WA sandalwood in 2008.

Investors in the sandalwood plantation have been promised 100% upfront tax deduction for any outlaying costs.

This year, TFS is telling current and prospective investors the price will grow 16.7% over a 20-year period.

The current value of Indian sandalwood is \$112,000 a tonne.

Many superannuation schemes have invested because of the generosity of tax concessions due to its so-called carbon-capture status.

Sandalwood has a poorly developed root system and is classified as a hemi-parasite, due to its inability to fix nitrogen in the soil.

It needs other trees and legumes to grow and survive.

It takes about 12-15 years for the Indian sandalwood tree to mature, although this figure may have to be adjusted in WA conditions, depending on soil and climate.

Some experts suggest it may take up to 40 years before it is ready for harvest.

The **oil** from sandalwood is contained in the heartwood and the entire tree is removed at harvest including the roots which also contain some heartwood.

Oil content is estimated at about 3.5% of the weight of the tree.

The wood will be sold to make small furniture items, joss sticks, wood carving, soaps and to the perfume industry including the giant Chanel.

Each tree is expected to bring in about \$3000, but this is sheer speculation.

It is thought sales will mainly go to India and **China**.

Australian native sandalwood *Santalum spicatum*, has been grown successfully in the southern wheatbelt of WA since the 1840s.

It also needs to be co-planted with about 45 different native hosts found naturally around the tree.

It is currently being grown in south-west WA where the soil has been heavily salinated and is no longer useful for food crop production

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