Brokers Sniff Sweet Potential In TFS Corp

TFS Corp (TFC) has new arrangements with Asian buyers of its Indian sandalwood that are set to absorb the next five years of supply currently controlled by TFS.

Brokers brushed aside a strong first half result to highlight the potential of these contracts. Alongside the pharmaceutical contract with Galderma, TFS has contracts for 150 tonnes of heartwood to a Chinese wood customer and 30 tonnes to an existing Indian customer, as well as over a tonne of oil to a fine fragrance customer.

TFS has now forward-sold all its owned production for the next two years. Canaccord Genuity believes this situation significantly de-risks the business and the investment thesis. The company has moved from a pure plantation manager to a product distribution company that should generate lucrative cash flow for shareholders.

TFS has multi-year agreements with Chinese and Indian buyers of heartwood at prices similar to the Galderma deal, at around US$4,500/kg oil. Exact pricing depends on the quality and quantity of the heartwood delivered.

Supply over the next six years is expected to average around 300 tonnes per annum of heartwood. This is, in turn, expected to generate annual revenue of over $70m at more than 90% gross profit margins. Cannaccord Genuity highlights the lucrative nature of the asset base with an estimated all-in production cost of $500/kg over 15 years. Earnings are expected to increase 5-10% in FY16.

The loan book is currently at $38m and is expected to convert to cash in the current half. Going forward, Canaccord Genuity expects third party financing of retail grower loans will remove the funding requirements on the balance sheet through a cumulative build of a loan book through Arwon Financing.

TFS is currently seeking to secure third party funding of the 2016 retail product. This will significantly improve the earnings quality of the business, the broker contends. Plantation sales for FY16 currently stand at 1,000 hectares, up 50% on FY15. This is the highest level of forward sales in the company's history.

The company's contract with Galderma, a subsidiary of Nestle, has launched its sandalwood oil, a long-time ingredient in perfumery, into the therapeutics industry. Around 1m Benzac units, the Galdema over-the-counter acne medication, were shipped in the December quarter, representing a threefold increase in royalty payments to TFS.

The continued development of the company's pharmaceutical subsidiary has potential to be worth more than its plantation management business, in Canaccord Genuity's opinion. The broker suspects the company will validate this value through a minority listing on a foreign stock exchange in due course. Canaccord Genuity retains a Buy rating and $3.24 target.

Moelis is a little more circumspect regarding the financial and commercial impact of Benzac royalties but agrees the signing of additional supply agreements de-risks the demand expectations and yield assumptions to be realised over coming harvests.

The signing of multiple supply agreements for 60% of the 2016 harvest is a positive reflection on medium-term demand, in the broker's view, particularly give uncertainties in the past. The Chinese and Indian agreements provide further quality and diversity for longer term demand. The broker's near-term forecasts are based on the 2016 harvest, timed to contribute to FY17 earnings. A Buy rating and $1.95 target are maintained.

UBS uses a long run sandalwood oil prices of US$2,800/kg in its estimates but envisages upside risk to this forecast, should the Chinese and Indian wood market embrace the TFS product. The broker also notes new pharmaceutical trials such using the oil for skin warts. TFS expects at least one new pharma product containing its Indian sandalwood oil in 2017.

The attraction in the stock is based on Australia's relative geopolitical risk advantage, and the long lead time to sandalwood production which has resulted in widespread illegal harvesting of sandalwood around the world.

The tree is very difficult to grow being semi parasitic and TFS has a first mover advantage of around 20 years, in the broker's opinion. Production is forecast to increase by more than 20 times over the next 10 years. UBS retains a Buy rating and $3.25 target.

Source: http://www.fnarena.com/index2.cfm?type=dsp_newsitem&n=DE8478D5-A401-14DF-E55BF1BEC573802E

March 1st 2016