



## TFS Corporation - January 2016 Update

### Summary

Stellar FY earnings reported in August.

Annual dividend yield of 2%+.

Market cap is roughly equal to NAV.

TFS Corporation ([OTC:TFSCF](#))

Featured In: July 2015

Partnership Average Cost per Share: \$1.86 AUD

Current Market Price (January 15, 2016): \$1.52 AUD

TFS Corporation was the Partnership's featured investment in July 2015. The company remains my favorite forestry pick - I see deep value with minimal downside risk. In H2 2015, the company reported the following significant events: (1) three new additions to the company's already impressive stakeholder base, (2) stellar earnings from the trailing 12 months, and (3) distribution of the company's annual dividend payment.

It is well documented that Harvard, the Church of England, and at least one Middle Eastern sovereign wealth fund have invested either alongside TFS or directly into the company. (Remember that while TFS directly owns ~4k hectares of sandalwood plantations, it also manages over ~6k hectares for institutional/high net worth clients. This speaks to its deep knowledge and experience in this field.) Within the past 6 months, we've seen 3 new institutions become substantial TFS shareholders through common share purchases on the open market. First, in early July, a T. Rowe Price fund took a 5% stake in TFS shares. Less than a month later, seven separate Merrill Lynch funds became involved - for a collective 5% stake. More recently, in Q4, nine UBS-affiliated funds have taken a collective 5% TFS position. While these transactions have yet to spur a major rise in TFS' share price, it is encouraging to see shares consolidating into stronger hands. This will continue into 2016.

On August 31st, TFS reported earnings for the trailing 12 months (the company's fiscal year ends on June 30th). These earnings reiterated the immense opportunity presented by TFS shares at current prices. From a valuation standpoint, the company is very cheap - with a P/E multiple of ~4.8 at current. That said, the majority of earnings were non-cash (i.e. increased valuations of the company's biological assets due to the continued rise in sandalwood prices); TFS' cash EBITDA multiple is higher at ~17. While this number does not look as enticing, it is still impressive given that every year TFS invests a significant percentage of its earnings into new plantations. For some perspective, the company hopes to have 25k hectares under management/direct ownership by 2025 (versus a current total of 10k hectares). Over this period, near-term cash earnings will be depressed as the company pursues longer-term value. This may deter investors with shorter time horizons, but this is exactly what the Partnership wants to see.

Another development was the distribution of TFS' once annual dividend payment in early October. This is the third year in a row in which we saw a \$0.03 AUD distribution - implying an annual dividend yield of 2% at current share prices. While there are bigger yields out there, 2% isn't something to scoff at in today's low interest rate environment. I fully expect the company to maintain this distribution going forward and, considering that TFS' next harvest will be its biggest yet, wouldn't be surprised to see it increased in either 2016 or 2017.

Looking forward to H1 2016, there are two main milestones of note. The first involves the continued planting of additional hectares of Sandalwood (some of these additional trees will be directly owned by TFS; some will be planted on behalf of the company's institutional clients). More specifically, the company anticipates that over 1,500 new hectares will be planted in the period between June 2015 and June 2016. We will know whether this goal is hit when TFS reports FY earnings in August 2016. Secondly, the company is expected to announce long-term supply agreements with both Chinese and Middle Eastern customers within the next 6 months. The successful completion of these agreements would boost market confidence in TFS' business and potentially provide more clarity on market prices on Indian Sandalwood (it's unclear whether the agreed upon price will be publicly disclosed).

In sum, the opportunity still exists to buy TFS' shares on the cheap. For those with longer-term time horizons, TFS' shares offer compelling upside with minimal risk. (Keep in mind that the company's current market capitalization is roughly 10% below the value of TFS' net assets - implying very limited downside.) The market clearly doubts the credibility of TFS' core plantation ownership/management business. Continued operational execution and consistent dividend payments will slowly change this sentiment going forward.

Source: <http://seekingalpha.com/article/3856636-tfs-corporation-january-2016-update>

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