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ASX Release

TFS Beats Earnings Guidance as it Transforms Business Model

Highlights

- Cash NPAT of \$26.7m achieved growth of 14.7% ahead of guidance of 10%+
- 2H Dividend of 3.5 cps declared amounting to full year dividend of 4.75 cps, up 11.8%
- Successfully transformed business model from solely MIS with revenue from Non-MIS sales accounting for 73% of cash operating revenue
- MRA rebounded strongly with EBITDA of \$5.4m, growth of 58% v guidance of 20%, achieving a record result
- Balance sheet remains strong with low gearing at 19% and interest cover @10.5x
- Outlook is positive with wholesale deal flow to settle in FY11 following completion of land subdivision at Kingston Rest
- End market opportunities continue to develop in positive direction

TFS Executive Chairman Frank Wilson said TFS had delivered a strong result in difficult trading conditions.

“The business model has been successfully transitioned away from solely MIS, and evolved into one with a diverse mix of plantation and processing related sales.”

“We are seeing increased demand from wholesale investors from a variety of regions, including the USA, Europe and Asia and we expect their prominence in the TFS revenue profile to continue to grow”, Mr Wilson said.

“The performance of our processing division at Mount Romance was particularly pleasing as it demonstrates the resilience and underlying demand for sandalwood products in global markets”.

FY10 Results

TFS Corporation Ltd (TFS) (ASX: TFC) today announced a rise in Comprehensive Income after Tax of \$41.4m for the year to June 30, 2010. This result is an increase of 18.8% reported in the previous corresponding period (pcp).

In addition to the core operating performance, this result reflects the inclusion of both non-cash items such as deferred fees, tree revaluations, as well as the new accounting standard (AASB101) that encompasses the treatment of land that is either sold for cash or held for re-sale.

Deferred fees were up 31% to \$11.1m reflecting the rise in the size of the plantation estate over recent years. Cash flow from these fees will be realised as the harvest program commences in 2013. Revenue from tree revaluation was flat v pcp principally due to exchange rate movement.

The after tax contribution from land to the Comprehensive Income result was \$4.3m.

TFS has declared a 2H10 dividend 3.5 cps, up 16.7% on pcp, payable on 22 December 2010 and the record date is 01 December 2010. The dividend reflects full year dividend of 4.75 cps and a payout ratio of 40%.

Removing the non-cash items, TFS generated a Cash NPAT result of \$26.7m, up 14.7% on the FY09 result. The result includes a cash component of \$3.0m from the sale of land to wholesale investors which is set to be a recurring feature of the TFS wholesale business model.

The cash result generally reflects the emergence of the wholesale business as a key feature of the TFS business model which has developed as the MIS sector experiences significant difficulty. The result also reflects the strong recovery in MRA's fortunes with a 58% rise in EBITDA to \$5.4m.

Operating revenues

Operating revenues rose 24.4% year over year (yoy) to \$97.4m. Revenue growth reflected a combination of the 144% increase in establishment fees from the emerging wholesale product line, as well as the 62% growth in revenue from TFS' production business, Mt. Romance (MRA). These pleasing results more than offset the decline in the MIS performance with revenue falling 37%.

Cash EBITDA rose 12.2% to \$41.5m, a pleasing result given the lower MIS sales. EBITDA growth did not match revenue growth principally due to the lower margin reflected in the wholesale business as well as the lower margin contained in the MRA business, as compared with the traditional MIS business. TFS believes the margin reduction reflected this year is temporary, given the requirements in setting up the new wholesale product. TFS is already experiencing improved pricing power as demand continues to build within the global institutional investor base.

Operating costs

Operating costs (excluding D&A, interest and finance costs) rose 35% to \$56m. Cost growth included the cost of land sold to wholesale investors as well as variable cost growth at MRA. Expenses in the Plantation Management business were flat compared with the pcp reflecting disciplined management of the Sandalwood forestry operation. Raw material cost increases at MRA reflected an increase in sourcing private wood for the processing plant, which is more expensive than the bulk of the wood sourced from the FPC (Forest Products Commission).

Operating cash flow

Operating cash flow reported at -\$25.1m down from \$16.2m in the pcp. The drivers behind the result are as follows –

- Trade debtors of ~\$70m reflect
 - Fees to be received throughout the course of FY11 from wholesale investors once the subdivision of the Kingston Rest property is completed and new titles issue. These settlements will occur progressively commencing in September 2010.
- Payments to suppliers increased by \$10.0m to \$56.1m due to cost growth at MRA and the increasing cost associated with maintaining a larger plantation estate.

The operating cash flow result essentially reflects a temporary timing mismatch between when a sale to a wholesale investor is reported and when settlement and transfer of land titles occur. This temporary mismatch will be resolved through the course of FY11 as the subdivision of land at the

Kingston Rest property is completed and title to portions of the Kingston Rest property are transferred to investors.

During the period, TFS raised \$31.5m via an Institutional Placement and SPP. This helped to pay down debt however; this has been redrawn in light of the time involved in completing the Kingston Rest subdivision. Subsequently, net debt has increased from ~\$27m to ~\$47m. Gearing does remain low at 19.4% (ND / ND +E), up from 16.5% for the pcp. Upon completion of the Kingston Rest subdivision, net debt will reduce significantly and operating cash flow will correct to reflect the strong underlying fundamentals of the plantation business.

Wholesale – Institutional Investment

TFS' wholesale business reported excellent growth with sales volume up 123% to 782 ha. The growth in the wholesale business is a milestone event for TFS. It confirms a high level of interest from global investment houses (varied classes of institutional investment) that are seeking investment in long duration hard assets where the fundamentals behind the underlying commodity are exceptionally favourable.

The move into institutional investment channels clearly establishes TFS as a business that is no longer reliant on MIS revenue. Along with MRA, TFS is now operating a diversified business model that has proven its resilience to the domestic MIS market downturn and the global credit crisis.

Investment flow has been sourced from diverse regions covering US, Europe and Asia. As an indication of the scale of the investment pool that TFS is now able to tap into, it is instructive to note that in the US, institutional timberland investment has increased from US\$5b in 1991 to US\$50b in 2010 (DANA). This result excludes non-US investment which also encompasses major global investment houses.

TFS has established a strong pipeline of investors for FY11 and beyond.

MIS

TFS reported sales volume of 306 ha for the 2010 project, down 54.9% on the 678 ha reported in the pcp.

The decline in sales reflected the poor state of the MIS market. A number of key competitors have either gone into administration or pulled out of the market over the last 18 months. While industry sales have collapsed to be about 10% of their peak, TFS has managed to increase its recognition in the market as operating a quality project, leading to an improvement in market share to ~20%. TFS' project continues to be highly rated by industry analysts.

Although the MIS market is likely to remain subdued, it is still viable and TFS intends to retain a presence in the sector to provide diversification in the TFS investor base.

MRA

Mt. Romance Australia (MRA) generated EBITDA of \$5.4m, up 58.8% over the \$3.4m reported in the pcp. The result came in well ahead of previous guidance of growth of 20%. Pleasingly, this was also a record result since MRA's inception. This strong result was driven off the back of a 61.9% increase in revenue to \$18.3m.

MRA sold over 19 tonnes of oil in the period, up 81.1% and cleared the backlog of inventory recorded at FY09.

The EBITDA margin held above 29%, but reported a slight fall due to the impact of the 35% depreciation in the INR v AUD which impacted gross selling prices.

A key driver of the result was the market penetration into India of MRA's spicatum oil (Australian native sandalwood). This was a pleasing outcome as it establishes TFS as a reliable supplier of sandalwood oil to India, with a view to expanding TFS' presence over the long-term as its album plantations come on stream.

It is also worth noting that MRA is successfully developing interest in new oil and wood markets in the Middle East and sales are expected to grow in this region over the next two years.

Land Bank

TFS acquired 400 ha of new land and 339 ha of new leases in the period. TFS has now established ~3,500 ha of Indian Sandalwood plantations for investors and ~300 ha on its own account.

TFS now owns ~61% of the entire plantable real estate which establishes solid foundations for security of land tenure and the balance sheet.

Ord Stage 2 is progressing well with Federal & State funding of \$400m into infrastructure occurring. Land release is expected to occur in 2011 with ~3,000 ha of suitable land for sandalwood.

TFS is pleased to announce that an MOU has been signed with MG Corporation regarding leases over 1,000 ha in Ord Stage 2. The MOU relates to a shareholding in a JV Co with MG Corporation that will own land that TFS will lease. The investment in the JV Co is modest yet secures a significant tract of suitable land for future plantation establishment.

This arrangement does not preclude TFS from acquiring / sourcing additional parcels of land within the Ord Stage 2 region which aggregate up to a further 12,000 ha.

Due diligence on the 8,000 ha CPC property is continuing.

Sandalwood Market

Sandalwood oil spot prices remain at elevated levels and are recovering from the minor fall induced by the GFC. Given the tight supply conditions and the strong demand fundamentals, TFS expects to continue to observe a firm bid for the commodity and long-term price appreciation.

Sandalwood is an endangered species in the wild and is listed as vulnerable under the World Conservation Union.

Sandalwood is a key ingredient for markets and product categories that exhibit superior growth characteristics driven by demand from two of the fastest growing economies in the world.

According to the McKinsey Global Institute survey on the rise of the Indian middle class, by 2025 ~43% of the population will have reached middle class levels in USD equivalent purchasing power terms, up from ~5% in 2005.

The expected rise in disposable incomes is expected to drive consumption of Sandalwood oil and other products from a sustainable and reliable source, which TFS can service.

While India is the historic home of Sandalwood, it is worth noting that current consumption is diverse, deep and not dominated by any particular group, region or industry and this places TFS in a favourable position.

TFS commences its first commercial harvest in 2013, with contracted oil volumes priced above current spot prices. Significant revenue potential is building over the next decade and beyond as TFS' supply comes on line.

ViroXis

During FY10, TFS established a conditional supply agreement to supply up to 3 tonnes of oil pa at a premium to spot prices. The supply is conditional upon ViroXis completing its US FDA human trial program for the development of a drug, albuterpenoids. This drug is being developed to treat topical viral skin infections in adults and children.

Advice from ViroXis is that they remain on track with their human trial program.

Should material developments occur, TFS will keep the market informed.

Outlook

TFS believes the outlook for FY11 is positive. There will be a significant increase in positive operating cash flow as settlement of institutional sales occurs throughout the year. Our balance sheet is in a strong position and it is anticipated that TFS historical conservative gearing levels will continue.

The global price for Indian sandalwood is resuming its upward path after minimal price volatility during the worst of the GFC. It is the key ingredient for markets and product categories which exhibit superior growth rates and is driven by demand from two of the fastest growing economies in the world. Supply competition is extremely limited.

Total Indian Sandalwood plantation sales in FY11 are expected to at least equal FY10 and a further increase in non MIS institutional sales is expected, given the strong investment demand across a variety of regions.

Earnings from Mount Romance are expected to grow as demand tightens and marketing into China and the Middle East gains momentum. The strategic value of Mount Romance is clear despite the recent cyclical downturn.

TFS is in a strong position in the global sandalwood market with critical supply coming on line in three years, just as supply from Indian native forests is rapidly diminishing.

Frank Wilson
Executive Chairman
Ph: 08 9386 3299

Quentin Megson
Chief Financial Officer

For further investor and analyst queries, please contact:

Martyn Jacobs
General Manager – Corporate Strategy
Ph: 0412 785 180

ABOUT TFS

TFS Corporation Ltd (ASX: TFC) is an owner and manager of Indian sandalwood plantations in the east Kimberley region of Western Australia. As part of its vision to be a vertically integrated producer of finished sandalwood products, TFS owns a significant proportion of the plantations in its own right and in 2008 acquired Mount Romance Australia (Mount Romance), the Albany-based sandalwood processor and oil distributor.

TFS was founded in 1997 to exploit the success of government trials into the plantation growth of Indian sandalwood in the Ord River Irrigation Area (ORIA) of north-east Western Australia.

TFS's first planting was in 1999 and it now manages the largest area of Indian sandalwood plantation in the world, with approximately 3,500 hectares planted in the ORIA. TFS plantations are managed on behalf of both retail and institutional investors.

TFS has a land bank of over 2,600 plantable hectares for future sandalwood plantings in the ORIA and at its Kingston Rest property 65 kilometres south of the ORIA.

The company listed on the Australian Stock Exchange in December 2004 and is currently capitalised at approximately \$190 million.

TFS is committed to adopting and maintaining the highest environmental and ethical standards in all aspects of its business. All plantations are grown on land that has previously been used for agricultural or horticultural production. As the first ORIA land owner to recycle its water, TFS was the winner of the 2006 State Regional Water Award.

TFS was recently ranked as an industry leader in ethical and sustainable practices by Oekom Research, a leading international ratings agency.

In 2009, TFS entered the prestigious Forbes Asia Pacific's *'Best Under a Billion'*, which recognises the Top 200 companies from more than 25,326 publicly-listed firms in the Asia/Pacific region with revenue of less than US\$1 billion.



About Indian Sandalwood

Indian sandalwood has a history as a tradeable commodity spanning thousands of years, but is now endangered due to the illegal harvest of wild trees throughout the world. As a result, Indian sandalwood is the world's most expensive tropical hardwood and continues to increase in price each year. Its heartwood currently trades for in excess of A\$110,000 per tonne, having risen at a compounded rate of over 18% per annum over the past 18 years.

Indian sandalwood oil is a globally important ingredient in fine fragrances, cosmetics and toiletries, incense sticks, and for medicinal purposes (aromatherapy and Chinese medicine) and the wood is used for high quality carvings.

Indian sandalwood has a well entrenched market throughout the world, particularly in India and China, two of the fastest growing economies in the world.