

## TFS Corporation Ltd

Guidance implies solid second half

- **Result.** TFC today announced 1H10 revenue of \$14.7 million, 71% above the pcp but 10% below our forecast. Normalised NPAT came in at -\$4.4 million. Due to the seasonal nature of this business, where the majority of sales occur in the last two months of the financial year, little analysis can be extracted from the 1H10 profit and loss accounts.
- **Wholesale.** Of most relevance, payment for the initial sale of 350Ha (Beyond Carbon product) is on track to be received by April 2010. A further sale of 500Ha is also set to be achieved by June FY10. Importantly, future wholesale sales are to be on shorter payment terms. We view the success of this wholesale initiative as being fundamental to the potential positive re-rating of the stock as it diversifies away from the more volatile (and controversial) retail MIS market.
- **MRA.** In spite of a weak 1H due to weakness in the European fragrance market, MRA sales has recovered sharply in early 2H10 and TFC predicts a 10%+ increase on FY09 EBITDA from this division.
- **Operating cash outflow** was \$26.7 million, driven by \$44.8 million of payments to suppliers. TFC management specifies that this was largely due to the preparation of the Kingston Rest estate which now has approximately 1,400Ha of land ready for planting. Gearing (ND/ND+E) remains at a comfortable 17%. Management is targeting a zero net debt position by the end of FY10.
- **Management guidance is for NPAT growth of 10%+ over FY09.**
- We like TFC's long term fundamentals and believe, at an FY10E P/E of 6x, it represents good value. We reduce our FY10 and FY11E NPAT estimates by 3% and 1% respectively. Our PT reduces to \$1.72/share. **We remain Overweight.**

### Overweight

TFC.AX, TFC AU

Price: A\$0.89

▼ **Price Target: A\$1.72**  
Previous: A\$1.76

#### Emerging Companies

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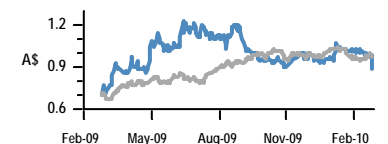
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J.P. Morgan Securities Australia Limited

#### Price Performance



	YTD	1m	3m	12m
Abs	-6.3%	-12.3%	-11.4%	26.2%
Rel	-0.7%	-9.8%	-8.8%	-10.9%

#### TFS Corporation Ltd (Reuters: TFC.AX, Bloomberg: TFC AU)

Year-end Jun (A\$)	FY08A	FY09A	FY10E	FY11E
Total Revenue (A\$ mn)	61.7	78.4	84.1	90.4
EBITDA (A\$ mn)	35.7	37.0	43.0	47.1
Net profit after tax (A\$ mn)	22.9	23.3	27.2	30.2
EPS (A\$)	0.124	0.124	0.145	0.161
P/E (x)	7.2	7.2	6.1	5.5
EV/EBITDA	5.5	6.2	5.1	4.7
Dividend (A\$)	0.04	0.04	0.06	0.08
Net Yield (%)	4.5%	4.8%	6.5%	9.1%
Normalised* EPS (A\$)	0.124	0.124	0.145	0.161
Normalised* EPS growth (%)	37.0%	0.0%	16.8%	11.0%
Normalised* P/E (x)	7.2	7.2	6.1	5.5
Relative P/E (%)	49.5%	41.2%	37.5%	39.4%

Source: Company data, Bloomberg, J.P. Morgan estimates.

#### Company Data

52-week range (A\$)	1.30 - 0.69
Market capitalisation (A\$ bn)	0.20
Market capitalisation (\$ bn)	0.18
Fiscal Year End	Jun
Price (A\$)	0.89
Date Of Price	25 Feb 10
Shares outstanding (mn)	226.8
ASX100	3,766.7
ASX200-Ind	6,327.4
NTA/Sh^ (A\$)	0.84
Net Debt* (A\$ bn)	0.02

See page 7 for analyst certification and important disclosures, including non-US analyst disclosures.

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## 1H10 Earnings

TFC today announced 1H10 revenue of \$14.7 million, 71% above the pcp but 10% below our forecast. Normalised NPAT came in at -\$4.4 million. Due to the seasonal nature of this business where the majority of sales occur in the last two months of the financial year, little analysis can be extracted from the 1H10 profit and loss accounts.

A 1.25cps interim dividend was declared.

Table 1: 1H10 Earnings Summary

\$ in millions, cps

	1H10 Actual	1H10 JPM Estimate	Variance (%)	1H09 Actual	Change on pcp (%)
Revenue	14.7	16.4	-10%	8.6	71%
EBITDA	-1.2	-0.4	195%	-2.9	-59%
EBITDA Margin	-8.1%	-2.5%	230%	-33.8%	-76%
EBIT	-2.0	-1.2	63%	-3.5	-43%
EBIT Margin	-13.6%	-7.5%	82%	-40.9%	-67%
Net Interest	-0.5	-0.5	0%	-0.5	0%
NPBT	-4.1	-2.5	62%	-3.9	4%
Tax	-0.3	0.8	-140%	-2.1	-85%
NPAT	-4.4	-1.8	149%	-6.0	-27%
NPAT Margin	-29.7%	-10.7%	178%	-69.2%	-57%
Normalised EPS	-1.9	-0.9	107%	-3.2	-39%

Source: Company reports and J.P. Morgan estimates.

### Key Takeaways

- Management guidance is for NPAT growth of 10%+ over FY09. This implies NPAT greater than \$25.6 million.
- TFC on track to receive cash from initial wholesale sale (Beyond Carbon) by April 2010.
- Further wholesale investments (on short payment terms) expected in FY10.
- Management anticipated total sales of ~1,100Ha in FY10.
- Interest in wholesale product from offshore investment funds markedly increasing (likely to place upward pressure on longer term sale price).
- Weak operating cash flow largely due to development of Kingston Rest estate (now 1,400Ha available for planting).
- Development cost of land (per Ha) is likely to increase as land bank increases and becomes more segregated. Management intends to pass cost on to grower.
- TFC intend to diversify into an Australian Sandalwood product (application already submitted to the ATO for a product ruling).

## Earnings Revisions

We reduce our FY10 and FY11E NPAT estimates by 3% and 1% respectively

Table 2: Earnings Revisions

\$ in millions, cps

	FY09 Actual	FY10 Current	FY10 Previous	Change	FY11 Current	FY11 Previous	Change
Revenue	78.4	83.2	85.5	-2.7%	89.5	91.9	-2.6%
EBITDA	37.0	43.0	45.1	-4.5%	47.1	49.2	-4.2%
EBITDA Margin	47.2%	51.7%	52.7%	-1.8%	52.7%	53.6%	-1.7%
EBIT	35.6	41.4	43.4	-4.7%	45.2	47.2	-4.4%
EBIT Margin	45.5%	49.7%	50.8%	-2.0%	50.5%	51.4%	-1.8%
NPAT	23.3	27.2	28.0	-3.0%	30.2	30.6	-1.2%
NPAT Margin	29.7%	32.7%	32.8%	-0.3%	33.7%	33.3%	1.4%

Source: Company reports and J.P. Morgan estimates.

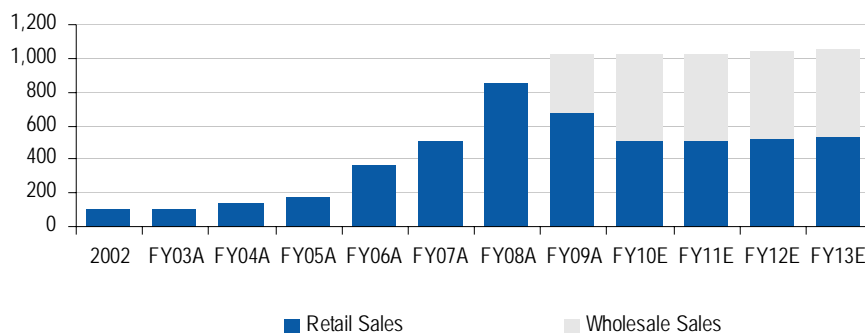
### Wholesale versus Retail assumptions

With respect to the sales mix going forward, the key assumptions we make in our model are:

1. TFC maintain annual sales of 1,020Ha in FY10E and FY11E with forecast sales to increase post FY11 by 2% annually.
2. TFC sells approximately 50% of its product through wholesale channels.

Figure 1: Product Sales Mix, Actual and Forecast FY03A - FY13E

Ha



Source: J.P. Morgan estimates, Company data.

### Investment Case

We expect TFC to continue to hold up well in a market that has seen many of its peers suffer. We believe there are numerous reasons for this. 1) TFC's balance sheet remains strong providing the company with opportunities for acquisition and land sourcing, 2) market share has increased considerably on the back of key competitors 'exiting' the market, 3) TFC continues to attract significant wholesale demand which will reduce dependence on MIS sales and 4) TFC's product has an attractive real rate of return on its product, clearly placing it at the upper echelon of both MIS and wholesale product offerings. **We remain Overweight.**

### Price Target

We decrease our price target from \$1.76/share to \$1.72/share (driven by our earnings revisions), dated December 2010. This is derived from the average of our DCF valuation and P/E-based valuations. Our P/E valuation adopts a FY10E multiple of

10x which we believe is reflective of its sector average. Our DCF uses assumptions of 4.5% risk free rate, 2% terminal growth rate, 1.3 Beta. Our WACC is 10%.

The key risks to our price target are further changes in tax legislation or a decline in the global price of sandalwood oil.

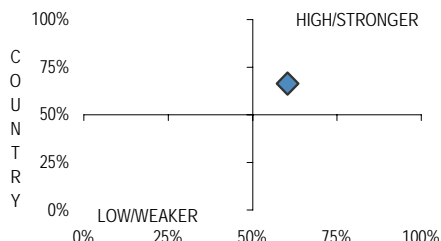
All Data As Of 25-Feb-10

## Q-Snapshot: TFS Corp. Ltd.

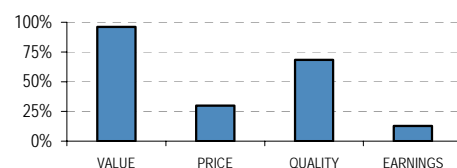
Quant Return Drivers (a Score >50% indicates company ranks 'above average')

Score 0% (worst) to 100% (best)	vs Country	vs Industry	Raw Value
<b>Value</b>			
P/E Vs Market (12mth fwd EPS)	97%	95%	0.5x
P/E Vs Sector (12mth fwd EPS)	97%	96%	0.4x
EPS Growth (forecast)	24%	11%	6.2%
<b>Value Score</b>	<b>96%</b>	<b>91%</b>	
<b>Price Momentum</b>			
12 Month Price Momentum	33%	36%	43.5%
1 Month Price Reversion	42%	32%	-0.5%
<b>Momentum Score</b>	<b>30%</b>	<b>29%</b>	
<b>Quality</b>			
Return On Equity (forecast)	79%	85%	22.1%
Earnings Risk (Variation in Consensus)	47%	64%	0.14
<b>Quality Score</b>	<b>69%</b>	<b>84%</b>	
<b>Earnings &amp; Sentiment</b>			
Earnings Momentum 3mth (risk adjusted)	21%	25%	-57.8
1 Mth Change in Avg Recom.	28%	44%	0.00
Net Revisions FY2 EPS	13%	9%	-100%
<b>Earnings &amp; Sentiment Score</b>	<b>13%</b>	<b>12%</b>	
<b>COMPOSITE Q-SCORE* (0% To 100%)</b>	<b>66%</b>	<b>60%</b>	

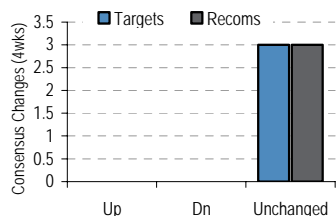
J.P. Morgan Composite Q-Score



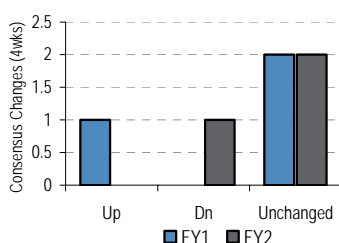
Quant Return Drivers Summary (vs Country)



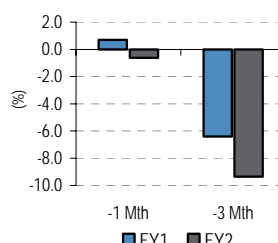
Targets & Recommendations\*\*



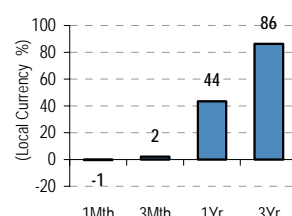
EPS Revisions\*\*



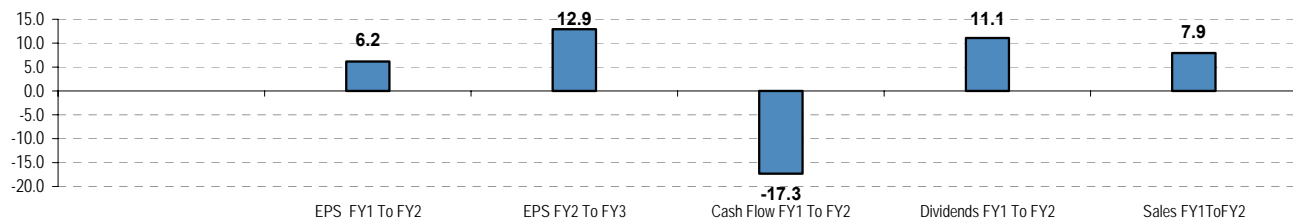
EPS Momentum (%)



Historical Total Return (%)



Consensus Growth Outlook (%)



Closest in Country by Size (Consensus. ADV = average daily value traded in US\$m over the last 3 mths)

Code	Name	Industry	USD MCAP	ADV	PE FY1	Q-Score*
MPO-AU	Molopo Energy Ltd.	Oil & Gas Production	202	1.01	-45.6	11%
TNE-AU	Technology One Ltd.	Information Technology Services	202	0.18	13.2	21%
VPG-AU	Valad Property Group	Real Estate Investment Trusts	199	1.19	6.5	15%
AJL-AU	AJ Lucas Group Ltd.	Oilfield Services/Equipment	198	0.92	-15.2	6%
DWS-AU	DWS Advanced Business Solutions Ltd.	Information Technology Services	196	0.19	11.6	93%
<b>TFC-AU</b>	<b>TFS Corp. Ltd.</b>	<b>Forest Products</b>	<b>195</b>	<b>0.29</b>	<b>6.8</b>	<b>66%</b>
SKE-AU	Skilled Group Ltd.	Personnel Services	195	0.74	12.6	55%
TOX-AU	Tox Free Solutions Ltd.	Environmental Services	188	0.36	17.2	63%
GDY-AU	Geodynamics Ltd.	Alternative Power Generation	188	0.21	-6.0	6%
CDA-AU	Codan Ltd.	Telecommunications Equipment	186	0.03	9.4	52%
BRG-AU	Breville Group Ltd.	Wholesale Distributors	185	0.18	9.1	92%

Source: Factset, Thomson and J.P. Morgan Quantitative Research. For an explanation of the Q-Snapshot, please visit <http://jpmorgan.hk.acrobat.com/qsnapshot/>  
Q-Snapshots are a product of J.P. Morgan's Global Quantitative Analysis team and provide quantitative metrics summarized in an overall company 'Q-Score.'  
Q-Snapshots are based on consensus data and should not be considered as having a direct relationship with the J.P. Morgan analysts' recommendation.  
\* The Composite Q-Score is calculated by weighting and combining the 10 Quant return drivers shown. The higher the Q-Score the higher the one month expected return. On a 14 Year back-test the stocks with the highest Q-Scores have been shown (on average) to significantly outperform those stocks with the lowest Q-Scores in this universe. \*\* The number of up, down and unchanged target prices, recommendations or EPS forecasts that make up consensus.

## TFS Corporation Ltd: Summary of Financials

*A\$ in millions, year end Jun*

Income Statement	FY08	FY09	FY10E	FY11E	FY12E	Balance Sheet	FY08	FY09	FY10E	FY11E	FY12E
Total Revenue	61.7	78.4	84.1	90.4	103.7	Cash & Bills	16.9	38.7	22.0	24.6	29.0
Revenue Growth Y/Y	60.6%	26.9%	7.3%	7.5%	14.8%	Debtors	36.3	50.0	53.4	56.6	60.1
<b>EBITDA</b>	<b>35.7</b>	<b>37.0</b>	<b>43.0</b>	<b>47.1</b>	<b>57.7</b>	Investments	-	-	-	-	-
Depreciation & Amortisation	-0.8	-1.4	-1.6	-2.0	-2.4	Inventories	0.8	6.9	14.9	18.0	21.8
<b>EBIT</b>	<b>34.9</b>	<b>35.6</b>	<b>41.4</b>	<b>45.2</b>	<b>55.3</b>	Other Current Assets	-	-	-	-	-
Net Interest	-0.6	-2.7	-3.4	-2.9	-3.2	<b>Current Assets</b>	<b>54.0</b>	<b>95.6</b>	<b>90.2</b>	<b>99.2</b>	<b>110.8</b>
<b>Pre-Tax Profit</b>	<b>34.3</b>	<b>33.0</b>	<b>38.9</b>	<b>43.1</b>	<b>53.0</b>	Receivables	15.7	33.3	23.0	25.3	27.9
Tax	-11.4	-9.7	-11.7	-12.9	-15.9	Investments	-	-	-	-	-
Minority Interests	0.0	0.0	0.0	0.0	0.0	Inventories	-	-	-	-	-
Preference Dividends	-	-	-	-	-	PP&E	58.5	69.0	74.5	78.4	82.8
<b>NPAT before Abnormals</b>	<b>22.9</b>	<b>23.3</b>	<b>27.2</b>	<b>30.2</b>	<b>37.1</b>	Goodwill	-	-	-	-	-
<b>NPAT after Abnormals</b>	<b>22.9</b>	<b>23.3</b>	<b>27.2</b>	<b>30.2</b>	<b>37.1</b>	Other Intangibles	-	-	-	-	-
<b>Normalised NPAT</b>	<b>22.9</b>	<b>23.3</b>	<b>27.2</b>	<b>30.2</b>	<b>37.1</b>	Pension Fund Assets	-	-	-	-	-
# Shares Outstanding	187.3	191.3	219.3	219.3	219.3	Future Income Tax Benefits	0.9	5.6	4.0	4.6	5.4
						Other Non Current Assets	37.6	82.3	99.8	107.3	116.5
<b>Cash Flow Statement</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10E</b>	<b>FY11E</b>	<b>FY12E</b>	<b>Non Current Assets</b>	<b>112.7</b>	<b>190.2</b>	<b>201.3</b>	<b>215.7</b>	<b>232.6</b>
EBIT	34.9	35.6	41.4	45.2	55.3	<b>Total Assets</b>	<b>166.7</b>	<b>285.8</b>	<b>291.5</b>	<b>314.9</b>	<b>343.4</b>
Depreciation & Amortisation	0.8	1.4	1.6	2.0	2.4	Creditors	13.1	19.3	7.2	7.9	8.7
Net Interest (Paid)/Recd	-0.6	-2.7	-1.8	-2.0	-2.3	Current Borrowings	0.5	0.4	0.9	1.1	1.4
Tax (Paid)	-7.9	-6.8	-13.8	-12.9	-15.9	Current Lease Liabilities	-	-	-	-	-
Inc/(Dec) in Provisions	-	-	-	-	-	Current Provisions	-	-	-	-	-
(Inc)/Dec in Working Capital	0.0	-16.1	-23.1	-5.6	-6.4	Other Current Liabilities	8.7	29.4	22.9	26.4	31.1
Other Operating Items	-0.1	-0.1	-3.2	-4.8	-5.6	<b>Current Liabilities</b>	<b>22.4</b>	<b>49.1</b>	<b>31.0</b>	<b>35.5</b>	<b>41.2</b>
<b>Operating Cash Flow</b>	<b>27.1</b>	<b>11.2</b>	<b>1.1</b>	<b>21.7</b>	<b>27.4</b>	Non Current Creditors	-	-	-	-	-
Gross Capex	-20.2	-4.2	-16.3	-3.9	-4.5	Non Current Borrowings	11.1	65.1	37.8	41.7	45.9
Sale of Fixed Assets	0.0	0.0	0.0	0.0	0.0	Non Current Lease Liabilities	-	-	-	-	-
Net Capex	-20.2	-4.2	-16.3	-3.9	-4.5	Non Current Provisions	-	-	-	-	-
Net Acquisitions	0.0	-8.3	-0.2	0.0	0.0	Pension Fund Liabilities	-	-	-	-	-
Other Investing Items	-1.8	-3.1	5.6	-0.0	-0.0	Deferred Income Tax Liability	-	-	-	-	-
<b>Investing Cash Flow</b>	<b>-22.0</b>	<b>-15.6</b>	<b>-10.7</b>	<b>-3.9</b>	<b>-4.5</b>	Other Non Current Liabilities	19.2	36.6	38.8	38.8	38.8
Equity Issued	19.8	19.8	31.5	0.0	0.0	<b>Non Current Liabilities</b>	<b>30.4</b>	<b>101.7</b>	<b>76.5</b>	<b>80.4</b>	<b>84.7</b>
Dividends Paid	-5.6	-7.0	-11.4	-15.2	-18.5	<b>Total Liabilities</b>	<b>52.7</b>	<b>150.8</b>	<b>107.5</b>	<b>115.9</b>	<b>125.9</b>
Inc/(Dec) in Borrowings	-	-	-	-	-	Total Ordinary Equity	39.7	43.0	76.0	76.0	76.0
Other Financing Items	-11.2	13.6	-27.8	0.0	0.0	Outside Equity Interests	-	-	-	-	-
<b>Financing Cash Flow</b>	<b>3.0</b>	<b>26.4</b>	<b>-7.7</b>	<b>-15.2</b>	<b>-18.5</b>	Other Equity	-	-	-	-	-
<b>Net Cash Flow</b>	<b>8.1</b>	<b>22.0</b>	<b>-17.3</b>	<b>2.6</b>	<b>4.4</b>	<b>Total Equity</b>	<b>114.0</b>	<b>135.1</b>	<b>184.0</b>	<b>199.0</b>	<b>217.6</b>
						Net Debt / (Net Debt + Equity)	-4.8%	16.5%	8.3%	8.4%	7.8%
<b>Per Share Data A\$</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10E</b>	<b>FY11E</b>	<b>FY12E</b>	<b>Valuation Metrics</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10E</b>	<b>FY11E</b>	<b>FY12E</b>
Reported EPS	0.124	0.124	0.145	0.161	0.198	Reported P/E	7.2	7.2	6.1	5.5	4.5
Normalised EPS	0.124	0.124	0.145	0.161	0.198	Normalised P/E	7.2	7.2	6.1	5.5	4.5
DPS	0.04	0.04	0.06	0.08	0.10	Net Yield	4.5%	4.8%	6.5%	9.1%	11.1%
NTA	0.61	0.71	0.84	0.91	0.99	Price to Book	1.4	1.2	0.9	0.8	0.8
						EV/EBITDA	5.5	6.2	5.1	4.7	3.8

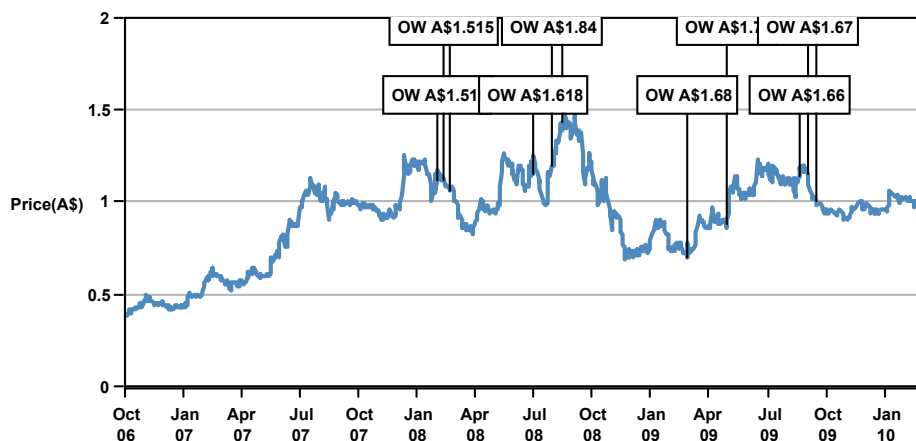
Source: Company reports and J.P. Morgan estimates.

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**Important Disclosures**

TFS Corporation Ltd (TFC.AX) Price Chart



Date	Rating	Share Price (A\$)	Price Target (A\$)
01-Feb-08	OW	1.12	1.52
11-Feb-08	OW	1.12	1.52
22-Feb-08	OW	1.06	1.50
01-Jul-08	OW	1.15	1.62
29-Jul-08	OW	1.20	1.84
14-Aug-08	OW	1.44	1.92
26-Feb-09	OW	0.70	1.68
29-Apr-09	OW	0.88	1.79
20-Aug-09	OW	1.14	1.66
02-Sep-09	OW	1.16	1.67
16-Sep-09	OW	1.00	1.76

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.  
 Initiated coverage Feb 01, 2008. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.  
 J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

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