

ArborGen Holdings

FY22 results

Shifting focus to US South and Brazil

Basic materials

ArborGen delivered solid FY22 sales growth across continuing operations, with revenues up 11% to US\$47.6m. Record US advanced genetic seedling sales, up 32% y-o-y, reflect the company's focus on advanced genetics. Management also completed its strategic review, shifting focus to the high-growth US South and Brazilian markets, divesting the Australian and New Zealand business, exploring opportunities in using trees to offset carbon emissions and strategically expanding in its core markets. ArborGen is well positioned to deliver on its new strategy; we are reviewing our estimates and will update them in the near future.

Year end	Revenue (US\$m)	EBITDA* (US\$m)	EBIT** (US\$m)	EPS (c)	EV/revenue (x)	Net debt*** (US\$m)
03/21 (restated)	42.8	7.4	1.0	0.3	3.0	33.3
03/22	47.6	10.1	2.7	0.3	2.7	16.5

Note: *EBITDA is US GAAP, adjusting for investments in intellectual property, government grants, inventory adjustments, etc. **EBIT excludes strategic review costs, grants, etc.

***Includes capitalised leases. FY21 numbers have been restated to reflect the divestment.

FY22: Harvesting sales in both US and Brazil

In FY22, ArborGen generated solid results across continuing operations in the US and Brazil, growing revenues 11% y-o-y to \$47.6m, with US sales rising \$3.1m to \$39.9m and Brazil increasing \$1.7m to \$7.7m. Adjusted US-GAAP EBITDA from continuing operations rose 36% y-o-y, while management strengthened the balance sheet, lowering net debt to \$16.5m from FY21's \$33.3m (\$27.4m and \$11.5m, excluding leases). Seedling sales rose 3m seedlings y-o-y to 362m in FY22, although US sales were affected by the COVID-19 pandemic and fell 3% to 284m seedlings.

Strategic review completed: Three new initiatives

Over the last year, ArborGen conducted a strategic review and revised its strategy to target several new initiatives. First, it will focus on the high-growth US South and Brazil markets. ArborGen should benefit from growing demand, as it is the leading commercial supplier of advanced genetics loblolly seedlings in the US South. In Brazil, ArborGen has expanded to become one of the largest commercial suppliers of eucalyptus and loblolly pine seedlings and expects to see rising demand.

Because of the shift in geographic focus, management sold its mature Australia and New Zealand business in November 2021 for NZ\$22.25m. Second, management is evaluating opportunities in emerging carbon markets, where trees can be used to offset carbon emissions. Finally, ArborGen will strategically invest in opportunities in its core markets and build its advanced genetics MCP supply seed supply to minimise its reliance on single year harvests.

Outlook: Look to high-growth US and Brazil markets

While global supply chain issues and inflation may continue in FY23, management projects solid sales growth of its advanced genetic products in FY24 and beyond due to its emphasis on the higher-growth markets of the US South and Brazil. To offset a recent freeze in the Eastern US region, management is maximizing its November 2022 harvest (expected to be well in excess of FY24e's expected sales).

30 June 2022

Price **NZ\$0.22**

Market cap **NZ\$110m**
US\$0.63/NZ\$

Net debt (US\$m) as of March 2022
(includes lease obligations) 16.5

Shares in issue 501.5m

Free float 33%

Code ARB

Primary exchange NZX

Secondary exchange N/A

Share price performance



Business description

ArborGen Holdings is an NZX-listed investment company and is the world's largest integrated developer, commercial manufacturer and supplier of advanced forestry seedlings with operations in the United States and Brazil.

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FY22: US sales growth and completed strategic review

ArborGen enjoyed solid financial results in FY22 across its continuing operations, as presented in Exhibit 1. Revenues reached US\$47.6m, growing 11% y-o-y, with its key US region's sales at US\$39.9m, up \$3.1m y-o-y, and Brazilian sales rising US\$1.7m to US\$7.7m. Notably, ArborGen delivered its highest ever US advanced genetic sales, 32% higher than last year. Gross margins improved nearly 100bps y-o-y to 37%, boosting FY22's operating earnings from continuing operations (before other significant items) to US\$2.7m versus US\$1.0m in FY21. Adjusted US-GAAP EBITDA from continuing operations reached US\$10.1m, rising 36% y-o-y, while net profit from continuing operations remained steady at US\$0.3/share. Net debt fell to US\$16.5m (including lease liabilities of US\$5.0m) (FY21: US\$33.3m), as it was able to pay down a significant amount of its debt due to the proceeds from the NZ\$22.5m sale of its Australian/New Zealand business in November 2021.

Exhibit 1: Financial performance (continuing operations)

US\$m	FY22	FY21 (restated)	% change
Revenue	47.6	42.8	+11%
Gross profit	17.8	15.6	+14%
Operating earnings, normalized*	2.7	1.0	+170%
Net earnings from continuing operations	1.7	1.5	+13%
Net earnings from discontinued operations	0	1.7	N/A
EPS (cents per share)	0.3	0.3	0%
Net debt (including financial leases)	16.5	33.3	(50%)
Cash from operations	7.5	9.9	(24%)
Adjusted US-GAAP EBITDA Reconciliation			
Net earnings from continuing operations	1.7	1.5	+13%
Less tax benefit	(4.7)	(0.6)	N/A
Plus financing expense	1.7	2.0	(15%)
Plus D&A	9.6	9.8	(2%)
Plus corporate costs	1.0	1.3	(23%)
IFRS EBITDA – ArborGen	9.3	14.0	(34%)
Investments in intellectual property	(3.1)	(3.7)	N/A
Other IFRS adjustments	(0.1)	(1.0)	N/A
Other significant items	4.0	(1.9)	N/A
Adjusted US-GAAP EBITDA	10.1	7.4	36%

Source: ArborGen, Edison Investment Research. Note: *Before government grant income, seedlings write-off, strategic review costs, etc.

As displayed in Exhibit 2, seedling sales rose slightly to 362m units versus 359m in FY21, as the COVID-19 pandemic affected US seedling sales, which fell 3% to 284m. However, US loblolly advanced genetics seeds rose to 42% of total seedling sales, boosted by ARB's focus on growing its advanced genetics business. Advanced genetic seedling sales also were up nearly 60% to the private landowner segment, a key area of expected growth. While large national accounts like real estate investment trusts and timber investment management organisations accounted for most of ArborGen's advanced genetics volume, sales to the private landowner segment have grown to about 35% of advanced genetics volume. Brazil sales rose to 78m seedlings, up 13m y-o-y as both eucalyptus and pine seedling sales grew.

Exhibit 2: Seedling sales

Region	FY22 (m units)	FY21 (m units)
US	284	294
US loblolly advanced genetics as % of total	42%	32%
Brazil	78	65
Total	362	359

Source: ArborGen, Edison Investment Research

Revised strategy stemming from recent strategic review

ArborGen recently completed its FY22 strategic review, and considered various options to unlock value, including reinvestments, sales, a US listing (though it concluded the cost currently outweighs the benefits of a US listing), among other options. Resulting from this review, ArborGen revised its strategy to focus on the following initiatives:

- **Refocus business on high-growth markets of US South and Brazil.** The US and Brazil are now the primary focus of ARB's growth strategy, as both are supported by solid fundamentals and are expected to enjoy high growth. Management believes that the long-term underlying fundamentals are strong for the Southern US forestry markets and associated sales of advanced genetic products. Management expects that market growth will be supported by an underbuilt and ageing US housing stock, as well as a large proportion of adults moving into the house buying phase. As a result, demand for wood products and the upstream timber supply should rise, with Forest Economic Advisors projecting the strongest increase in lumber production to be in the US South, growing 24% above FY21 and reaching 26.0bn board feet by 2025.¹ ArborGen is the leading commercial supplier of proprietary advanced genetics loblolly seedlings in the US South and will likely benefit from this trend, already having seen increasing demand for both its bareroot and containerised MCP seedlings (its highest value seedlings). In line with this expected growth, ArborGen plans to expand its in-house container capacity across two existing owned sites, boosting in-house production from 10m to 16m containerised seedlings per year. ArborGen has also grown to become one of the largest commercial suppliers of eucalyptus and loblolly pine seedlings in the Brazilian market, as it replicates its US strategy to convert the Brazilian market to products with superior genetics. According to management, this growth is enabled by Brazil's strong, underlying market fundamentals, with increasing domestic and export demand. To support this growth, management recently acquired a 10m seedling capacity nursery in Canoinhas, Santa Catarina, Brazil, to strengthen its position in the local pine markets. Furthermore, it plans to expand internal eucalyptus production capacity later in CY22 through leasing a third eucalyptus nursery, potentially raising internal eucalyptus capacity to nearly 50m seedlings per annum. Because of this geographic shift in focus to its traditional and emerging high-growth markets of the US South and Brazil, management sold its mature Australia and New Zealand business in November 2021 for NZ\$22.25m, using the cash to strengthen its balance sheet (ie paying down debt), and provide capital to invest in targeted growth areas.
- **Opportunities in emerging carbon markets.** With the global emphasis on reducing greenhouse gases, new opportunities have arisen based on the role trees can play in offsetting carbon emissions. Management stresses that its advanced genetics and strong channels to forest landowners in the US South make it uniquely positioned to exploit and benefit from these opportunities. For instance, ArborGen is engaged with various carbon registries and major carbon companies, looking at developing protocols for plantation forestry, as forest-based carbon projects will be key in creating new demand for seedlings. Furthermore, management is meeting with carbon project developers to provide seedlings to large-scale afforestation and reforestation projects in the Southern US.
- **Advanced genetics MCP seed supply.** Growing its seed supply is also a key area of focus for ArborGen, especially its advanced genetics MCP seed inventory as it seeks to reduce the risk from a single year's harvest. Seed inventory can be held in storage for several years, and the company has about one to two years of MCP inventory on-hand for its Western regions, but faces constraints in the Eastern region. ArborGen's overall orchard footprint is 70% young orchards, and as these mature and become more productive, it will seek to bag as many flowers as possible to maximise seed output in the medium term. Unfortunately, ArborGen

¹ Forest Economic Advisors 2nd Quarter 2022 Timber Quarterly Forecast.

suffered a freeze event and, combined with high winds during this year's pollination season, its pine flowers at Eastern US orchards were damaged, which will have an impact on cones and seeds due to be harvested in November 2023 and available for FY25 sales. However, it did not affect cones on trees that will be harvested in November 2022 and available for FY24 and beyond sales, nor did the orchards suffer any long-term damage. ArborGen recognised US\$1.5m in costs in FY22 related to the freeze event. Management expects to harvest advanced genetics MCP seed equivalent to over 200m seedlings in the US South in November 2022, well in excess of FY24's forecasted sales. That projected surplus, the ability to use material from neighboring areas and the fact that ArborGen has several years of open pollinated seed inventory should somewhat offset the effect of the freeze.

Exhibit 3: Financial summary

	US\$m	2021 (restated)	2022
		IFRS	IFRS
Year end 31 March			
PROFIT & LOSS			
Revenue	42.8	47.6	
Cost of Sales	(27.2)	(29.8)	
Gross Profit	15.6	17.8	
Operating Expenses	(15.4)	(15.1)	
Other Income/(Expense)	0.8	-	
EBITDA - US GAAP, Adjusted	7.4	10.1	
EBITDA - IFRS - ArborGen	14.0	9.3	
D&A	9.8	9.6	
Operating Profit (before except.)	1.0	2.7	
Exceptionals/Other	1.9	(4.0)	
Operating Profit/(Loss) (EBIT)	2.9	(1.3)	
Net Interest and financial expense	(2.0)	(1.7)	
Profit Before Tax (norm)	(1.0)	1.0	
Profit Before Tax (IFRS)	0.9	(3.0)	
Tax	0.6	4.7	
Profit After Tax (norm)	(0.4)	5.7	
Profit After Tax (IFRS)	1.5	1.7	
P/(L) from discontinued operations	1.7	-	
Net income (IFRS)	3.2	1.7	
Average Number of Shares Outstanding, basic, millions	499.5	500.8	
EPS - normalised, continuing operations, basic (US cents)	(0.1)	1.1	
EPS - normalised, continuing operations, diluted (US cents)	(0.1)	1.1	
EPS - IFRS, continuing operations, basic (US cents)	0.3	0.3	
Dividend per share (US cents)	-	-	
Gross Margin (%)	36.4%	37.4%	
EBITDA Margin (%)	17.3%	21.2%	
Operating Margin (before except.) (%)	2.3%	5.7%	
BALANCE SHEET			
Fixed Assets	150.4	138.8	
Intangible Assets	101.3	97.1	
Tangible Assets	43.3	32.9	
Right of Use Assets	5.8	4.7	
Other	-	4.1	
Current Assets	52.9	53.3	
Cash and liquid deposits	6.2	15.2	
Receivables	12.2	10.8	
Inventories	34.5	27.3	
Current Liabilities	(15.9)	(10.5)	
Trade and other payables	(13.1)	(8.7)	
Current Debt	(1.0)	(1.0)	
Lease liabilities	(0.8)	(0.8)	
Other	(1.0)	-	
Long Term Liabilities	(39.2)	(30.2)	
Long term debt	(32.6)	(25.7)	
Lease liabilities	(5.1)	(4.2)	
Other	(1.5)	(0.3)	
Shareholder's Equity	148.2	151.4	
CASH FLOW			
Operating Cash Flow (before interest, tax, etc.)	8.1	10.8	
Financing expense	2.0	1.7	
Tax	(0.6)	(4.7)	
FX	0.4	(0.3)	
Capex	(1.0)	(1.5)	
Investment in Intellectual Property	(3.7)	(3.1)	
Acquisitions/disposals	-	15.2	
Lease payments	(1.3)	(0.9)	
Interest paid	(2.0)	(1.7)	
Other	-	-	
Change in net cash	1.9	15.5	
Opening net debt/(cash), not incl. leases	29.6	27.4	
Exchange rate movements	0.3	0.0	
Closing net debt/(cash), not incl. leases	27.4	11.5	
Closing net debt/(cash), incl. leases	33.3	16.5	

Source: ArborGen

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