Rubicon

H119 results

Well-positioned going into H2

Basic materials

Rubicon's H1 performance contained typical seasonal trading features ahead of the more important H2 trading period and our earnings estimates are unchanged. We are encouraged to see a number of positive commercial steps being taken in each of the main countries, which will support future aspirations. Our earnings estimates are unchanged as is our previous DCF valuation analysis which indicated a NZ$0.74 per share valuation.

Year end	Revenue (US$m)	EBITDA – US GAAP (US$m)	PBT* (US$m)	EPS* (c)	P/E (x)	EV/EBITDA (x)
03/18**	35	6	4	1.2	12.7	14.4
03/19e	50	5	5	1.1	14.7	18.7
03/20e	59	9	10	2.0	7.8	10.0

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles and exceptional items. **Six-month trading period only.

First half reflects seasonal trading pattern

Rubicon's maiden first-half report (to September) as a focused, advanced tree seedling development and supply business contained good updates on operational and commercial initiatives in the seasonally quieter section of the year. For the record, the company generated revenue of US$10m and a US GAAP EBITDA loss of US$5m (before restructuring costs of US$2m) in the period. The underlying cash outflow performance was consistent with the seasonal trading pattern, in our view, and the final deferred consideration payment of US$10m for ArborGen was also in line with previous guidance. Net debt at the period end stood at US$24m.

Improving ArborGen financial returns

Notwithstanding some disruption from US weather events around the end of H1, Rubicon should be able to clearly demonstrate its business model characteristics in H2 through notably stronger revenue, EBITDA and positive cash flows. Our earnings expectations are unchanged for all three forecast years, which include a group US GAAP US$5m EBITDA expectation for FY19 (i.e US$7m ArborGen EBITDA less US$2m Rubicon public company costs). After a period of corporate and management change, the stage is set for ArborGen to convert its market presence and proposition to forestry plantation owners into improving financial returns for shareholders. With a number of new commercial agreements announced in the past 12 months, business momentum appears to be positive.

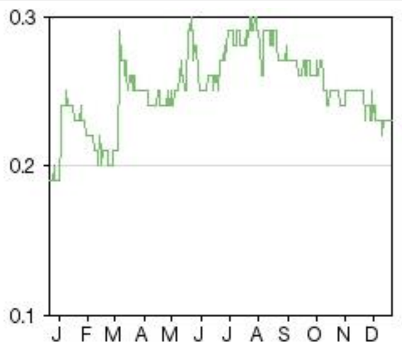
Valuation: Up year-to-date, but well off earlier highs

Rubicon's share price has risen by c 18% ytd but is over 20% off from the 29.5c high seen in July. At this stage, we see no reason to change our initial DCF valuation approach, which gave a core gross equity value for Rubicon equal to NZ$0.74 per share, before adjusting for outstanding warrants and options. On our estimates, the company's market valuation compresses from a P/E of 14.7x and EV/EBITDA of 18.7x for the current year, to 6.2x and 7.5x, respectively, by FY21.

20 December 2018

Price	**NZ$0.23**
Market cap	**NZ$112m**
	NZ$/US$0.68
Net debt (US$m) at end-September 2018	24
Shares in issue	487.9m
Free float	53%
Code	RBC
Primary exchange	NZX
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(8.2)	(13.5)	15.4
Rel (local)	(7.5)	(6.6)	14.5
52-week high/low		NZ$0.3	NZ$0.2

Business description

Rubicon is an NZX-listed investment company whose ArborGen subsidiary is the world's largest integrated developer, commercial manufacturer and supplier of advanced forestry seedlings with operations in the US, Brazil and Australasia.

Next events

FY19 year end	March

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Edison profile page

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H119 results overview

We do not have a true comparator period for Rubicon's H119 results, given the change in corporate structure and change of year-end. ArborGen is Rubicon's sole operating company now and during the seasonally quieter first half of its financial year, the Rubicon Group generated a US GAAP EBITDA loss of US$5m (before restructuring costs). Further actions were also taken to develop ArborGen commercially.

No geographical sales split was provided at the interim stage, but for seasonal reasons non-US sales were the bulk of the H1 total. Our regional comments are as follows:

US: Weather events around the half-year end

The primary tree seedling planting period in the US south-eastern region takes place during the second half of ArborGen's trading year. Customer shipments are second-half-weighted but towards the end of H1 they may have been affected to some extent by Hurricane Florence (category 2 at the point of landfall, second week of September) and Michael at the beginning of H2 (category 4, third week of October). The company's US GAAP guidance for ArborGen for the year ('approaching US$7m') is unchanged, which suggests that cost reduction actions taken will compensate for any sales shortfall. ArborGen's own seedling nurseries were unaffected but one (of nine) seed orchards did sustain some damage. The extent of this (ie seed production volumes for 2019 planting to produce seedlings for FY21) is still to be disclosed; for modelling purposes, we have effectively assumed that our existing seedling volume expectations will be met from a combination of the ongoing ArborGen facilities and its two new nursery management agreements (Taylor Nursery in Trenton SC, signed in February and, more recently, Texmark Timber Treasury's nurseries and seed orchards in Texas, signed in November). Under these agreements, ArborGen leases existing operations (for 10 years and five years, respectively, the latter with options to transfer ownership) to effectively increase seedling capacity by 60m seedlings without significant upfront capital investment. We will monitor the production from these two new arrangements (the latter of which is not included in our forecasts) and balance this against any short-term orchard impact as more details emerge, if necessary.

Brazil: Moving forward with eucalyptus licensing

There were no specific updates regarding Brazilian operations in the first half, although we note the separate 22 November announcement regarding the commercialisation of Gerdau Aços Longos SA's eucalyptus clones. ArborGen has exclusive development rights here and this adds to the company's existing licensing arrangements with International Paper do Brazil and local seedling portfolio offering for this species. Initial sales may occur towards the end of FY20 and start to build in FY21 in a local market that is estimated by management to be c 700m seedlings per annum. ArborGen currently services less than 10% of this total volume or c 15–20% of the non-captive addressable market.

ANZ: National planting programme underway

In the context of ArborGen's c 16m annual seedling sales in New Zealand, an agreement with Crown Forestry (which manages the New Zealand government's commercial forestry assets) to supply an additional c 12m in FY20 is significant new business and this is already factored into our existing estimates. Given that the government has a 10-year/one billion tree-planting programme, we consider that there is a good likelihood of follow-on supply agreements, but our model does not currently assume this.

Operational cash control, M&A flows end

Payment of the final US$10m deferred consideration for acquiring ArborGen minorities from the former partner shareholders was the dominant cash flow item in H119 and explained a substantial portion of the US$14m increase in net debt in the period to US$24m at the end of September.

At the operational level, Rubicon saw a US$3m trading cash outflow comprising the profit performance outlined earlier and a US$1m working capital inflow. Given the seasonal inventory build at the half-year stage (and US$6m absorption for the period), we consider this to be a well-managed outturn. The interest cash payment of US$1m was in line with the P&L and no cash tax was paid during H1. After taking into account disposal proceeds, net tangible fixed asset investment was also zero, although US$2m R&D costs were capitalised and flowed out as cash. Lastly, the receipt of US$2m as the final payment for non-core business assets sold in the prior year completes the cash-flow picture for H1.

Cash-flow outlook: now that M&A effects have worked through Rubicon’s reporting cycle, this gives a clearer picture of the company’s financial position. The company’s financing structure comprises a US$12m asset-backed term loan with 18 years to run and a newly increased and extended US$17m revolving credit facility to August 2020. So, with net bank debt at the end of H1 of US$12m and our expectation of a c US$5m cash inflow in H2, Rubicon appears to have a solid funding base. Our model includes improving operating cash-flow performances in future periods and net debt trending down currently.

Aiming to take share in growing economies

We have trimmed our FY19 revenue and gross profit projections to take account of the potential impacts from the US weather events described earlier, although we expect this to be compensated for by cost reduction activity elsewhere. Consequently, our group US GAAP US$5m EBITDA positive expectation for the year is unchanged. This is in line with company guidance for ArborGen to generate US$7m EBITDA less our assumed US$2m of Rubicon public company costs for the year. If some US planting deferral does happen, there is an argument for some catch-up activity in FY20; at this stage we have not assumed that this is the case and have made no other changes to our estimates.

The backdrop is for growth to continue in all three of ArborGen’s main country economies, although perhaps at a slower rate than in the current year in the US and New Zealand, where monetary tightening is occurring. The bigger picture is, of course, for ArborGen to take market share in the US market through the delivery of advanced seedlings that bring productivity benefits to commercial forestry owners.

Exhibit 1: Financial summary

	US$m	2017R	2018	2019e	2020e	2021e
March (from 2018 onwards)		15m to Sep	6m to March			
PROFIT & LOSS						
Revenue		6	35	50	59	65
Cost of Sales		(4)	(19)	(29)	(34)	(38)
Gross Profit		2	16	20	25	27
EBITDA - US GAAP		(6)	6	5	9	12
EBITDA - NZ IFRS		(1)	6	10	14	17
Operating Profit (before GW and except.)		(2)	5	7	11	14
Intangible Amortisation - internal		0	0	0	0	0
Exceptionals & Amortisation - external		(1)	(4)	(8)	(6)	(6)
Associate		3	0	0	0	0
Operating Profit		0	1	(1)	6	8
Net Interest		(2)	(1)	(2)	(2)	(1)
Profit Before Tax (norm)		(1)	4	5	10	12
Profit Before Tax (FRS 3)		(2)	0	(2)	4	7
Tax		0	2	0	0	0
Minorities		0	0	0	0	0
Discontinued		(4)	0	0	0	0
Profit After Tax (norm)		(1)	6	5	10	12
Profit After Tax (FRS 3)		(6)	2	(2)	4	7
Average Number of Shares Outstanding (m)		425.0	487.9	487.9	487.9	487.9
EPS - normalised (US c)		(0.2)	1.2	1.1	2.0	2.5
EPS - FRS 3 (US c)		(1.4)	0.4	(0.5)	0.9	1.4
Dividend per share (US c)		0.0	0.0	0.0	0.0	0.0
Gross Margin (%)		33.3	45.7	40.5	41.6	42.2
EBITDA Margin (%)		-16.7	17.1	20.4	24.2	25.6
Operating Margin (before GW and except.) (%)		-33.3	14.3	14.3	19.1	21.0
BALANCE SHEET						
Fixed Assets		187	151	147	145	142
Intangible Assets		125	107	106	106	105
Tangible Assets		62	44	41	39	37
Investments		0	0	0	0	0
Current Assets		81	64	51	59	69
Stocks		41	25	27	32	34
Debtors		9	10	10	12	13
Cash		31	29	14	16	22
Current Liabilities		(57)	(36)	(13)	(14)	(14)
Creditors		(38)	(20)	(13)	(14)	(14)
Short term borrowings		(19)	(16)	0	0	0
Long Term Liabilities		(51)	(27)	(37)	(37)	(37)
Long term borrowings		(45)	(23)	(33)	(33)	(33)
Other long term liabilities		(6)	(4)	(4)	(4)	(4)
Net Assets		160	152	149	153	159
CASH FLOW						
Operating Cash Flow		(3)	4	6	9	13
Net Interest		(4)	(2)	(2)	(2)	(1)
Tax		0	0	0	0	0
Capex		(5)	(3)	(5)	(6)	(6)
Acquisitions/disposals		66	2	(8)	0	0
Financing		12	(1)	0	0	0
Dividends		0	0	0	0	0
Net Cash Flow		66	0	(9)	2	6
Opening net debt/(cash)		65	33	10	19	17
HP finance leases initiated		0	0	0	0	0
Other		(34)	23	0	0	0
Closing net debt/(cash)		33	10	19	17	11

Source: Rubicon, Edison Investment Research. Note: 2017R was restated to show discontinued operations separately. Significant other items in 2017R and 2018 cash flow relate to M&A activity associated with the disposed Tenon operations.

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