EDISON

Rubicon

FY13 results

Strong progress from both Tenon and ArborGen

Building materials & agrichemical

FY13 saw Tenon and ArborGen improve their financial performance and put in place banking facilities for their next growth phases. These results reinforce our view that Rubicon's (RBC) share price understates the underlying value of its investments – worth c NZ$0.90 per share – and we expect to see this discount narrow over time.

Year end	Revenue (US$m)	EBITDA (US$m)	PBT* (US$m)	EPS* (c)	DPS (c)	P/E (x)	EV/EBITDA (x)
06/12	334	0	(9)	(1.1)	0.0	N/A	N/A
06/13	364	3	(6)	(1.3)	0.0	N/A	38.1
06/14e	389	11	3	0.2	0.0	145.8	11.1
06/15e	420	18	11	0.8	0.0	32.5	7.1

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Tenon delivering improved results

Tenon forms the bulk of Rubicon's results and reported FY13 numbers confirmed a strengthening financial performance as the year progressed, consistent with a US housing market recovery. EBITDA rose by US$3m to US$5m following revenue growth of 9%; the US newbuild/pro-dealer segment was the most active, with remodelling/home improvement retail beginning to improve toward the period end. Australasian trading benefited from both volume growth and mix improvements. Tenon is well positioned for the next stage of the US cyclical upturn, having increased operational efficiency, invested in inventory and put new banking facilities in place. Our Tenon estimates have risen, driven by underlying trading upgrades and more favourable exchange rates and this is reflected in our revised Rubicon estimates.

Growing and maturing ArborGen business model

Newsflow for ArborGen is positive on a number of fronts. Seedling volume growth with an increased proportion of advanced genetics drove revenue growth of 14% in FY13, with an US$8m EBITDA contribution (pre-R&D and central costs). Integrating CellFor has enhanced strategic focus with faster commercialisation of advanced products targeted in the US. Scale eucalyptus production in Brazil is now to begin in CY14. A neutral fully expensed EBITDA position is ArborGen's target for FY14. This should reduce the funding required from shareholder partners, and with banking facilities now in place to 2015, ArborGen's business model is starting to mature. Rubicon has stated that an IPO of ArborGen remains a strategic priority.

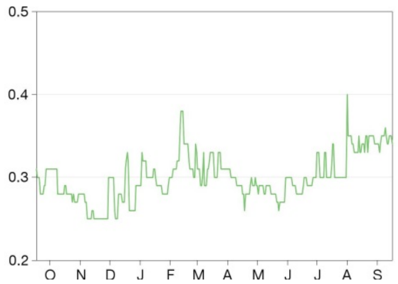
Valuation: Investment performance reinforces upside

Since our initiation note in June, Rubicon's share price has risen by 21% (Tenon is up 30%, at NZ$1.43). At current prices, ArborGen's implied c US$220m value (or NZ$0.23 per RBC share) sits at a sizeable discount to our previously outlined c US$360m (existing markets) and c US$300m (new markets) valuations, together equivalent to c NZ$0.69 (at NZ$/US$ 0.795) per RBC share. If we also factor in our revised Tenon valuation (mid-point c NZ$0.24 per RBC share) and adjust for c NZ$0.04 per share debt, there remains clear upside from current levels.

17 September 2013

Price	**NZ$0.34**
Market cap	**NZ$129m**
	US$0.795/NZ$
Net debt (US$m) as at June 2013	61 (consolidated)
Shares in issue	379.7m
Free float	77%
Code	RBC
Primary exchange	NZX
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	0.0	21.4	21.4
Rel (local)	(3.3)	15.2	3.1
52-week high/low		NZ$0.38	NZ$0.25

Business description

Rubicon is a forestry investment company with holdings in Tenon (NZ-listed, US-focused appearance wood product distributor) and ArborGen (an international developer and supplier of advanced forestry seedlings).

Next events

ASM	December 2013

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Moving in the right direction

Rubicon fully consolidates the earnings of Tenon (59%-owned) with minority deductions and this forms the bulk of its financial statements. ArborGen (31.67%-owned) is treated as an associate investment and carried as a non-current asset; as adjusted PAT (after capitalising product costs) is around zero, no associate profit or loss line is visible. Partner funding payments appear as an investment in associate in Rubicon's cash flow statement. At the group level, Rubicon recorded a much-improved operating loss of US$1m in FY13 (versus US$10m in FY12) before US$5m finance costs resulted in a pre-tax loss of US$6m (US$14m in FY12).

Tenon's recovery is underway

A year that started tentatively in trading terms ended strongly for Tenon with accelerating revenue growth and improving profitability. This was achieved despite some tightness in the supply chain, absorbing c US$1m business re-engineering costs and an adverse average NZ$/US$ rate (causing an estimated further US$1m drag on reported results). North American and Australasian operations both made progress, with EBITDA increasing from US$1m in H1 to US$4m in H2 (compared to US$2m for FY12 as a whole). Further progress is anticipated; upgrades to our existing underlying estimates are enhanced by a stronger prevailing US dollar (NZ$/US$ assumption moving from 0.82 to 0.795). Consequently, our FY14 and FY15 EBITDA expectations for Tenon are now US$13m and US$20m respectively (up c US$1m and US$4m respectively compared to our previous estimates).

Strategically, Tenon remains well placed to benefit from a broadening out of the US housing market into remodelling sectors and has invested in increased inventory to maintain service levels into the next phase of recovery. In the near term, management has elected to focus on realising gains from operational efficiency improvements and enhanced market shares made in the US in recent years as volumes return toward mid-cycle levels. While a possible entry into China is still under active review, in the near term the company will be focusing its resources on the recovering US housing market where earnings leverage is greatest. After the FY13 results, Tenon announced revised banking facilities (expanded from US$54 to US$70m, with a five-year term to September 2018), which provides clear funding visibility for the ongoing US housing recovery. We discuss Tenon's FY13 results and prospects in more detail in a recently published update note, Healthy upside.

ArborGen is making progress on a number of fronts

ArborGen is a 31.67%-owned associate and is a private company, so does not report full results independently.

Revenue growth and developing mix: Rubicon states that ArborGen's revenues grew by 14% (to US$30m) in the year with an increase in the volume of seedlings sold of 9.5% (to 273m). The US is the largest market served (c 90% of volume), and within this, loblolly pine (chiefly for south-east US plantation forests) is the dominant species, accounting for 90% of FY13 US sales volumes. ArborGen's advanced genetics seedling sales in the region rose by 80% (to 29m) in the year and ArborGen is targeting a further 50% increase in FY14. This strategic sales migration from traditional, open pollinated seedlings to those produced from advanced genetics (using mass control pollination and varietal techniques) means that average selling prices should rise materially over time – as already seen in the NZ market – and this mix shift will have contributed to the implicit 4% increase in average seedling price in FY13.

Improving financial performance: ArborGen achieved earnings before R&D and corporate overhead of US$8m. An R&D review in FY13 has scaled back longer-term research project spend, in favour of increased resource being focused on commercialising advanced genetics seedlings. Rubicon and its two other shareholder partners each contributed c US$4m in FY13 to fund ArborGen's ongoing business development. Its year-end net debt position is understood to have been lower yoy (in the low-US$20m range). Note that ArborGen management is targeting a neutral EBITDA position in FY14 after expensing all R&D and corporate costs. This would be a major milestone in the company's development toward a standalone business entity and maturing business model. As a result, the cash call on partner investors should start to reduce from FY14.

Visible funding arrangements: We view the revised and extended banking facilities of ArborGen as significant. With visible banking arrangements in place through to late-2015 (US$26m to August in the US, NZ$4.5m to November in New Zealand) management has flexibility to develop the business further and to choose an appropriate time for its IPO.

Fresh strategic impetus: The acquisition of CellFor (in August 2012) appears to have been a seminal development both in its own right (bringing in pine varietal seedling technology in North America and South America) and in the context of ArborGen's refocused strategic direction. The R&D emphasis is now biased toward the faster commercialisation of ArborGen's enlarged advanced (non-GE) seedling portfolio. Advanced biotechnology techniques (including predictive genomic selection) materially shorten the development cycle timeline to reach the production phase earlier. Additionally, non-GE advanced seedlings do not require regulatory approval further reducing the time to commercialisation. With a strengthened management team is in place to execute this programme and a structured approach to market development, the US and Brazil are the primary geographies targeted (as already active and advanced), with China and Europe possible future regional extensions.

Rubicon's annual cash requirements expected to reduce

Rubicon ended FY13 with consolidated net debt of US$61m, of which US$12m resides in Rubicon and US$49m in Tenon (non-recourse). This represented a c US$8m reduction in holding company debt, US$15m net new equity funding[1] early in the year net of central costs (US$2m), interest (US$1m) and associate funding (US$4m).

In FY14, ArborGen's cash funding requirements may be lower than FY13, indicating that Rubicon should continue to operate within its existing borrowing facilities (of US$20m, term ending 1 July 2014). In the event that ArborGen's development is slower than currently anticipated and additional partner funding is required, this may need to be revisited. The other side of the coin is that once ArborGen becomes cash neutral/positive, Rubicon's annual cash outflow should be modest. At some point, we would expect cash inflows to occur either as Tenon returns to paying dividends and/or there is a valuation event that enables Rubicon to monetise some of the value in one or other of its investments.

Tenon recovery mirrored in Rubicon estimate upgrades

As outlined earlier, Tenon's financial performance is the primary driver of Rubicon's own reported results. Having put through post-FY13 result upgrades for Tenon, we now reflect this in our Rubicon estimates. As shown in Exhibit 1, we anticipate a material uplift in earnings – both against previous years and previous estimates – in FY14 and FY15.

Exhibit 1: Rubicon revised estimates

	EPS*			PBT			EBITDA		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
2013	(1.2)	(1.3)		(5)	(6)		3	3	
2014e	0.0	0.2	N/M	2	3	+50%	10	11	+10%
2015e	0.7	0.8	+14%	6	11	+83%	14	18	+29%

Source: Edison Investment Research. *Note: previous estimate did not include a Tenon tax charge for FY15.

[1] Equivalent to NZ$21m net, via a 1:3 rights issue at NZ$0.22, Theoretical ex-rights price c NZ$0.34.

Exhibit 2: Financial summary

US$m	2011	2012	2013	2014e	2015e	2016e
June	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	326	334	364	389	420	454
Cost of Sales	(241)	(252)	(281)	(294)	(315)	(338)
Gross Profit	85	82	83	94	105	117
EBITDA	6	0	3	11	18	25
Operating Profit (before GW and except.)	(0)	(5)	(1)	8	14	22
Intangible Amortisation	0	0	0	0	0	0
Exceptionals	0	(5)	0	0	0	0
Associate	(1)	0	(0)	0	0	1
Operating Profit	(1)	(10)	(1)	8	15	23
Net Interest	(4)	(4)	(5)	(4)	(4)	(4)
Profit Before Tax (norm)	(5)	(9)	(6)	3	11	19
Profit Before Tax (FRS 3)	(5)	(14)	(6)	3	11	19
Tax	(1)	2	0	0	(4)	(7)
Profit After Tax (norm)	(6)	(7)	(6)	3	7	12
Profit After Tax (FRS 3)	(6)	(12)	(6)	3	7	12
Average Number of Shares Outstanding (m)	285.0	284.8	378.5	379.7	379.7	379.7
EPS - normalised (c)	(1.8)	(1.1)	(1.3)	0.2	0.8	1.7
EPS - FRS 3 (c)	(1.8)	(2.8)	(1.3)	0.2	0.8	1.7
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	26.1	24.6	22.8	24.3	25.0	25.7
EBITDA Margin (%)	1.8	0.0	0.8	2.8	4.2	5.6
Operating Margin (before GW and except.) (%)	0.0	-1.5	-0.3	1.9	3.4	4.8
BALANCE SHEET						
Fixed Assets	189	196	199	201	202	202
Intangible Assets	85	85	85	85	85	85
Tangible Assets	29	25	23	22	20	19
Investments	75	86	91	94	97	98
Current Assets	82	87	106	112	120	134
Stocks	53	53	72	75	81	87
Debtors	22	29	33	35	38	41
Cash	2	0	0	0	0	6
Current Liabilities	(36)	(35)	(49)	(53)	(55)	(58)
Creditors	(27)	(33)	(46)	(47)	(49)	(52)
Short term borrowings	(9)	(2)	(3)	(6)	(6)	(6)
Long Term Liabilities	(31)	(57)	(58)	(58)	(58)	(58)
Long term borrowings	(31)	(57)	(58)	(58)	(58)	(58)
Other long term liabilities	0	0	0	0	0	0
Net Assets	204	191	199	202	209	221
CASH FLOW						
Operating Cash Flow	3	(4)	(10)	7	12	19
Net Interest	(5)	(3)	(4)	(4)	(4)	(4)
Tax	(1)	0	0	0	(4)	(7)
Capex	(2)	(2)	1	(2)	(2)	(2)
Acquisitions/disposals	(4)	(9)	(4)	(4)	(2)	0
Financing	0	(1)	15	0	0	0
Dividends	0	0	0	0	0	0
Net Cash Flow	(8)	(19)	(2)	(3)	0	6
Opening net debt/(cash)	30	38	59	61	64	64
HP finance leases initiated	0	0	0	0	0	0
Other	0	(2)	0	0	(0)	(0)
Closing net debt/(cash)	38	59	61	64	64	58

Source: Edison Investment Research, Rubicon accounts

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