North American Energy Partners Inc.
Q2 Conference Call Transcript
CHECK AGAINST DELIVERY

Operator: Good morning ladies and gentlemen. Welcome to the North American Energy Partners 2007 Second Quarter Conference Call. At this time all participants are in listen-only mode. Following management's prepared remarks, there will be an opportunity for analysts, shareholders and bondholders to ask their questions. The media may monitor this call in listen-only mode. They are free to quote any member of management, but they are asked not to quote remarks from any other participant without that participant's permission.

If anyone has any trouble hearing the conference, please lift your handset and press star zero for an operator at any time. I advise participants that this conference call is also being webcast on the company's website at nacg.ca.

I will now turn the conference over to Mr. Vincent Gallant, Vice President Corporate of North American Energy Partners Inc. Please go ahead, sir.

Vincent Gallant: Thank you. Good morning ladies and gentlemen and thank you for joining us on the North American Energy Partners Inc. Conference Call. Today, we will be discussing our financial results for the period ended September 30th, 2006. I remind you that our fiscal year end is March 31, so this is our second quarter for our 2007 fiscal year.

Participating with me is Rod Ruston, our President and Chief Executive Officer; Doug Wilkes, our Vice President Finance and Chief Financial Officer; and Bill Koehn, our Vice President Operations and Chief Operating Officer.

A live webcast of this call is currently available in the Investor Relations section of our website at nacg.ca, and a transcript will be posted within a few days. For instant replay access until December 6th, refer to the dial-in information in our News Release issued yesterday.

As you know, we completed our Initial Public Offering last week. In connection with the closing of the offering on November 28th, just two days ago, we amalgamated NACG Holdings Inc., NACG Preferred Corp., and North American Energy Partners Inc., into one entity continuing under the name North American Energy Partners Inc. The common shares of this new entity North American Energy Partners Inc. are the shares issued in the public offering. These shares commenced trading on the Toronto Stock Exchange and the New York Stock Exchange on November 22nd.

Before I turn the call over to Rod, I'd like to remind everyone that statements made during our prepared remarks or in the Q&A portion of the conference call with reference to management's expectations or predictions of the future, are forward looking statements.

All statements made today, which are not statements of historical fact, are considered to be forward-looking statements. The business prospects of North American Energy Partners are subject to a number of risks and uncertainties, which may cause material differences in actual results. For more information about these risks, please refer to our final prospectus dated November 21st, which was filed with the securities regulators in Canada and the United States.

Management does not intent to provide any financial guidance. After our prepared remarks we look forward to taking your questions, and we ask that you ask one question and then re-queue in order to give everyone in the queue an opportunity to ask their questions. At this time, I will turn the call over to our CEO, Rod Ruston.

Rod Ruston: Thanks Vince and good morning ladies and gentlemen. I'm delighted to be speaking to you this morning. This conference call marks the first for North American as a public company, and we're thrilled about this new opportunity. As I'm sure most of you know, we were recently on the road show, visiting potential investors, and your presence on this call is an indication of our success in listing the company and attracting new equity investors to the organization.

In the quarter, North American attained revenue of $130 million, which is a five percent increase over the same period last year. A consolidated EBITDA of nearly $16 million contributed to a healthy cash balance of nearly $37 million at the end of the quarter. These results are largely attributed to North American's continued work in Fort McMurray together with some new contracts, including more Mining and Site Preparation work for Shell at their new Jackpine Mine and substantial Piling work at Shell's Upgrader Expansion Project at the Scotford facility.

Bill Koehn, our Chief Operating Officer, will go into greater detail about our new projects in a few minutes.

As far as the divisions are concerned, Piling operated well with revenue increasing to $50 million from $42 million for the same period last year. Segment profit results are up almost $5 million due to increased volume, higher margin work and efficient project execution. Mining and Site Preparation revenue increased by $6 million to $100 million, largely due to continued ramp up of the CNRL Overburden Removal Project as more equipment is added each quarter.

Segment profit also rose about $3 million primarily due to higher project volumes at better margins. We commenced the wind down of our business with Grande Cache Coal during the quarter, and the equipment from that site has already been assigned to higher margin work in the oil sands area and will commence in December.

Pipeline revenue decreased from $8 million to $3 million as a result of less work being requested by EnCana, resulting in a $1 million decline in operating segment profit compared to the same period last year. However, as I stated in the recent road show, our pipeline work is seasonal. With winter fast approaching, the Pipeline division is currently ramping up. Over summer, bidding in the Pipeline division has been more active compared to previous years and over a more diverse client base, which has been a strategic move we have planned for the last year. As a result, we expect pipeline work to pick up considerably in the two remaining quarters. And, for example, we commenced the new 40-kilometer pipeline project for Husky late in the quarter.

We've made great progress in dealing with the worldwide tire shortage and managed to secure a one-year supply of tires for our large haul trucks up to the 240-ton capacity, which are among the largest in our fleet.

While we have a supply of tires for most of our large truck fleet, as I mentioned on the road show, the supply for our 330-ton trucks used at CNRL has been insufficient to allow the four trucks we own to be taken off blocks and mobilized. We are working with alternative suppliers on a long-term agreement to source tires for these trucks.

We've had a significant level of recruitment activity to attract the best talent in order to drive our company forward, expanding our efforts to find qualified candidates both inside and outside of Canada. We believe the labor shortage will continue to be a challenge for everyone, so we are also mitigating this risk by continued extensive training of our existing employees.

We also continue to build our health and safety program at North American and continue to progress our enhanced operational efficiency within the organization.

Our strong business relationship with our customers is a key to maintaining our position as the service provider of choice in the oil sands, while our business structure enables us to service both our existing customers and attract new customers. As a result of our recent listing, we have also developed a stronger balance sheet to support not only the current activities but our expansion plans.

As you can see, North American is focused on continued growth and building a strong, sustainable foundation for our organization. And with that, I'm pleased to introduce Doug Wilkes, our Vice President of Finance and CFO who will elaborate on this quarter's financial performance.

Doug Wilkes: Thank you Rod and hello everyone. As I'm sure most of you are aware, I joined the company a few months ago. By way of a short introduction, I'm a 20-year chartered accountant and my professional life has been spent in resource-based businesses.

For your information, the following discussion is in Canadian dollars and relates to the three months ended September 30th, 2006, as compared to the three months ended September 30th, 2005.

Revenue for the three months was $130 million, a 4.9% or a $6 million increase over 2005. Increases in both our Mining and Site Preparation and Piling businesses was somewhat offset by a decline in Pipeline. Segment profits also improved by $6 million from $16 million in 2005 to $22 million in 2006, with margins in both Mining and Site Preparation and Piling improving over 2005. Pipeline was a marginal contributor to segment profits as this business typically performs most of its work in the winter months.

Operating income was $9.7 million down $6.2 million from the 2005 amount of $15.9 million. Non-recurring charges in G&A and equipment plus higher structural spending in anticipation of business growth in the oil sands region were the prime reasons for the decline.

Net loss for the three months was $4.6 million compared to net income of $11.6 million in 2005. In addition to lower operating income as described previously, higher interest costs, unrealized losses on derivative instruments and tax changes were the primary causes of the decline.

In 2005, valuation of the NAEPI Series B preferred shares resulted in a $5 million credit against interest expense. In 2006, the charge to expense for the same shares was approximately $1 million. Interest costs on senior notes remained unchanged.

Ten million dollars was spent on capital in the quarter with the majority spent on growth as opposed to sustaining capital. In addition, we have added three large lease trucks for a single contract in the oil sands.

As you know, our IPO was completed last week with the financial close on Tuesday of this week. After fees and expenses, the company received approximately $150 million. The 9% senior notes have been repaid and all preferred stock has either been purchased and cancelled or converted to

common stock. Leases for equipment that are being bought out will be completed shortly.

That summarizes our Q2 results. I will now turn the call over to Bill Koehn.

William Koehn: Thanks Doug and good morning everyone. All three of our operating segments did well compared to last year with Piling showing the largest increase.

The Piling division had an outstanding quarter with revenue of $27 million, which is a $5 million improvement. The division segment profit also increased substantially rising from $4.8 million to $9.3 million. This segment has been experiencing steady growth due to two main reasons. First, intensified demand for piling services in the Edmonton, Calgary, Fort McMurray, Regina and Vancouver regions has been steadily climbing. With our knowledge and expertise, we are able to complete much of this work and we can do so more efficiently. Some of our new-awarded contracts include the large Piling project for Shell as mentioned by Rod, as well as a substantial amount of commercial work through our regional offices. This brings me to the second reason, which is the consistent expansion in the scope of existing projects. We recently acquired Midwest Micropile to expand our service offerings. We also continued to add continuous flight auger drills to our fleet, and we are happy with the results of utilizing the new technology. Essentially, this allows the company to introduce this new technology to western Canada, which improves our segment's operating efficiency.

The Mining and Site Preparation segment continued to progress well and is on schedule on all oils and mine sites. Revenue for the quarter was $100 million, which is a $7 million increase. This increase was primarily attributed to the ramp-up on the CNRL overburden contract. Progress on the DeBeers site is progressing ahead of schedule and the company is well positioned to acquire additional work, which is required there. Segment profit also increased by $3 million from $9.5 million to $12.5 million. One of the new projects we were awarded in the quarter was the Crusher Slot as well as the building of the Cantera access road both for the new Jackpine Mine in Fort McMurray.

Pipeline revenue was $3 million this quarter showing a $5 million decline, which can be attributed primarily to the seasonality of pipeline work. As most of you know, the best season for this segment is during the winter when the ground is frozen and more stable to work on. Accordingly, we bid most of our projects for a winter construction period. However, with the rise in the oil and gas industry's spending and in light of all the projects to come, we anticipate a large amount of demand for our pipeline services. We also started a 40-kilometer pipeline

project for Husky late in the quarter, as Rod mentioned previously.

At this point, I will turn the call back to the operator to open the line for questions.

Operator: Thank you. To ask a question, please return to your handset and press the numbers 01. If you wish to withdraw your question, you can press the pound sign. So if you have any question, please press 01 now.

First question is from Matt Duncan, Stephens Inc. Please go ahead, sir.

Matt Duncan: Good morning guys.

Doug Wilkes: Hi Matt.

Matt Duncan: Just a couple of quick questions here. First of all, as I look at this quarter, I mean, you know, I'm trying to get a feel for what the pro forma might have looked like post deal and I know you guys didn't really go into that. I assumed that net income would have been reasonably higher in a post-IPO environment, correct?

Doug Wilkes: That's right, Matt.

Matt Duncan: Can you give us any idea if you would've actually had net income or would it still maybe have been a small net loss?

Doug Wilkes: Well, we had in the quarter, we had non-recurring costs--not all--some of it was related to the IPO but it was just more outside the IPO—of about $6 million in the quarter. And I almost hesitate to say non-recurring because some of that, some of those costs are going to reoccur again in Q4, but there were certainly costs that would be unusual in the ongoing operation of the business. The other items that would have been affected were the ones that were described in the pro formas in the prospectus and they were the lease costs and the interest costs, not only on the 9% notes but also on the preferred shares that were taken out in the quarter. So I would say when you put them all together, we would have been income positive including all of the--call them the one-time charges--both IPO and non-IPO.

Operator: Next question is from Jamie Cooke from Credit Suisse. Please go ahead.

Jamie Cooke: Hi. Good morning.

Rodney Ruston: Hi Jamie.

Jamie Cooke: I guess my first question Rod, when I'm looking at your margin performance in the second quarter, you showed especially in

the Mining, Site Prep and the Piling, you showed a pretty good improvement year-over-year and a little better relative to my expectations. So can you just sort of expand on that? Is there anything unusual? And while you're not giving guidance, I mean, do you think that this is sustainable or that we could see improved margins going forward?

Rodney Ruston: There's nothing unusual that's happened, Jamie. Our margins somewhat depend on what jobs we get at any point in time, and as we've said on the road show, if it's related to the longer term type jobs or the contracts that we have on sites in regard to our service contracts then it tends to be a slightly lower margin than if it's short term, quick response type work. This slightly higher margin would just be the fact that there was a bit more short-term quick response type work in the quarter.

Moderator: Next question is from Jacob Bout from CIBC World Markets. Please go ahead.

Jacob Bout: Yes, good morning. First, just a question on your G&A, given the $10 million sub-point seven revenue, a pick up obviously from a year ago. Just want to understand, how we should be looking at that going forward? What you're targeting for percentage of revenue? And then, if you could just comment quickly on the Birch Mountain contract.

Doug Wilkes: Okay. Jacob, I'll take them kind of one at a time. In G&A, the one-time costs, and they really were one-time costs that were included in that G&A number, were about $1.1 million. So those were charges that won't reoccur, and some of them were IPO related and some of them weren't.

We're going through a period of growth in the company. And part of that preparation for the company moving forward is creating more capacity on our administration side of our business. And at the same time, we do have higher costs for things like consulting in legal and audit that we expect over the next 18 months or so will come off. So I would say, when we're at the end of our SOX implementation process with the deadline at the end of March in 2008, our G&A we will expect it to be somewhat under the--we're at about 6.4% in terms of dollar sales and in terms of cash costs and G&A**.** It's a little bit higher when you add in some of the non-cash costs, but we expect that to be well south of 6% going forward. And when I say going forward, I mean after the next fiscal year and not next year.

For the second one, Birch Mountain. Birch Mountain, the only update I can give you is the update that you can see in their press release. They did do a financing and that financing is expected to close on or about December the 5th and as a result of that, we expect that we will be paid the amounts owed to us shortly thereafter.

Rod Ruston: Also on the Birch Mountain on the operations side, we've worked now with Birch Mountain for a long time and in fact it's a very good relationship, so we put equipment on their site that sort of is counter cyclical to the demand we have for our equipment elsewhere, so with our biggest operating period in the winter, we tend to move a lot of our equipment off there, so we don't have a big exposure with Birch Mountain at the present time and our equipment's operating on another site. As the winter period slows down, I expect that we'll be working again with Birch Mountain next year.

Operator: Tom Rinaldi from Brent Corp., please go ahead with your question.

Tom Rinaldi: Yes, good morning. I just wanted to make sure I understood the sort of a run rate SG&A better. I'm kind of getting a little bit lost in what is sort of unusual but might repeat in the fourth quarter and also ramping-up your needs on the administrative side, is there a number when things get to normal that we can kind of think of?

Doug Wilkes: Okay Tom, the repeatable thing that I came up with was, that was not in G&A. The G&A costs, the $1.1 are real one-time charges. What you should look at for G&A for the next period of time and I would say it through the next 18 months in the company, if you use 6% of sales that would be a pretty fair estimate of where we're going to be for that period.

Operator: Lou Nardi from BMO Capital Markets, please go ahead with your question.

Lou Nardi: Good morning, CapEx is a little lower in the quarter than I was looking for. Could you give us some idea on what it's going to look like for the rest of the year?

Doug Wilkes: The guidance that we've given on capital for the full year is--now, not including the buyout of the operating leases, which is on top of that.

Lou Nardi: Right.

Doug Wilkes: We'll be in the $60 million range and we still expect that that will be the number.

Operator: Matt Duncan from Stephens Inc., please go ahead.

Matt Duncan: Hey guys, just a quick follow up on--and this is really kind of for Doug. On that $6 million in one-time cost, I'm trying to figure out how much of that is in the equipment expense line, the equipment cost line and what exactly were those one-time charges, what were they for?

Doug Wilkes: About $4.5 of it is net, and they relate to costs associated with implementing our process improvement project that's going

across the company, and we're getting to the end of the use of outside resources for that.

Operator: Once again if you want to ask a question, you can press 01. Jacob Bout from CIBC World Markets, please go ahead.

Jacob Bout: Yeah, just a question on the tires for the--I think you said the 330-ton trucks. When do you expect that issue to be resolved and then what type of a--I meant, I'm assuming, once you get those tires, you're going to be able to run those kind of a 7,000 hours per year type, right?

William Koehn: Yeah, with respect to the overall worldwide shortage of tires I know that both Bridgestone in Japan and Michelin in the U.S. are both looking at expansions. I'm not sure where they are with respect to those announcements on those planned expansions. We anticipate that that tire shortage will continue for a substantial bit of time. As far as relief, there are some coming from softening markets and in the commodities with respect to coal, but looking out 2010 is not--those are the numbers being bantered around within the industry, where we may see some complete relief. As for the issues that we're looking at as far as alternate suppliers are--is usually--it's around recapping existing tires. We have a core tire that can be recapped, looking at used tires, looking at new tires through different management, all those activities we're pursuing. With respect to total hours on a truck, yeah, the 7,000 is not a bad number, it could be a little less. Between six and 7,000, you would look at.

Operator: Next question from Matt Duncan, please go ahead.

Matt Duncan: Hey guys, last couple of questions here. Rod, can you talk, number one, a little bit about where you are on your current capacity utilization for your equipment, and secondly can you address the--was there any difference in revenue growth for work in the oil sands and outside the oil sands in the quarter?

Rod Ruston: The utilization of our equipment, we're working on putting in measures, it's a measure that in the past hasn't been used. We've started a broad company-wide measure about nine, 10 months ago, which is our utilization is around 26% if you take that every piece of equipment, significant piece of equipment, that we have got is capable of working 24 hours a day, seven days a week. Now the difficulty with that is that with some of our equipment, we just don't do that. For example, our pipelining equipment, we work mainly in winter and in summer it's idle, but we're still working on a breakdown to put ourselves in a position where we've got categories of equipment that we can have an expectation, okay. It's mining equipment that's used entirely on mining. We expect 24/7 and we expect the utilization up in the 80's.

If it's pipeline equipment, we expect utilization for a third of the year and therefore that utilization will be--within that third of the year--we'll have some measure as to what our expected utilization for it is. I think the important thing to remember is that when we buy a piece of equipment and we price that piece of equipment into the market, we price that piece of equipment based on our expectation of its working time within our business. It'll be probably another six months before I can give any form of additional detail on how we're going to be measuring the efficiency of our equipment.

Operator: Once again if you want to ask--

Rod Ruston: There was a second question there. I'm trying to think of what it was.

William Koehn: Matt, what was your second question?

Operator: Go ahead Matt, please.

Matt Duncan: The second question pertained to the growth in your revenue both within the oil sands and outside the oil sands. Was there any meaningful difference in revenue growth within and without and the outside of the oil sands?

Rod Ruston: Yes, in fact the revenue growth that did occur was mainly in the oil sands because we did taper off on Grande Cache but they--that was bounced down to some extent by increased revenue from our DeBeers diamond. When we went on the road show, we said our revenue balance would tend to be 70, 75% from the oil sands, 25% outside. That's the strategy that we intend to continue, so we intend to target replacing Grande Cache with some other opportunity outside the oil sands, of which there's a number that are coming up.

Operator: Once again if you have any more questions, you can press 01 now please. There are currently no other questions in the queue, sir.

Vincent Gallant: Thank you very much everyone for joining us today on the Second Quarter Conference Call, and we look forward to talking to you again at the end of our Third Quarter in the month of February. Our quarter being December but we'll be talking to you in February. Thanks very much.

Operator: Thank you. Ladies and gentlemen, this concludes the North American Energy Partners Second Quarter Earnings Conference Call. Thank you for your participation.