North American Energy Partners Inc.
Q3 Conference Call Transcript
CHECK AGAINST DELIVERY

Operator: Good morning, ladies and gentlemen. Welcome to the North American Energy Partners Fiscal 2007 Third Quarter Earnings 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.

I advise participants that this call is also being webcast on the company's website at nacg.ca.

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

Vincent Gallant: Good morning, ladies and gentlemen and thank you for joining us on the North American Energy Partners Inc. Conference Call this morning. Today, we will be discussing our financial results for our Third Fiscal Quarter ended December 31st, 2006.

Participating with me today 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 of Operations and Chief Operating Officer.

As stated by the Operator, a live and on-demand webcast of this call is currently available in the Investor Relations section of our website at nacg.ca. A podcast and transcript will also be available following the call. For instant replay access until midnight on Thursday, February 22nd, please refer to the information in the news release we issued yesterday.

Before I turn the call over to Rod, I would 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 our 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 our future results. For more information about these risks, please refer to our third quarter MD&A, which is available on Sedar and Edgar.

As we mentioned on our last call, management does not intend to provide any financial guidance. After our prepared remarks, we look forward to taking your questions but we ask that you pose one question at a time in order to give everyone an opportunity to speak. 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 with all of you this morning at our first investor call-in since our IPO last November.

Well it's been a good quarter. Firstly, of course, we completed the IPO and listed on both the TSX and the NYSE to raise $153 million Canadian which we subsequently used to pay down some of our debt and to buy some leased trucks. As a result, our balance sheet is much healthier today than it was this time last year.

Secondly, we've achieved all the reporting requirements of a listed company with what I believe was a very smooth and well managed process through the quarter end.

And finally, we achieved excellent results for the quarter with record revenue of $156 million, some 28% better than last year. This translated into $25 million in Consolidated EBITDA and a net income of $6.6 million or $0.27 per share, aided in part by the impact of the IPO, the details of which will be provided to you by Doug very shortly.

Similarly, Bill Koehn will provide you further details of our operational performance but in general, our Mining and Site Preparation and our Piling segments have continued to perform well. However our Pipeline division experienced some difficulties due largely to some very adverse weather conditions, which resulted in a loss being incurred on some of their work. In spite of this, I'm confident that this division we can continue to build as evidenced by our exclusive negotiations currently being held with Kinder Morgan Canada on their TMX Anchor Loop project for work worth approximately $170 million over two years. The contract for this project is being structured such that the issues which impacted the loss-making jobs I mentioned previously are not a risk in this work.

I will now hand over to Doug, our Vice President Finance and CFO who will elaborate on this quarter's financial results.

Doug Wilkes: Thank you Rod and good morning everyone. All of the financial amounts that I'm about to discuss, except where I indicate otherwise, are for the three months ended December 31st, 2006 as compared to the three months ended December 31st, 2005, with all amounts in Canadian dollars.

Revenue for the three months was $155.9 million a $34.5 million increase over the prior year. The revenue increase was broad-based with each division experiencing gains of at least 24%.

Gross profit was $26 million, $12.2 million higher than last year where we recorded $13.8 million--$6.5 million of this related to favourable adjustments resulting from the IPO. Operationally, gross profit as a percent of sales improved to 12.5% from 11.3% in the prior year.

Continued improvements in the Mining and Site Preparation and Piling divisions were somewhat offset by losses in the Pipeline division and higher equipment costs, which were up approximately $10 million year-over-year. These increased equipment costs were driven by higher operating hours and significantly higher costs for tires.

Our tire costs in Q3 were $6.4 million, almost 50% higher than each of the first two quarters, and resulted from higher use of tires purchased from tire brokers. We do not expect to see much, if any, easing in the tire shortage over the next several quarters, which will translate into higher than normal tire costs for the duration of the shortage. We will recover a percentage of these increased costs over time through a tire premium charge to our customers.

General and administrative costs were $11.6 million, $3.4 million higher than last year. Two million of the increase resulted from the termination of an advisory services agreement as part of the IPO, with higher staffing levels accounting for most of the balance of the increase.

Interest costs rose $1 million year-over-year, with most of the increase due to one-time impacts from the IPO. In future quarters, interest will be lower as a result of retiring the nine percent bonds.

The net impact of other items, including foreign exchange and gains and losses associated with derivatives and IPO-related transactions was to increase pre-tax income by $1.2 million in the quarter. In the prior year, the net impact of similar items was to increase pre-tax income by $4.6 million.

Net income was $6.6 million, or $0.27 per share, up $4.5 million from the prior year amount of $2.1 million, or $0.11 per share. Approximately $2.5 million or $0.10 per share of the net income in this quarter is attributed to the IPO, with operations earning approximately $4 million.

Consolidated EBITDA was $24.7 million, up from $11.5 million in the same period last year. Seven million of this EBITDA resulted from the IPO, with $17.7 million being generated by operations. As a percent of revenues, Consolidated EBITDA generated by operations was 11.3% this year versus 9.5% for the same period last year.

Capital spending in the quarter was $78.4 million, of which $44.6 million was for purchasing leased equipment as part of the IPO. Most of the remaining Capex was for growth and was in large part for the acquisition of ten new mining trucks.

As a result of capital and tire acquisitions plus a build up in receivables, net cash balances declined by approximately $45 million in the third quarter. Increases in holdbacks and late payments from two customers were the main causes for our receivables increase. With a more modest capital slate in the fourth quarter and the expected improvements in collections, we expect that we will be in a positive cash position by year end.

That summarizes our third quarter financial results. I will now turn the call over to Bill Koehn.

William Koehn: Thanks Doug and good morning everyone.

Overall, our operations performed well this quarter. The Mining and Site Preparation segment had a great quarter, earning revenue of $111.4 million, which is a 24% increase from the same period last year.

Segment profits increased significantly over the prior year to $9 million, or 8% of revenue, due to large contracts such as Jackpine Mine and the continued ramp-up on our 10-year CNRL overburden contract. Work on the CNRL 10-year overburden contract continues to go as planned with calendar year end targets being achieved. The DeBeers Victor Diamond Mine is recognizing revenues at higher than anticipated levels and remains ahead of schedule. Our work on the Albian Crusher Slot project also proceeds on time and at favourable margins. Heavy construction and mining equipment services have been in demand with work being completed for Syncrude Canada, Albian Sands Energy and Suncor. We are also providing constructability services for Suncor's MNU and Voyageur projects.

The Piling division continued to achieve excellent results again this quarter with revenue of $29.2 million and profit of $10.3 million, which is a 35% margin. Piling activities continue to be strong in all regions of Alberta, British Columbia and Saskatchewan. Our work load in Vancouver and Regina is growing as we secure new projects in these regions. We continue to be very busy in the Calgary region with foundation and shoring projects and work progressing on schedule. New capital projects are being started at Suncor in Fort McMurray. With our recent $1.7 million acquisition of the piling contractor Midwest Technologies finalized in the quarter, we are now able to install specialized micropiles which are ideally suited in confined and congested plant sites. These piles are unique because of their small size and design load capabilities.

Pipeline revenue was $15.3 million but due to weather and changed operating conditions, we lost $1.8 million. Going forward, our contracting strategy is to mitigate the risk of uncontrollable conditions wherever possible in the Pipeline division. As announced in our news release issued yesterday, we are in the final stages of negotiations with Kinder Morgan Canada for the supply of pipeline construction services for the TMX Anchor Loop project. The project, with an approximate value of $170 million, starts near Hinton, Alberta and runs for 160 kilometers through Jasper National Park and terminates just outside of Mount Robson Provincial Park.

I will now turn the call back to the operator to open the line for questions.

Operator: Thank you. To ask a question, please press the numbers 01 on your touchtone phone. If you wish to withdraw your question, you can press the pound sign. To allow others the opportunity to ask their question, please limit your inquiry to one question and one follow-up question only. If you have further questions, please press 01 to return to the queue. If you have any questions, please press 01 now.

Our first question is from Matt Duncan from Stephens Inc. Go ahead, please.

Matt Duncan: Good morning guys.

Rod Ruston: Good day Matt.

Matt Duncan: Just a quick question here on the contract that you're negotiating with Kinder Morgan. A $170 million contract, I assume that that's, from the way you're talking, is going to fall all in fiscal '08 and fiscal '09. And I'm curious on the impact of margin. Are you going to have to hire new employees to service that contract? And, you know, how is mitigating the risk of it--sounds like you're going to put the risk of weather on them--how is that going to affect your profitability for that contract?

Miles Safranovich: Hi, Matt. This is Miles here. The contract will be developed so that we do not carry that risk. We're working closely with Kinder Morgan to develop the budget together as well as to develop risk allowances within the budget. And the first part of your question was--new employees? We'll be able to manage this project mostly through our existing pipeline division and we will have to bring on some new project hires but that will not impact our overall G&A.

Matt Duncan: Okay, thanks.

Operator: Thank you. The next question is from Bob Schenosky from Jefferies & Company. Go ahead, please.

Bob Schenosky: Good morning.

Doug Wilkes: Good morning, Bob.

Bob Schenosky: A quick question for Miles. On the Kinder pipeline, can you offer a sense at all in terms of what you may think operating margins could look like for that project?

Miles Safranovich: We're still in negotiations with the client at this point in time and that's all I can say.

Bob Schenosky: Okay. That's fair enough. I understand. Separately, on the Mining and Site Preparation division, revenues were terrific in the quarter. Can you give us a sense at all of what we're looking at potentially for the next quarter here and if there's anything new in terms of potential contracts that you've been working on?

Doug Wilkes: Yeah, Bob. It's Doug. At the beginning of the call I think we said that we're going to try to steer clear away from financial guidance of any type. I guess the only thing that we can say, I think Bill did describe the nature and the extent of work that we are doing in the Mining division and, you know, our fourth quarter is generally a very strong quarter for the company, company-wide.

Operator: Thank you. And the next question is from Evan Templeton from Jefferies & Company. Go ahead, please.

Evan Templeton: Hi, thanks. Just a question on the Pipeline segment. You know, you experienced the operating loss of $1.8 million in this quarter--have those two projects been completed, or do you anticipate you'll see some negative margin impact in the fourth quarter?

Doug Wilkes: They're both near completion and the way the accounting works for these, Evan, is when you anticipate a loss you record the whole loss on the project. You don't do it on a percent complete basis.

Evan Templeton: Okay, great.

Operator: Thank you. And the next question is from Lou Nardi from BMO Capital Markets. Go ahead, please.

Lou Nardi: Hi guys. I just wanted to double-check something. There was a difference again this quarter between your segment profit and your gross profit and I think Doug said something about $6 million of some special item that helped gross profit in the quarter. Could you elaborate on that a little bit?

Doug Wilkes: Oh, yeah. One of the things we had as part of the IPO is over-hours--when we use equipment, we record the use of the equipment in our financial statements and when we buy out leases, the parts that we charge as over-hours, which are potential future payments to the lease company, are payments that don't get made. And as part of the IPO, we recovered $6.5 million of those costs and they were not included in segment profit.

Operator: Thank you. And the next question is from Jacob Bout from CIBC World Markets. Go ahead, please.

Jacob Bout: Hi, good morning. Just on the tires, there. How many trucks do you have on blocks right now because you don't have tires? And maybe you can just expand upon what the increase in costs for the tires is on a quarterly basis?

Bill Koehn: Sure, Bill Koehn here. There are three trucks that we own that are on blocks at this time. And--

Rod Ruston: That means we've taken two off in the last month or so.

Bill Koehn: And the second part of your question was the increase costs?

Jacob Bout: Yeah, the increased cost. I mean, what are those tires--they're going for what, $30-35,000 or something like that?

Doug Wilkes: Well, I can tell you, Jacob that our increased cost in the quarter was about $3.5 million over what it has been in prior quarters. Now the way the accounting works on this is we expense the tire when we put it on the truck and we recover a portion of the increased costs through tire premiums charged to customers over the life of the tire. So we, in effect, pre-pay the cost of the tire and then it comes back.

Operator: Thank you. And the next question is from John Kim from SAB Capital.

John Kim: Hey guys, good quarter. Two quick questions. On your SG&A rate, if you back out the $2 million or so that's IPO-related, that means you're running at slightly less than $10 million a quarter. Is that kind of a normalized run rate?

Doug Wilkes: No, the run rate would be closer to about $9 million a quarter, John.

John Kim: Okay, so $9 million a quarter--so that's about $36 million for the whole--is there like stock expense comp or anything like that in there?

Doug Wilkes: Yes. We put everything in G&A that would be considered anything like if there's a cost associated with stock option grants or anything like that, it's all in there.

John Kim: Okay. Is it fair to say the number's going to be like $40 million or less for the--I mean, how should I think about that number going into the fiscal year? Is it around $40 million or is it higher than that, significantly higher or lower?

Doug Wilkes: This is one of those guidance questions again.

John Kim: Is it a guidance question? Okay.

Doug Wilkes: Yeah.

John Kim: All right.

Doug Wilkes: I think--all I can tell you is just in the area of G&A is we are running right now at $3 million and the reality of our business is as the business grows, those monthly amounts will go up.

John Kim: Okay.

Doug Wilkes: But the targets that we talked about, particularly after SOX implementation is completed in the company, are still the targets that we are going to be achieving.

Operator: Thank you. And the next question is from Matt Duncan from Stephens Inc. Go ahead.

Matt Duncan: Hey, guys. Just a follow-up on numbers for the quarter. Just want to make sure we have a good picture of what sort of a post-IPO net income number might have been. And Doug, I know last quarter there were some consulting fees in the equipment cost line to the order of about $4.5 million. Did any of that repeat again in the December quarter? And if so, will it repeat going forward? And were there any other one-time items other than the ones detailed in the press release about the IPO?

Doug Wilkes: Yes. The quarter without the IPO effect, Matt, was about $4 million. The IPO added just under $2.5 million in net income, so on an operations basis it was about $4 million. Now in terms of the consultant costs that were in equipment, it's just over $2 million--sorry, closer to $3 million and that project is, at this point, pretty well wound down.

Operator: Thank you. And your next question is from Evan Templeton from Jefferies & Company. Go ahead, please.

Evan Templeton: Just another kind of housekeeping type issue. Do you have a breakout of the equipment hours by various segments?

Doug Wilkes: Yes, we do. It's in the MD&A under the segmented reporting section, Evan.

Evan Templeton: Okay, fantastic. That's it.

Operator: Thank you. And your next question is from Jacob Bout from CIBC World Markets. Go ahead, please.

Jacob Bout: Sure. Just a question on taxes here. Your future tax gain in the quarter, how did that arise--and then when do you think you're going to start paying cash taxes and an effective tax rate as well?

Doug Wilkes: The effective tax rate going forward will be closer to 32%. For the quarter the--

Jacob Bout: Sorry, 32?

Doug Wilkes: Around 32%--it's like 32.1%, Jacob, so 32%. The tax provision and the future tax item in this quarter were virtually all IPO-related with respect to our retirement of debt that caused the permanent differences to result in virtually--well, it was actually a recovery of taxes for the quarter. We expect given where we think we're going to be in terms of earning debt that we will start paying cash taxes later, so for part of our 2008 fiscal earnings will be somewhat cash taxable but it's not going to be for next year that significant of an item either. We will probably be looking fully taxable on our earnings for the year after that.

Rod Ruston: Jacob, while you're on the call on this question, I'll just add a bit to the previous question that you asked and that is you mentioned tire cost around about $37-$40,000. Large truck tires are up by three to four times that on average nowadays.

Operator: Thank you. The next question is from Lou Nardi from BMO Capital Markets. Go ahead, please.

Lou Nardi: I noticed that the availability under the bank agreement was down to $10 million at the end of the quarter and I know that the fourth quarter is usually the strongest but I don't know what other needs etc., you might have. Is there any thought about expanding the bank line?

Doug Wilkes: Yeah. We're looking at our complete financial structure now, Jacob. Sorry. Is this Jacob or Lou? Sorry, Lou. Yeah, we're going through that process right now.

Lou Nardi: Thanks.

Operator: Thank you. And the next question is from Steve Man from Jefferies & Company. Go ahead, please.

Steve Man: Good morning. Just a couple of housekeeping questions, please. What's the outstanding share count?

Doug Wilkes: Just under 35 million shares.

Steve Man: Okay. And then tax rate for the next quarter?

Doug Wilkes: Thirty-two percent.

Steve Man: Thirty-two percent. Okay. Great. Thank you.

Operator: Thank you. And the next question is from Matt Duncan from Stephens Inc. Go ahead, please.

Matt Duncan: Hey, guys. I just want to look at the expense lines, project costs and equipment costs a little bit more for the quarter. The project costs line expenses came in at about 59% of revenue. That was, you know, quite a bit higher sequentially and versus our expectation. How much of that is related to, you know, tires, which I would suspect is probably an equipment cost, but more maybe the Pipeline division's loss. And if I understand you correctly, Doug, the accounting is such that you take all the loss in this quarter so it's a percent of revenue. Would it be reasonable to expect the project costs to go down rather meaningfully sequentially?

Doug Wilkes: Let me kind of unwind that into a few different spots there, Matt. The tires that get charged directly to project costs would be tires related to CNRL.

Matt Duncan: Okay.

Doug Wilkes: Tires related to all other projects are charged through equipment and then recovered to projects on an agreed rate basis. The losses in the Pipeline division, if you take a look at the segment reporting, had a significant impact on that percentage analysis that you do have. We also have been doing different kinds of work in the quarter. So when you boil them all down and you assume that Pipeline is going to normalize in the quarter and--tires are going to be with us so we shouldn't just walk by that one. Higher tire costs for the foreseeable future are going to be with us so we will see some higher costs through equipment and project costs for those increased costs for tires. But I would say on an operational basis, your assumption is a fair one to make.

Operator: Thank you. There are no further questions in the queue.

If there are any other questions, it's 01 on the touchtone phone.

We have one more there. Next question is from Jacob Bout from CIBC World Markets. Go ahead, please.

Jacob Bout: Sure. Just a question on the Mining and Site Prep. When I take a look at the profits margins for this quarter they came in roughly around 8%. That's versus 5.3% in the year prior. How much of that increase is due to positive one-time impact in the IPO? And maybe you could talk a little bit about the seasonality and how we should be looking at this because clearly historically you've had much higher profit margins in the first and the fourth quarter, third quarter looking to be the weakest.

Doug Wilkes: Yeah. Jacob, there was no one-time impacts of the IPO at the segment line. That is all operational.

Jacob Bout: Okay.

Doug Wilkes: The real change year-over-year is the CNRL site grading job. That is complete.

Operator: Thank you. And the next question is from Jamie Cook from Credit Suisse.

Jamie Cook: Wow, they finally let me ask a question.

Rod Ruston: Hi, Jamie.

Jamie Cook: Congratulations. Nice quarter. I was getting nervous. You know, I guess a lot of the questions have been asked. I guess Rod can you just speak to, you know, a lot of people are concerned given the fluctuation in oil and gas prices. Just in terms of your perspective on the market, are you seeing any larger projects start to go? And can you just talk about the pricing environment from your side, whether you're going to be able to get more favourable pricing?

Rod Ruston: No, we aren't seeing projects go away. There's still a lot of work out there. What we are seeing is some increased competition up there with more organizations trying to get into the market. What we're making sure that we do with our customers is maintain sensible pricing levels, obviously getting the best that we can reasonably but without trying to push it too hard so that we maintain our competitive position. The other thing that's happening is that we're moving more away from the higher risk type contracts and there's a lot more of the low risk cost reimbursable contracts that are coming out now.

Operator: Thank you. And the next question is from Matt Duncan from Stephens, Inc. Go ahead, please.

Matt Duncan: Hey, guys. Last question here. On the Piling division, it obviously was very strong in the quarter. Can you talk about--were there any large contracts that were completed this quarter that could've driven that number higher or should we think about this as sort of a good trend line to look at for the business going forward?

Doug Wilkes: Yeah, right now it's kind of at a steady state, Matt. It's really been driven by the overall demand for piling in western Canada and there were no large contracts that had unusually high profit margins that would have affected that number that are going to disappear.

Operator: Thank you and there are no further questions in the queue.

Rod Ruston: Okay, thank you everybody for joining us. As you are aware, the transcript of this call will be available on our website.

We look forward to talking to you again in the near future.

Operator: Thank you. And this concludes the North American Energy Partners Conference Call. Thank you for your participation.