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MD on Results & Outlook

Open Briefing interview with Managing Director and CEO Brenden Mitchell

Boom Logistics Limited
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In this Open Briefing®, Brenden discusses:

- Restructuring to match assets/capacity to current demand environment
- Focus on growth areas, redeployment of under-utilised assets, labour flexibility
- Free cash flow to be used for further debt reduction, share buyback

Record of interview:

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Boom Logistics Limited today reported a net loss of $2.5 million for the year ended 30 June 2013, compared with profit of $19.7 million in the previous year. Excluding non-recurring items, trading EBIT was $26.0 million, down 27 percent, on revenue of $338.4 million, down 3 percent. In the second half, trading EBIT fell to $8.2 million, down 58 percent from the previous corresponding period, on revenue of $152.7 million, down 12 percent. How did trading performance in the fourth (June) quarter compare with your expectations at the time of your third quarter trading update in May? Are there any indications that trading conditions have bottomed?

MD & CEO Brenden Mitchell
At the time of our update we noted we were $7.0 million below expectations in the third quarter. That trend continued in the fourth quarter, with the added, and unexpected, impact of unseasonal poor weather in May/June in Western Australia, and further delays in the utilities sector.

We believe activity has bottomed out but at this point in time it's difficult for us to determine how fast it will recover. There's still little work in the infrastructure sector outside of mining and gas, but fortunately utilities work is increasing in August and we've been able to obtain additional work for our larger cranes – that activity was very lean in the second half. Maintenance activity continues to be subdued in our major markets, with continued pressure in every aspect of the coal sector.

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The reported result included restructuring costs of $4.8 million after tax, and asset impairment costs of $7.7 million after tax relating to obsolete or non-core fleet. What confidence do you have that your current fleet is appropriate to address current market requirements? Are further impairments likely if market conditions deteriorate?

MD & CEO Brenden Mitchell
We've invested heavily in recent years to ensure we have a well balanced, mobile fleet that's suited to the mining, resources, energy, utility and infrastructure sectors. That's allowed us to release 66 assets that were on average 17.6 years old, of which over half had low capacities of 20 tonnes or under, and nearly a quarter of which were non-core brands with low brand recognition. We prefer to have a more consistent fleet.

By releasing these older assets we'll be able to take a cash return and pay down debt. The access assets we've impaired are being managed for cash and the impairment reflects the poor market conditions currently in the construction sectors.

Given the release of the older assets and the impairment of the access assets, we don't foresee any further asset impairments.

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You've indicated that more restructuring is planned, including renegotiation of EBA arrangements, overhead reduction and further potential redundancies, and that achieving greater flexibility in Boom's labour model is a priority. Are the costs of this further restructuring likely to be material? What is the labour model you're targeting and what are the potential earnings benefits?

MD & CEO Brenden Mitchell
We simply have to be more competitive, and have a more competitive labour model to ensure our customers receive the most effective service. We're targeting a model that reflects our customers' requirements, and we need our people and the CFMEU to recognise that if labour costs are not recoverable from our customers, we're too costly and everyone loses.

We hope to achieve the desired outcome by agreeing more flexible hours and rates that are comparable with competitors. If this can't be done we'll look at other alternatives, including outsourcing labour or sub-contracting. If we need to do the latter, there will be more redundancies, however we want to achieve the outcomes that work for our people, our shareholders and our customers.

In terms of overheads, we're targeting another $2.0 million in overhead savings, largely as a result of the investment we've made in improved systems in FY2012 and FY2013. The majority of the redundancies and restructure costs associated with that, as well as with the restructuring required due to the loss of the BHP Billiton ports contract, have been recognised in our FY2013 accounts.

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The Crane Logistics business booked EBIT of $31.5 million for the year, down 19 percent, on revenue of $280.3 million, down 2 percent. The second half saw EBIT fall 49 percent to $10.0 million on revenue of $124.2 million, down 12 percent, reflecting weakness in east cost coal and infrastructure. Your cost reductions took effect in the June quarter and you expect full benefits in FY2014. Will the full benefits be available if revenue continues to fall and are there any factors that might offset the realisation of the benefits?

MD & CEO Brenden Mitchell
If activity continues to fall, we'll need to respond further. However we must look to grow our revenue and establish ourselves in new markets, particularly given we haven't retained the BHPB ports contract in northwest Western Australia. There will be a transition period as we build up new revenues, even with more work associated with the Gorgon project. That could offset the benefits to some extent, however as opportunities in the infrastructure area improve and we look to grow share in some of the new projects we haven't previously been involved in, we believe the changes we've made will make us more competitive for the longer term.

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EBIT margin in the Crane Logistics business fell to 8.0 percent in the second half, down from 13.8 percent in the first half. Do you expect a return to double digit margins in the nearer term?

MD & CEO Brenden Mitchell
Usually the third quarter is our lightest quarter given there are more holidays during that period and it's when weather can impact operations. Then, in the fourth quarter we saw the coal price drop even further and that put enormous pressure on our customers' margins which certainly reduced activity.

The actions we've taken are about ensuring we have the appropriate resourcing to suit customers' current production volumes and with that in place, we'd expect margin recovery as we go forward. Also, because of the subdued activity, we've got lower utilisation levels than we'd like which means we're able to release some assets to projects that previously we weren't able to be involved in. So with more assets employed in different areas, we believe we can improve our margins.

Last year was very challenging and disappointing in terms of the results we achieved but we're now focusing on those areas where we can get appropriate margins. In the current environment, with activity in the gas sector increasing compared with coal, we're looking to achieve better outcomes in that area, whereas in the past, given forecasting on coal was strong until only 12 months ago, our assets had been tied up in trying to satisfy those customers.

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Boom Sherrin, your travel towers business, booked EBIT of $8.0 million on revenue of $57.4 million, down 10 percent. EBIT margin improved slightly in the second half to 14.0 percent from 13.9 percent in the first half, in spite of falls in revenue and EBIT versus the previous second half, reflecting your "manage for cash" strategy in the non-core parts of the business. With projects in the telecommunications and energy sectors beginning to come on line, what is the outlook for Boom Sherrin earnings and margins in the current year?

MD & CEO Brenden Mitchell
We expect revenue in our travel towers business to improve further this financial year and EBIT margin to increase at least a couple of percentage points over FY2013. Largely that's because delayed projects are now getting under way, so our investment in this area will begin to bear fruit and we expect both telecommunications and power revenues to be stronger in FY2014.

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Boom generated net operating cash flow of $51.0 million for the year, up from $36.4 million in the previous year, largely reflecting a $9.4 million reduction in working capital. Are further improvements in working capital achievable nearer term?

MD & CEO Brenden Mitchell
There was a significant improvement in working capital last year and we expect some further improvement, albeit our customers tend to delay payment in this environment. The systems improvements we've implemented, along with the centralisation of some activities, should drive further savings.

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Capex totalled $62.3 million, up from $46.7 million, and you've indicated there will be "limited" capex requirements in FY14. To what extent does this assume that demand conditions will remain around current levels?

MD & CEO Brenden Mitchell
We assume activity on the east coast will continue to be subdued and that our utilisation on the east coast can increase somewhere in the order of 10 percent before we'd need to consider additional capex for our current customers. However, we'll invest in travel towers to replace an old fleet and meet the anticipated growth in demand. There may also be some capex to support new projects if they come along and need some specific equipment. On

the whole we believe we've got a balanced fleet and that we'll be able to satisfy the majority of demand without further investment this year.

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As at 30 June, net debt was $115.8 million, down from $127.8 million six months earlier. Gearing was 37.0 percent, down from 39.5 percent. You've indicated you will use free cash flow to further deleverage the balance sheet. What do see as the appropriate level of gearing for the restructured business?

MD & CEO Brenden Mitchell
In the current environment we think gearing of between 30 and 35 percent would be a comfortable level for us. When we have a clearer view of the economy and activity, we'd like to make a return to our shareholders rather than pay down more debt but given recent economic volatility, both in Australia and globally, and the subdued level of activity, we believe we should maintain a gearing level within the range of 30 to 35 percent.

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Boom has not paid dividends for three years and you've indicated that once the balance sheet has been deleveraged, you would look to conduct a share buyback. Why is a buyback being considered as a means of making a return to shareholders rather than a dividend? Under what circumstances might you consider reinstating a dividend?

MD & CEO Brenden Mitchell
Whilst we have a share price well below our net tangible asset value of $0.51 per share, it makes a lot of sense to initiate a share buyback at the appropriate time. Ultimately we'd like to be able to both buy back shares and pay a dividend, and the board will continue to look at that through the year. Meanwhile, we think it's important to signal that we're looking to return capital to our shareholders who have remained patient through what has been a very challenging period.

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Boom's ROE (trading NPAT/average equity) fell to 3.3 percent in FY2013 from 5.9 percent in the previous year. What do you see as an acceptable level of ROE for the company over the cycle and is it achievable under Boom's current business structure?

MD & CEO Brenden Mitchell
We want to deliver at an operating level an EBIT return on capital employed of 13 percent or more but we effectively delivered only 6 percent in FY2013 so we clearly have to improve significantly. We've continued to adjust to the environment but we have to further refine our model, reduce our overheads and most importantly, introduce a responsive labour model whilst also striking the right balance between wet hire, where we include labour, and dry hire, where we hire our equipment without labour. If we do this and there's a reasonable level of activity in the economy generally, we believe we can deliver an acceptable ROCE and ROE.

Every sector of the economy is doing it quite tough at the moment. Even in the iron ore sector, where growth is expected to be quite strong over the next three or four years, there's enormous pressure on companies to reduce their costs. In that environment, we need to ensure we're a leaner organisation, which is why we've been focusing on getting our systems and infrastructure right, allowing us to reduce overheads.

In terms of labour model, one of the issues we have is inflexibility, and that's an area we've been driving to improve, particularly in Queensland and northwest Western Australia where we've been at a competitive disadvantage because of that inflexibility. We believe that if we can change that we can deliver a better outcome, and we'll continue to push that message to our employees. We think there needs to be an understanding, including in the unions that have a very strong hold on our industry, that continually increasing costs without flexibility is not going to be sustainable longer term. We need a model where people can earn a good income out of what they do with the skills they have, and where we're able to recover our labour costs from our customers and still add value for our customers.

That's the key issue for us and we'll continue to drive to get the right structure in place. That's a reasonable challenge, but we need to continue to work towards that and with our employees.

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Thank you Brenden.

For more information about Boom Logistics, visit www.boomlogistics.com.au or call Brenden Mitchell or CFO Iona MacPherson on +61 3 9207 2500.

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