# MD on FY13 Outlook

Open Briefing interview with MD & CEO Brenden Mitchell

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### In this Open Briefing®, Brenden discusses:

- Changing demand environment and impact on outlook
- Expected impact of recent restructuring
- Improving balance sheet, cash generation and shareholder returns

### Record of interview:

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Boom Logistics Limited today reported trading net profit after tax of $8.8 million for the first half ended 31 December 2012, up 28 percent from the previous corresponding period (pcp), reflecting trading EBIT growth of 12 percent to $17.8 million and a $0.7 million reduction in borrowing costs to $5.2 million. You expect EBIT of $39 million for the full year ending 30 June 2013, up 10 percent, implying second half growth of 8 percent. EBIT growth has slowed from FY2012's 53 percent, with pressure from mining clients seeking cost reductions and lower activity in the construction and infrastructure sectors. What is the downside risk to your guidance?

**MD & CEO Brenden Mitchell**
Our guidance is premised on our continuing the trading performance improvement we achieved over the first half. Also, to achieve guidance we need to maintain our current major contracts and our operating performance within those. We also need a reasonable run with the weather – we can't afford the disruption of significant weather events – and no further delays in infrastructure projects.

In fact, one of the key issues we faced during the first half was the impact of infrastructure and utilities project delays. That impacted our performance more than the volatility in the mining and resources sector, albeit that also caused us some pain.

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Boom's statutory NPAT of $7.6 million, down 5 percent from the pcp, included one-off restructuring costs for your operations in the Bowen Basin, Port Kembla and Brisbane. To what extent do you see the current demand trends, particularly in the mining sector, as structural rather than cyclical? Will your recent restructuring enable Boom to maintain its margins and competitiveness in a changed environment?

**MD & CEO Brenden Mitchell**
It's worth noting that our statutory NPAT in the previous period also included a profit of $3 million after tax on the sale of the Victorian Tower Crane assets. Excluding that, statutory profit in the recent first half was up substantially.

Certainly there's a new operating paradigm, particularly in the coal sector, where our customers have been very much impacted by the combination of declining commodity prices and the strong Australian dollar and had to review their cost profiles. Over the last two or three years, the focus of the sector has been production: not production at any cost but production at quite high cost. Now the focus is around quality production and finding new ways of operating that ensure the cost profile is a lot lower.

There's also a normal cyclical element impacting demand. For instance, in the heavy haulage parts of our business, there isn't as much equipment being moved because capital expenditure has been curtailed in the short term while the miners and their suppliers try to deal with their current pain and reach an understanding of what the longer term trends will be. This has certainly impacted our east coast business. For example, around Newcastle where you've got a lot of services that support the coal industry, capital expenditure has been put on hold, but you'd expect that to make a cyclical come-back.

The restructuring we've done has been very much about trying to get flexibility into our operations. In the Bowen Basin, it's been about getting more flexibility in our labour arrangements so we can match our resources to the demands of our customers. In Port Kembla and Brisbane it's been about proceeding with our strategy of reducing our exposure to the metropolitan markets, where low margin "taxi" hire arrangements with customers are common, and developing our regional markets where we can focus on contracted services to the resources and energy sectors.

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What flexibility do you have within your current operational structure to reduce costs and how are you seeking to structure new contracts in response to customers' changing demands?

**MD & CEO Brenden Mitchell**
Given our priority has to be improving our return on investment, it's critical that when we're talking to customers about a contract, there's a recognition that we have capital employed and that we have to have an appropriate return. The key determinant of our returns revolves very much around our labour force and how flexible our labour arrangements are. This is a real challenge following a period of significant skill shortages, where demands for high wage increases and improved conditions had been largely met.

We're working very closely with our employees to explain why we need more flexibility: that we can't have unproductive increases in labour costs, and that improvements in conditions have to go with productivity. We've had to make redundancies, and if we need to make more, we will. We'd much prefer however, to have our employees and their representatives appreciate that for us all to be successful, we have to be more flexible.

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Boom's Crane Logistics business booked EBIT of $21.5 million in the first half, up 14 percent, on revenue of $156.0 million, up 13 percent, with growth in Western Australia and the start-up of the Olympic Dam maintenance contract offsetting the impact of greater volatility in demand in your east coast coal markets. How has Crane Logistics' commodity exposure changed and how is the change in mix expected to impact the returns and growth prospects of the business?

**MD & CEO Brenden Mitchell**
Over the last three years we've focussed on broadening our commodity exposure and we believe that means that over time our earnings should be less volatile. At the moment our new contract with Olympic Dam is performing solidly, and iron ore is continuing to grow in volume terms so our Western Australia business is very solid, but coal is quite vulnerable. Three years ago, Western Australia and iron ore weren't performing well. By having the breadth of exposure we have now, we expect to have a more consistent earnings profile.

Broadening our commodity exposure has also meant we've been able to develop critical mass in the regions we've targeted which has enabled us to leverage our infrastructure and improve our return on capital; and this is evident in Western Australia.

I firmly believe that once we understand the new paradigm in coal, we'll be able to adjust our capital and resources accordingly to get the same returns we've been able to achieve out of coal in the past. We hope to be able to work through most of these issues in the next six months.

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In the Boom Sherrin business, EBIT increased 17 percent to $4.1 million on revenue of $29.5 million, down 13 percent. EBIT margin rose to 13.9 percent from 10.3 percent, reflecting recent restructuring to focus on the core travel towers business. Are margins sustainable at this level? What opportunities do you see for the business?

**MD & CEO Brenden Mitchell**
We think there are very strong growth opportunities in the travel tower part of our business, with the requirement for the power sector to continue to upgrade and maintain its infrastructure and with the investment in new telecommunications infrastructure associated with the NBN and 4G roll-outs. We see very strong growth over the next three years and believe overall our margins will improve: we're managing our non-core access business for cash and in travel towers we're seeking to better leverage our infrastructure to reduce costs. That's why we plan a significant capital spend on travel towers over the next three years.

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Boom generated net operating cash flow of $26.2 million in the first half, up from $22.2 million in the pcp. Excluding the impact of the transfer of an $11.5 million letter of credit from payables to borrowings, working capital increased slightly over the first half, and remains above past levels relative to sales. What scope is there to reduce the working capital requirements of the business in the shorter term?

**MD & CEO Brenden Mitchell**
We're really focusing on reducing our working capital requirements and at least returning to our previous working capital to sales ratio. Some of our blue chip customers have been paying us late, and we've been working closely with them to resolve different process issues and ensure invoicing and payment can proceed smoothly. We're seeking a significant improvement there given the requirements our customers have of us to be more efficient and supply better service. Clearly we need to be paid on terms that allow that to be done effectively. We expect a marked improvement in our receivables over the remaining four months of the financial year.

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Including capex of $42.7 million, up from $28.0 million, free cash flow after net investment was negative $13.7 million. With capex of $60 million flagged for the full year, what is your level of certainty regarding return on investment in the current environment? How indicative is this year's capex of your future investment intentions?

**MD & CEO Brenden Mitchell**
We've been focusing our capex on specific growth opportunities, particularly in the Crane Logistics business. In the case of travel towers, we're committed in FY2014 to invest $20 million in that area. Going forward, we're looking at annual replacement capital of around $30 million before any growth capital. In Crane Logistics, growth investment will be focused on new contracts with blue chip customers where our returns will justify the investment.

Assuming we're able to win contracts at the appropriate returns, we can fund up to $60 million capex comfortably and still deliver a return to our shareholders.

We'll continue to focus on improving our return on capital however this has been challenging recently. I don't think anyone would have expected coal prices to sink as much as they did or that iron ore would have such short-term volatility. One factor impacting us in the last six months, and looking forward six months, is the lack of infrastructure development on the east coast. That's the smaller part of our business, but it's where we haven't been able to get close to an appropriate level of return this financial year. We're looking for governments to invest more proactively in infrastructure that will improve our overall competiveness as a country.

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As at 31 December, net debt was $127.8 million, up from $113.8 million six months earlier. Gearing was 39.5 percent, up from 36.0 percent. Can you continue to fund capex via borrowings? What is your current balance sheet capacity to grow the business organically?

**MD & CEO Brenden Mitchell**
In the nearer term, we'll continue to fund our growth capital program out of operating cash flow and debt.

The business continues to generate strong cash flows and we have sufficient capacity in our debt arrangements to fund our capital requirements.

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Boom has not paid dividends for three years. Under what conditions might the company consider reinstating a dividend?

**MD & CEO Brenden Mitchell**
As we stated at our AGM, we're looking to pay a final dividend, for the current year, that is payment will be made in FY2014. We'll make a final assessment in relation to the form of the return closer to that time, but certainly the board is committed to getting back to delivering dividends consistently over time.

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Thank you Brenden.

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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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