SGH | Industrial Services, Media, Energy and Investments

Results Presentation –Year Ended 30 June 2015

Slide 1 – Ryan Stokes

Opening Slide

Good morning.

Welcome to the SGH Results presentation for the year ended 30 June 2015. I am Ryan Stokes, CEO and Managing Director. With me today is Richard Richards, our Chief Financial Officer.

I also want to acknowledge we have James Scott, SGH COO, Jarvas Croome, WesTrac Australia CEO, Greg Graham, CE WesTrac NSW, Michael Byrne, Coates CEO, and the SGH finance team in attendance today.

Let's go to slide 2.

Slide 2 – Ryan Stokes

Agenda

Our agenda for today – I will go through the Highlights and outlook. Richard will discuss the financial results. I will then comment on our major businesses and investments.

Slide 3 – Ryan Stokes

Disclaimer

This is our standard disclaimer. On to slide 4.

Slide 4 – Ryan Stokes

This is a quick shot of Cat equipment at Bondi Beach following the April storms this year.

Slide 5 – Ryan Stokes

Group Overview: Our Businesses

This table provides an overview of our businesses and their strategic positioning. We note that WesTrac, Coates and Seven West Media are all market leaders in their respective industries.

Slide 6 – Ryan Stokes

Group Overview: Highlights

The resource cycle has both an investment cycle and production cycle. We've seen a record investment period over the last 5 years, characterised by record levels of new equipment, and today in the production cycle we have record exports of iron ore and coal.

WesTrac Australia's product support revenue is up 13 per cent against the prior year. This is an area of continued opportunity as record resource production volumes will provide ongoing maintenance opportunities.

A key focus is to drive strong cashflow through the disciplined management of working capital – see underlying EBITDA cash conversion of 99% unchanged from FY14. We have a strong balance sheet.

Today we have declared an unchanged final ordinary dividend of 20c per share, in line with our objective of maintaining and growing our dividend over the medium term and demonstrating our confidence in the business.

The further share buyback announced in February of up to 17.7m shares will recommence subject to trading volumes and market conditions to provide value to our shareholders.

Finally we achieved an underlying EBIT of $315m for the year, which was down 14.7% on the prior year (excluding SGH Energy) and was at the lower end of the guidance range we issued at our AGM.

Slide 7 – Ryan Stokes

Key Financials

Our group revenue was $2.8 billion down 10% on the prior year.

Our underlying earnings before interest and tax was $315 million, down 16% for the year, and, as I mentioned earlier, was down 14.7% excluding SGH Energy.

Underlying net profit after tax was $204 million and underlying EPS was 59 cents per share. The full year dividend represents a 68% pay out on underlying earnings, including the 20c final dividend, payable in October 2015.

The statutory loss for the year of $359m includes a number of non-cash impairment provisions which are reflected in the $563m significant items that form the bridge to our underlying result.

Richard will take you through the financial details shortly.

Slide 8 – Ryan Stokes

Transformation

We continue to stream line our cost base and drive productivity improvements to align with the needs of our customers. This is an important and ongoing initiative.

As mentioned earlier, we are also implementing system enhancements to achieve greater efficiencies and better customer integration.

Our focus remains to build on our market leading positions across all of our businesses through efficiencies and innovation.

Our market leading positions, the strength of our balance sheet, and the capability of our management teams provide SGH the financial and operating confidence to consider new opportunities as they arise.

We also reiterate our commitment to further improve safety performance, this is important for our people and our customers. This is at the heart of everything we do across the Group.

As I mentioned the transformation journey is ongoing. While we're pleased with the results to date, there is much more we need to do in order to fully capitalise on the current production cycle.

Slide 9 – Ryan Stokes

Outlook

The market is transitioning with a focus on the production cycle. We see the record iron ore and coal production as presenting an opportunity for our business --- but it requires our business to evolve to meet the current conditions.

In Australia, the transition from the mining investment to production boom presents ongoing product support opportunities. However new equipment sales are expected to remain soft during FY16.

In China the economic transition from infrastructure to a consumption-led growth requires focus on costs and for us to look for new sector opportunities, such as standby power generation.

We aim to grow market share across all of our businesses by continually refining our cost base, driving efficiency improvements and enhancing our customer offering.

Our efforts in realising value within the property portfolio should see SGH record approximately $30m in pre-tax profit in FY16 – this will not be reflected as part of the underlying result.

All in all, trading conditions indicate that FY16 underlying EBIT will be approximately 10% below FY15, subject to there being no further deterioration in market conditions.

Now over to Richard with a more in-depth look at our financials, starting on slide 10.

Slide 10 – Richard Richards

Consolidated Profit & Loss

Thanks Ryan and good morning. Slide 10 provides a summary of both the Statutory and Underlying Net Profit after Tax for the year and I refer you to the Financial Statements contained within the Annual Report for the detailed statutory presentation and the reconciliation of Significant Items.

The Group incurred a statutory net loss after tax for the year of $359 million which was predominantly driven by non-cash impairments recognised against Seven West Media, WesTrac China, Coates Hire, AllightSykes and the listed portfolio totalling $894 million.

Underlying EBIT, excluding the earnings contribution for SGH Energy (formerly Nexus), was $320 million, down 15 per cent and in line with guidance. Including SGH Energy, underlying EBIT was $315 million down 16 per cent.

Commodity prices have continued to fall with iron ore down 37 per cent and coal down 20 per cent year-on-year. Our industrial services businesses have been impacted, with major customers responding by reducing capital investment and targeting lower operating costs, requiring our businesses to respond accordingly.

Consolidated revenue decreased by 10 per cent to $2.8 billion, principally driven by a $418 million reduction in product sales in WesTrac Australia. Pleasingly, however, product support revenue increased by 13 per cent with part sales increasing 15 per cent. This is due to increased maintenance work on installed equipment delivering record production.

Expenses, excluding depreciation and amortisation increased by 4 per cent largely reflecting the non-cash impairments. Excluding these impairments, total expenses excluding depreciation and amortisation actually fell by 9 per cent as the Group's industrial services businesses continue to reduce costs to support operating margins, resulting in an underlying EBITDA decline of 11 per cent to $377 million.

Depreciation and amortisation expense increased by $14 million, negatively impacted by a reduction in the useful life of WesTrac China's rental fleet, as well as the amortisation of customer intangibles referable to the acquisition of EMP.

Underlying net financing costs increased by $11 million reflecting higher net debt as a result of increased investments.

The underlying effective tax rate was 12 per cent, 46 per cent lower than prior year, reflecting the benefits of the proportion of fully-franked dividends as a percentage of underlying income.

Slide 11 – Richard Richards

Significant Items

Consistent with prior reporting periods, Significant Items reflect potentially non-recurrent items that arose during the year and contributed a net loss after tax of $563 million to the Group's statutory result.

Significant Items primarily relate to the Group's share of Seven West Media's television licence and goodwill impairment, reducing the carrying value of the investment in Seven West Media by $409 million, as well as the impairment of the carrying value of Coates Hire of $114 million, the impairment of the WesTrac China distribution network intangible of $237 million and the AllightSykes goodwill and intangibles.

SGH also recognised its share of Coates Hire's significant items, being fleet impairment and restructuring costs of $49 million.

Also included are the costs associated with the Group's restructuring activities which resulted in the reduction of 332 FTE positions or 7 per cent of the workforce across our operating businesses. We have also consolidation of various operating sites to facilitate lean manufacturing and enable labour productivity improvements.

Other Significant Items for the year include SGH's gain on the sale of investments and mark-to-market on derivatives and FX benefits totalling $6 million and a favourable legal judgement of $11 million relating to a legacy withholding tax case, currently subject to appeal.

Net financing costs also benefited from the recognition of $16 million of establishment and extension fees relating to the financing of Nexus during its Administration.

The tax benefit of $142 million within Significant Items relates to the finalisation of a tax objection relating to the formation of SGH, with $175m being the tax effect referable to other Significant Items.

Slide 12 – Richard Richards

Earnings Summary

Slide 12 details the Underlying EBIT result across each operating segment with an allocation of Significant Items from Slide 11, providing a reconciliation back to Statutory EBIT.

Underlying EBIT declined from $374 million to $315 million in the year, driven by a 17 per cent decrease in WesTrac Australia, partially offset by a 13 per cent increase in WesTrac China.

Coates Hire recorded a 70 per cent decline reflecting lower fleet utilisation and margin compression. This was due to a reduction in the number of large infrastructure, energy and mining projects, particularly in Western Australia and Queensland.

Media's contribution of $104 million was flat year on year but includes a $9 million benefit on converting the CPS, excluding this gain the media segment would have been down 10 per cent reflecting deterioration in advertising spend across TV and Newspapers.

The Energy Segment shows the $1 million loss realised from Bivins Ranch and Longtom operations after adjusting for acquisition costs.

Other costs relates to the corporate office which have increased 9 per cent after excluding the withholding tax judgement award and unrealised FX benefits.

Slide 13 – Richard Richards

Consolidated Balance Sheet

A summary consolidated balance sheet is detailed on slide 13.

Trade and other receivables fell $60 million reflecting the softer capital sales and by a further 88 million to the return cash collateral previously provided in favour of Santos and covering derivative positions.

Inventory levels increased by $73 million as WesTrac China built power systems stock to fulfil a major contract for data warehousing in FY16 and WesTrac Australia acquired new cores to support new component exchange and rebuild contracts.

The decline in Investments is largely due to SWM and Coates impairment offset by increases in the investment portfolio due to the acquisition of 19.9 per cent interests in Beach and Drillsearch net of the sale of our residual interest in Agricultural Bank of China.

Oil and natural gas assets increased by $376 million with the Group now wholly-owning the Longtom and 15 per cent interest in Crux gas assets in the Gippsland and Browse Basins. Also included is the 11.2 per cent interest in the Bivins Ranch asset in Texas.

Intangible assets fell $158 million reflecting the impairments recognised which were due to reductions in the medium term growth outlook of the respective businesses partially offset by the provisional recognition of goodwill on the acquisition of Nexus of $26 million as well as the Group's $21 million investment in SAP.

Provisions increases of $69 million relate to the restoration obligations and onerous contracts recognised on the acquisition of Nexus offset by a $17 million reduction in the provision for new equipment warranties in WesTrac Australia.

Net tax liabilities have decreased by $255 million which principally relates to stepping up the tax cost base of assets arising on the formation of SGH and the SWM impairment recognised in the year.

The increase in Deferred Revenue of $88 million is due to the receipt of progress payments for long term maintenance and repair contracts (MARCs) and advance payments in China for powers systems projects.

The $133 million increase in Derivative financial instruments principally relates to gains on cross currency swaps used to hedge various tranches of USPP notes.

The Group's net debt has increased by $275 million, as the Group utilised free cash flow and undrawn facilities to make net investments in Nexus Energy and built positions in Beach and Drillsearch.

Furthermore we have driven reduced operating leverage in our equity accounted investments, with the net debt in Coates reducing by $125 million and SWM reducing by $426 million.

It is also noted that the liquidity of the Group's $1.1 billion listed investment portfolio means that net debt is effectively minimal.

Slide 14 – Richard Richards

Operating Cash Flow

On slide 14, we highlight the strong cash conversion that continues to be achieved by the Group.

Despite the $46 million reduction in the underlying EBITDA for FY15, the Group's net operating cash flows increased by $42 million or 17 per cent as WesTrac Australia and China continue to focus on driving working capital. This represents underlying EBITDA cash conversion of 99 per cent for the year.

Slide 15 – Richard Richards

Total Cash Flow

The net investing cash outflows of $261 million for FY15 represents the significant investing activities including the incremental cash flow associated with the acquisition of Nexus for $48 million (net of cash acquired of $15 million), as well as the acquisition of 19.9 per cent stakes in Beach Energy and Drillsearch Energy. Offsetting this was the divestment of the remaining interest in Agricultural Bank of China.

Financing cash flows reflect the $40 million cost attributable to the share buy-back, $120 million for ordinary dividends paid and $26 million for TELYS4 dividends and increased net debt to fund additional investments.

Slide 16 – Richard Richards

Consolidated Debt Maturity Profile

Slide 16 presents our debt maturity profile.

At year end, SGH had $2.6 billion in total facilities with $967 million currently available to be drawn, $290 million in available cash. Our weighted average debt duration was 4 years.

Whilst the China facilities are reported as current, these facilities have historically been consistently renewed.

In addition to tenor, diversity of funding sources is critical to SGH's treasury risk management. SGH has maintained continued access to syndicated bank, capital markets and OEM financing across various jurisdictions.

This available capacity, when coupled with our current cash and listed investment portfolio, provides the Group with $2.3 billion of effective liquidity.

Slide 17 – Richard Richards

Capital Management

During FY15 the Group completed its on-market share buy-back of approximately 6.4 million shares at a cost of $40 million. In February we announced details of a further on-market buy-back of up to 17.7m shares. The buy-back was put on hold pending a number of potentially market sensitive corporate actions which have now been disclosed.

It is now proposed that this buy-back program will be resumed as part of SGH's ongoing capital management strategy, having regard to the current share price levels compared to the Board's view of the Company's intrinsic value.

This is consistent with the Group's ongoing capital management strategy to efficiently utilise available capital to improve shareholder returns. The buy-back will be EPS accretive and funded out of existing cash reserves.

A final fully-franked dividend of 20 cents per ordinary share has also been declared. This represents a payout ratio of 68 per cent of the underlying earnings and a 8.6 per cent cash yield or 12.3 per cent gross yield after adjusting for franking credits on yesterday's closing share price.

Slide 18 – Richard Richards

Key Financial Initiatives

The Group has a number of financial highlights.

The strength of the recurring parts and service business in WesTrac Australia is benefiting from increased production volumes which are expected to continue.

We have successful closed $2.5 billion of refinancing's, providing certainty for our businesses and demonstrating debt markets strong credit support for SGH Group.

We made significant progress towards realising substantial value across both our direct and indirect property assets, and concluded tax disputes with the ATO generated material tax benefits, as did the successful withholding tax litigation now being appealed

Finally, the investment portfolio continued to outperformance the ASX 200

Now I'll hand you back to Ryan to provide his insight into the operating performance of each division.

Slide 20 – Ryan Stokes

WesTrac Australia Overview

Thank you, Richard. Slide 20 and the WesTrac Australia overview.

Australia is producing record volumes of iron ore and coal. While much has been made of the commodity prices we think it's important to also look at the total production volumes. The graph provides some perspective.

There are more than 750mt of Iron Ore exported from WA and close to 200mt of Coal in NSW. That requires a significant amount of activity – the production boom.

There are increasing maintenance opportunities as the installed base ages. We estimate that we have approx $1bn of work-in hand and forecast recurrent maintenance revenue with our major customers.

There has been major work on the transformation of WesTrac for this cycle, including actively driving cost efficiency along with improvements to our systems, processes, and culture.

Progress continues with the ERP upgrade (S3) with the implementation of the financial, planning and administrative modules completed as scheduled in June 2015 and the implementation of the core operations and sales modules by mid-2016.

The new system and processes will help drive a step change in productivity and deliver estimated annual cost savings of $38m pa once complete.

Slide 21 – Ryan Stokes

WesTrac Australia Results

Moving to slide 21.

Continued high production levels have resulted in increased maintenance work, which is reflected in the 13 per cent growth in parts and service revenue for the period.

As the investment phase concludes there has been a reduction in the demand for new machines in the mining sector with a 57% decline over the year.

However the benefit of the increased proportion of product support revenue, together with cost management and headcount reductions were not enough to offset the impact the reduced capital sales. As a result, EBIT dropped 17 per cent to $168 million for the year.

While we made inroads in addressing our costs our work continues in driving headcount and site consolidation activity to ensure we are best positioned for the market conditions.

Slide 23 – Ryan Stokes

WesTrac China Results

The team in China have delivered a 9% improvement in EBIT to US$19.7m continuing the turnaround recorded in FY14 despite a declining construction market.

WesTrac China excavator sales were down 45% for the year although we significantly grew our market share over the same period. The growth in data warehouses resulted in strong demand for standby-by power generation which partly offset the decline in excavator sales.

We are seeing signs of the market maturing with the growth in market share. The value proposition for the quality CAT product is being recognised and accepted by customers along with the effective work of our WesTrac China team.

The benefit of cost management, headcount reductions, and increased proportion of product support revenue offset the impact of the 22 per cent reduction in capital sales and resulted in EBIT margin improvement from 3.2% to 4.2%.

Slide 25 – Ryan Stokes

Coates Hire

Coates is the market leading equipment hire company in the country with approximately $1bn of equipment at WDV.

SGH effectively owns 46% of Coates and recognises it as an equity accounted investment.

Revenue was down 16% for the year, negatively impacted by major mining and infrastructure projects such as CSG-LNG construction nearing completion. This was partly offset with increased infrastructure and residential construction activity in NSW. We expect trading conditions to remain competitive.

The strategic priorities are clear. To grow share of wallet – increase market share, sweat the assets harder, focus on costs, cash flow, and grow profit.

In addition site consolidation, headcount reductions and procurement initiatives have been undertaken.

The Coates team have also successfully refinanced their $1.2bn syndicated debt facilities for a further 4 years with increased covenant headroom providing flexibility to support future growth strategies.

Slide 27 – Ryan Stokes

Media Investments P&L

The contribution to SGH Group EBIT from Media of $104m was largely unchanged from the prior year. The underlying profit contribution from Seven West Media ordinary equity is $66 million and the convertible preference share instrument contributed $38 million.

This period saw continued leadership in TV with Seven recording a 40 per cent revenue share in the year ended June 2015 and with market share growth in Digital and Magazines. Seven has secured long term deals for key sporting rights and it will be first to stream to mobile all its broadcast channels.

Despite the current advertising environment, SWM has focused on and delivered unchanged share and leadership while driving cost efficiencies, with newspaper costs down 4.8 per cent, magazines down 8 per cent and TV costs down 1 per cent.

While the company performed well in a difficult market, underlying EBIT of $356 million was down 13 per cent on the prior year.

Disciplined capital management together with a $308m capital raising are reflected in the 37% net debt reduction to $733 million.

Finally SWM has provided guidance that FY16 underlying EBIT will be 5-10% down on FY15.

Slide 29 – Ryan Stokes

Energy – East Coast Update

A key theme underpinning our energy strategy is the anticipated shortage of East Coast gas coinciding with the ramp up of the 3 LNG export facilities at Gladstone in 2017/2018. We still believe in this thematic.

In addition Australia’s proximity to the Asian LNG market energy demand growth represents a strong comparative advantage.

Our East Coast gas assets namely the Longtom and Gemfish resources are located in the Gippsland Basin off Victoria and are ideally placed to service this demand.

As a result of our agreement to terminate the Longtom contract with Santos, SGH Energy is better placed to pursue improved gas supply agreements or other options.

To support our initiatives we have the SGH Energy team, a small and highly experienced team along with the appointment of David McEvoy to the board and we retain Don’s expertise on a consultancy arrangement going forward.

Slide 30 – Ryan Stokes

Energy – WA and USA update

In WA we are focussed on pursuing the earliest development option for our Crux joint venture and have completed the drilling of the Auriga test well with test results still in the process of being analysed.

With Auriga while we can’t be definitive in the outcome we can say the drilling has found hydrocarbons.

At Bivins Ranch in Texas which is operated by Apache Corporation. We are confident in Apache’s ability to maximise value from the field.

Slide 32 – Ryan Stokes

Investments Profit and Loss

The contribution to segment EBIT of $39 million was driven by dividends from the listed investment portfolio. The $3 million net gains realised on shares and derivatives have been excluded from this result and treated as a Significant Item.

Slide 33 – Ryan Stokes

SGH Property Portfolio

We have reached practical completion for Kings Square 3 in July, Kings Square 2 in August, and Kings Square 4 is scheduled for PC in early September.

King Square 6-7, which we own outright, has received the development approval for a 563 apartment residential development. We are going to explore partnership options.

The redevelopment of the Chanel Seven Perth site, Seven Hills, will commence later this year. The site is anticipated to yield approximately 80-100 residential blocks.

Our property initiatives are anticipated to yield a ~$30m pre-tax gain in 2016.

Slide 34 – Ryan Stokes

SGH Investment Portfolio

During the financial year our listed investment portfolio again performed well, providing the Group with $42 million in dividend income at a gross yield of 6.1 per cent. The period saw a $34 million net economic gain on the investment portfolio, of which a net $3m was realised.

During the period, $234 million was realised through the sale of listed investments offset by derivative settlements, and investments made during the period at a cost of $378 million which included the acquisition of 19.9 per cent stakes in Beach Energy and Drillsearch Energy.

At 30 June 2015, the listed portfolio had a market value of $1.1billion which included net unrealised gains of $241 million. An impairment provision of $26m has been recognised in the P&L as a significant item. The balance of these net gains do not form part of the Group's profit result and are included within our reserve balances and will be released to the P&L when the investments are sold.

Slide 35 – Ryan Stokes

Outlook: Key Takeaways and Questions

I want to leave you with some key messages about the Group.

Firstly, we are well positioned for this resource production cycle with our WesTrac parts and service support model.

Secondly, we have a strong balance sheet and cash flow generating businesses.

Thirdly, we remain focused on the transformation process for our businesses in this cycle, through driving cost and efficiency. That work continues.

Improving productivity, cost efficiency and strengthening our market-leading positions is a focus for SGH.

We continue to make efficient use of available capital. This also includes the share buy-back and our objective to maintain and grow our dividend over time, as part of our overall capital management.

Trading conditions indicate FY16 underlying EBIT to be 10 per cent below FY15, subject to there being no further deterioration in market conditions.

Thank you. We would be pleased to take your questions at this time.