MD on FY2015 Outlook

Open Briefing interview with MD Brenden Mitchell

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In this Open Briefing®, Brenden discusses:

- New opportunities provide some signs of upside
- Strong free cash flow supports debt reduction
- Capex needs remain limited

Record of interview:

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Boom Logistics Limited (ASX: BOL) today reported a statutory net loss of $79.5 million for the year ended 30 June 2014, compared with a loss of $2.5 million for the previous year. Trading EBIT was $14.0 million, down from $26.0 million. Trading EBIT dropped to $1.5 million in the second half of FY2014, down from $8.2 million in the previous corresponding period and $12.5 million in the first half. How do current trading conditions compare with those in the second half, and are there any signs that the market has bottomed?

MD Brenden Mitchell
It is difficult to say that the market has bottomed, but we believe our business has come through the worst of it. We're still seeing the same continuing pressures and issues in the coal sectors in New South Wales and in mining in Western Australia. Wherever there is mining there are challenges in terms of pricing pressures and competition. A number of projects are coming off line and there are more cranes coming into the market and competing for our type of work.

Offsetting this, we have specific contracts giving us work that is known and planned, and newer contracts coming on line in infrastructure. We're seeing opportunities, for example in wind farm and high voltage transmission work, and we've signed new clients such as Aurizon. In most of these cases, factors other than just pricing count. So from this perspective, we believe our business has bottomed.

Nevertheless we continue to focus on restructuring the business to better serve our customers who are still under significant pressure. And we continue to strive to achieve flexibility in the business so we can respond to the continuing volatility in demand.

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One feature of your FY2014 result was your strong cash flow. Free cash flow was $25.0 million, compared with negative free cash flow of $1.4 million in the previous year, and Boom reduced net debt to $89.5 million as at 30 June 2014, down from $115.8 million a year earlier. Gearing stood at 38.2 percent, versus 37.0 percent, and you've indicated that debt reduction will remain a priority in the year ahead. What level of gearing do you see as appropriate for the business?

MD Brenden Mitchell

Our perspective based on the current market conditions is that a gearing level of 30 to 35 percent is appropriate. The fact that we've been able to reduce debt, as we set out to do, we believe should provide some comfort for the shareholders who have supported us in a very difficult environment.

We believe it's important to reduce debt further and ensure our balance sheet is in order so we can focus on delivering to the emerging infrastructure projects and drive higher returns in future.

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Boom had operating cash flow of $25.3 million FY2014, and capex of $15.9 million, with free cash flow benefitting from $17.3 million in sales of non-core assets. Boom had $15.5 million of "assets held for sale" on its balance sheet as at 30 June. Can the business continue to generate positive operating cash flow in the current environment? To what extent will further debt reduction depend on asset sales?

MD Brenden Mitchell

We believe we can continue to generate good operating cash flow from the core operations, and asset sales will add to that. We're confident we'll be able to sell our non-core and surplus assets given our success in the last 12 months. Following our asset sales over the past year, the average age of our crane fleet has been maintained at around nine years and that's a good outcome for the business. We're still in a position to support our customers with quality equipment, and we expect our maintenance spend to reduce because we've targeted the sales of older surplus assets.

We'll continue to use proceeds from the sale of non-core and surplus assets to pay down debt and we should still be in a position to undertake some targeted capital expenditure in response to specific customer demands.

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Capex totalled $15.9 million in FY2014, well down from $62.3 million in the previous year, and you've indicated that your fleet is well balanced and sufficient to meet current demand. In light of your new client opportunities, what is the expected level of capex going forward?

MD Brenden Mitchell

We expect capex in the order of $15 million to $20 million in the current year, of which $5 million to $6 million would be maintenance capital. Not a significant amount of capex is currently committed so we remain flexible. A number of assets have been released out of the BMA contract and while some will be sold, others can be distributed to parts of the business where we see growth opportunities.

We don't foresee any major capex requirement in the medium term. Our current fleet is relatively young and we have some flexibility to move assets in response to client requirements. Given the relative oversupply in some segments of the market, we also see opportunities where we might be able to work cost-effectively with other fleet owners, rather than investing in new assets ourselves, to service particular contracts.

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Boom's result included a goodwill impairment charge of $70.8 million, and the company now carries no goodwill on its balance sheet. Other non-trading items included restructuring charges of $8.2 million, versus $6.8 million in the previous year, and asset impairment charges of $9.3 million versus $11.0 million. What was the rationale for reducing goodwill to zero, and will further significant restructuring of the business be required in the current year?

MD Brenden Mitchell
Whilst we expect some improvement in the market in the medium to long term, particularly due to infrastructure demand, given the continuing volatility in demand, we've taken a conservative approach to valuing the goodwill and have written it off. Under accounting standards, we have to value goodwill on the basis of projected cash flows in the current financial year, that is FY2015. We've taken a prudent approach to estimating our current year cash flows given market conditions make it difficult to predict outcomes with any certainty. We've also taken into account recent ASIC guidelines that say that where there has been significant disparity between actual cash flows and budgeted cash flows, asset values should be reviewed. This has been the case for Boom. This is a non-cash adjustment, and doesn't impact actual cash flows.

Other than the Queensland and One Boom restructuring, we don't have plans for further significant restructuring. This year we're focussing on the One Boom integration, and any additional restructuring will relate to working through issues as they arise. For example, where there are opportunities, we might see sense in moving assets closer to those opportunities, and that might require adjustments to existing operations.

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Boom has taken significant costs out of the business in recent periods, and the One Boom project is expected to further streamline operations by merging the Crane Logistics and Boom Sherrin businesses. Can you quantify the annualised impact these initiatives will have on your cost base and the expected impact in the current year?

MD Brenden Mitchell
We have a general plan to reduce overheads by at least 1 percent of revenue in the current year, some of which will come from work already done. Our significant recent investment in systems and improving business processes will support further operating efficiencies.

The purpose of the One Boom integration is more about the interface with our customers than about taking costs out. We believe there are opportunities to grow revenue by bringing the skills, experience and value proposition of our travel tower and crane logistics businesses together, and giving our sales people a more focused approach. While One Boom will bring us some opportunities to consolidate properties and overheads, its focus is on delivering the right revenue outcomes through the integration and our people will be key to delivering those outcomes.

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Boom has done a lot of work in recent periods to renegotiate existing EBAs with its workforce and one of your priorities in the current year is improving the company's labour cost base so that it reflects recent changes in market conditions. What is the "right" labour model for Boom and how would having the right model in place impact your cost base and competitive position?

MD Brenden Mitchell
The right labour model for Boom is one that best delivers for our customers. That means working with our employees to clearly understand customer demand and responding to that in a way that's cost effective, secures employment for our people and gives them the opportunity to earn a good, viable income. Importantly, we also need to be able to recover our labour costs from our customers. That may mean different labour models in our different depots around the country, including more flexible EBAs in locations where demand is more variable.

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Boom had transitioned out of its loss-making contract with BHP Billiton Mitsubishi Alliance (BMA) as of 30 June, and you've continued to win new clients, including non-resources clients such as Vestas Wind Farm and Aurizon. What are Boom's key new client

opportunities in the nearer term and how does the structure of your new contracts differ from past contracts such as BMA?

MD Brenden Mitchell

We don't want to say too much about new client opportunities because of competition issues. But I can comment on the structure of the BMA contract. The contract was set in a time when demand was exceptionally strong, and it required a significant number of assets and people to service it effectively. The utilisation of the assets was very high and the contract required us to make available a certain number of assets at the mine sites. So we were committed to a certain amount of capital, but a reducing revenue stream and a high level of volatility meant that we couldn't recover the cost of those assets or the costs of our labour.

In structuring our contracts going forward, we're looking to base them on the utilisation we can achieve out of assets for each project and ensure we don't lock in assets unless there is a specific demand for them.

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Boom received a "first strike" at its AGM last year, with over 25 percent of shareholders voting against its remuneration report. What have been the key shareholder issues regarding the remuneration report and how has the company sought to address them?

MD Brenden Mitchell

It's worth noting that quite a number of shareholders didn't vote at the AGM, and that the "strike" represented 25 percent of the shareholders who actually lodged a vote. In discussions with shareholders post the AGM, there seemed to be some misunderstanding around bonuses that were paid in FY2013, but which actually related to FY2012, a year in which Boom exceeded its targets.

In addressing the issue, we've made it very clear that in terms of remuneration we recognise the state of the economy in general and how our business is performing in particular. Our senior executives have all agreed to a salary freeze, which started in July 2012 and is continuing for a further 12 months. In addition, as noted in the FY2014 remuneration report, I've also requested a 10 percent reduction in my salary in the current year, as an indication of our commitment to our shareholders. We also hope this will help our people understand that we need to be flexible and adjust to the climate we're in.

In addition, our senior executives have again agreed to forego their short term incentive plan, which is part of their contracts, for the next 12 months. This recognises that paying a short term incentive would not necessarily send the right signal in the current environment. We're trying to send a signal to our people and our shareholders that as a group we're committed to delivering better shareholder returns. It's appropriate that in these circumstances we lead by example.

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Boom has indicated that once market conditions have stabilised and you have some clear foresight of future activity, you will initiate a share buy-back. Can you provide any indication of a time line for a buy-back? Given Boom has not paid a dividend for four years, why do you prefer a buy-back over a dividend as a way of making a return to shareholders?

MD Brenden Mitchell

Our share price is well below our net tangible asset value of $0.49 per share. So the most effective way of giving value to shareholders is buying back shares at a discounted rate. Also, a buy-back would be more tax-effective for our shareholders as the company currently has no franking credits.

Conditions are volatile at the moment, and we would have to see signs that conditions were improving and that infrastructure demand was coming on line before we considered any buy-back activity. Most observers are saying that infrastructure spending in Australia, outside the major gas projects that are beginning to tail off, is not likely to increase significantly for another 12 months at least. When it does, we think we'll be in a good position to successfully win work and therefore deliver returns to shareholders.

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Thank you Brenden.

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

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