SGH | Industrial Services, Media, Energy and Investments

Results Release – Six Months Ended 31 December 2018

Slide 1 – Ryan Stokes

Opening Slide

Good morning and welcome to the Seven Group Holdings results presentation for the six months ended 31 December 2018.

I am Ryan Stokes, CEO and Managing Director.

With me today is Richard Richards, Group CFO, who will present the financial results for the half year.

Slide 3 – Ryan Stokes

Group Overview

This slide provides a recap of the SGH story. We have a strong Industrial Services segment led by WesTrac and Coates Hire. We are leaders in providing equipment solutions to major customers in the mining, construction and infrastructure sectors.

In the energy sector, our investment in Beach Energy is aligned to the rising demand for East Coast gas. Beach has retained its position as the lowest cost oil producer in the Cooper Basin. Our SGH Energy assets provide further opportunities to create value.

In media, we are the largest shareholder in Seven West Media, the leading free-to-air television broadcaster.

On to slide 4.

Slide 4 – Ryan Stokes

People, Safety and Culture

As a Group that employees more than 5,600 people, and in the industries that we operate in, the safety and welfare of our people will always be a priority. Our safety statistics have improved across the Group's businesses in the past six months, and we are targeting further improvements through safety culture and staff engagement programs.

Safety is more than a mere right to work with our major customers, it is a comparative advantage and key part of our customer and employee value proposition.

On to slide 5.

Slide 5 – Ryan Stokes

Group Highlights

SGH has repositioned over the past 18 months to take full advantage of three principal growth opportunities – mining production cycle, infrastructure investment and East Coast energy demand. The results for the half year reflect these pivots and the delivery of strategic initiatives to drive earnings growth for the company.

Group EBIT for the half increased by 68 per cent to $375 million driven by revenue growth in all businesses and improved margins, reflecting operating leverage and cost discipline. Trading revenue increased by 45 per cent to $2 billion for the half while the share of associate net profits increased by 56 per cent.

WesTrac again achieved record parts shipments during the half, up 27 per cent on the prior corresponding period. Customer demand continues to build as the customer fleets work harder. This half also saw an increase in autonomous conversions to existing fleet, proving Cat's advantage in autonomous haulage.

Coates Hire is competing aggressively while continuing to enhance its operating model, however like others in the sector, project transition delays have impacted momentum.

Beach continues to outperform, as evidenced by its recent upgrade to production and EBITDA guidance. Their strong free cash flow means the business is targeting to be debt free by the end of this quarter.

The performance of the Group at an operating level has been supplemented by further strengthening the balance sheet. The conversion of the TELYS4, refinancing of the corporate facility and the issue of convertible notes have enhanced the Group's capital structure and materially lowered our borrowing costs.

This has also allowed us to reinvest in our businesses, through additional WesTrac parts inventory, reinvestment in Coates Hire fleet, and additional investment in Beach, all of which reflect our confidence in their respective opportunities.

On to slide 6.

Slide 6 – Ryan Stokes

Key Financials

Underlying EBIT for the half was up 68 per cent to $375 million or 40 per cent on a pro-forma basis after adjusting for Coates Hire consolidation in the prior corresponding period. Underlying net profit after tax was up 61 per cent to $257 million.

Underlying earnings per share was 78 cents, up 59 per cent on the prior half.

Underlying EBTIDA cash conversion for the half was 59 per cent, an improvement from the prior half. Cash conversion was impacted by a higher proportion of earnings from equity accounted investments, together with the growth in WesTrac and the corresponding increased investment in inventory.

On a statutory basis, EBIT was $178 million and statutory net profit after tax was $60 million, primarily as a result of the impairment of the SWM investment on a mark-to-market basis.

Today we have declared an interim fully franked ordinary dividend of 21 cents per share.

I will now hand over to Richard to take you through the Group's financials for the half-year.

Richard.

Slide 8 – Profit and Loss

Thank you, Ryan and good morning.

Slide 8 provides both the statutory and underlying net profit after tax for the period. I refer you to the 4D for the detailed statutory presentation.

This profit result reflects the Group's strong financial performance across all of our operating businesses and below the line benefiting from our recent capital management initiatives.

Group underlying EBIT of $375 million was up 68 per cent against the prior corresponding period. To add context to this outstanding result, this half has delivered more in underlying earnings than each full year from FY14 through FY17.

Consolidated trading revenue was up $629 million or 45 per cent to $2 billion.

Product sales revenue of $461 million was up $110 million or 31 per cent off strong mining and construction sector demand.

Product support revenue of $1.1 billion was up $187 million or 21 per cent. All of our major customers increased their level of demand, driven by a need to execute maintenance plans that were deferred in recent years.

Equipment hire revenue for the half was $489 million up $334 million or 215 per cent on the prior corresponding half which included approximately two months of consolidated Coates Hire revenue.

Ryan will discuss each segment's specific financial result later in his presentation.

Results from equity accounted investees improved 56 per cent to $114 million, including an additional $54 million contributed by Beach Energy to the Group result.

Other income reduced by 15 per cent to $30 million, due to a combination of lower dividend income from the listed portfolio, lower distributions from an unlisted offshore media fund and the fair value movement of derivatives. Partially offsetting these were a gain on disposal of fixed assets in Coates Hire and gain on restructure of the Group's property investments.

Expenses, excluding depreciation and amortisation, increased by 38 per cent to $1.7 billion. Within this, materials cost of inventory and sales increased by 27 per cent to $1 billion and employee benefits expense increased by 48 per cent to $387 million. Excluding Coates Hire, employee benefits expense was up 16 per cent and consistent with the 14 per cent increase in WesTrac FTEs over the year.

Increases in repairs, maintenance and consumables of $56 million mainly related to the consolidation of Coates Hire for the full period.

The relative difference between revenue and expense growth reflects the operating leverage inherent in our main businesses.

Depreciation and amortisation expense were stable within each business, however, the consolidation of Coates Hire for the full period resulted in a $45 million increase for the Group.

The Group's underlying effective tax rate increased to 21 per cent in the half, reflecting a more normalised rate for the Group. The lower rate in the prior corresponding period also reflected the utilisation of unbooked capital losses.

Slide 9 – Significant Items

Significant items reflect non-recurrent items that arose during the year. During the half, the decline in the SWM share price resulted in an impairment of $225 million to the book value of our investment, reflecting its market value as at 31 December.

There was no tax benefit associated with this given that the impairment expense is not deductible for tax purposes. This results in the Group's effective tax rate for the year being 45 per cent.

Partially offsetting this was a $29 million gain on the mark-to-market of the option embedded within the convertible notes.

These items totalled $197 million and reduced the underlying net profit after tax of $258 million to $61 million on a statutory basis.

Slide 10 – Earnings Summary

Slide 10 details the underlying EBIT result across each segment, providing a reconciliation to statutory EBIT after allocation of the significant items from Slide 9.

Slide 11 – Cash Flow

Underlying operating cash flow was $276 million, an increase of $122 million from the prior corresponding half. This represents underlying EBITDA cash conversion of 59 per cent, which is a slight improvement for the half. Operating cash has been impacted by the growth of WesTrac and the continued investment in machines and parts, given the strength of the mining demand pipeline, and stocking to partially mitigate increased lead times.

Cash flow from investing activities utilised $216 million which included $111 million for the additional three per cent investment in Beach, $82 million in Coates net capital expenditure and $24 million in other capital expenditure in WesTrac, offshore media investments and the Crux Project.

Cash flow from financing utilised $45 million, comprising $67 million in ordinary dividends, which was offset by net debt drawdown of $22 million.

The net cash outflow for the period was $29 million and net debt, after considering FX movements increased by $86 million to $2.1 billion.

Slide 12 – Cash Flow by Segment

Slide 12 highlights the EBITDA cash conversion by segment.

WesTrac, after investing in inventory to fund its growth achieved 65 per cent, while Coates Hire, through strong working capital management, achieved 88 per cent conversion.

Cash conversion has also been impacted by the increased proportion of non-cash earnings from equity accounted investments.

However, in the case of both Beach and SWM, their free cash flow has been applied towards debt reduction and strengthening their respective balance sheets, of which the Group is supportive.

Slide 13 – Balance Sheet

The Group had net assets of $2.9 billion as at 31 December increasing $49 million during the half. This reflects the $61 million statutory net profit for the period, along with increases to shareholder equity of $32 million to reflect shareholder approval of the convertible notes and $33 million to reflect the net change in fair value of financial assets measured through other comprehensive income. Offsetting these was the ordinary dividend payment of $67 million in the half and the tax effect of income recognised via OCI of $9 million.

Trade and other receivables reduced by $89 million, driven by improved debtor days within WesTrac and the elimination of Coates receivables on consolidation.

Inventories increased by $81 million due to selected investments by WesTrac in parts and components to support future sales growth. Committed sales in WesTrac have increased significantly compared to the same time last year, supporting the Group's decision to further invest in the business.

The value of investments increased by $36 million, reflecting the additional investment of $111m in Beach, together with the share of associate net profit. Offsetting this was the mark-to-market impairment of the SWM investment.

It should however be noted that the unrecognised profit on our investment in Beach Energy currently is $607 million.

Provisions decreased by $29 million mainly due to a reclassification of warranties to deferred income, consistent with AASB 15.

Derivative financial instruments movement of $93m includes the favourable mark-to-market of cross currency swaps hedging the Group's USPP. In addition, the $61m previously recognised as the fair value of the option embedded in the convertible notes has been reclassified with $32 million now recognised in equity and $29 million realised as income for the half.

Net tax liabilities of $346 million include an increase in the current tax liability of $82 million, consistent with the increase in effective tax rate.

Slide 14 – Capital Management

The strong operating results across the Group are enabled by a balance sheet that has supported our growth initiatives and allowed us to reinvest. The capital structure has been further enhanced during the half and our effective cost of funds has materially reduced from a year ago.

Initiatives such as the TELYS4 conversion and the issue of convertible notes were executed to plan and were met with strong support from the market, while our banking syndicate was supportive of the $1.3 billion refinancing of the corporate facility, which achieved an increase in facility size and extended tenor.

There is no better example of the value delivered by these funding initiatives than our net interest expense line for the half, which increased by $3 million, notwithstanding more than $1 billion in Coates Hire debt acquired.

We anticipate further opportunities to reduce our funding costs as historical borrowings such as the USPP mature.

At 31 December, the Group held $2.8 billion in total facilities with $704 million undrawn and $77m in available cash. Average facility tenor is 4 years with the next major refinancing still three years away. The gearing ratio for the Group is currently 42 per cent, however taking into account the listed portfolio and the market value of Beach in excess of its book value and debt related derivatives this decreases it to 29 per cent.

Now I'll hand you back to Ryan who will provide a more detailed review of the operating performance of our businesses.

Slide 16 – Ryan Stokes

WesTrac Australia Highlights

Thank you, Richard. On to slide 16.

WesTrac's strong operating performance continued in the half, driven by mining production at record levels, an increase in fleet utilisation by customers, and a growing average fleet age which is approaching 10 years.

Customers are continually looking to extract greater productivity, with the use of sophisticated maintenance programs to support the fleet and extend equipment life, driving the demand for parts and service.

WesTrac also benefited in the half from an increase in machine rebuilds and strong customer demand for autonomous conversion of existing fleet, with 48 kits supplied, more than double the 22 kits in the prior year.

We are also seeing other opportunities beginning to emerge in rare earth metals and through the resurgence in gold production.

Slide 17 – Ryan Stokes

WesTrac Australia Results

WesTrac is delivering financial performance across all aspects of the business. Revenue growth was achieved in WA and NSW, in mining, in large and general construction, and both in new equipment sales and product support.

A record 3.5 million parts were shipped in WA and NSW during the half, up 27 per cent on the prior corresponding period. Product support sales were up 22 per cent or $187 million. This reflects the quality of the CAT product which is allowing customers to extend equipment life, backed by WesTrac's ability to service through parts and maintenance.

Product sales were up 33 per cent to $432 million for the period with market share increases achieved across mining, infrastructure and construction segments.

WesTrac's EBIT for the half of $150 million was up 49 per cent and EBIT margin expanded from 8.4 per cent to 10.1 per cent, reflecting the operating leverage and cost discipline.

Looking ahead, the current level of committed sales is higher than the same time last year, and recent investments in selected parts and component inventory will support the expected level of forthcoming sales.

Slide 19 – Ryan Stokes

Coates Hire Highlights

Coates Hire remains the market leader in rental equipment, with a branch network and product range capable of servicing multiple market segments across all states. This is a comparative advantage in the current environment, where notwithstanding the size of the infrastructure investment pipeline, the overall market appears subdued due to project transition delays and unseasonal weather.

The east coast continues to perform, although Queensland has slowed, Victoria remains strong and WA is showing signs of growth.

Time utilisation was slightly lower over the half, mainly limited to certain product categories, and not a broad-based decline across the business. Pleasingly, financial utilisation improved by 3.2 per cent, driven by economic discipline with management focused on maximising the rate of return on new and existing fleet.

Coates has increased market share and will continue to utilise its scale, together with specific actions, including digitisation to maintain and grow market share in the second half.

Slide 20 – Ryan Stokes

Coates Hire Results

Despite the competitive market conditions, Coates Hire delivered revenue growth of 3 per cent in the half to $493 million.

EBIT of $102 million was up by 20 per cent and EBIT margin expanded from 17.8 per cent to 20.5 per cent, reflecting the degree of operating leverage in the business, improved rate of return on assets, and cost discipline.

Operating cash of $134 million was generated in the half at an EBITDA cash flow conversion rate of 88 per cent. Net capital expenditure in the half was $82 million

Looking ahead, our priority remains on maximising return on investment and free cash flow, through strategies to optimise the way fleet is priced, managed and utilised, and ensuring that the business is positioned well for market opportunities through the cycle.

Slide 22 – Ryan Stokes

Beach Investment

The Group invested an additional $111 million in Beach in November, increasing our stake in the company to 28.6 per cent with a current investment value of $[1.3] billion. This reflects our confidence in management's ability to execute its vision of being Australia's premier multi-basin upstream oil and gas company.

Our strategic investment to capture East Coast gas demand has delivered with Beach reporting production above market expectations and a shift in production mix post the Lattice acquisition. The integration process for Lattice is complete, ahead of schedule, with higher synergy benefits of $60 million, as well as strong operating cash flow that will see the company debt-free upon completion of the Otway sell down by the end of this quarter, two years ahead of target.

The expanded portfolio has diversified Beach's traditional reliance on oil production, with gas now representing more than 60 per cent of production and a substantial reserves replacement opportunity. This positions them favourably in a tight East Coast gas market.

Beach announced a strong first half result with production up 193 per cent on the prior corresponding period to 15.2 Mmboe, and operating cash flow of $479 million for the half. The Group's share of NPAT for the half was $77 million, up 241 per cent or $54 million on the prior corresponding period.

Beach has upgraded its guidance for FY19, with production now expected to be 28 to 29 Mmboe and EBITDA guidance has increased by $200 million to $1.25 to $1.35 billion. Development activity is set to accelerate in the second half through value-accretive projects in the Western Flank and onshore / offshore Otway.

Slide 23 – Ryan Stokes

Other Energy Assets

The Group holds a 15 per cent interest in Crux, an important part of Shell's gas portfolio as the primary source of backfill to the Prelude FLNG project. Crux FEED contracts have been awarded and an 18-month work plan is underway ahead of a final investment decision (FID) in mid 2020.

Crux represents a further opportunity for the Group to deliver a return on investment from its energy assets, either by capitalising on the strong investor demand for Australian LNG assets, or by delivering LNG volumes into a global market projected to be under-supplied in the mid 2020's.

Longtom is a 100 per cent owned asset in the Gippsland Basin. We are continuing to evaluate pathways to market. We have the potential to supply 80 PJ via Longtom and approximately 135 PJ via other Gippsland Basin resources to East Coast gas users.

Slide 25 – Ryan Stokes

Seven West Media Highlights

Seven West Media is the #1 television network, marking its 12th consecutive calendar year of ratings leadership in 2018. The AFL and cricket provide year-round coverage of the leading sport in each season, enhancing the audience reach that is critical to advertisers wanting to build their brands.

The media operating model continues to evolve. Seven West Media has delivered pleasing results in digital through 7plus, together with growth in production and distribution through Seven Studios.

Cost reductions remain a focus throughout the business. The net group cost savings target has increased to $30-40 million in FY19, up from previous guidance of $10-20 million.

Seven West Media's underlying EBIT of $147 million for the half was down 4 per cent on the prior corresponding period. Group costs were flat after taking into account the cricket. Group net debt was reduced by $121 million.

Overall, the Media segment contributed EBIT of $42 million in the half, down 20 per cent on the prior corresponding period. This includes a $4.5 million reduction in distributions from the Group's investment in an unlisted offshore media fund.

Looking ahead, Seven West Media expects FY19 underlying EBIT to grow by 0 to 5 per cent, despite softer ad market conditions extending through Q3.

Slide 26 – Ryan Stokes

Listed Investments

We have traditionally held the listed portfolio as a store of value and source of additional yield for the Group. It has also facilitated other investments such as Beach, which we subsequently moved into our Energy segment.

As at 31 December 2018, the market value of the portfolio was $325 million.

Subsequent to the balance date, and in line with our intention of divesting the portfolio over time, we have sold $96 million in shares from the portfolio.

Slide 28 – Ryan Stokes

Outlook: Key Takeaways and Questions

The Group has delivered a strong first half result underpinned by our three growth drivers, being the mining production cycle, infrastructure investment and East Coast gas demand.

We are delivering earnings growth through focused initiatives in each business targeting revenue growth, efficiency and cost discipline. All of our businesses are delivering. We are unlocking operating leverage across the Group while maximising free cash flow and maintaining a strong balance sheet, providing us with flexibility to pursue further strategic growth initiatives.

WesTrac continues to benefit from the strong mining production cycle, with high levels of fleet utilisation and an ageing fleet profile driving the demand for parts and maintenance.

Coates Hire is positioned well to capture new revenue opportunities and win market share. While the market remains competitive, the infrastructure pipeline remains strong with ongoing potential as new projects as committed.

Beach has continued its positive trend of outperformance on production volume, pricing, and field operating costs as reflected in its recent guidance upgrade. Crux has a clear pathway to market and is now progressing through FEED towards a mid-2020 final investment decision.

At Seven West Media, continued ratings success and an expanded cost reduction program are expected to result in FY19 underlying EBIT growth of 0 to 5 per cent despite softer ad market conditions.

We reiterate that FY19 underlying EBIT expected to be approximately 25 per cent above FY18 underlying EBIT on a continuing operations basis.

Slide 29 – Ryan Stokes

Disclaimer

Finally, this is our standard disclaimer.

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