SGH | Industrial Services, Media, Energy and Investments

Results Release – Full Year Ended 30 June 2019

Slide 1 – Ryan Stokes

Opening Slide

Good morning and welcome to the Seven Group Holdings results presentation for the year ended 30 June 2019.

I am Ryan Stokes, CEO and Managing Director.

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

Slide 3 – Ryan Stokes

Group Overview – Businesses and Markets

We have a summary of our key businesses and the value proposition within the markets they serve. SGH is a diverse company with a strong Industrial Services segment.

Through WesTrac and Coates, we hold market leading positions in equipment solutions for major mining and a diversified set of infrastructure and construction customers.

The equipment and solutions we provide support our customers to meet their construction and mining requirements most efficiently, through quality products, leading technology, and high levels of after-sales support.

Beach Energy, in which we own a 28 per cent stake, is a key supplier of gas to the East Coast market, with a portfolio of development and exploration opportunities to grow production and reserves. Our SGH Energy assets also provide opportunities in domestic gas and LNG exports.

In media, we hold a 41% interest in Seven West Media, one of the largest media companies in Australia.

On to slide 4.

Slide 4 – Ryan Stokes

Group Overview – People, Safety and Culture

Our people are committed to supporting our customers with high standards of service, support and innovative thinking. This is a key attribute of the culture across all our businesses, making our people our most important asset.

We therefore have a duty to protect the safety and welfare of our people, and we continue to expand our commitment through leadership and safety cultural programs, such as the "Built By Us" program in WesTrac.

Safety is our top priority. While we have made positive progress on our key metrics we are aiming to continuously improve in this area.

On to slide 5.

Slide 5 – Ryan Stokes

Group Overview – Highlights

Our businesses have performed strongly in FY19. The full year result announced today is in line with the upgraded guidance that we provided in April, with Group underlying EBIT of $695 million for the year, up 40 per cent on FY18.

The result reflects the level of operating performance achieved by our businesses across the three growth thematics of mining production, infrastructure investment, and domestic energy demand.

This year's result has delivered robust, sustainable growth in revenue and underlying earnings. Revenue was up 27 per cent to $4.1 billion. EBIT margin expanded to 16.1 per cent. Operating cash flow of $411 million was up 62 per cent on the prior year.

The Group is generating more than double the underlying EBIT than it was in 2016.

This has been led by the performance of WesTrac, which saw continued growth in parts demand during the year. WesTrac set a record for parts lines invoiced, up 11 per cent to 6.4 million, driven by customer demand to maintain high machine utilisation rates and extend equipment life. This was boosted by growth in new equipment sales and the continued adoption of autonomous technology.

Coates delivered earnings growth despite a relatively stable revenue base. Its diversified end markets and limited exposure to the residential construction market has helped insulate against the trends recently seen in the wider construction and building materials sector. The growing pipeline of infrastructure projects will continue to create opportunities over the medium to long term.

Beach's strong operational results were delivered through production growth, facility reliability and high customer demand, resulting in SGH's share of Beach NPAT more than doubling to $158 million. We are pleased to see Beach finish the year in a net cash position.

FY19 also saw some significant milestones on Crux, which is more than half-way through FEED and has commercial tolling agreements in place with the now operational Prelude FLNG facility.

On to slide 6.

Slide 6 – Ryan Stokes

Key Financials

Underlying EBIT for the year was up 40 per cent to $695 million. Underlying net profit after tax was up 49 per cent to $479 million. Underlying earnings per share was 143 cents, up 47 per cent on the prior year.

Underlying EBITDA cash conversion of 59 per cent was a 5 per cent improvement on the prior year. Cash flow was impacted by our investment in working capital to fund the future sales opportunity, particularly in WesTrac.

On a statutory basis, EBIT was $436 million and statutory net profit after tax was $219 million, impacted by significant items of $260 million, including $291 million share of equity accounted investee significant items and mark-to-market impairment relating to the Seven West Media investment.

Today we have declared a final 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 full-year.

Richard.

Slide 8 – Richard Richards

Profit and Loss

Thank you, Ryan and good morning.

Slide 8 provides both the statutory and underlying net profit after tax for the year. I refer you to the Annual Report for the detailed statutory presentation.

The financial result for the year reflects the continued strong performance of WesTrac and Coates and their ability to win market share and grow revenue while maintaining cost discipline to deliver margin improvement. The performance of Beach is also pleasing, with record production, high realised oil and gas prices, and continued low field operating costs, resulting in significant growth in Beach's contribution to SGH earnings.

Group underlying EBIT of $695m was up 40% on prior year, in line with the increased earnings guidance provided in April.

Consolidated trading revenue of $4.1b was up 27%, an increase of $876m on the prior year. $344m of this was delivered through continued parts and service revenue growth in WesTrac up 19%. $245m was delivered through an increase in WesTrac's capital sales, mainly new equipment, up 38 % with $307m being the full year impact of consolidating Coates, whose rental income was relatively stable on a standalone basis.

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

Results from equity accounted investees improved 46% to $210m, attributable to strong result from Beach.

Other income reduced by 18% to $54m reflecting lower dividend income from the listed portfolio which we sold down by $196m during the year.
Expenses, excluding depreciation and amortisation, increased by 24% to $3.5b. Cost of inventory sold increased by 24% to $2.1b and employee benefits expense increased by 25% to $790m.

On a pro-forma basis adjusting for Coates, employee benefits expense increased by 11% and total expenses, excluding depreciation and amortisation, increased by 14 %. The relative difference between revenue and expense growth reflects the operating leverage inherent in our key businesses.

Depreciation and amortisation expense increased $54m predominately due to the consolidation of Coates for the full year. The $23m increase in WesTrac reflects the decision to lease four 794 electric drive off highway trucks to prove up their relative performance in iron ore applications.

The Group's underlying effective tax rate was stable at 19% for the year. Whilst the rate is expected to remain around this level, the Group has moved into a tax-paying position this year.

Slide 9 – Richard Richards

Significant Items

During the year, the Group incurred a net $260m in Significant Items, reducing the statutory net profit after tax from $479m to $219m.

Significant Items primarily relating to the investment in SWM, including $233m relating to SGH's share of SWM's significant items, and a mark-to-market impairment of $58m to the carrying value of our investment based on share price at 30 June 2019.

There was no tax benefit associated with this impairment as it is not deductible. This results in the Group's statutory effective tax rate for the year increasing to 34%.
Significant Items also included a benefit of $29m relating to the mark-to-market gain on the option embedded within the convertible notes.

Slide 10 – Richard Richards

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.

The year-on-year change in the underlying segment EBIT of approximately 40% within Industrial Services and 118% in Energy showcases the continued strength of these growth drivers for SGH.

Slide 11 – Richard Richards

Cash Flow

Underlying operating cash flow was $411m, an increase of 62% or $158m on prior year. This represents underlying EBITDA cash conversion of 59%, a 5% improvement for the year. Our key businesses are continuing to grow and capture revenue opportunity, we have invested more in working capital, particularly in WesTrac, to continue to support our customers in their drive for higher production and WesTrac to achieve forecasted growth.

Cash flow from investing activities utilised $189m which we have mainly applied towards growing our existing businesses and investment in Beach. This includes net capital expenditure of $194m in Coates and $62m in WesTrac.

We also invested $111m for an additional 3% interest in Beach, increasing our stake to 28.6%.

Part funding these investments is $184m in net sale proceeds from the listed portfolio and distributions from a private media investment fund in China.

Cash flow from financing utilised $249m, comprising $138m in ordinary dividends and net $110m in debt repayments.
Overall cash decreased by $27m while net debt reduced by $38m to under $2b after taking into account the impact of foreign currency movements.

Slide 12 – Richard Richards

Balance Sheet

The Group had net assets of $3b at 30 June, increasing $176m over the year. This movement includes the $219m statutory net profit for the year less the ordinary dividend payment of $138m. Other amounts increasing shareholder's equity primarily relating to $63m change in fair value of financial assets measures through other comprehensive income and $32m to reflect shareholder approval of the embedded option value in the convertible notes.

The key movement on the balance sheet relates to the $103m in additional inventory at 30 June. As a percentage of expected sales, we are comfortable that the level of inventory is in line with historical levels. The level of committed orders in WesTrac is firming which provides further confidence in the outlook.

The value of investments decreased by $74m. This movement includes the additional investment of $111m in Beach, offset by divestments including $196m in sales from the listed portfolio. The equity-accounted share of Beach net profit of $161m was largely offset by the $182m equity account share of SWM's net loss. While the investment in SWM is reported on the balance sheet at its $285m market value as at 30 June, it should be noted that the Beach investment is held at its equity accounted value of $742m, significantly below its market value as at 30 June. In an economic sense, the unrecognised mark-to-market value of Beach today would add $678m to SGH's net assets.

Property, plant and equipment increased by $76m including four 794 electric drive off-highway mining trucks added to the rental fleet.

Provisions decreased by $45m including the impact of a reclassification of warranties to deferred income, consistent with AASB 15, along with reduction in provisions against specific equipment warranties and service contracts.

The increase in net tax liabilities of $117m mainly relates to the current tax liability, reflecting the Group's tax payable position.

Derivative financial instruments increased by $92m including a favourable mark-to-market of $31m, mainly relating to cross currency swaps hedging the Group's USPP, and $61m previously recognised as the fair value of the option embedded in the convertible notes which has been reclassified to equity.

Slide 13 – Richard Richards

Capital Management

Maintaining a strong balance sheet is a priority for SGH, allowing us to position the Group for growth and to act upon investment and capital structure opportunities available in the market.

In FY19 we enhanced our capital structure by converting the TELYS4 shares to ordinary shares, allowing unification of our capital structure while delivering a 5% increase in free float, enhancing the market depth for SGH shares and reducing our cost of capital. We refinanced our senior corporate debt, extending tenor to 2021 and 2023, increasing the facility size to $1.3 billion, and reducing our credit margin.

These initiatives received strong support from the market and have delivered a material reduction in the Group's funding cost.

At 30 June, the Group held $2.9 billion in total facilities with $839m undrawn and $78m in available cash. Average facility tenor is 3.6 years with the next major refinancing in 2021. The 40% gearing ratio calculated from our reported balance sheet effectively reduces to 27% when taking into account the value of the listed portfolio, the favourable mark-to-market of our debt hedging instruments and the market value of Beach in excess of its book value.

This leaves the Group in an extremely strong position to fund our growth ambitions, with more than $1.1b in potential liquidity available at short notice.

Slide 14 – Richard Richards

AASB 16 Leases

The Group will adopt the AASB 16 leasing standard effective as of 1 July 2019. The standard requires operating leases that were previously off-balance to be recognised as Right of Use assets. The Group will adopt the full retrospective method, requiring each lease to be restated as if the standard had applied from the inception of each lease.

The operating lease payment that was previously expensed will be replaced by depreciation of the asset plus an effective interest cost embedded in the lease payments. The cumulative difference in actual versus restated costs is recognised in retained earnings at the date of initial application, being 1 July 2019.

This will result in disclosure amendments to the Group's balance sheet and reported EBITDA, EBIT and operating cash flow going forward.

The table on this slide summarises the estimated balance sheet and P&L impact in FY20. Right of Use assets of $668m will be recognised together with a corresponding lease liability of $856m. The cumulative historical difference of $188m is reflected as a reduction to retained earnings. EBITDA is expected to increase by $103m and EBIT by $32.5m, while net profit after tax is expected to reduce by $12.5m. The Group is not required to restate the FY19 result or any prior years to reflect AASB 16.

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

Industrial Services – WesTrac Highlights

Thank you, Richard. On to slide 16.

Continued strength in mining production volume has contributed to the growth in demand for WesTrac parts and service required to maintain a hard-working installed fleet. With WesTrac's support, miners are capturing efficiency gains by being able to run CAT machines at a higher utilisation rate over a longer equipment life span.

Through FY19 WesTrac has delivered record parts and service income with 6.4 million parts lines invoiced during the year. There is close integration with our customers to support their activities as they continue to extend fleet lives and increase productivity of their fleets.

Work continues with a range of mining customers on technology solutions to deliver optimal productivity and WesTrac has a team of 90 machine control and guidance technicians on hand to support the growing demand for autonomous technology and conversion.

Earlier in the year, Rio announced it will be working with WesTrac and CAT on the Koodaideri "Mine of the Future", and will be responsible for all technology installation and commissioning of fleet. This includes autonomous 793F mining trucks as well as hydraulic excavators, dozers, graders and other ancillary fleet.

Other major projects set to commence in the near future provide a further pipeline of opportunities for new equipment sales.

Slide 17 – Ryan Stokes

Industrial Services – WesTrac Financials

WesTrac's product support revenue was up 19 per cent in FY19, driven by the 11 per cent increase in parts lines invoiced.

Product sales revenue was up 38 per cent, including a strong lift in mining equipment sales of 60 per cent, showing signs of a capital replacement cycle, albeit off a low base compared to historical levels.

Customer demand for autonomous technology to be retrofitted to existing equipment through conversion kits was high, with 197 autonomous trucks operating in WA as of 30 June 2019.

WesTrac's EBIT for the year of $286 million was 41 per cent above the prior year and EBIT margin improved by 1.1 per cent to 9.4 per cent.

Looking ahead, the current level of committed sales is higher than the same time last year, and WesTrac has continued to invest in parts inventory and components to ensure that customer demand can be met.

WesTrac is also planning to invest in our WA Guildford site to enhance site capacity and improve the velocity of activity. This will include a reorganisation of workflows designed to boost productivity levels, allowing equipment to be assembled, serviced, or rebuilt quicker than before.

Slide 19 – Ryan Stokes

Industrial Services – Coates Highlights

Coates provides equipment to a diverse range of end markets, including engineering and construction, mining and resources, and non-residential construction, which together account for almost 75 per cent of revenue. Unlike others in the market, Coates has limited exposure to vertical construction which represents 3 per cent of revenue.

The market for rental equipment is competitive and has been impacted by project delays and a marked slowdown in Queensland during the year. There is however a need for infrastructure investment and the outlook for the state is positive over the medium-term.

New South Wales and Victoria remain on a stable trajectory, while WA growth is providing opportunities in that market.

As the market leader, Coates is well positioned relative to competitors to benefit from the growing long-term pipeline of infrastructure projects. The focus is to continue improving the customer experience, including the planned rollout of online hiring and real-time pricing in FY20, and to optimise the fleet composition for current and future opportunities.

This involves fleet renewal to meet customer requirements, fleet investment in certain market segments to take market share, and continued operational excellence in order to drive the rate of return from existing fleet.

At the end of July we announced the retirement of Coates CEO Jeff Fraser and appointment of SGH COO Murray Vitlich into the role as Acting CEO. Murray brings extensive experience running industrial companies and was previously on the board of Coates for the last two years.

Slide 20 – Ryan Stokes

Industrial Services – Coates Financials

Coates generated $184 million in EBIT, up 7 per cent on the prior year on a pro-forma basis. This was despite a 2 per cent reduction in revenue to $957 million, which reflects a lower result in Queensland due to project delays in the current year and the benefit of the Commonwealth Games in the prior year. Overall time utilisation was slightly lower at 55 per cent but remains above the historical average.

EBIT margin was up 1.6 per cent to 19.2 per cent.

Net capital expenditure was $194 million during the year, reflecting the level of confidence we have in the opportunities available over the medium to long term, and desire to lower the average fleet age.

Looking ahead, our strategic initiatives are continuing within the business, and we are planning more work on digital capability to enhance customer support and drive efficiency.

Slide 22 – Ryan Stokes

Energy – Beach Investment

The Group's investment in Beach has been pivotal for our energy strategy which has focused on the East Coast gas and domestic energy demand opportunity. Beach is a key supplier to this market and has built a track record of operational excellence, discipline, and successful execution.

Beach contributed $158 million towards Group EBIT. Production of 29 Mmboe was up 55 per cent on the prior year. Free cash flow of $557 million during the year has moved Beach into a net cash position of $172 million.

Key milestones during the year were the Otway sell down for $262 million and subsequent commencement of development drilling, and FID taken on Waitsia Stage 1 in the Perth Basin. A highly successful drilling program in the Cooper Basin also helped to deliver overall reserves replacement of 204 per cent during the year.

With a diverse portfolio of domestic gas and emerging LNG export opportunities, and a strong balance sheet, we have full confidence that Beach will continue to deliver for its shareholders.

Beach has provided guidance of 27 to 29 Mmboe production, $750 to $850 million in capital expenditure and $1.25 to $1.4 billion in EBITDA.

Slide 23 – Ryan Stokes

Energy – SGH Energy

During the year we also saw some significant milestones on Crux, which is 15 per cent owned by SGH Energy. Crux is the primary source of backfill gas to the Prelude FLNG facility which shipped its first cargo in June this year.

The LNG market is increasingly focused on brownfield developments that utilise existing infrastructure and therefore enhance the rate of return for upstream and mid-stream parties. Crux is a perfect example of this.

Commercial tolling agreements are in place with Prelude and we are more than half-way through FEED, targeting FID for mid-2020, first production in 2024 to 2025, and a production life extending for more than 15 years.

We are focused on maximising value for our shareholders and we have the balance sheet flexibility to pursue a parallel price discovery process and will transact if an acceptable value threshold can be achieved.

With Longtom we have 80PJ of gas to service the east coast gas market, we are currently evaluating partnerships and a stand-alone investment opportunity to bring this gas to market.

Slide 25 – Ryan Stokes

Media – Seven West Media

Seven West Media has continued to deliver significant audiences across its multiple platforms, including the leading television network, publishing interests, and rapidly growing digital offerings and global content production capability.

SWM contributed $51 million in underlying earnings towards Group EBIT, down 13 per cent on the prior year.

Other media investments contributed $15 million towards Group EBIT, up 7 per cent on the prior year. These investments relate to the Group's historic interests in private investment funds focused on media and entertainment in China that are now being realised.

The statutory result was impacted by $291 million in significant items relating to the Group's share of non-cash impairments and restructuring costs recognised by SWM along with the mark-to-market write down of the carrying value of the Group's investment.

Looking ahead, the recently announced appointment of James Warburton as MD&CEO will bring a strong focus on execution of our core business and how the company can deliver strategic growth. The business is well positioned to take advantage of opportunities in the media sector.

Slide 26 – Ryan Stokes

Listed Investments

In line with our previous commitment to sell down the listed portfolio over time, we realised $196 million in value from the portfolio during the year. Contribution to the Group's FY19 EBIT was $21 million and this will be lower going forward.

Our property investments include residual portfolio holdings and we will continue to progress these over time as opportunities present.

Slide 28 – Ryan Stokes

Outlook FY20

Now moving to our outlook for the year ahead.

We see opportunities for growth in our Industrial Services and Energy businesses, as they continue to benefit from the strong medium to long term outlook for mining production, infrastructure investment, and domestic energy.

We have strengthened our balance sheet through recent capital market initiatives, and net debt is now below $2 billion, positioning the Group to pursue the next wave of growth through reinvestment in our existing businesses and new opportunities to expand in our three core growth drivers.

WesTrac will continue experiencing growth in demand for parts and service to support the high level of ongoing mining activity. New projects are creating the opportunity to grow the installed base, while ancillary services such as autonomous technology conversion and component rebuilds continue to grow.

Coates is in a market that is expected to remain competitive over the next 12 months. However, its level of diversification across end markets and national footprint is unlocking opportunities in certain market segments. New revenue opportunities continue to emerge over the medium to long term through the growing infrastructure pipeline.

Beach has built a strong operational and management track record and will continue to be a key supplier to the East Coast market, underpinned by production and reserves growth through its development and exploration initiatives. Other opportunities are emerging in the West Coast domestic market and LNG exports.

A sale process is underway for Crux and we are focused on pursuing the most value-accretive outcome for our shareholders.

At SWM, there is a renewed focus on transformation initiatives along with how they drive revenue and costs. The company has provided FY20 underlying EBIT guidance of $190 – 200 million including the impacts of AASB 16 and the new leadership is focused on how they grow value.

For SGH our objective is to grow shareholder returns, by ensuring our businesses continue to perform and deliver market-leading positions, as we look to position our businesses to best drive value and realise their potential.

On a Group basis, FY20 underlying EBIT growth is expected in the mid to high single digits against FY19 underlying EBIT including the impacts of AASB 16, subject to there being no material adverse changes in trading conditions.

Slide 29 – Ryan Stokes

Disclaimer

Finally, this is our standard disclaimer.

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