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Lodgement of Open Briefing

Henry Walker Eltin Group Limited
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Record of interview:

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Henry Walker Eltin Group Limited recently announced a pre-tax profit of $6.9 million in the six months to December 31, 2003. In the same period last year you reported a pre-tax loss of $30.8 million. Where are you in the turnaround of this company?

CEO Bruce James
The company's track record over the last three to four years has clearly been poor. The last half year is the first profit result in line with management expectations for some time. We've definitely stabilised the ship.

But, there remain issues that have to be resolved if we’re to generate acceptable returns. Plant is the obvious one. Improvements in plant management are essential if we’re to see a steady improvement in margins.

New contracts and our strong order book give us the opportunity to achieve a far better outcome going forward, and we think this latest result, although the margins on the surface are disappointing, is a first step towards achieving our longer-term goals.

One of the key issues we obviously face is getting the optimal funding mix to finance our new growth, and that's something we're going to be focused on in the next couple of quarters. Our capex program is going to rise and we will be reviewing all the options relating to operating leases, buying and the mix of debt and equity, with the aim of making sure we maximise shareholders' returns. I'm not going to go into the details on funding issues and I'm not making any specific profit forecasts, but what I will say is that we've put this company in a position to grow.

After a period of serious instability, I'm looking forward to the next few years of talking about growth rather than the issues of reorganisation, write-offs and bad contracts that were my focus in my first year as CEO.

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Although the profit result was in line with your advice at the AGM in November why wasn't a stronger profit performance more evident in the last six months?

CEO Bruce James
Specific negatives included the under-budget performance of HWE Civil, the strength of the Australian dollar which impacted on the contribution from the Yandi iron ore contract, the lack of any contribution from the Cockatoo Island joint venture mine and the ongoing need to more efficiently manage our plant.

We have limited the impact of the Australian dollar's rise with productivity improvements at Yandi and the other negatives are likely to become positives in 2005.

HWE Civil recently won a new contract with Vopak and has another two contracts under final negotiation totaling $70 million. We've retained resources within HWE Civil and have the capacity to manage the growing order book. I've got a $200 million revenue target in mind for civil work in 2005 and that will certainly lift our returns. In relation to Cockatoo Island, I'd expect a positive contribution in 2005. We've overcome the operational problems and confirmed reserves.

Plant management is a major issue. Current under recoveries on plant are a legacy of past policy and we're actively managing for a better outcome. We are focusing on plant utilisation and availability on a site by site basis. Repairs and maintenance programs are under review and decision making has been moved closer to the work face. This means that clear accountability for cost has been pushed into each business.

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Previously you've indicated a margin of 4 percent is an appropriate return for your contracting businesses. What needs to occur to achieve that margin and when do you consider it likely you'll achieve that margin across your contracting operations?

CEO Bruce James
We have to get our volume up whilst continuing to improve margins. I've mentioned the recovery in Civil and we've got strong work on hand in both HWE Mining and Simon Engineeering. In the last period our EBIT margin was 2.5 percent. If we strip out HWE Civil it was 3.0 percent. A target of 3.3 to 3.5 percent is embedded in our thinking for 2005. Beyond that, there's more scope.

I'm expecting our corporate and business unit overheads to remain stable during the growth phase. I believe we can manage at least $1.5 billion in revenue on our existing structure.

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Your order book has risen to $2.2 billion from $1.1 billion at December 2002. What benchmark returns do you seek in the tendering process?

CFO Andrew Price
The returns required are dependent upon the nature and location of the contract and the type of equipment required to undertake the work. As a general rule of thumb we require at least 20 percent return on assets employed at the project level. We review this on a case by case basis, particularly where the equipment will be off balance sheet.

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Why are you growing more rapidly in mining when you previously stated you'd grow the services stream of your business?

CEO Bruce James
Our desire to grow the services stream hasn't diminished but we need to manage that growth appropriately and balance it with higher than anticipated demand from the resources sector. Our strategy for a 50:25/25 mix between mining services and the other service streams remains in place. However, our strategy must also have the flexibility to react to changes in demand in the various marketplaces in which we operate.

The increase in mining work will, to some extent, mask the growth we anticipate in HWE Civil and Simon Engineering, but we are definitely seeing signs of growth emerging. Last year, Simon Engineering lifted its order book from approximately $140 million to $310 million and we need to execute that new business efficiently and profitably. The civil business is also securing new contracts as I mentioned previously and we're confident that these new contracts will result in solid returns for the business.

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The cash flow statement notes that investment in plant, property and equipment was only $15.4 million versus $58.4 million in the previous corresponding period. Why was it low in the recent six months?

CFO Andrew Price
A combination of factors. Due to negotiations, the timetable for some of the new contracts has slipped a few months and that's pushed some capex into the second half. Also, with some of the new and existing work we've been able to redeploy some plant and reduce the amount of idle plant. For example, approximately 75 percent of the fleet required on one recently awarded underground contract was sourced from existing equipment, while 100 percent of the equipment on another underground job was supplied by the client.

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What is the forward capex program?

CFO Andrew Price
Capex in 2003 was approximately $96 million and I expect this year to be in line with that in 2003 or a little higher. A lot will depend on the timing of new work commencements and our final decisions on capital structure. Obviously it will be heavily skewed to the second half year. Included in our forecast is an expectation on the commencement of projected contracts, the timing of which may fall into the 2005 year.

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Net debt to shareholders' funds has improved recently to 58.1 percent from 73.5 percent as at June 2003. Are you now expecting the ratio to rise and what would you regard as an appropriate range for this measure?

CFO Andrew Price
From 2001 to 2003, gearing ranged from 65 to 90 percent and we think that range is too high. Our general objective would be to keep it below 65 percent with a long-term objective closer to 50 percent, but I accept we could rise above that level for a short period, especially as we bring on some new work. We're currently reviewing our plans in relation to debt levels and the mix of on balance sheet and off balance sheet funding required for the growth being experienced.

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Is there any intention to boost funding from asset sales?

CFO Andrew Price
We have assets outside the core contracting business and we will sell those assets if we think we can get better returns elsewhere. Non-core assets are constantly reviewed.

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You received a tax credit in the latest period that boosted net profit to $12.4 million. Will you return to normal tax rates in the second half?

CFO Andrew Price
Yes. The one-off benefits of the tax consolidation process have now been fully crystalised. We do not expect any major adjustments in the second half that will affect the tax expense calculations.

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You've mentioned you won't give specific profit forecasts but what level of guidance can you provide?

CEO Bruce James
At the AGM in November we said we'd produce a second-half year modestly above the first-half year. We're talking pre-tax profit. That statement remains valid. We also said the 2005 year would more clearly reflect the improvements underway in the company and that statement also remains valid. We're laying a foundation to grow steadily over time.

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Is it your intention to restore the dividend and what is your capability to frank a dividend payment?

CEO Bruce James
The directors wish to declare a final dividend this year so long as we meet our plan. We have plenty of surplus franking and should be able to fully frank any payment.

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Thank you Bruce and Andrew.

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