Conference Transcription

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Imdex Limited

Imdex Limited FY11 Half Year Result

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Start of Transcript

Operator: This is PGI. Please stand by, we're about to begin. G'day everyone and welcome to the Imdex Limited FY11 Half Year Result conference call.

At this time for opening remarks, I would like to turn the conference over to your moderator today, Mr Bernie Ridgeway, Managing Director of the Imdex Limited. Please go ahead.

Bernie Ridgeway: Hello everyone and thank you [Richard]. I will begin by providing an overview of the Imdex Group result for the first half of FY11. Paul Evans, Imdex's CFO and Company Secretary, will then present a more detailed analysis of the financials.

I will then cover the operations and divisional performance, comment on the outlook regarding Imdex's main markets of mining, oil and gas, and outline Imdex's strategy and opportunities for growth in second half '11 and beyond.

Time has been allowed for questions at the conclusion of the presentation. For listeners who are not familiar with the Imdex Group, some additional slides have been included in the appendices. Further information can also be found on our website.

Ladies and gentlemen, I would like to make a few key points at the beginning of our presentation. Imdex has achieved record half year performance and delivered consistent improvement in revenue and EBITDA since the second half '09 low point. Our strategy of continuing to invest through the global financial crisis is supporting our ability to capitalise and improve the industry dynamics.

The simplification of brands and realignment of our business to a regional basis has been well executed and is delivering results. We have market-leading technology and our new product pipeline is exciting. We have a number of excellent growth opportunities which we'll commence in second half '11 and continue for many years to come.

Now let's get a little more specific and turn to Slide 7, which provides an overview of the key results. Revenue from continuing operations was $95.9 million, being 64% up on the pcp.

EBITA from continuing operations was up 182% to $21.2 million with net profit after tax before nonoperational items up 301% to $11.4 million.

The Company performed strongly in the improved market conditions experienced in the first half of the 2011 financial year. Imdex achieved some significant milestones during first half '11, including the highest revenue and profit levels and record mining tool rental numbers.

Our cash flow from operations was up 202% on the pcp and our balance sheet remains strong with net debt to total capital at 18.4%, which is below the 19.6% gearing at 10 June, and interest cover to EBITA of 16 times.

The Directors have reinstated the dividend by declaring a fully franked interim dividend of 1.75 cents per share, given the improved trading conditions and forward visibility in our key markets. The Board's goal of delivering a growing dividend stream reflecting the earnings profile of the company and in balance with the Company's capital needs remains a high priority.

The robust trading conditions experienced in first half '11 have continued into the second half, and we expect to see further growth given Imdex's strong market positions, leading technologies, resilient business model and robust strategy.

Moving to Slide 8, during the half we experienced strong growth in the mining tool rental fleet, with new highs achieved prior to the seasonal slowdown in December 2010. Pleasingly, tool numbers on active hire at the end of January 2011 saw a new record being reached.

The regional business model for the mining side of our activities, which became effective 1 July 2010, positively impacted our business during first half '11 and will continue to do so in the foreseeable future.

The acquisition of Fluidstar has been seamless and has performed above expectations since the date of acquisition. We have continued to streamline our business with the relocation of Imdex Technology, Sweden to Australia and Germany. We have changed our business model for the oil and gas down hole instrumentation from a products model to a services based model.

In doing so, we have formed a joint venture with DHS Oil, based in Dubai. DHSO is an existing user of our technology and is majority owned by Lime Rock, which has a proven track record of growing specialist oil and gas businesses.

On 17 December 2010, we announced the proposed acquisition of Mud-Data, a drilling fluids and equipment supplier to the oil and gas and geothermal markets in Europe. This is an exciting acquisition which provides a solid base for growing a substantial drilling fluids and equipment business right across Europe.

Our solids control technology for the diamond drilling industry has provided many challenges, however, we now have the right expertise and a commercial technology.

It is pleasing to note that we won the WA Innovator of the Year Award with this technology which offers the global mining and exploration industry a solution to the current practice of digging drilling fluid sumps beside the drilling rig. We are confident that offering an environmentally friendly solution will become industry standard practice in due course.

As illustrated by the bar charts on Slide 9, Imdex’s revenue was a new record and exceeded those experienced prior to the global financial crisis. Our first half '11 revenue of $95.9 million is 19% up on the previous peak half revenue experienced in first half '09. The minerals division was very strong with robust demand for both Drilling Fluids and Down Hole Instrumentation.

The increase in revenue resulted from continued robust trading conditions and increased market share.

Moving to Slide 10, you can see that the Minerals Division, consisting of AMC and Reflex, contributed 85% of revenue in the first half. In the Minerals Division, the rebranding of our drilling fluids to AMC across the globe was positively received by our customers and has been seamless.

In the oil and gas space, both our drilling fluids through AMC and our Flexit down hole instrumentation were below expectations during the period and contributed 15% of revenue.

Slide 11 clearly shows the recovery in EBITA since the low point in second half '09. Total EBITA for the half was $21.2 million, up 182% on the pcp at an EBITA margin of 22%.

Before moving onto the operational review and outlook for Imdex's principal markets, strategies and opportunities for future growth, I will hand over to Paul Evans for a more detailed look at Imdex's financial performance.

Paul Evans: Thank you Bernie. Slide 13 outlines the financial results in more detail and compares the result for first half '11 against the prior corresponding period.

As Bernie indicated, revenue from continuing operations for the half year was $95.9 million. This was up 64% on first half '10. First half '11 operating profit after tax was $12.1 million compared to $2.9 million before non-recurring items for the prior corresponding period.

The effective tax rate for the period was 26.5%, due to an overprovision arising from FY10. Adjusting for the overprovision, the effective tax rate was 30%. The overprovision largely relates to differing tax treatment on the loan interest for SEH.

Cash flow from operations increased 202% to $13.9 million from the prior year, reflecting the improved trading conditions in this half over the prior corresponding period.

Moving to Slide 14, total assets have increased $29.5 million since 30 June 2010, largely due to the improved trading and the acquisition of Fluidstar.

Our working capital investment has increased in line with the growth in business activity, particularly in the area of stock in the fluids' business.

Our total debt position has increased by $8.6 million since 30 June 2010, following the increase in facility limits secured for the Fluidstar and Ecospin acquisition.

During the period we also converted $5 million from our Australian loan facility to our Canadian loan facility to provide a more effective natural hedge from our growing Canadian business.

The increase in our tax payable arises largely due to the improved trading position and FY10 taxes that become due and payable in the second half '11.

Slide 15 details our current debt profile in more detail. At 31 December 2010 Imdex had $40.6 million total debt, with the composition changing for the reasons previously stated. Net debt, being total debt less cash held, has increased only $1.7 million from 30 June 2010 up to $24.7 million.

Despite debt levels increasing from 30 June 2010, gearing levels have decreased slightly to 18.4% from 19.6% due to the improved asset position.

I'll now pass back to Bernie for the remaining part of the presentation.

Bernie Ridgeway: Thanks, Paul. As many of you know, Imdex operates two divisions being Drilling Fluids and Chemicals, and Down Hole Instrumentation. These two divisions mainly supply two key global end markets, namely mining and mineral exploration, and oil and gas.

As stated earlier, we implemented a regional structure on 1 July 2010 for our mining business which means a different reporting regime where the contributions from Drilling Fluids and Down Hole Instrumentation are combined for the region.

As you can see, the bar charts on Slide 17, which demonstrates the strength in this side of our business, record revenue of $81.5 million was 19% up on the previous peak achieved in first half '09, was 75% up on the pcp.

Asia Pacific is the dominant region generating 57% of revenue, whilst the Americas and Africa contributed strongly with 26% and 15% of revenue respectively.

We expect to drive further increases in the Drilling Fluids and Down Hole Instrumentation mining business in second half '11 and beyond.

Mineral exploration expenditure in Asia Pacific, Africa, Canada and Latin America was strong in first half '11, with major customers such as Boart Longyear, Major Drilling, Layne Christensen, Energold, Foraco, including Adviser Drilling, Geosearch, Ausdrill, Swick and a host of other leading drilling contractors around the world experiencing increased drill rig utilisation and demand for Imdex’s products.

AMC is the leading brand of drilling fluids for the global mining industry and ongoing product development ensured that Reflex remained the number one supplier of down hole instrumentation to the mining and mineral exploration industry globally.

I have spoken before about our unique surface and underground solids control equipment for the diamond drilling industry. It is becoming environmentally unacceptable to have sumps with the drilling fluids next to the drilling rig.

Our technology allows drilling fluids to be contained while the solids are removed from the fluid and disposed of separately. Water conservation and zero footprint with no environmental damage are key advantages of using this technology.

There will be no meaningful contribution from this technology in FY11, however, we expect significant growth in FY12 and the following few years as the technology is rolled out globally and the industry fully embraces the advantages of using this technology.

It is expected that Minerals Division revenue and margins will continue to trend upwards.

Slide 19 clearly shows the benefit of our global structure and continued spending on product development, and being the technology market leader.

After the seasonal slowdown in December 2009, we witnessed a sharp increase in activity from January 2010 onwards. This trend continued right through to the December 2010 seasonal slowdown.

Along the way, new monthly records were being achieved. However, a new record was set in the first month of second half eleven, where mining tools on rental at 31 January 2011 reached a new high and were 33% above the previous peak reached in July 2008.

Drill rig utilisation is likely to continue to increase in line with predictions by drilling companies, therefore we would expect further marginal increases in the mining tool rental fleet in the run up to 30 June 2011.

The bar charts on Slide 20 show that in first half '11 the Oil and Gas Division generated $14.4 million in revenue, compared to $11.1 million in second half '10 and $11.9 million in the pcp.

It was 11% down on peak revenue of $16.2 million in second half '09, primarily due to the underperformance of the Flexit down hole instrumentation and delays caused by extensive flooding in the onshore Australian oil and gas industry

Moving to Slide 21, during the half we continued improvements on existing down hole instrumentation, particularly to Target INS and commenced field testing of the Drop version of the Target INS tool. In relation to the Drop version, we expect commercial units to be delivered in mid-2011.

As announced to the ASX on 21 January 2011, Imdex has agreed to the formation of a 50/50 joint venture with DHS Oil Holdings Pty Ltd, majority owned by Lime Rock, based in Dubai.

DHSO already operates the Flexit technology and the global joint venture should allow Flexit to gain a better and more sustainable return than under the previous products model. The joint venture will be effective in this current quarter. The DHSO joint venture should contribute meaningfully to revenue and profits from FY12.

As announced to the ASX on 17 December 2010, Imdex entered into a heads of agreement to acquire 100% of the issued share capital of Mud-Data, which is a drilling fluids and equipment supplier primarily based in Germany.

Mud-Data is a specialist products and equipment supplier to the oil and gas and geothermal industries in Germany. Under the ownership of Imdex, capability and geographic reach will be substantially expanded and will cover all of Europe.

The Mud-Data acquisition allows Imdex to accelerate growth plans in Europe and increases our product offering. Completion is expected in the current quarter and Mud-Data should be a significant contributor to revenue and profits in FY12 and beyond.

Now I'd like to spend a few minutes on the Company's outlook and prospects going forward. Our focus strategy of supplying drilling fluids and down hole instrumentation to two main end markets of mining and oil and gas is robust and will continue.

As illustrated by Slide 23, Imdex will continue to concentrate on late stage minerals applications and further penetrate underdeveloped mining markets globally, while growing our Oil and Gas business for both Drilling Fluids and Down Hole Instrumentation.

Our medium term objective is to generate at least 40% of Group revenue from the oil and gas industry. In FY11. revenue from this sector should approximate 15%, which is down marginally on the 17% in FY10. However, in FY12 we should see significant contributions from the DHSO joint venture and the Mud-Data acquisition.

We believe that this business sector diversification is logical and is an extension of our existing business into a sector in which we have considerable expertise.

On Slide 24, we have listed the key drivers for our business where mineral exploration spend and drill rig utilisation are very important. Drilling rigs require drilling fluid and down hole instrumentation, and as utilisation levels increase the demand for Imdex products increases. This in turn drives increases in the mining tool rental fleet and our growing relationships with global customers ensures a more sustainable business.

Investing in research and product development to continue technology and market leadership and enhancing operational efficiencies are key components in maintaining these strong relationships, and we will continue to do that.

The simplification of our brands and the implementation of the regional business model for our mining business has already paid dividends and will continue to benefit the Group for many years to come.

Global nonferrous exploration expenditure has made a rapid recovery post-the GFC and large, intermediate and junior companies are all back out exploring.

Beacon Securities estimates that global nonferrous exploration expenditure in calendar year 2011 will be up 20% on 2010 levels. Given the current levels of activity globally, this estimate may prove to be very accurate and would put expenditure back above pre-GFC levels. Commodity prices appear robust and resource companies are well funded.

The spending is occurring in all major mining regions. Globally, the main activity is around gold, copper, nickel and uranium. There is also much activity in the iron ore and coal sectors.

Many of you have seen this slide previously, however, the facts remain the same, that is, there are long lead times from discovery to production and discovery is becoming increasingly challenging. Ore bodies are deeper, more complicated and cost significantly more to bring into production.

This is good news for Imdex because mining companies will need to continue spending on exploration and development, requiring down hole instrumentation and drilling fluids to be able to access deeper and more complicated ore bodies.

A similar picture applies to the oil and gas industry on Slide 26, where new discoveries are deeper and more complicated and more costly to develop. The International Energy Agency has estimated E & P spending in 2011 to be up on those levels experienced in 2010.

Both the onshore and offshore rig counts are around historical highs. By way of clarification, the DHSO joint venture is supplying services to both the onshore and offshore oil and gas industry, whilst the AMC fluids business is aimed at niche markets in the onshore industry.

In summary, I would like to close with the following remarks on Slide 27. We finished FY10 strongly and in first half '11 revenue and profits are the highest recorded by Imdex, allowing the reinstatement of an interim dividend.

Our mining tool rental fleet at 31 January, 2011 was 33% above the previous peak reached in July 2008. Our balance sheet is in good shape and we continued spending on product development through the GFC, which has delivered a wider suite of tools and further improved technologies.

The strength of our balance sheet has allowed us to pursue attractive growth opportunities, such as the acquisition of Fluidstar, the formation of the DHSO joint venture and the proposed acquisition of Mud-Data.

We continued to strengthen the management and global structure, and have simplified our business by having only three brands to ensure Imdex is well positioned to service current robust levels of industry activity.

Given the underlying fundamentals of Imdex’s core markets, the trend experienced in first half '11 has continued into second half '11. As outlined on this call, in addition to increasing revenues we also expect margins to improve further.

Imdex is well positioned to capitalise on a number of acquisition and organic growth opportunities and increase shareholder value over the longer term, given the Company’s market positioning, unique suite of proprietary technologies, customer relationships and global footprint.

That brings the formal part of our presentation to an end. Paul and I are now happy to answer any queries you may have.

Operator: Thank you. We will now move to the question and answer session. Your first question comes from the line of Duncan Simmons from Merrill Lynch. Your line is now open, please go ahead.

Duncan Simmons: (Merrill Lynch, Analyst) I just wondered if you could just go through a couple of things with me. Firstly, just in terms of your tool fleet, is there any way that you could give us some granularity on I guess the increased level of capital employed that you've put out there in the first half of this year compared to last year, and where you expect that's going, just in percentage terms?

Bernie Ridgeway: It's difficult to answer that question specifically on this call, Duncan, but our tools - I think, as you know, we own our own IP and we do our own manufacturing. So from a CapEx perspective, it's not that great. I mean, we can probably supply those details offline if you need them, separately.

Duncan Simmons: (Merrill Lynch, Analyst) Okay. That's great, and then I guess the other two questions, they're only quite minor, is just in terms of working capital, just looking into the sequential period for the second half, do you think that the first half balance sheet gives us a good indication of where your days receivable, days inventory et cetera, will end up for the year?

Paul Evans: Duncan, you've seen the stock build up over the last half. There will be a little bit more of that going into the second half, but I would hope to see us improve our DSOs, or data standing, as we move forward, so at similar levels or better at 30 June.

Duncan Simmons: (Merrill Lynch, Analyst) Right, okay.

Bernie Ridgeway: Duncan, just to clarify that, also you realise that those increased stock levels include the acquisition of Fluidstar.

Duncan Simmons: (Merrill Lynch, Analyst) Yes, for sure. So it's really, like I guess you had a really good result on the debtors. The inventory remained about at 69 days, and does that stay at 69 days in line with sales growth, and that's I guess where I was looking.

Paul Evans: Yes, I guess we'll always carry reasonably high stock levels in comparison to our competitors, because we put stock on the ground, close to our customers. That's one of our differentiators.

Duncan Simmons: (Merrill Lynch, Analyst) Then the other question, in terms of effective tax rates for the year, have you guys got any guidance on that? Do you think you'll be at 30% next year?

Bernie Ridgeway: Normalised, out tax rates should run at 30% going forward.

Duncan Simmons: (Merrill Lynch, Analyst) Yes, okay. Well, thanks very much and congratulations on the result.

Operator: Your next question comes from the line of Nathan Riley from Goldman Sachs. Your line is now open, please go ahead.

Nathan Riley: (Goldman Sachs, Analyst) Two questions from me. First one is just in relation to the EBITA margin. I'm just looking at the first quarter and second quarter split, just noting the first quarter, EBITA margin came in at around 24.1% and dropped to about 20% in 2Q for an overall half year, an EBITA margin 22.1%.

Can you please talk to what was driving that drop off in EBITA at the margin level, just given the increase in revenue?

Paul Evans: Yes Nathan, good to see you on the call and it's a fair point too, but the margin dilution there is really cost-related rather than on the sell side. We had an extra half million dollars worth of FX in the second quarter versus the first quarter. We had probably another just over a million dollars worth of extra costs in the second quarter that weren't there in the first quarter, to do with acquisitions, [Camtech] litigation and so on.

So if you weigh those back I think you'll find that there's been no margin dilution. So that's the good news as far as you're concerned because we don’t have to put prices up, et cetera, to reflect the margin generated in the first quarter.

Nathan Riley: (Goldman Sachs, Analyst) Okay. So when you're talking about continued improvement in EBITA margin going forward, you're talking about that underlying sort of 24%-type level?

Paul Evans: Yes, I think we should be okay on that. I mean, we've got our tool rental fees at record highs at the end of January. We've got Fluidstar for six months in the second half versus four months in the first half, and continued robust trading around the globe. So I think you'll see margins being healthy in the second half.

Nathan Riley: (Goldman Sachs, Analyst) Okay, thank you. The second question, just in relation to the Oil and Gas segment, I just note from the segment note you've got here - first time disclosed - it came out at a loss in the first half. Can you please talk to that and also just give us an indication whether you expect that to turn around in the second half?

Paul Evans: Yes, just on that, I mean I did make the comment during the call, Nathan, that the Oil and Gas Division underperformed throughout the half. On the instrumentation side, the reason we're changing the products model to a services based model is exactly that. On the Fluids side, you know, we underperformed there through a lot of flooding of onshore Australia, which has impacted our trading there.

So we've still got to carry those fixed costs and so on. So we'd expect that in the second half we'll see improvement on the Fluids side.

We expected to complete the DSHO joint venture in the current quarter, but you won't see much effect of that in this half. So the bottom line is we'd expect to be profitable in that Oil and Gas sector in this half.

Nathan Riley: (Goldman Sachs, Analyst) That's good, thanks for that.

Operator: It appears there are no further questions at this time. I'll now hand the call back to Mr Bernie Ridgeway.

Bernie Ridgeway: Thanks very much, Richard. That completes the presentation. If anybody would like to give Paul or I a call after this conference call, we're more than happy to take questions offline. Thank you.

Operator: This concludes today's conference. Thank you all for your participation.

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