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**Lodgement of Market Briefing**

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# Market Briefing

## SXE Managing Director on results, strategy and outlook

**Interview with Simon High (Managing Director& CEO)**

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### Market Briefing

Southern Cross recently reported its results which showed a full year loss of $1.7 million. What were the major factors impacting the result?

**Simon High**

The full year result for 2011 can be broken into two halves. We reached the bottom of our cycle in late calendar 2010/early 2011 and we have subsequently seen a significant turnaround with stronger margins and revenue. The improvement in industry conditions is now being played out in our order book. The second half could have been even stronger, but was held back by some delays on projects we were awarded back in March that commenced later than anticipated.

The Pluto contract was challenging, but ultimately successful and is now finalised. We were pleased with the quality of work we completed and our safety performance, and we're satisfied with the commercial outcome of this project. This was the first time we have been involved in a major LNG project and we have developed good credentials that position us well for future work on the west and east coasts.

The result also included $600,000 in incremental costs related to the Leighton contract for Gorgon that didn't proceed and was fully expensed in the second half. In addition, we incurred increased interest charges related to an overdraft to fund working capital for the Pluto project, which is also reflected in the result.

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The business did record a gross margin of 25.5% for the second half. Is this a reasonable indicator of margins for FY12?

**Simon High**

The 25.5% gross margin figure includes provision for the final resolution of claims for the Pluto project. Without this, the gross margin would have been more like 21%. Given the mix of work in the order book at the moment, the gross margin is expected to be around that level for the remainder of FY12. In the second half of the year we would expect to see an improvement in margins for work already contracted and a further improvement in margins as additional work flows through to the order book. Our target gross margin figure going forward is between 20 to 30% across the cycle.

The 2011 result included overheads as a percentage of revenue of 16%. This means we have capacity to grow, and the current overhead structure means we can book in the range of $150 million to $200 million in revenue without changing the overhead structure substantially. At these levels of revenue we should see optimal overheads as a percentage of revenue of between 8% and 10%.

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Your order book stands at $75 million, up from $27 million at 30 June 2010. How good a lead indicator is the size of the order book and when will we see the order book translating into revenues?

**Simon High**

All work included in the $75 million figure will be executed in FY12. As to whether this figure is a leading indicator, we started FY11 with $27 million in the order book and finished the year with $102 million in the order book. The additional $75 million in revenue was executed through a tight cycle with competitive margins.

We have started this year with better margins and it's conceivable we will see large double digit growth in FY12 compared to FY11.

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You have just announced a preferred contractor agreement with Rio Tinto. What does this mean for SXE in terms of likely contracts and impact on the order book?

**Simon High**

We are extremely pleased with this win, which extends the existing eight-year relationship we have with Rio Tinto working on its Cape Lambert port.

We anticipate the first piece of work under the new contract will start in the second half of FY12 and expect work to continue for a five-year period. The contract has benefits for both Rio and SXE in terms of committed capacity and certainty of project delivery.

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Will this additional work flow have an impact on working capital and require an additional capital raising?

**Simon High**

Based on our modelling and the way the contract is drafted, we have sufficient working capital to take on this work without needing to raise extra capital. The terms of the contract mean it is working capital neutral.

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With the increasing workload and order book, how critical is people numbers to your business, and how easy is it to recruit and retain people in the current market environment?

**Simon High**

We're a service business, so the more people we have, the more revenue we can generate. At the moment we are recruiting 100 people for the Sino Iron project and we're not having any difficulties finding the right people to bring on to the project.

But we expect to see a significant tightening of the labour market in six to nine months' time, particularly with skilled tradespeople. We are exploring avenues to recruit from overseas, and our head of training is reviewing sites overseas to conduct accreditation programs to bring in electricians. We expect similar constraints with construction managers and are looking at recruiting in North America and the UK.

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You have announced the business now has five business lines, with an additional operation, support and maintenance business line. Can you explain the nature of work in this new business line and the rationale for this initiative?

**Simon High**

SXE has historically been a capex project construction business. While this focus will remain and grow, we also want to develop the opex part of our business, which is less cyclical and typically involves longer duration contracts (normally three to five years).

Currently we have around $15 million to $20 million in recurrent revenue. The new business line will operate in a similar fashion to the construction business and will be involved in major shutdowns and minor upgrades to brownfield plants.

The aim of this business is to generate sufficient earnings to fund overheads for the group and de-risk the business against a downturn in the resource construction cycle.

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Can you also provide further insight on the likely mix of domestic versus international business in the future?

**Simon High**

Over the next three years the Australian operations will be the largest contributor to the business and the relative size of our international operations will decrease by virtue of the sheer size of the Australian market. But this does not mean international work is unimportant to our success. We have a permanent base in Lima in South America and we expect to undertake at least one project in South America and Africa each year.

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Given the current volatility in global financial markets, have you seen any delays in project commencements?

**Simon High**

Not at all. Iron ore miners are looking to accelerate investment plans, rather than delay them.

Our key clients Rio Tinto, BHP Billiton and Sino Iron are well-funded businesses that don't need to go to the financial markets to fund their expansion. So any volatility in global capital markets is unlikely to reduce their access to funding or delay projects.

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Will there be any impact on the business from the introduction of a carbon tax?

**Simon High**

Not that we're seeing at present, but the ramifications on most of our current and future clients is still evolving. The projects we deal with are well advanced and our clients have not given any indication they will delay projects as a result of the carbon tax.

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How is the business tracking against expectations for FY12?

**Simon High**

Performance was much improved in the second half of FY11 and this trend continued throughout July 2011. Our order book is strong and we anticipate a reasonable level of performance in the first half of FY12, and expect to hear about the outcome of bids on a number of significant projects in the second half of FY12. The year has started profitably and with positive cash flow and while it is still early in the new financial year, we're pleased with our performance so far.

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Thank you Simon.

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