SWICK
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Company Insight
the intelligent market update

Swick Mining Services Limited **Date of Lodgement: 6/2/12**

Title: "Company Insight – Swick half year results and ongoing strategy"

Highlights of Interview

- **MD Kent Swick outlines the Company's strong revenue growth in HI of FY12 and an NPAT increase of 193% on the previous corrsponding period**
- **Outlines Swick's strategic business focus and its strategic approach to pricing conditions, contracting and cost control**
- **Explains how Swick is attending to the key drivers in the business**
- **Explains the positive impact on the business of the 2011 restructuring and the degearing this has made possible; and the productivity intiatives that should benefit Swick's future performance and cashflows**
- **Outlines Swick's approach to maintaining future dividends**

Record of interview:

In this interview Kent Swick, the MD of Swick Mining Services Limited (ASX: SWK, market capitalisation A$77 million), answers questions about the Company's business strategy and its successful H1 profit announcement for FY2012.

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During FY11 Swick generated new and profitable work, growing revenue 16%, while simultaneously undergoing a restructuring. How is Swick's revenue performing in FY12, and how are those revenues translating into profitable business?

Managing Director, Kent Swick
Revenues in the first half of FY12 were just under $70 million and whilst we're inherently subject to fluctuations, we're tracking well relative to our full year guidance number of $130 million. On our current performance, revenues are up about 30% over last year.

On the key depreciation and interest items, our fleet is around three to four years old on average, so it's relatively young, but not brand new, and the charge reflects that. Further, amortisation is lower in the past and following the restructuring, there's a much reduced interest charge. So by year end, we'll be in a net cash position and a lot more of our EBITDA should flow through to the bottom line from FY13 onwards.

We're also working hard on our EBITDA margins, with a number of efficiency programs and productivity-based projects that should benefit the bottom line in forthcoming years.

We’re obviously very pleased that our H1 FY12 NPAT has increased 193% over the previous corresponding period – and to have declared our maiden fully franked dividend – so we think our initiatives have an excellent foundation.

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What is Swick’s corporate view of overall business conditions in its target area of underground mineral drilling, and what is the basis of the Company’s strategic approach?

Kent Swick
At the ground level we’re seeing a continued interest in drilling: there’s no pullback in demand, but by the same token we’re not in a bull market either. We see ourselves in a relatively steady demand phase and most of the contracts are renewals, but that’s partly because we’re cautious in our business and we target specific brownfields operations, that is, existing operations or work in and around operating mines, primarily reserve definition. We prefer this model, where infrastructure is available such as airfields, good camps, logistics and communications. Those circumstances allow us to lever off the infrastructure and facilitate the provision of a high quality, safety-focused service.

We’ve discovered a long time ago that brownfields operations are the target market for any sustainable business. We’re achieving our profitability in the absence of huge pieces of new business, but we’re seeing a decent flow of tender opportunities and we’re winning a reasonable share of them. We think this is enough to sustain a good outlook. With brownfields operations, these jobs don’t tend to come to an end – compared with one-off contracting they continue unless the mine closes or goes onto care-and-maintenance or if the client relationship breaks down. But I’ve been doing this business for 15 years and we’ve only lost a couple of clients apart from mines shutting down. So we’ve found that once we establish relationships, although drilling demand does fluctuate, two-year contracts tend to go into multi-year or decade long relationships.

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To what extent are you experiencing competitive pricing conditions in the current drilling environment? And to what extent does the availability of skilled personnel or equipment affect Swick’s ability to deliver on its contracts?

Kent Swick
In the brownfields market it is always competitive regardless of the outside cycle. The contracts we bid on are quite large and the brownfields operators have the ability to offer continuity in order to secure their cost bases, so we’re not really experiencing boom time pricing. In the past, during downturns, we’ve had to work with our clients to mitigate their difficulties and so we do what we can to limit our charges and help our clients in the downturn. That helps in a small way to sustain their businesses, but it keeps our rigs in work and what goes around generally comes around, and so building good relationships equates to good business.

But we’re in normalised pricing times now.

Of course, pricing pressure can come from your peers but in our business which is essentially underground diamond drilling, we have two major competitors in Australia and it depends on how hungry they are at time of tender. However we’re pretty mindful of our client relationships and we try to protect them.

We know there's a lot of focus on the cost pressures of maintaining a labour force in the WA environment. However, we're pretty specialised and focused on underground drilling and with about 450 operational employees in Australia, we can generate drillers with that base. We've got very good training systems and a training-from-within culture. Also, underground diamond drilling, whilst effectively a trade, is not as complicated as certain other types of drilling so whilst we always have to do recruitment and training, it normally isn't an issue on the critical path. The turnover can be high with the entry-level guys or drillers assistants, however once you are a driller inside Swick you tend to be quite happy with the Company and its focus on quality so we don't lose too many at that level.. With skilled tradesmen, we're the same as any other company – they're difficult to retain and expensive at the moment. But we know our place in the market and we continue to find people. Overall, there's no risk to our business from the people side in the current circumstances.

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Is Swick experiencing any issues in relation to fixed price contracts, or structural shifts for example in terms of risk sharing?

Kent Swick
Our contracts tend to be 'schedule of rates'. We don't find that we're being asked to fix-price, or have cost-plus arrangements either. The more productive we are, the more we can earn and the lower cost per-metre we can bid in our tenders. We're very focused on productivity. We're also very focused on safety for our employees and that is extremely important for our clients. We are constantly working towards a safe and productive culture and invest heavily in this area of our business.

One of the things we do well at Swick is design and build equipment with ergonomics and safety in mind, not just productivity. People always come first but it is productivity that pays the bills. Productivity advantages give the client an overall dividend by way of a reduced cost-per-metre - because their fixed costs are divided by more production – so we don't see the market moving away from our preferred system of schedule-of-rates charging. Thus, we're not – and we don't see ourselves becoming - caught in fixed price contracts in a rising price environment. It would be highly unusual for drilling contractors to face that risk. We'll obviously have to fix our rates on an annual basis, with annual rise-and-fall adjustments, and so we'll carry that risk throughout the year. We price our contracts very carefully and our financial and operational controls track performance continuously to the site level.

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In the current environment, are there any differences in the way Swick manages project delivery? And how has Swick's safety performance fared?

Kent Swick
Total value to clients involves price, service quality and reliability. We have very good, reliable equipment, productivity and safety. In keeping with our goal of offering excellent value and developing strong relationships, we don't compromise the long-term health of our delivery. We are a different provider in that respect – Swick is known for having high reliability of equipment, service and safety. We're also focused on some pretty key R&D projects around reducing hazard exposures, increasing productivity and reducing the number of men required to drill.

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Overall, what is the impact of current market conditions on Swick's key outcomes such as book size, rig utilisation, average revenue per operating rig, operating margins and returns?

Kent Swick
Current market conditions are pretty good although we always see fluctuations of course. In the last half, we had a couple of profitable North American jobs suspended while the clients raised money – so we are exposed to some extent to the debt and equity markets - but in general it is only a small effect. The biggest driver on Swick's performance is rig utilisation, so it's important that we get our assets built and employed. We have a strong focus on business development and as our rig utilisation has increased, we are further expanding our rig fleet with specific business targets and expectations in mind.

The other main driver is earnings per shift, which is the average revenue per operating rig per month. To enhance this, we utilise double shift work wherever possible and sustain high mechanical availability by focusing on maintenance and field service. We also have critical manning ratios we need to maintain in order to ensure we can crew the rigs at all times and generally we have an eye productivity output.

Importantly, we also have a good reputation for the standards and reliability of our equipment, but the key is to focus on the deliverables and how we achieve them.

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By commodity, Swick's client base portfolio is mainly gold-based. Are you satisfied with this, and do you target any different commodity mix?

Kent Swick
Our gold focus is a deliberate strategy. In the 2008 downturn we were heavily exposed to the nickel market in Western Australia and what we found was that as the number of rigs peeled off, the gold sector was maintaining and increasing demand. We've therefore managed to successfully refocus our business over the past few years, including spreading our operations across Australia into Queensland, New South Wales and Tasmania, to get the right commodity and geographical mix. Not only have we demonstrated that our business is inherently adaptable, but it has been a wise, strategic move.

As I've mentioned before, brownfields focus is very important to us. We want to limit our exposure to the short-term fluctuations in the greenfields drilling market. It's very difficult for Swick to be to be truly competitive on rates for 'one-offs' as we are established to cater for the higher demands of the brownfields operators, with particular focus on safety and training. To do otherwise just doesn't seem to work. We do some greenfields work, but they tend to be large, long-term agreements and we set these sites up on a very similar basis to our brownfields work.

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Can you explain Swick's North American business, how it fits into the Company's business strategy and its general strategic approach to expansion?

Kent Swick
Growth tends to have three horizons – building brand acceptance, penetrating the market and then consolidation. We had a lot of excitement around the development in 2004 of a unique underground diamond drill rig and as a result Swick went from a private family company into

to the public arena but we've found that Swick's real value proposition is built around production per man hour and our very productive rigs. Since rigs are not cheap to build, our most suitable markets are first-world nations where safety and productivity are important and labour rates are relatively high. North America has a similar focus on productivity and safety and a similar cost base, so we figure that this is where our Australian success is most likely to be replicated.

We're in the early stage of the acceptance phase in North America. We began operations in September 2009 and we turn over approximately $10-15 million a year in that region, so we've successfully started, but we'll need to expand and build our brand before we can really call it a penetration. These things take time, but we believe we have a good foundation and that our fundamental strategy is sound. We don't have any short term issues and we have plenty of opportunities in Australia. In the longer-term, I think North America should be able to provide great returns for shareholders and we believe we'll be in the market penetration phase at the time we maximise our position in the Australian market. That will be the best outcome for the business – sustainable, steady global growth across two key regions.

We're investigating Africa, but it's not a really high priority for the strategic reasons I've outlined – and because there's plenty of work elsewhere in the short to medium term. However if we might want to be in Africa in 5 to 10 years, we need to be thinking about it now. So we're starting some reconnaissance and research, but it is not our focus. We very clearly understand our strategic and competitive positioning.

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Earlier this year Swick disposed of the Surface Diamond Drilling Division for $17 million cash. What effect has this disposal had on Swick's profitability and returns, and on its ability to do business?

Kent Swick
We sold the business because we couldn't see ourselves developing a competitive advantage and becoming a preferred supplier especially in an acceptable timeframe given the other opportunities in our business, and particularly the need to put the business on a sustainable footing. We'd have been successful if we'd persisted, but it would have taken us 4 or 5 years to get into the top tier, so we decided to dispose of the division. It was an opportune time to sell with the upsurge of surface drilling activity. We know the purchaser is very happy with the acquisition, but it was an excellent outcome for Swick.

We were able to reduce debt, fix our balance sheet and focus on what we're really good at. We now have net debt of only $6 million at 31 December 2011 and we expect to be net cash positive by the end of FY12. The return on assets in our continuing business is also better than before. All in all, it was a good decision for our shareholders and it has allowed us to re-capitalise and invest in the key safety and productivity initiatives that should yield good results for the business in the forthcoming year. We're trialing these prototypes at the moment and hope to commercialise them in 2013/14.

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What is Swick's outlook for rig utilisation?

Kent Swick
We've got good utilisation at the moment, but it does fluctuate. Even while obtaining such good results in the first half of FY12 we've seen some seasonality in Australia and client

delays in North America. For FY12, and without any further additional contracts, we see a rebound in utilisation with two new Australian contracts –Panoramic at Savannah and Sandfire at DeGrussa - and in North America as clients recommence their operations in the second half of FY12, and with Newmont in Nevada. Of course, underlying this we have our solid base of excellent, loyal and long-term clients across a good commodity base.

As I've mentioned, we are expanding our rig fleet. We're putting 2 extra skid-mounted rigs into North America which are more appropriate to that market, and we are completing 6 mobile rigs in the current half-year based on anticipated demand. While we won't put high probabilities on certain tenders, we know there are a few good tenders of which we should win our fair share. So we intend to have a fleet available to meet reasonable expectations of demand.

I should add that when we calculate our expected net debt position at the end of FY12, we're accounting for the costs associated with this rig expansion.

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Swick has a reputation for being an innovator, particularly in underground diamond drilling. What new innovations can the market expect from the Research and Development activities that you believe will give Swick an advantage over competitors?

Kent Swick
In underground mines, you want your equipment to have the highest possible power in the smallest possible package. At present our competitors' equipment tends to occupy a bigger footprint and is less versatile and powerful than ours. Even though our current equipment advantage is important, we want to be the world's best underground diamond driller on all bases. It's around 80% of our total revenue and with our competitors it's the reverse, so we should be the best. We continue to focus on people, productivity and safety.

We're currently working on a unique rod handling system which has been an issue for underground where space is very restricted and where it's not cost-effective to put in larger drill stations. We'll be launching a unique solution later in the second half that will dramatically reduce the risk that our drill helpers are exposed to. That'll significantly improve both our safety performance and our retention. Drill helping is an entry level position and it's quite a shock to the young guys facing life on a minesite and extremely hard work. This improvement will take away some of the hard work and boost our skill retention, which will obviously improve the performance of our business.

We're also focused on a productivity project, aiming to reduce non-drilling time whilst underground by reducing the time taken to pull tubes and remove core from the ground. We're working on high speed retrieval systems to get core out, which have shown productivity improvements in the field by up to 10%. We're starting to integrate this technology and roll that through our business, through our fleet of around 50 rigs, which will take 12 to 18 months, but that should yield great results.

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Resources markets are currently experiencing volatility as well as growth. How is Swick positioned to deal with volatility in terms of its business?

Kent Swick
Exposure to gold should buffer the impact of another global crisis. Further, our debt is now low and our balance sheet is more robust so if significant revenue was to come off we can reduce our variable costs pretty easily. We have also shown that our business is adaptable through our switch from nickel to gold some years back. We are much better placed than we were 3 or 4 years ago.

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How do you summarise Swick's development strategy, business priorities and competitive advantages; and how does this translate into a value proposition for shareholders?

Kent Swick
Our Company's competitive advantage is not limited to our equipment, and we believe the focus on safety, quality and productivity provides the right mix to build and maintain our market base. We're also focused on the return on capital for shareholders so where our original rig builds were based on Atlas Copco carriers and Boart Longyear drilling components, we're now building the vast majority of the future components of the rigs in-house – particularly the carrier which will be 100% Swick-built. So we expect that our future capital builds from 2013 onwards should be about two-thirds the cost of our existing rigs. This is a very important factor. We can get our capital costs down and share this benefit with both our clients and our shareholders. The productivity and manning improvements that are in train will also sustain our business, offer greater market penetration and benefit the mining houses, our employees and shareholders. The returns to all our stakeholders should get better and better over time.

Finally, our focus on underground diamond drilling means the investment required relative to revenue is about a quarter of the investment required for surface drilling, so improved asset returns should be evident as we aim to deliver significant free cash and dividends going forward. Our initial dividend is only 0.5 cents a share but the fundamentals are there for growth in yield over time, and we'll look to build to dividends that are around 50% of our free cashflow.

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Thank you, Kent.