SWICK
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Company Insight
the intelligent market update

Swick Mining Services Limited

Date of Lodgement: 6/6/12

Title: "Company Insight – Update for 3Q FY12"

Highlights of Interview

- **Affirms that revenues and profits are tracking to consensus forecasts for FY12**
- **Excellent tendering success in 3Q FY12 establishes a solid foundation for growth in FY13**
- **Explains the basis of confidence in North American business and future rig utilisation in that market**
- **Explains the Company's continued strength in the Australian underground diamond drilling market and the initiatives to sustain Swick's competitive advantage**
- **Explains why strong utilisation for the Company's 6-rig expansion should ensure profitable paybacks.**

Record of interview:

We interview Kent Swick, the MD of Swick Mining Services Limited (ASX: SWK, market capitalisation A$66 million) about the Company's 3Q update for FY2012.

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You have advised a 3Q FY12 revenue figure of $31.3 million, and maintain your full-year guidance of $130–135 million. Overall, what are your reflections on the Company's results and operations for the quarter?

Managing Director, Kent Swick
Although people might say our 3Q revenues were less than one-quarter of the full-year, our 3Q revenues were in fact 'as expected'. This is because of a slightly reduced quarterly run-rate due to the combination of seasonal effects and the Christmas and New Year shut downs. This is the expectation in most drilling businesses, and most companies – like us - budget accordingly. In Australia, RC rigs are generally less utilised due to hot and cyclonic weather in northern parts and the operating clients tend to shut down for a period over the festive season to give their staff a break at that time of year. So this factor was taken into consideration. Our 3Q result takes our revenues to a March YTD of $101 million, and we maintain our full year guidance of revenue in the region of $130 to $135 million.

Our 3Q was, though, an outstanding quarter in the business development sense where we secured a number of additional contracts that total 13 full time rigs in work. These contracts range from one to three years in length, but because our customers tend to renew, we believe these contracts will end up having a considerably greater duration. We are progressively mobilising into these contracts and will have the full benefit of the additional revenue run-rate from July 2012 onwards. As a result, with the additional run-rate, we anticipate significantly improved FY13 financials.

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Rig utilisation has been more subdued in North America and the Australian surface RC market – why has this occurred, and do you foresee this situation continuing?

Kent Swick
The North American division saw another project put on care and maintenance and the net result was a low utilisation of three rigs out of eleven at the end of March. However, since then we have secured another contract at Tennessee Zinc Mines with a new client, Nyrstar, which sees another full-time rig in work as well as an additional rig being utilised in Nevada. So we are back to five rigs operating in North America with a number of further opportunities to come towards the end of the calendar year.

In Australia, the RC market exhibits seasonal workload fluctuations due to hot and cyclonic weather making northern parts of Australia relatively unreliable for access, and all drilling contractors budget for significant drop off in utilisation in Q3. Looking forward more broadly, the squeeze on junior funding as equity markets tighten could affect underlying demand for surface rigs if companies without appropriate free operational cashflow defer exploration. I am not expecting RC utilisation to peak this calendar year, but we have solid bookings for four RC rigs at present out of a total of seven and several irons still in the fire.

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What is the basis of your confidence that the Company's North American market will continue to develop? What strategic factors support your views?

Kent Swick
We believe North America is a key future market and we will continue to develop our business in that region.

Commercially and strategically, North America makes sense. In the medium and longer term, our objective is to develop our business in a high-quality market with a lower cost base than the Australian division, and we believe we have made significant inroads in building the foundation to secure the Company's goal. In a business sense, this is a very relationship-driven market and we are building our connections with key customers. We have long-term contracts with major miners Newmont in the US and Vale in Canada and we will focus on servicing these large clients to the best of our ability. Our experience has been that if we do this, these relationships will grow over time. Local employment and community support in North America is also very important, so we are confident that we'll generate results from our focus on high-quality service delivery, the safety of our employees and ensuring local input.

North American tendering opportunities generally follow the normal calendar year so there is a significant amount of work up for tender in the first half of FY13. We'll be approaching these tenders using the very successful pricing models we have recently developed, which have a key focus on manning ratios and the best-in-practice productivity of the Swick rigs. This focus on our operating costs and manning has yielded significant contract awards and commercial results here in Australia.

I expect the Company's overall approach, which focuses on total value due to productivity, safety and efficiency, will yield similar successes in the North American market.

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To what do you attribute the strength of the demand you're experiencing in the Australian underground drilling market, and why would you expect this to continue?

Kent Swick
One of the strategic goals that we have pursued, and successfully achieved, is to de-risk the business as much as possible by servicing underground mining clients in operating mines in Australia, and generally in the gold or copper/gold sector of the market. This 'brownfield' focus – as we term it - in these sectors - means that despite equity market fluctuations, the solid underlying cash flow from operations in many of these mines will keep our rigs spinning.

The strong demand we're experiencing in underground diamond drilling is also – and right at the heart of it - a function of the value and quality of our service offering. Within the Company, we maintain the desire to constantly improve and we focus internally on stretch targets and making our crews the most professional and safety conscious in the industry. We also keep improving our rigs and equipment to yield higher productivity, and maintain a focus on our key cost drivers.

Swick's key areas of Research and Development focus are high-speed core recovery, rod handling and automation, and in all of these areas, the Company's R&D department has made significant strides. We believe our project outcomes will yield significant mutually beneficial outcomes for Swick and our clients, that our relationships will be more secure and profitable, and that this will underpin the demand for our services.

The Company's five-year goal is to "double our metres per manhour", and by focusing on this key metric - and working in the way I've described - we will ensure we remain the industry's most efficient and best-value service provider. At the same time, we'll also still be making appropriate margins on this high-quality service provision that will deliver solid returns to our shareholders.

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The Company's monthly 'Average Revenue per Operating Rig' has remained very high. What factors does this reflect, and can you give an indication of how margins are behaving?

Kent Swick
The Company's high monthly Average Revenue per Operating Rig (ARPOR) reflects our focus on productivity and also the improvement in revenues as we adjust contract rates at renewal. The Company is very successful in renewing our contracts - on a mutually-agreeable basis or at re-tender if required - because the Company delivers a high-quality and reliable service to our clients. Under our contracts we can recover some cost increases under our standard 12-month rise-and-fall clauses however the significant step-ups occur at renewal.

Again, the key point behind this ARPOR metric is that productivity is the real 'win-win' for the Company and its clients. Therefore, we believe that our efforts to continually improve our drilling equipment and driller skill levels, as well as to introduce and deliver R&D initiatives, will result in significant improvements in our financial performance in FY13 and FY14.

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The Company is constructing another six (6) underground rigs to meet demand in the underground market. Why are you undertaking this expansion occurring when overall rig utilisation declined during the third quarter?

Kent Swick
Despite the absolute number at the end of 3Q being down slightly, the number of new contract awards secured during 3Q FY12 will increase our utilisation by 30 June 2012 to 48 rigs out of a fleet of 50 for the Australian underground diamond drilling division. In addition, the increasing demand from existing customers means that we are forecasting a significant net gain in utilisation over the next six months and we have to cater for this demand.

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What will the rig expansion cost, and how will it be funded?

Kent Swick
We expect the six additional rigs, all associated equipment and tooling will cost around $6 million, which will be funded from internal cashflow. There will be no increase in net debt.

Significantly, these new rigs are the first fully 'in-house, Swick-built' rigs where we manufacture the entire carrier, boom and drilling components in-house and do not rely on previous OEM components. This contains capital costs and allows us to make a number of significant improvements to the power, flexibility and ergonomics of the rig. All new rigs will have 110kW of contained power as a standard feature which makes them the world's most powerful rig in the smallest possible mobile package.

We believe these features will ensure strong utilisation for the rig expansion and profitable paybacks.

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You have spoken about innovation and R&D as one of the foundations for Swick's ongoing development and you mention 'safety and efficiency' as key targets. Why are these factors so important to development of the Company's business and how does the Company achieve its objectives in these areas?

Kent Swick
Safety and efficiency are critical to our reputation and financial performance and our clients also regard these factors as critical. The best case study for this is the Swick mobile underground diamond rig - from first development in June 2004 we have constructed and deployed a fleet of 58 of these highly efficient rigs, and we continue to expand the fleet. The outcome, from commercialising this internal R&D idea, is that Swick has – in only eight years and without acquisitions - become the world's largest underground diamond drilling contractor (a point we can calculate from the public announcements by leading competitors).

Swick's market profile and success is primarily due to our R&D philosophy. I am a professional mechanical engineer but more importantly a fourth-generation driller so and I can see potential improvements in our drilling equipment and systems every day. So while I am not able to operate the current design software, I am capable of getting my points across to the team on what I believe will be of value to the business. We also have an extremely professional engineering team and a dedicated R&D team that keep delivering innovations. In addition, our operational employees are encouraged and empowered to bring forward their ideas and we greatly appreciate their input into the designs that make their workplace more safe and productive. Our people want to leave our mark on the global mineral drilling market.

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How does the Company account for R&D expenditure, and how do you see this expenditure being recouped?

Kent Swick
We treat our R&D according to the proper accounting standards, that is, we capitalise the expenditure and amortise it over the expected equipment life. We write down non-commercial results, but we are generally very good at converting ideas to commercially successful products. We also upgrade our older rigs as new improvements come along so that as far as possible, our whole rig fleet is upgraded to current standard. We recover R&D investment via improved competitive advantage, efficiency and safety, as well as an overall enhanced perception of Swick in the market place. So, we win new work, secure renewals, and develop sustainable, growing revenues and margins.

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Overall, what are your reflections on the impact of last year's restructuring on enabling the Company to operate and respond to market conditions?

Kent Swick
We sold the surface diamond division last year to ensure we would maintain a competitive advantage in what we do. The sale gave the Company the opportunity and resources to continue to develop and invest in underground diamond drilling, our area of strength. We believe we've used the opportunity well. With the proceeds of the sale, we've been able to accelerate our R&D initiatives, which experience shows will yield greater returns for our shareholders and further secure our competitive advantages.

Swick now has the size and reputation where it can attract significant talent to its executive leadership team. Our recent additions have provided excellent leadership and direction, and improved standards in management systems, risk analysis, strategy and business planning. Importantly, I am freed up to spend more time with the operations group and with clients - to ensure that we are delivering a best-value service, at the highest standards possible, and meeting our client's current and ongoing requirements. We are very customer-driven and so we intend to remain focused on the key metric of productivity per manhour that ultimately will benefit all of our stakeholders.

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Thank you, Kent.