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The Manager

Market Announcements Office

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Edited transcript from 2018 annual results

Attached is an edited copy of the transcript from the financial results briefing for release to the market.

EDITED TRANSCRIPTION

Company:	**PWR Performance Products**
Date:	**27 August 2018**
Time:	**10:00am AEST**
Duration:	**40 minutes**

Operator: Welcome to the PWR Performance Products End of Year Results Release. All participants are in a listen-only mode. There'll be a presentation followed by a question and answer session. If you wish to ask a question you will need to press the star key, followed by the number one on your telephone keypad. I would now like to hand the conference over to Mr Kees Weel, Managing Director. Please go ahead.

Kees Weel: Good morning everybody. Thank you very much for dialling in. Appreciate it. I think a lot of you would have seen the result that was posted on the ASX on Friday and yes, it's been a good year. We've certainly kicked quite a few goals. And as we all know we've been working on our long-term growth strategy and the pipeline. So, I just want to run through a few key points about PWR.

Obviously, our revenue this year was $52m with an EBITDA of $16m and the NPAT of $11m. The total share dividend is up 30% from last year to 7.3c per share. So, as you see there not a lot has changed but we're certainly pushing forward to global technology partners around the world. During the next six to 12 months there'll be some announcements on that. Our staff increases over the last two years has been significant and as we've said there we've got 230 staff across three continents. And we are certainly pushing very hard on our R&D and our future productivity. It's been a very strong year. And when you look at our revenue going up 8% and our net coming in at close on 19% up, we think that's a reasonable result, particularly with an underlying NPAT of $12m, from a few costs being taken out with changes in the US which you've all read about.

I've spoken about the dividend which has been solid. It's on our upper end of our scale and we see that continuing in the next few years. And with a very strong cash position with $12M in the bank at the end of the financial year, which is very healthy for us. Plus, we have no core debt. On our financial performance I'd just like to hand over to Stuart, our CFO, and he'll run through some of the appropriate numbers that everybody needs to know.

Stuart Smith: Thanks Kees. Just starting at the top line, the revenue number's up 8%, as everybody's aware of. The growth and the UK/Europe and Australia was very good and very strong. Offsetting that was the decrease in revenue at C&R in the States, and that was expected as we exit from the non-core components of the business. This was highlighted before I started at PWR that there wasn't much return on that additional revenue. So, even though $3.5M of revenue has gone at C&R it clearly had no impact on the bottom line, which is testimony to the fact that it was not generating a return.

EBITDA - using statutory results which incorporates the abnormal items. The non-recurring items were highlighted in the presentation pack. And then of course the statutory NPAT of $11M is up over 18% on the previous year and the underlying NPAT is up 30% on the previous year. That's translated into the dividend, which is also up 30%.

Cash conversion was a key thing with EBITDA converting to cash at 101% at the headline level. At the statutory level, because of some of the non-cash adjustments that were processed, that's sitting at 101%, which is an enviable number to have. But in reality the underlying rate is at 96%, which is still a very good EBITDA to cash conversation rate.

Kees Weel: I'm not sure if you want to run through some of the balance sheet items, Stuart.

Stuart Smith: The other side of the equation is the net cash position, which Kees mentioned. $12M with no net debt is as a result of that strong cash conversation from EBITDA. Trade and receivables are up slightly, which is to be expected with the increase in the revenue. Inventories have decreased and net working capital has improved, resulting in about $800,000 being released from working capital. The balance sheet shows a big increase in assets, plants and equipment and that's primarily driven through C&R with the completion of the furnace and production line. And that was bought on stream and depreciated from the 1st of February. Intangibles are still exactly as they are and of course trade payables have increased slightly, again as a result of the focus on working capital. There's nothing else that stands out. It's a very clean balance sheet and it's pretty self-explanatory.

Working capital in the cashflows - as I mentioned before the conversation of EBITDA to cash is very healthy. Do we expect that to continue going forward? I certainly see no reason why that should change. And, again, focusing on working capital and further improvements of working capital are certainly high on my agenda. But capex doesn't reflect – capital expenditure of $5.2m doesn't include the announcement that we made of a $10m program. That's still going to be continuing through FY19 and even some equipment will only come through in FY20.

There's long lead times on some of these machines and also obviously we'll put them in at optimal times around business requirements. Kees, maybe you want to go back to the business outlook.

Kees Weel: The business outlook and the business overview moving forward, we see as very strong. We've got a very strong pipeline. We've spoken before about the OEM programs moving forward into next year, into next calendar year, to the end of this financial year. There'll be a little bit of revenue drop into FY19 financial year but we've got the four new ones (previously announced) coming online.

Obviously we've got the current GT40 program which is a five year program in the States. So, all those programs remain very strong. There's a few movements in there being some numbers that have gone up, some numbers have gone down but overall it's a very healthy revenue stream coming on. We only see that improving as we're getting very close to signing another couple of contracts over the next six to eight months.

Before I go onto the new facility, our competitor position is always being closely monitored. We had one of our competitors in Europe that is exiting the business at the end of this calendar year. We've made some significant inroads with some of their customers and that remains very positive for us, for our future growth coming particularly out of Europe.

Our new facility is up and running at Ormeau and it's been very positive. And that will be further developed and improved over this next six to eight months particularly. As Stuart said some of the new machines have some long lead time, particularly on our R&D side, but that will certainly help us with our R&D push into different parts of technology through other businesses and categories.

Human resources. It's certainly been a long, targeted recruitment program and ongoing. Over the last six weeks we've actually put on 15 staff. We've signed another six apprentices for this year, through our apprenticeship program which is very healthy. And that's what we rely upon moving forward with people moving up through the company. Stuart has talked about our capex program of $10m earlier. That is certainly well and truly on line, with probably more to come in the next financial year as well.

Efficiency improvements in the operations has been very good and the results show that. If we can increase our revenue by 8.5%, 9%, and drop out the bottom line of 18.5%, 19%, I think that's fairly good. Our continuous diversion into different applications, particularly into electronics and battery cooling, a lot of that has come on the back of the technology that we've been able to achieve and perform in F1 and Formula E programs. And with the battery and the electronics cooling area we find that a very big push for us and we feel that's going to help us with our emerging technologies. I've spoken about it before and although it's been slow, it's now coming into line fairly fast and we feel we'll be in a position to make some further announcements over the next six to eight months on some of our partners moving forward globally in that area.

The growth and the efficiency within the company has been very strong, with culture and quality the biggest things that we depend on. And we certainly pushed very hard at the board level to make sure that our STIP, the Short-Term Incentive Program, is extended further to more employees.

In our technology development areas, particularly in motorsports, we see a continuous increase with the billet machined tanks. We have another two very large machines currently being put in at this stage and they'll be up and running by Christmas ready for the rush. We touched on the electronic vehicles and emerging technologies. That's a very worthwhile thing to keep in the back of our mind as that is where that future's going. So, all in all we find ourselves in a very positive space and the pipeline over the next 12 months to 24 months is going to be certainly exciting.

The last slide, the capex slide, is self-explanatory. This includes CNC machines, 3D aluminium printers and CT scanners. We've got our small vacuum braze heat treatment facility happening. So, it's been very strong and it's exciting times for us. We'll obviously hope to have a lot more to say at the AGM. So, it's very positive and we look forward for your continued support in our stock. And I guess I'll leave it over to any questions that someone might have.

Operator: Thank you. If you wish to ask a question, please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star two. If you are on a speaker phone, please pick up the handset to ask your question. Your first question comes from Chris Savage from Bell Potter Securities. Please go ahead.

Chris Savage: Thank you and good morning. Kees, you flagged that key competitor in Europe closing out by the end of the calendar year. Do you expect them to supply any parts to the F1 next season or is that just going to be a gap in the market for you to potentially fill?

Kees Weel: They've certainly flagged that they won't be doing any further development for next year. We've certainly been engaged with the majority of their customer base. But we're very heavily involved particularly with those F1 customers in developing and designing the cooling packages for next year's cars. So, they won't be able to leave it to the end of the year to decide. A lot of people have already – I would say 99% of the people have already jumped on board with us and we will see that come into fruition particularly in the first few months of next year.

Chris Savage: Have you got the capacity to take on most of that shortfall in supply?

Kees Weel: Certainly, yes. And that's part of the reason why we leased that other building next door. And what we've been doing the last 12 to 18 months is ramping up our staff and training, ready for the influx of growth right across the company, not only in F1 but right across all our groups of businesses. And particularly with the emerging technology, I have flagged that as a fairly substantial increase over the next 12 months in that area. And that looks very positive.

Chris Savage: And just second question if I may. Obviously in FY18 there were a number of one-offs, largely or wholly around C&R. Is there any more to go? Any more one-offs we should expect in FY19?

Kees Weel: No, certainly not. The reason why we tried to put it all into this year, we felt get it all out of the way and let everybody concentrate on our future. And there's certainly nothing that is on the horizon that we know of. And we'd be certainly telling you if it was. That we see nothing of that and we see another positive year ahead of us.

Chris Savage: So, we could expect or should expect C&R to return to profitability and similar if not better margins than before?

Kees Weel: Correct.

Chris Savage: Okay. Thanks very much.

Operator: Thank you. Your next question comes from Alex Lu from Morgans. Please go ahead.

Alex Lu: Morning guys. Just a few questions for me. So, maybe I could just ask on sales. So, British pound sales were up pretty strongly, up 27%. Australian dollar sales were up 20% and obviously US dollar sales down 19. So, just wondering if you could just go through some of the key drivers for the performances of those regions please.

Kees Weel: We spoke about this a few times internally and what have you and the sales, particularly out of Europe, there's no real area which is more than another. When you look at our pie chart of different areas of our business it's very positive, Alex, right across the board. And, yes, obviously we say that the UK has a very substantial driver to our business, but even our domestic market here in Australia has been very positive the last 12 months and we see that continuing in strength as well. So, with what we're doing in Europe, there's certainly some of the OE programs happening this financial year and probably more so into the next financial year but they'll start towards the end of this financial year. And that will only continue with further development with some of the OE areas that we're dealing with. I would think it's across the board an improvement and particularly C&R is certainly on the turn now. They're starting their OE program next year, next calendar year, with the Ford GT500. And we're actually doing a runrate test of that in September so we are ready to go. It's positive right across the board.

Alex Lu: And specifically the aftermarket segment in the US, maybe just an update on how that's going and the traction that you're getting, is it better or worse than you were expecting there, Kees?

Kees Weel: It's about on line. It's about on line where we expect. We always knew it was going to take a little while. We're fairly impatient people, as you know, and I'm sure investors know that. But, look, with the tax incentives that Mr Trump has put in over there, particularly for export out of the US, it is certainly encouraging. The tax rate for the export out of the States, if it's made in the States and exported effectively drops down to 13%. So, there's an incentive to do some of our programs for Europe. We'll certainly manufacture them in the USA where we can which will also help alleviate pressure on Australia. Our capacity here is very full. That will help us to continue to do our niche programs here that are very lucrative for us and I think it'll work pretty well that way.

Alex Lu: And just final one from me. So, just another question on Marsden. So, you said that a lot of the Marsden customers are beginning to come over to you guys. But just interested in your comments on say the competitive environment going forward. Do you expect any new competitors to come in and potentially replace Marsden? Or how do you see it playing out?

Kees Weel: What we've seen, Alex, is that we haven't seen anybody else pop their head up. But that doesn't mean to say that they won't. As we all know we visualise things at a very wide angle. Marsden weren't a big supplier over the last 12 to 18 months. So, we've been speaking to all of them and doing prototypes and testing and validation for their new cars moving forward for next year. So, everybody's engaged with us and we haven't had a sniff of anybody else coming on the scene. That doesn't mean to say that we're cocky but we're certainly very vigilant and we will stay that way. We're vigilant but certainly very confident as well.

Alex Lu: All right. Thanks a lot, Kees.

Kees Weel: Thanks.

Operator: Thank you. Your next question comes from Wayne Jones from Ganes Capital Management. Please go ahead.

Wayne Jones: G'day guys and congratulations with all the results. I just want to go back onto C&R. Last year in the annual report you flagged that you were going to drop those distribution agreements and revenue would go down. And you flagged that the EBITDA would drop about $200,000 in C&R. But we've gone from a turnaround of about $1.7M for the last couple of years to a loss of $630,000 of the EBITDA line. Is there any reason there for the extra couple of million dollars that we should know about?

Kees Weel: Well, what we did say last year and the year before, that we were dropping some of the non-core programs that weren't bringing any revenue in. They were bringing revenue in but no net profit. And on top of that, NASCAR had gone to a spec core, which kicked in at the beginning of this year. So, the last six months there was a significant loss out of the NASCAR area. We have got that spec core, we do supply everybody in NASCAR, but they brought in a spec core to cut some costs out of that. So, there's certainly been nothing abnormal of what we've spoken about before.

Wayne Jones: Are we likely to go back to that $1.7m EBITDA going forward? Is that the sort of number you expect?

Stuart Smith: I would hope we go back to more than that but there's certainly no reason why we shouldn't go back to that level.

Wayne Jones: And just on Marsden, and you'll probably talk about the AGM, but there's no likelihood of them selling part of their business to another competitor?

Kees Weel: No.

Wayne Jones: No?

Kees Weel: No. Just for everybody's interests, Marsden is owned by United Technologies Group out of America. And United Technologies bought Marsden in 2000 I think. United Technologies is an aerospace company and they bought Marsden mainly for product to use in aerospace. At that stage they kept a small area of their factory to do motorsport. And the reason that – as they have said that they're getting out of motorsport because the aerospace business is certainly very demanding and they feel that they wanted to concentrate all their efforts onto aerospace moving forward.

Operator: Thank you. Once again, if you wish to ask a question please press star one on your telephone and wait for your name to be announced. Your next question comes from Marshall Vann, private investor. Please go ahead.

Marshall Vann: Hi Kees, hi Stuart.

Kees Weel: Hey, Marshall. How are you, mate?

Marshall Vann: Good. Good. Congratulations. A couple of questions. Once again over 83% of your revenue is in foreign currency so I noticed you did some hedging during the year which generated a loss of $230,000. I suppose the challenge with hedging is if you don't hedge it moves the wrong way and if you do hedge it moves the wrong way. What's your view going forward on your hedging strategy, particularly in GBP currency?

Kees Weel: We're working on a program at the moment, Marshall, that hopefully we'll have in place over the next 30 to 60 days for that. Because obviously the majority of our revenue coming in from Europe is from January through to July. So, we have got a little bit of time. Not that we want to waste time on that. Yes, we will be putting some hedging forward in one form or another. Little bit early to tell what that will be. Look, I think the way the exchange rates moved over the last 12 months I think we came out reasonably well with only being down a couple of hundred thousand on that. Because it was volatile there for a while. It's always a concern for everybody, we understand that. And we were actually just talking about it earlier this morning, as nobody knows what Brexit is actually going to do in the next six months. As one of our board members, Roland Dane, pointed out at the board meeting, if someone did know it'd be a miracle. Because he speaks to a lot of people in the UK particularly as he's still got business interests over there, and does a lot of export out of the UK and he said they're not the wiser. So, it is early days we will be certainly doing some hedging moving forward, that's for sure.

Marshall Vann: Another question maybe for Stuart. The effective tax rate this year is down from 28% to 25% and I know you made reference to trying to use more favourable tax regimes. So, do you see that rate coming down in the future? And then the second part of that is, is there any likely impact on franking credits in the foreseeable future?

Stuart Smith: So, the first question. Look, in terms of the effect of rate of tax, I don't expect it to come down significantly – I don't expect it to come down from where it is in the next financial year. Going forward, once we transition and get more revenue through C&R, that will certainly have an impact. And of course that depends on where it's sold and incentives around that. So, that's something for FY20 and beyond. The second part in terms of the franking credits, I don't think that that's an issue at the moment. The amount of profit that we make in Australia is significant and we've also got a fairly healthy franking credit account at the moment.

Marshall Vann: Okay, that's great. One last question, please. Just the building next door, where are you at on that? Are operations running there now?

Kees Weel: Yeah. All the specially built and the F1 build is in there and operating. We just put another new wire cut machine in there last week and transitioned some CNC machining centres in there. So, that's 100% locked down now. And now we're starting to work on the other 50% of the building, which is particularly R&D and a future technology area for that. So, that will be certainly filled up fairly quickly but it certainly gives us the capacity to do a lot more capacity without the restrictions that we've had before. It's really going very, very well.

Marshall Vann: Okay, that's it. Thanks guys.

Kees Weel: Okay, thanks, Marshall.

Operator: Thank you. Your next question comes from Tama Willis from Devon Funds Management. Please go ahead.

Tama Willis: Hi, Kees, Tama here.

Kees Weel: Hi.

Tama Willis: Just a quick one on the emerging technologies. Looks like some good revenues coming through already in 2018. Can you elaborate a bit on the items that are benefiting this current year and where do you see that business getting to over the next couple of years? And the second question was just on – the cost performance looked pretty good. And just any points on investment in the business this year to meet some of the demand that you're clearly seeing.

Kees Weel: I'll handle your first one first. The emerging technology sector, as we've said before, is come from a very low base. So, we don't want to talk too much about percentages but the actual revenue that's starting to come in from that is starting to creep up. Future wise we are certainly seeing a lot of – I'll say a lot of interest in certain types of electronic and battery cooling, particularly cooling for the electronics of autonomous vehicles. Autonomous vehicles seem to be certainly well in demand, particularly in America.

It's a bit early to say, I don't want to let our gunpowder off too early, but we feel the next six to eight months will have a significant announcement for our future emerging technology business, particularly in the electronics and computer cooling for vehicles. But other than that, we're also doing a lot of other cooling applications. So, they have several commercial applications. With our investments moving forward, as I said earlier on and Stuart alluded to it, the $10m that we announced for our Capex spend some time ago, we've probably spent probably half of that, a little bit over that. And some of the machines that are on order have long lead times but will certainly fall into this financial year. And beyond that there's always going to be a smaller Capex with different things that we do, but they'll be all based on specific programs and so we don't see anything that's sticking out and say, "Hey, this is where we want to spend a whole heap of money on that." So, it'll be program-specific moving forward.

As far as acquisitions go. I'll handle that as well while we're at it. We have had some offers over the last 12 months which we've declined. We've had a look through the front door a little bit but have seen no reasonable bolt-on deal that we could do that would help us moving forward or gain any other technical advantage that we might have at this stage. So, we're still very heavily involved in our own R&D moving forward and we feel that's the best way to keep spending on our own R&D rather than trying to buy someone else's that has no significant value in the long-term.

Tama Willis: Great. Thanks very much.

Kees Weel: Thanks, Tama.

Female: There are no further questions at this time. I'll now hand back to Mr Weel for closing remarks.

Kees Weel: Thank you. I'd like to thank everybody for dialling in today. I'm sure most of you – we'll talk over the next two or three days and next following weeks. Everybody knows what we're doing. I hope there's been no surprises. We don't like them. No one likes surprises. As far as moving forward, we feel that the next 12 to 18 months is certainly exciting and we've been building up for this, we've spent a lot of money on Capex and people over the last 12 to 18 months. And we are certainly backing ourselves for a very solid year this year and an extra busy year next year. So, thank you all and hope everybody has a good day. Thank you.

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