BBA Aviation 2012 Final Results

Overview and strategy update – Simon Pryce

Q: Aviation markets have, as you say, been softer than anticipated. So how do you assess these full-year results against that stubborn backdrop?

A: As you quite rightly point out, in 2012 our markets were somewhat weaker than we had originally anticipated. And of course we did suffer from a weak de-icing season, particularly when you compare it to what was quite a strong de-icing season in 2011. So against that background, I think the business has actually performed very well.

In Flight Support, although we did see revenues down 1 per cent, that was actually an outperformance to the markets, which was pleasing to see. And that was more than made up for by our Aftermarket businesses that were actually 3 per cent ahead.

And if you look at below the revenue line, in terms of operating performances, all of our businesses performed well during the year against the backgrounds that they faced. We saw good cash conversion. We announced an increased dividend. We created more investment capacity, to help facilitate further our strategic plan execution.

We made good strategic progress during the year. We spent $35m on strategic acquisitions, and with the recent announcement of our potential award of the second FBO at San Jose, we will have committed to $70m of growth investments in 2012.

We have enhanced our Commercial Aviation Services. PLH and Drydon gave us access to Canada for the first time in our Engine Repair and Overhaul business. We continue to expand the licences that we have authorisations on, which allows us to provide a broader range of services to our customers.

And in Legacy, we continue to expand our licence portfolio. So if you stand back and look at it against that background, I think we had a very good year.

Q: And the acquisitions you refer to, how are they bedding down?

A: Pleasingly, we're getting quite good at these sorts of things now. All the acquisitions that we made during the year have at least met or exceeded the expectations we had of them when we acquired. And we actually see more opportunity, really from all of them, than we initially thought when we made the purchases.

Q: And you still see significant potential for further operational improvement. That's prompted a change in the management structure of the two divisions. So what's the rationale here?

A: I think rather than the change being prompted by the opportunity, the structural change we've gone through is a continuing evolution at BBA Aviation. If you look at the progress we've made over the last five years, we've gone from a very disparate set of five individual businesses to a much more consolidated and focused global aviation services and aftermarket provider.

Our businesses are working better together. We are identifying and realising opportunities for cost improvement, for efficiency gains, for best-in-class process and practice sharing.

And the organisation change that we announced at the beginning of this year is really a continuation of setting our business up to take advantage of the really significant growth opportunities that we see going forward. Those growth opportunities come from the markets in which we operate. They come from the consolidation opportunities that we see. They come from the continued execution of our strategy.

And whilst the outside world won't see anything materially different as a result of this change, where we do anticipate change over the next few years is in the back office, where we can see better opportunities for common process, common practice, information sharing and cross-business cooperation. And I think that's what we'll see evolve over the next few years.

Financial results – Mark Hoad, Finance Director

Q: Revenues increased 2 per cent in the full year. But operating profit was down 2 per cent, excluding exceptionals. So why was that?

A: There's a few things going on with revenue. First of all, there's a $15m increase associated with fuel price inflation, which is a straight pass-through to the customer that has no impact on profitability at all. We had $56m contribution from acquisitions. And if you strip those two things out, on an organic basis, revenue declined by 1 per cent. That compares with market declines of between 1 per cent and 4 per cent in the B&GA and Commercial markets.

Now, we've worked hard through operational improvement to mitigate the impact of those market declines, but really the reduction in profitability is driven by the lack of de-icing that we had in the year.

Q: And talk us through those exceptional items, because pre-tax profits were considerably lower.

A: Yes. We did have exceptional costs last year, but we also had an exceptional interest income of $12m at the pre-tax level. This year we've had $33m of exceptional items, of which $21m are cash exceptionals. So within there, there is $13m of structural cost initiatives, namely the Finance Synergy Project and the closure of Basingstoke, the APPH site. There is $7m of acquisition costs, $8m of non-cash amortisation of intangibles, and then another $5m of other restructuring exceptional items.

Q: And what specific costs did you take out during 2012?

A: So, in terms of structural cost reduction, as I say, there were two principal initiatives: the Finance Transformation Project, or Finance Synergy Project, which saw us establishing two business support centres, one in Orlando and one in Luton, and transferring transactional processing out of the business units and into those centres of excellence. And from that we've had a $2m cost reduction in 2012, and there's another $2m to come in 2013.

We've transferred Component Repair capability out of Basingstoke and into the main Runcorn. By doing that, we've avoided $4m of CapEx spend at Basingstoke, and generated $1m of annualised savings.

Q: And return on capital of 10 per cent leaves you further away from your 12 per cent target than you were last year. So how disappointed are you? And will you still stick to this target?

A: So the 10 per cent return on invested capital that we achieved in 2012 compares with 10.6 per cent in 2011. That reduction is principally linked to that lack of de-icing that we talked about previously. Clearly, it's disappointing to have this metric go backward, but we're comfortable it will recover, and we remain completely confident and committed to achieving that 12 per cent through cycle return.

Q: And you mentioned good cash conversion in the statement, but net debt has gone up. Why is that?

A: Operating profit was converted into operating cash flow at 91 per cent, which is in the middle of our target range, and that's what we expected to happen. That translated into free cash flow of $121.2m. Now that free cash flow was consumed by, first of all, returning almost $70m to shareholders in the form of dividends. We spent roughly $35m on acquisitions. And then we've also spent $11m closing out cross-currency swaps, and a further $12m purchasing shares to satisfy share option exercises and long-term incentive plans.

Q: What update can you give us on leverage? Are you still happy with the investment capacity available to you?

A: Our net debt to EBITDA was 1.6x at the end of 2012, and that compares with 1.5x at the end of 2011. So it's marginally below our target range of 1.75x to 2.25x. And we're completely comfortable that at that level that gives us about \$250m to \$300m capacity in 2013. And as we said before, we'll continue to generate investment capacity as we go forward.

Q: And the dividend you are proposing? You are confident that a 5 per cent increase is appropriate at this time?

A: The Board proposed a final dividend of 10.45 cents, which would take the full year dividend to 14.65 cents, as you say, a 5 per cent increase for the year.

That really reflects, first of all the progressive dividend policy we have and also the Board's confidence in the medium terms prospects for the Group. At that level, the dividend is covered 2x and with the balance sheet as strong as it is, the Board is completely comfortable it is an appropriate level of increase.

Flight Support – Simon Pryce

Q: Signature has, as you have mentioned, outperformed the market. Was that all down to network expansion? How much can be attributed to TailWins, the customer loyalty programme, for example?

A: Signature has a unique network and that allows it to put in place an awful lot of commercial initiatives to provide the sorts of services that Signature provides to its customer most effectively in a way that suits the customers' needs and demands.

I think that the network has strengthened during the course of the year. Our Signature Select programme has added four locations during the course of the year. We have a very good pipeline of active discussions to continue to expand that low-capital way of enhancing our network.

We have also acquired FBOs in Omaha and started up a greenfield operation in Berlin. We have now got 115 FBOs in that network, of which 70 are in North America. That allows those commercial initiatives that we have undertaken, of which TailWins is just one, to be very effective. And that is why Signature continues to outperform the markets in which it operates.

Q: And what will drive future expansion? Will it be acquisitions or will it be that Signature Select model?

A: I think it is a combination of those two things, acquisitions and Signature Select, but also other organic investments that we see. For example, we have announced the complete extension and redevelopment of our Luton facility. That will create imbedded growth and increase the network strength. So I think there are three ways in which we will continue to expand, and make more relevant to our customers, the Signature network.

Q: What else can you tell us about the San Jose deal?

A: San Jose is currently a sole source FBO. The airport authority sought an RFP last year and I am pleased to say that the airport authority has recommended that as a result of that RFP, we be awarded a second FBO. It is a very big and potential development for us. We are doing it in partnership with the founders of Google. And it will result in the development of a 29 acre site on that field. And it will be one of our biggest FBOs in our network.

Q: Turning to ASIG. What have been some of the significant contract wins and losses here?

A: ASIG had a challenging start to the year. We lost a major cabin cleaning contract with BA at Heathrow. We partially replaced that with new business at United, but it did take us some time for the new contract wins and renewals to kick in. However, I am very pleased with the performance of ASIG, particularly in the last quarter in that regard.

We have renewed a very large FedEx into-plane contract in 27 cities. We have got new contract wins for ASIG, with Spirit, with American, and a very good maintenance win at LAX. So, I am pleased with the momentum that ASIG has generated during the course of the year and, as usual, it has dealt with its contract wins and losses very effectively

Q: And what was behind the last of the BA contract?

A: Well, it was clearly disappointing because we have had a long relationship with British Airways on cabin cleaning. However, at the end of the day, we have very firm financial matrix against which we have to perform. We will not take on contract that we do not think will allow us to provide the right quality of service and still make money for BBA Aviation's shareholders.

But, pleasingly, we continue to look at other services that we can provide to our customers which perhaps have more barriers to entry. The GE engine wash business is a good example of that. We would not have won that without the boarder engine expertise that we have in the Group. That is a great additional to the technical services that we can provide our commercial customers as they seek to manage and control both their fuel and their engine maintenance costs.

Aftermarket Services – Simon Pryce

Q: Turning to Aftermarket Services, ERO revenues are up by 5 per cent for the full year, but what is behind the slowdown we have seen in the second half?

A: Well, ERO started 2012 with a very good order book, really driven by the big increase we saw in flying hours in the first quarter of 2011. As flying hours have flattened, then ERO's maintenance inputs have softened a bit. But, we are very pleased with their continued share gain and they are well set for 2013.

Q: You highlight that Legacy has trebled in size since 2006. Is that level of growth sustainable?

A: I think it is. There is a massive demand in the world for OE standard and legacy components to support an aging fleet of military, commercial and business in general aviation aircraft. And Legacy's unique business model makes those parts available when customers need them, at a price that is appropriate for those customers.

We have only just scratched the surface on Legacy. We had some good licence wins in 2012, but not as many perhaps as we would have liked. But, I am pleased to say that our new licence pipeline as we enter 2013 is as strong as it has ever been. I think as the OEs and the tier ones look at how to best manage their support for the legacy fleet and identify that the BBA Aviation Legacy business is a very good way of handling certain components, and supporting those customers in the future.

Q: And we've talked about this a lot, but could APPH finally be on the front foot?

A: APPH has been through a tough three years. It was the last of our businesses to really see the downturn and we have been working hard to right size APPH to the markets in which it operates and the opportunities that it sees. It did have a much better second half. That is a function in part of increased volume, increased spares demand, but also OE build on some of the new programmes that they are working on. But, also, really good operational improvement and we have talked a little bit about the footprint reduction that they have achieved and that's actually increased the efficiency of our production by centralising some of our coating capability.

APPH is, I think, has got a bit of a wind behind it now. They are continuing to focus on operational improvement. They have some contract issues and supply chain issues to work through, but there is really good momentum up there now and I am really pleased with the progress that they are making.

Outlook – Simon Pryce

Q: Can you give us a little more detail about the leading indicators that you say support "medium term recovery and structural growth"?

A: Off the back of a market that effectively has been flat for three years, I think it is important that we do not lose sight of the potential of market growth and recovery in Business & General Aviation space.

I think our medium and long-term indicators are as strong as they have been since 2007 for that recovery. I think , if you look at things like the second-hand value of planes, the proportion of the in-service fleet available for resale, all of those are stable. There is a very big pick up in second hand transactions in

2012. There are new planes coming into service right now, some of them which create a whole new class of business in general aviation jets. The G650 is a good example.

The OEs themselves are forecasting a pick up in jet deliveries, for the first time in three years, in 2013. They are actually anticipating that over 10,000 jets will be delivered over the next 10 years. They've said that for a bit, but for the first time it is being supported by real orders.

In June, NetJets made a $9.7 billion order and that was closely followed in November by VistaJet, that ordered nearly $8 billion worth of Bombardier planes.

So, generally, there is very positive momentum. Not just in our space, but also in the broader economic indicators. Particularly in North America, where we are at last seeing some pick up in consumer interest and in housing.

Q: Staying with North America, it has been a long time since the business in general aviation market grew at the target 4 per cent - 6 per cent. This must be a concern?

A: I do not think it is a concern. The only concern I have is our ability to predict when it will happen, not if it will happen. There is not really any alternative to Business & General Aviation for certain types of users in the US. There are not any efficient, inter-modal alternatives. There are big physical, geographical separations between business and population centres in North America. Business & General Aviation is an increasingly cost effective way of travelling around, particularly as America's commercial network migrates to a hub and spoke model.

So, it is not a matter of whether or not this growth will happen. It is just a matter of predicting when.

Q: You say you see BBA playing a role in further market consolidation. Will this be focused on any area of the business in particular?

A: I think our strategy has been consistent for three or four years now. We operate in very fragmented spaces, of which our FBO business, Signature, is one. We will continue to see consolidation in that space and we will be participating in that consolidation.

Q: There has been some ownership changes in the FBO marketplace. So how could this affect your ability to expand?

A: I think there has always been competition for FBOs. I am not surprised that there is buyer interest in some of these assets. We always face competition when we are looking at FBOs because buyers see the same things in these FBOs that we do. That is the ability to benefit from the very real recovery and long-term structural growth that exists in this business at some stage in the future.

Q: And, outside of the US, where do you see the most attractive growth opportunities?

A: I think the US is our major marketplace. It is the place where most business in general aviation and commercial flying happens. But, we have a material presence in Europe and there are a number of places in Europe where we would like to continue to expand our FBO business into.

And, of course, our operations in Asia Pacific, although relatively small, are in a part of the world where we will see, over the next 10 years, significant growth and the ability to provide the services that we provide in more developed economies over time.

Q: So, if 2012 was, in your words, "another year of operational improvement, structural cost reduction and strategic progress", what will 2013 be?

A: I think 2013 is likely to be more of the same. I do not think that we are forecasting for anything other than flat markets. Whilst we are seeing medium and long term indicators probably as positive as they have been since 2007, we have not seen that yet translated into a material improvement in business in general aviation flying. So, I think it is prudent, from where we sit today, at least for the first half, to plan for a pretty flat market.

But, of course, BBA Aviation's value proposition, and the way we continue to drive and create value going forward, does not just come from market growth. It does come from continued out performance; continued reductions in the costs of the services and the products that we deliver; increasing the attractiveness of those products and services to our customers; continued application of our investment capacity to consolidation in the spaces in which we operate.

So, generally, I think we are set fair for a good 2013. It will be more of the same, more effective and efficient delivery and creation of value.