2013 Interim results

Simon Pryce, CEO

Results overview

Q: Given the broadly flat markets you're operating in how pleased are you with these results? What's your assessment of the first half?

A: Well I think this is yet another set of results that proves that BBA Aviation's strategy for long-term sustainable value creation is working. We are going to create that value from four main blocks: its performance; cash generation; investment; and its growth. If you look at what we've delivered in the first half our businesses continued to show share gains, to show operating margin improvement, to show structural cost reduction. In terms of cash generation, we've doubled our free cash flow in the first half of 2013. We invested nearly $60m in new licenses and acquisitions. And importantly even in relatively flat markets we've delivered 3% revenue growth.

Now whilst the market piece of that, growth remains slow, it just is evidence of how well poised this Group is to generate cash even whilst markets and generate market, even whilst markets are relatively -- in a relatively slow growth phase and just demonstrates the accelerated potential of the Group that we'll see in a period of sustained business confidence and broader Business & General Aviation structural growth.

Q: And how has that flowed through into the financial performance?

A: Well I think our 3% revenue growth - of which 2% was organic - plus the operating performance improvement we've seen across the whole of our businesses translated into operating profit increase of 6%. Then positive developments in our interest costs and other items resulted in a profit before tax, increase of 14% and some reductions in our sustainable tax rate means that earnings per share were up a very creditable 22%. And of course finally the Board continues to operate its progressive dividend and the dividend increase that the Board has recommended is 5%.

Q: But there is still no sign of improvement in Business & General Aviation activity in the US. We've seen a decline of 3% in Europe. So how significant is this?

A: Well clearly business and general aviation movements globally are important to the Group, they drive 65% to 70% of the Group's businesses. And, as you've said, we did see a period where North America was broadly flat and Europe was down 3%. In terms of North America interestingly we continue to see signs, positive signs, of recovery, both in terms of the macroeconomic indicators that we care about and, importantly, some of the underlying business confidence indicators. And we are even beginning to see that flow through into strong growth throughout the first half in the North East where all the business centres tend to be and also in certain types of users, particularly chartered demand was up very strongly in the first half. However, much of the rest of North America remains very volatile. So I think it's too early to call a return to accelerated growth quite yet. It's not that it isn’t coming it's just a matter of when it comes.

In Europe, I think the macroeconomic conditions will mean that Europe will be a lower growth environment for some time to come. And then of course most importantly as you'll be getting used to now BBA Aviation continues to outperform its markets, so even in flat markets we still deliver growth this half of 3%.

Q: And so how sustainable is that profit increase that we've seen in the first half?

A: Well, as you can see, the first half saw good development in profitability with margins up in both divisions. And we did benefit from a much better and normalised de-icing season. And we also had a contribution in the first half of 2013 from our PLH Dryden acquisition, which we only acquired in August of last year. But even with that, over half of our growth was from organic share gains. And that combined with ongoing operating improvement means that actually the business delivered very effectively in the first half even on top of those two more one-off items. So we are very well placed, as we enter the second half of the year, for a continued and sustained development of our business.

Q: And you've referred already to free cash flow, which almost doubled, so what's driven that?

A: I think the free cash flow has, as you said, almost doubled and that's at a time when actually we've increased our capital expenditure by over $8m that's nearly 20%. And I think a lot of its due to our continuing focus on running the business and minimising the amount of capital we deploy in it. I think we have seen a reduced working capital outflow in the first half versus the first half last year, and that's despite actually having a big parts buy in our engine repair business at the end of last year which we only paid for this year which will work its way out during the course of the second half, so generally very good free cash flow performance and more to come.

Divisional performance

Q: And if you strip out what you say is a more normal de-icing period how disappointed are you at the lack of organic revenue growth that we've seen in Flight Support?

A: Actually, if you strip out both the impact of a normalized de-icing season - I think it's important to emphasis it was only a normalised de-icing season - and the impact of the PLH Dryden acquisition, about half our growth - nearly 1.5% - was actually from organic market share gains and so on and so forth, so actually the underlying businesses within Flight Support continue to perform very well.

Q: We've seen a mixed performance in Aftermarket Services and Systems so what have you done to offset that anticipated downturn at ERO and do you expect that downturn to continue into the second half?

A: Well of course firstly it's important to note that Aftermarket Services which has a much broader cyclical exposure still saw good progress in the first half of 2013 despite ERO having a very strong comparator half in 2012 and it did see some revenue decline. We did anticipate that in part and also have undergone, as part of our continuous focus on driving improvement in the business, a sales force reorganisation in Q2. We are already seeing the benefits of that reorganisation begin to flow through, and we anticipate ERO returning to growth in the second half. But of course, even though ERO had a challenging revenue half it was more than made up for a very strong performance from Legacy and indeed from APPH.

Strategic progress

Q: Turning to the reorganisation, what early results are we seeing?

A: Well I think both divisional teams are now embedded. They have already delivered the cost benefits that we envisaged at the time that we made the announcement at the beginning of the first half, and we'll see the full-year effect of those this year. But importantly they are beginning to identify opportunities for much closer cross-business collaboration, sharing of best in class process and practice, and an increased focus on customers and service delivery and performance. And we continue to anticipate some really good benefits from this reorganisation for the remainder of 2013 and beyond.

Q: Update us on the acquisitions made this year, starting with today's Westchester County announcement.

A: Well, as you can tell with nearly $60m invested in acquisitions and licenses it's been quite a busy first half. We did sign last week the acquisition of Jet

Systems at Westchester County. Westchester is the second busiest business and general aviation airport in North America. And this allows us to consolidate our already leading position on the field. And importantly for Jet Systems and its employees they've become part of the broader Signature Group and Signature network. And this allows customers to access the Signature high-end standard quality service across a range of FBOs in North America.

Q: And some of the other acquisitions?

A: So in addition to Jet Systems at Westchester County we've also acquired a majority share in the Starlink FBO at Montreal in Canada. This is important because, although relatively small, it is the first conversion of a Signature Select location to a majority-owned FBO within the Signature network. And we've also completed the acquisition of Gategroup's, commercial aviation services, selected commercial aviation services at Heathrow, Gatwick and Dublin. And then we shouldn't forget we also have signed a second license, and a much bigger license, with Curtiss-Wright in our legacy business. And this is the first major Legacy license we have signed for over 12 months.

Q: We've talked to your organic investment in the period, the ongoing upgrades or Signature FBOs and the further roll out of F1RST SUPPORT, for example.

A: Well as you know we have a number of ongoing projects that are incremental and growth in nature, we continue to see good development in those projects all of them are on plan and to cost. West Palm Beach will be finished in September of this year, about five months ahead of schedule. And we are also investing in places like Luton and of course the RFP which we won recently in San Jose where we've just received zoning consents. So all of that is building a good growth pipeline going forward.

But it's not just in Flight Support which we are investing in the future. We shouldn't forget the very significant engine buy which facilitates a lot of engine repair and overhaul activity within our ERO space. And also the roll out of F1RST SUPPORT, and in the first half of this year we completed a F1RST SUPPORT centre in Asia Pacific in Singapore so all in all a good period for organic investment.

Q: So what else can you tell us about the acquisition pipeline and the circa $300m investment capacity that you've talked about before?

A: Well, as you will remember from our previous conversations that the Group's cash generation capacity creates continuing and substantial investment capacity as we go forward. We've invested nearly $60m of this in the first half of this year, but that still leaves us with well over that $300m. And that's pleasing at a time where we see a very strong pipeline of opportunity, which we are beginning to convert. So I think we are well placed to continue to make good investments going forward.

I think the other thing that's important to remember is the Group remains very capital disciplined. And I think if there were a sustained period of time where our net leverage position remained at below our target range the Board would have to think about other means of making the capital structure more efficient. But from where we are today there is lots of opportunity to continue to invest our investment dollars in, in a very value disciplined way to create long-term sustainable value for the Group.

Outlook

Q: BBA Aviation's ROIC is flat at 10%, so are you still committed to a through-cycle ROIC of 12% implying that it will be well above that level at the peak of the cycle?

A: Absolutely, I think there is nothing that we've seen in the first half that has changed our view of the long-term attractiveness of the markets in which we operate and our ability to benefit hugely from them. Whilst our return on invested capital did only marginally tick up in the first half we are very comfortable that the long-term 12% pre-tax return is more than achievable, particularly as we get back to a period of more accelerated growth but also as a result of the continuing actions that we undertake and the outperformance that we deliver over and above our markets.

Q: And you refer to a return to "greater business confidence", but is there any real visibility of when this might materialise?

A: Well I think as we've always said in this business on a through-cycle basis our market is pretty predictable, it is however tough to make short-term judgments within a cycle. We are very confident that there is long-term structural growth to come in the business of general aviation and that we will benefit hugely from that growth when it comes. There are some continuing signs of recovery in North America, early lead indicators as I've mentioned, things like business flying in the business centres of the North East, charter flying which is very much done by business and on-demand. But until we see a period of more sustained business confidence we are not going to see that accelerated growth. But when it does happen, then we are very well placed to benefit from it.

Q: And what about the outlook for the full year?

A: So underlying the very strong performance in the first half we did have a contribution from the PLH Dryden acquisition, and of course benefited from a more normal de-icing season. But notwithstanding that, about half of the Group's growth came from organic activity and therefore we are very well set for the second half. And even in this low growth environment we continue to anticipate good progress in 2013. And I think importantly the Group continues to be more efficient, more effective and better able to benefit from the more accelerated growth that we'll see in a period of more sustained business confidence.