

BBA Aviation 2013 Final Results

Simon Pryce, CEO

Mark Hoad, Finance Director

Results overview

Simon Pryce

Q: 2013 was a busy year for BBA Aviation, with progress on many fronts. So talk us through the key contributing factors, as you see them.

A: Well, our market-leading businesses performed very well in flat markets. We produced a very good set of financial results. And importantly, we disposed of APPH well during the year. That focuses the group very much now on aviation support and Aftermarket Services, and we're also returning the proceeds of the APPH sale to shareholders, through a \$125m buyback. We saw good performance from both divisions. In Signature, we saw a very significant strengthening and expansion of their network in 2013, and in ASIG, with its renewed focus on customer service, the benefits of which we're already seeing in new business wins, they produced a very solid performance. And then in our Aftermarket Services division, we saw new OE relationships, we saw new authorisations and new licences and, all in all, produced a very solid set of operating results. And then finally, we've been working very hard on value creation and future growth. We've invested a further \$150m across both divisions during the course of the year, and indeed, since the year end, we've invested a further \$24m acquiring some FBOs, buying Skytanking, which enhances our position in North American fuelling and indeed have gotten a new licence, the first with Rolls-Royce for Dart engine overhaul. So all in all, 2013 was another year in which BBA Aviation continued to deliver.

Operational review

Mark Hoad

Q: BBA Aviation has delivered a strong financial performance in 2013, so talk me through the context for those results.

A: I agree. I think these were a good set of results, and I think there are three key strands to that. First of all, we're dealing with revenue growth of 2%, despite the fact that it was a fairly muted market backdrop. Secondly, we saw good progression in profitability. Operating profit was up 4% and earnings per share were up 9%, and then lastly, cash generation was really good once again. We had cash conversion of 101%, and free cash flow increased by 21% to \$146.5m. And I think that that set of results is really is yet again a reflection of the inherently attractive financial characteristics of the business.

Q: And in Flight support, you continue to outpace your market. So what's behind that outperformance again?

A: In Flight Support, organic revenue grew by 4%. In Signature, it was 4% growth compared to a market that grew by 2% in North America, whilst in Europe the market was down 2%. And the outperformance particularly came in North America, where it was very strong. On the ASIG side of the business, the market was down 1% in North America and 2% in Europe, and ASIG grew by 5%. Now, that was partly driven by the return to a normal de-icing season and partly because of contracts that we won late in 2012.

Q: And what's happened to margins in the period?

A: So margins overall for Flight Support have remained unchanged year on year, and this is because although, as I say, we saw good drop through on the organic revenue growth, we did have some higher cost inflation than we would ordinarily see, and there were two key factors at play here. First of all, in ASIG, we've been trying to drive operation improvement and improve the delivery standards, and we incurred some costs in the year to deliver that. And then secondly, in Signature, where over the last couple of years we've been securing lease extensions, those lease extensions had rent increases associated with them, and it will take us some time to recover that rent increase from the customers.

Q: And in Aftermarket Services, we saw some weakness in ERO, offset by a strong performance by Legacy, so talk us through that.

A: Yes, in Aftermarket Services, revenue was down 2% overall. As you say, Legacy Support had a really strong year, with 14% revenue growth. That was driven by a couple of things. First of all, demand for fuel system upgrades, relating to the GE fuel measurement business that we bought back in 2011, and secondly, there were a couple of large contracts, one for landing gear being delivered to the US government, the other one for LANTIRN ECUs. Those two contracts were substantially completed in the year. APPH performed well, reflecting the work that's been going on over the last couple of years and which set it up for the successful sale in February of 2014. And then lastly, ERO did have a more difficult year. Demand was soft in the first half of the year, and we had anticipated there would be some improvement in the second half, but actually, demand for Tay and TFE731 remained subdued, including the fourth quarter.

Q: Cash generation continues to be one of the business's core strengths, so talk us through free cash flow and what CapEx is planned for 2014?

A: So, as you say, cash is a key strength for us, and that was evidenced again this year with cash conversion of 101%, free cash flow increased by 21% to \$146.5m, and in that, cash conversion was up at 100%, notwithstanding the fact that capital expenditure increased in the year. Key projects continued to progress well. We completed the Newark FBO, we completed the Palm Beach NetJets facility. And then work on the Luton redevelopment is well underway. Going into 2014, we're going to see fairly sizable CapEx again, continuation of the Luton redevelopment programme. We're also starting work on the San Jose development, and for 2014 as a whole, I'd expect CapEx to be around 1.4 times depreciation and amortisation.

Q: And talk us through the update you provided on tax.

A: In 2013, the tax rate was 14.5%, marginally lower than we had in 2012. Going into 2014, I'd expect the tax rate to be somewhere in the 16% to 18% range.

Q: And we've talked about this previously, but what's your current assessment of return on invested capital progression, and do you have any plans to change that 12% target?

A: In 2013, return on invested capital improved by 20 basis points, notwithstanding the fact that we're making a lot of investment in the business that's going to drive growth and value creation in the future, and as to any change in the targets, absolutely not. We remain completely committed to delivering in excess of 12% return on invested capital through the cycle. We see no structural change in this business and have no reason to believe that that is not achievable.

Value creation and growth

Simon Pryce

Q: In 2013, you bought well and you sold well, so talk us through the key strategic investments that were made across the Group during the year.

A: Well, the \$150m of new investment that we've made in 2013 is spread across both divisions. In Flight Support, we've acquired significant FBOs at Westchester County and at Van Nuys in America, and that's consolidating our position on the second and sixth largest business and general aviation fields in North America. We've also acquired Starlink Aviation, or 75% of Starlink Aviation. That was our Signature Select location in Montreal, and this is the first conversion of a Signature Select to a majority-owned member of the Signature network, and it's pleasing to see the benefit that Signature Select can bring not only to our customers but also to the owners and ultimately to Signature itself.

And we've signed an interesting agreement with Imperial Oil in Canada. This gives us access to Imperial Oil's nearly 40 dealers and opens up a whole new market for our Signature Select offering. We've also won RFPs at San Jose, which we told you about last year, but now we have all the permits through and, in fact, ground-breaking was last week. And also in Trinidad, and we've started operations at Berlin Tegel and also at Changi in Singapore.

Q: And if we look at your expansion projects, are they proceeding to plan?

A: As you know, we're in the middle of quite an aggressive expansion programme on the organic front, and we've completed the projects that were due for completion, and we're making good progress on those that we're undertaking today. We opened the NetJets dedicated terminal at West Palm Beach a month early. We completed our Newark redevelopment in time for the 2013/14 Super Bowl. And finally, at Luton, we continue to progress well with that development. We're on target to open the FBO by 2015, and indeed, the hangar is already up on the far side of the field.

Q: And what about Aftermarket?

A: In Aftermarket, we've also had a good year. We've made significant strategic expansions into authorisations in the helicopter and rotary craft engine space and into APUs. And in Legacy, we've expanded the number of licensors that we work with and signed up five material new licences in 2013 that both extend our capabilities and our exposure to exciting legacy platforms.

Q: And since the end of the year, you've acquired Skytanking, so what's the rationale?

A: Skytanking is an interesting opportunity for us to expand our already market leading presence in the management of fuel farms and interplane refuelling in North America. As part of the transaction, it also allows us to exit from our sub-critical-mass fuelling operations in continental Europe. And, of course, we've also acquired two more FBOs in the first couple of months of this year. We've acquired our competitor at Detroit, and we've acquired a small FBO at Biggin Hill in the UK. Finally, in Legacy, we've continued to expand our relationships with licensors. We've entered our first licence with Rolls-Royce, which is for the full spares support for the Dart engine, so overall it's been a busy start to 2014.

Q: And if we return to the sale of APPH, what's the rationale behind that disposal?

A: APPH was the last of the BBA Aviation businesses to feel the effects of the economic downturn, and also it's the only part of the group that was really focused on product design and development and on manufacturing. And we've been working hard over the last couple of years, and the APPH team has done a great job in addressing some of the operational issues that the business faced and really setting it up for future growth. During the course of the last couple of years, we have received the odd approach for APPH from people interested in expanding and building a large landing gear business, so we decided to conduct a targeted process. And it became relatively quickly apparent that there was more value to be created for BBA Aviation's shareholders through selling APPH than there was through retaining it and integrating more effectively within our Aftermarket Services division. So we sold the business for \$128m at a nearly 18 times multiple of normalised operating profit to Heroux-Devtek. They're a focused Canadian landing gear manufacturer. It's a good result for BBA Aviation, and it's also a good result for the APPH employees, and we'll be returning the net proceeds of the sale to shareholders by way of a buyback.

Q: And to what extent was that share buyback determined by a scarcity of acquisition targets?

A: Not at all actually, I think the Board is very capital disciplined; we've got a very significant amount of financing capacity and our businesses, which generate a huge amount of cash, create more and more investment capacity as we continue to operate them effectively. We have a very solid pipeline of future investment opportunities and taking all that into account the Board feels very comfortable returning \$125m to shareholders and still having plenty of financing capacity to aggressively pursue our growth strategy.

Q: Pursuing, as you say, the growth strategy, what further opportunities for operational improvement do you see across the Group?

A: So there's also a lot of stuff that we're doing which is very much within our control. We have completed the transition to a two-divisional structure, and we've started to realise the benefits of operating more effectively together. But there's more of that to come, and that will be a process of continual improvement over the next couple of years. In a year of what we anticipate to be relatively flat engine repair demand, we're also taking a hard look at the ERO cost structure. We've known for some time that the ERO footprint in North America is relatively inefficient, so in this period of relatively low growth for engine repair, we've decided it's time to rationalise our footprint and invest in a state-of-the-art facility in North America. It's a two-year improvement programme. It will cost us about \$16m in cash. It will result in about an \$11m exceptional charge, but what it will leave is ERO with an excellent cost base and expanded services and capabilities and capacity in time for when the market returns to growth in 2015.

Q: And Sir Nigel Rudd has been appointed as Chairman designate. So is he now on board?

A: Yes. Sir Nigel joined the Board in December, and he steps into the role of Chairman at our AGM in May. He has big shoes to fill. Michael Harper has been a great guide and chair to this organisation over the last 10 years, and without his commitment and enthusiasm and guidance, the business would not be where it is today. But we're very pleased that somebody of Sir Nigel's calibre is stepping into Michael's shoes at this stage of the Group's development, where we are continuing to execute an ambitious growth strategy, and we look forward to Nigel continuing to lead us in the effective execution of it.

Outlook

Simon Pryce

Q: What gives you confidence in the industry's long-term potential?

A: Well, at our investor day in November, there were a couple of key takeaways. An independent expert confirmed our view that there's been no structural change in the business and general aviation market, particularly in North America. That means that over the long term and through cycle, B&GA in North America should grow at GDP plus. There are also a couple of signs that in a very depressed delivery environment, some of the medium-term indicators of demand for new and second-hand airplanes are beginning to improve. So the proportion of the fleet available for sale is now below the average of the last eight years and well below where we would consider it normal at this point in the cycle. Second-hand prices of airplanes have stabilised, and indeed in some categories have started to rise. So that all bodes well for good deliveries and improved deliveries in the medium term, but actually, throughout this cycle, the size of the fleet has been growing. So the thing that will really drive a return to growth in the short term in business and general aviation is utilization of the in-service fleet, and pleasingly, at the same investor day, the independent expert flagged what drives utilization actually is corporate confidence. And the best measure of corporate confidence is reinvestment or investment rates. And in North America, the sort of cash as a proportion of assets in total US

corporate balance sheets peaked in 2012 and has been coming down ever since. That's a sign of corporates beginning to reinvest. It's a sign of corporates becoming increasingly confident about their future, and that's what will drive a return to growth in business and general aviation.

Q: And if we look at the short term, US business jet activity has been improving in the last few quarters, so what does that mean in terms of growth for 2014?

A: Well, through the second half of 2013, whilst it's still very fragile and volatile, there was some sign that North American business general aviation flying was getting back to growth. And we saw 3% growth in Q3 and in Q4. As we enter 2014, therefore, we are cautiously optimistic. If we look at our markets, Europe is weak and we don't anticipate that recovering any time soon. North America, however, we have seen a continuation at least in part of the trends that we saw in the second half of last year, and corporate confidence continues to build. That's good news for Signature, with its strength in network, and ASIG, with its greater focus on customer service already winning it business, it means that subject to markets, we look forward to a year of good progress in Flight Support. In Aftermarket, our Legacy business had an excellent 2013, and it will see a slower 2014. It delivered a number of major contracts during the course of 2013, which we will only replace as our new licences kick in, but that's being broadly made up for our operational improvement programme in our engine repair business. So we expect Aftermarket to see less progress than Flight Support, but still some progress. So all in all, when we stand back and look at the group as a whole, on a performance basis, we look forward to continued good progress, and in addition, of course, we have our investment pipeline and our investment capacity, which in a very value-disciplined way we'll continue to deploy during the course of the year. So, as I say, we feel very -- we're cautiously optimistic about 2014.

Q: And looking across the divisions, how do you feel about BBA Aviation, and what's your aspiration for the year?

A: As I sit here today, I see our markets beginning to recover, and I see the long-term growth in those markets representing a very significant opportunity for us. I see us continuing to find ways of operating our businesses more effectively and to enhance our future performance. And I see us deploying our capital very effectively in the fragmented spaces in which we play. BBA Aviation is a unique business with a really exciting future.