

ASX ANNOUNCEMENT: 1 March 2010



CEO on H1 2010 Results

Open Briefing with CEO Graeme Sumner

Service Stream Limited
Level 12, 555 Lonsdale Street
MELBOURNE VIC 3000

In this Open Briefing[®], new CEO Graeme Sumner talks us through Service Stream's first half results for FY 2010

- Service Stream consolidates position for future growth
- Guidance of underlying EBITDA from operations for FY10 of \$24.3 million maintained
- Company has solid base to build from and pursue growth opportunities

Open Briefing interview:

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Service Stream reported a net loss of \$8.6 million for the first half of FY10, this is down from a profit of \$6.6 million for the previous corresponding period. What were the main factors that contributed to this result?

CEO Graeme Sumner

The reported results were primarily impacted by the loss on the McCourt Dando GCDA project where we wrote down \$15.8 million in costs, \$14.6 million for the claim itself and then another \$1.2 million for legal and consulting fees.

The other primary driver was the loss of earnings at TCI where we saw a significant shortfall in TCI's business, largely driven by the completion of projects that were not replaced.

Our result was also impacted by non-recurring payments of \$1.9 million as part of our contractual KPIs for Telstra and \$1.1 million in CEO transition costs.

On a underlying basis, before the McCourt Dando provision and the non-recurring payments, our EBITDA was \$13.7 million, which was down 10.4 per cent.

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Your cash flow traditionally in the first half is negative. For the first half of FY10 your outflow was less than \$1 million, compared to an outflow of \$16 million in the previous

corresponding period. What was the reason for this improvement and what are your expectations for cash flow in the second half?

CEO Graeme Sumner

Cash flow in the first half of FY09 was impacted by the McCourt Dando GCDA project where work was taking place that we weren't being compensated for. Cash flow for first half of FY10 was assisted by improvements in working capital. In particular we've improved our performance in receivables where the balance of trade debtors and accrued income has reduced by \$12.6 million, excluding the write down of the GCDA claim of \$14.6 million.

Our net operating cash flow for the second half of the year is expected to be positive, approximately \$10 million is what we're anticipating and we would therefore expect full year operating cash flow to be slightly above the \$8.2 million recorded for the 2009 financial year.

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Net debt at December 2009 was \$77.6 million, down from \$102.6 million at June 2009 following your capital raising of \$32.9 million, giving you gearing of 25.2 per cent. Are you comfortable with this level of debt? What is your target for gearing?

CEO Graeme Sumner

We are certainly aiming at reducing our debt further. We've announced another payment of \$7.5 million with our half year results and made that payment on February 25. We also expect to make further reductions before the end of the financial year.

Whilst we haven't set a specific gearing target, we are comfortable with the level of debt that we maintain, particularly on the back of a cautiously optimistic earnings outlook going forward.

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The AMRS business increased its revenue by 56 per cent to \$33.1 million and EBITDA by 124.2 per cent to \$3.8 million. What were the main drivers behind this improved performance?

CEO Graeme Sumner

The main drivers on AMRS performance were their ability to win new customers and drive their growth organically. This is demonstrated in top line growth of 55.9% to \$33.1 million, stemming from increased revenues from environmental programs and meter reading and installation services. This is a pleasing result as it demonstrates that AMRS have a good understanding of the markets that they operate in and the utility customer base.

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During the first half you secured new contracts and renewed existing contracts with clients that included Telstra, Western Power and CitiPower. Can you provide more detail around some of the more significant contracts? You are currently in final negotiations for \$90 million in contract renewals, do you expect to secure all this business?

CEO Graeme Sumner

We do expect to secure all of the \$90 million.

We are somewhat restricted in talking about the specifics of individual contracts because of the confidential nature of the contracts we have with our clients. But it's fair to say that all of the work is of a very similar nature and similar segments to what we have conducted in the past.

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Following a disappointing performance from McCourt Dando in FY09 you undertook an intensive review and implemented structural and personnel changes. Are you confident you have stabilised this business? Does it remain a core business for Service Stream?

CEO Graeme Sumner

The first point I'd like to emphasise is that we are getting out of the large civil construction business, which was really at the core of the problems associated with McCourt Dando. There are a number of small construction activities that that business undertakes that aligns with our core business. So we will maintain activity in the small end of the market, where the construction activity is complementary with the other things that we do.

We're confident that we've put the issues of McCourt Dando now behind us. We are completing a review of the Service Stream infrastructure business and we do therefore expect a few more changes to be made to ensure that Service Stream focuses on the things that it is best at.

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The company has an outstanding claim for \$14.6 million relating to the GCDA Project for work undertaken by McCourt Dando. You are pursuing this claim through legal proceedings and have made a provision for \$15.8 million against this claim. What is the basis for this dispute and how confident are you of achieving a successful outcome?

CEO Graeme Sumner

The dispute is about variations to a project that we undertook to install a pipeline as part of the construction of the Gold Coast desalination plant.

We have written off the full amount of the claim which suggests we are not confident that the claim has a likelihood of succeeding. Having said that, there are aspects to the claim that we do think have merit and we are in the final process of evaluating those claims and whether or not we will continue to pursue them. Obviously we will keep the market informed of actions that we intend to take, particularly if they provide any certainty around recovering any of that money.

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Service Stream is one of the main providers of field services to the telecommunications sector through the installation, maintenance and construction of fibre and broadband networks. What opportunity does the National Broadband Network present for Service Stream? Is the uncertainty of the roll out of the NBN having an impact on the company in the near term?

CEO Graeme Sumner

The opportunity for the National Broadband Network is obviously a tremendous one for Service Stream but remains uncertain at this point in time. We await the outcome of the

legislative and negotiation processes that are currently going on before we can confidently talk about what the size of the opportunity might be.

In the meantime there is uncertainty in the market, which is having a detrimental effect on telecommunications infrastructure expenditure. We are seeing examples of that, particularly in new estates where we now have houses that are not being cabled because it is unclear as to whether or not they should be cabled with copper or fibre. It is also unclear as to what the future ownership of that copper or fibre cabling will be.

That is acting as a handbrake on some expenditure and in the short term we expect that to continue. We look forward to clarity around the NBN process very soon and we think that this will help us to realise some of the opportunities that we are aware of.

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You expect your underlying EBITDA from operations for FY10 to be \$24.3 million, this implies the second half will be broadly in line with the first half. How confident are you of achieving this and what are the risks to your forecasts?

CEO Graeme Sumner

Our guidance of underlying EBITDA remains in place and we are cautiously optimistic about the outlook. Having said that, the risks centre around Telstra volumes, which again we believe are potentially impacted by the uncertainty surrounding NBN, and also the government's ongoing commitment to environment programs.

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You have decided not to pay an interim dividend this time around. Do you have a dividend policy? When do you anticipate dividend payments to resume?

CEO Graeme Sumner

The decision to pay a dividend is a board decision and one on which depends on the sustained financial performance of the company. Given the company's expected performance this financial year we do not intend to pay a dividend this year.

However, we would like to resume paying dividends next financial year but this of course will be a board decision and be subject to an improved performance in 2011.

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You have been CEO of Service Stream since January this year. What are your initial impressions of Service Stream and what are your key priorities for the next 12 months?

CEO Graeme Sumner

My initial impressions of Service Stream are that it has a strong core business and it is a competitive player in the telecommunications and utilities sectors. The company has a very good base to build from and all of the core operating units are making a solid contribution.

My priorities over the next 12 months are to focus on getting the company back to its core business, the things that Service Stream is very good at and to take advantage of the growth opportunities that we see in our core markets.

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Thank you Graeme.

For more information about Service Stream Limited, visit www.servicestream.com.au or call Graeme Sumner on +613 9677 8817

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