

Transcript of ShawCor's Fourth Quarter 2006 Results Conference Call

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OPERATOR: Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the ShawCor fourth quarter 2006 financial results conference call. At this time, all participants are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up for questions. If anyone has any difficulties hearing the conference, please press * followed by 0 for operator assistance at any time.

I would now like to turn the conference over to Mr. Gary Love, Vice-President of Finance and Chief Financial Officer. Please go ahead.

GARY LOVE (Vice-President, Finance, Chief Financial Officer, ShawCor Ltd.): Thanks, Julie. I'd like to take a moment to remind our listeners that today's conference call and webcast includes forward-looking statements that involve estimates, judgements, risks and uncertainties that may cause actual results to differ materially from those projected. The uncertainties include, among others, economic conditions, levels of drilling and pipeline activity, environmental and regulatory risks, liability claims, exchange rate fluctuations, political risk and raw material prices.

Further information on risks that could affect the company can be found in ShawCor's 2005 annual report and annual information form, as well as the quarterly reports for 2006. Copies of these reports are available on SEDAR at www.sedar.com and may also be found on the ShawCor website at www.shawcor.com.

Bill.

WILLIAM BUCKLEY (President and Chief Executive Officer, ShawCor Ltd.): Thank you, Gary, and good morning, everyone. We're speaking to you today from Singapore. We've had our board in the Far East region for facility and management reviews and we've had our board of directors meeting here earlier today. This is consistent with our continuing board review program.

Now having said that, we're obviously quite pleased with the operating results that we've reported today for both our fourth quarter and for full year 2006.

While the revenue growth was modest, we were able to fully replace the \$200 million in revenue contributed by the Langed project in 2005 through strong growth in our other operating regions. This was accomplished while also generating a 45-per-cent improvement in operating income year over year.

Revenue in the fourth quarter was stronger than we anticipated for several reasons. First, small-diameter coating demand in western Canada was much stronger than expected in the quarter. However, demand has now slowed and there is evidence of large inventories in the channel which may negatively impact Q1 and Q2 07.

Second, to meet service requirements at our large-diameter plants in western Canada, we attempted to add extra shifts in advance of our new

plant capacity in Camrose coming on stream and we were successful in adding shifts in Q4-06 which allowed us to increase large-diameter project shipments in the quarter.

Third, our Thermotite deepwater installation facility in Norway and our new deepwater facility in Brazil both achieved revenues in excess of forecast.

And finally, Shaw Pipeline Services had stronger revenues due to clients extending contracts.

Profits were higher in the quarter as a result of the stronger than projected revenue as well as positive variances and higher margins on the KOC, Reliance and other large-diameter projects, positive variation orders at our Shaw Pipeline Services Division and generally higher margins due to favourable mix and improved execution.

This provided results for the full year 2006 of revenues of \$1.06 billion, 5 per cent over 2005, representing a new record and we were able to replace the \$200 million Langed project revenues. And revenue, by the way, in the year has been restated to reflect the changed proportional consolidation of our APCO business unit.

Net income in 2006 reached \$92.6 million, or \$1.25 a share. That's up from \$0.85 a share achieved in 2005 if the one-time effects of the OMSCO sale are eliminated. This reflects a 47-per-cent increase and is a new record on a continuing operations basis.

In line with this strong performance, we announced today an increase in our dividend from \$0.18 per class A share to \$0.23 per class A share on an annualized basis, a 28-per-cent increase.

I'll provide some additional comments on our business activities and outlook but first I will ask our CFO, Gary Love, to provide additional details on the fourth quarter and full year 2006 results. Gary?

GARY LOVE: Yes, thanks, Bill.

Our fourth quarter press release provides a thorough outline of our quarterly results and I would encourage you obtain it from our website at www.shawcor.com.

The first factor that I'd like to highlight for you is the decision taken in the fourth quarter to account for our joint venture in Saudi Arabia on a proportionate consolidation basis.

This change has, in turn, necessitated the restatement of prior reported results. While the restatement doesn't change net income, we have restated 2005 revenue upward by \$8 million. In 2006, the impact of the change on the first nine months results was an increase in revenue of approximately \$20 million.

As Bill mentioned, fourth quarter results produced record operating income of \$41.8 million, up \$10 million over the fourth quarter of the prior year. This occurred despite the fact that revenue in the quarter was actually \$17 million lower than the fourth quarter of 2005.

The fourth quarter 2005 revenue had included \$42 million from the Langeled project in the North Sea. The completion of Langeled in the first quarter of 06 left a considerable gap to be filled; but if we look at the full year 2006 revenue for ShawCor, strong growth in our Far East, Middle East and Americas regions of our Bredero Shaw Division along with our other pipeline segment businesses, have fully offset the \$200 million in revenue gained in 05 from Langeled.

In our petrochemical and industrial segment, revenue compared with fourth quarter 2005 is up 16 per cent and has increased 14 per cent on a full-year basis.

Now, given that fourth quarter 2006 revenue was down from the prior year, the key factor that led to the 30-per-cent income growth in the quarter was the year-over-year improvement in operating margins.

On a consolidated basis, we went from 10.8 per cent operating margin, fourth quarter 05, to 15.1 per cent in the fourth quarter of 06. Operating margins in the pipeline segment reached 16.7 per cent versus 13.2 per cent in the prior year and this was due to higher-margin projects replacing the revenue that had been derived in 2005 from Langeled.

A second important factor in the growth of pipeline segment margins was the impact of increasing facility utilization in the Bredero Shaw Americas region.

Finally, pipeline segment margins have been positively impacted by steady gains in operational performance.

In our petrochemical and industrial segment, the margin gains that we've seen through the first nine months of 06 continued in the fourth quarter with our operating margin reaching 17.1 per cent; again, a reflection of improvements in operating performance and strong market demand that has seen our facilities operating at high levels of utilization.

Now looking at the fourth quarter compared to the third quarter of this year, revenue on a consolidated basis gained approximately \$25 million, or 10 per cent with the increase occurring in our pipeline and pipe services segment. And as Bill mentioned, this was the result of the strong, small-diameter activity in western Canada and the ramp up of large-diameter project work.

The other factor, of course, that Bill mentioned was the strong performance in our Thermotite operation in Norway and our Brazilian insulation operation.

The revenue gain coupled with the margin improvements that we've noted led to a quarter-over-quarter improvement in operating income for ShawCor of \$18 million.

As noted during previous conference calls, the strengthening of the Canadian dollar has, to a certain extent, obscured the growth occurring in our foreign currency entities when they're translated to Canadian dollars

for reporting purposes. The strength of the Canadian dollar versus foreign currencies reduced reported revenue during the year by \$42 million versus what we would have reported had we not experienced the Canadian dollar appreciation. The corresponding impact of the Canadian dollar appreciation on our reported operating income was a reduction of \$10.4 million.

The depreciation expense in the fourth quarter, at \$13.5 million, was in line with the second quarter of this year but sharply higher than the \$9.8 million reported in the fourth quarter of 2005. Included in fourth quarter depreciation are some equipment write-offs of approximately \$2 million related to asset redundancies. In addition, depreciation has increased over the prior year as a result of the new facility investments in Indonesia, our new insulation facility in Brazil and at our APCO joint venture in Saudi Arabia.

Now, with operating income up and depreciation higher, EBITDA for the fourth quarter reached a new record at \$54.5 million, or \$0.74 per share, up from \$36.9 million, or \$0.50 per share in the third quarter of this year and an improvement of 28 per cent from the prior year. The EBITDA margin of 19.7 per cent was up from 14.7 per cent in the third quarter and 14.5 per cent in the prior year.

And when we look at all of 2006, the full-year results, EBITDA has increased by 31 per cent to \$184 million, or \$2.48 per share.

The income tax expense in the fourth quarter of \$15.7 million represents an effective tax rate of just over 36 per cent. This is higher than our expected tax rate of 34 per cent.

During the fourth quarter, we did set up some tax reserves for specific issues that are under review by tax authorities in several jurisdictions. In addition, we have noted in the past that certain of our foreign operations that are incurring losses are not being tax affected. This factor continued on the fourth quarter although on a diminished basis compared with earlier quarters in 2006.

For the full year 2006, our income tax expense has generated an effective rate of 33 per cent and that's slightly below the expected rate and that's a result of the utilization of previously unrecognized tax losses.

You should also note that in 2005, our tax provision was benefited by a one-time tax recovery of \$18.4 million, or \$0.25 per share that arose on the sale of our OMSCO Division.

Looking at our cash flow statement, you will see that the company continues to generate very strong cash flow. Cash provided by continuing operations for the fourth quarter before working capital changes was \$42.9 million, or \$0.58 per share. This represented an improvement of 21 per cent from the \$0.47 per share in the prior year. For all of 2006, cash provided by continuing operations before working capital changes was \$140 million, or \$1.89 per share.

Net working capital increased by \$2.2 million in the quarter. This was an increase that was expected given the \$25 million quarter-over-quarter sales increase. It should be noted, however, that we continue to reduce our investment in accounts receivable as measured by the number of days sales outstanding and this metric has declined to 53 days from 59 days at the start of the year.

For 2006 the change in working capital has provided a source of cash flow of \$43 million and that's been driven by lower receivables and reduced project related inventory and prepaid expenses.

Capital expenditures on plant and equipment in the fourth quarter totalled \$18.1 million, major projects being the continued investment in our new Portland, Oregon pipe coating facility, the commencement of construction of our new facility in Camrose, Alberta, and the construction of new facilities at our APCO joint venture in Saudi Arabia.

Despite increasing growth capital expenditures, the strong cash flow from operations translated into continued strong free cash flow which, in the quarter, exceeded \$22 million and year to date exceeds \$123 million. As a result of this free cash flow, our cash balances have increased to \$309 million at the end of 2006, up from \$200 million at the start of the year. And I would note that that cash balance compares with our total outstanding debt of just \$90 million.

On that note, Bill, I'll turn it back to you.

WILLIAM BUCKLEY: Thank you, Gary.

I'd now like to provide a brief update of our current business activities and programs. Starting with the Americas region, as mentioned earlier, we are expecting reduced small-diameter coating activity. This should be offset by increased large-diameter project activity supported by our recent facility expansions in both Canada and the United States.

In Europe-Africa we're currently preparing to bid several large offshore projects in the North Sea and in the Baltic Sea. If we are successful in securing these projects, execution will begin in 2008. 2007 will continue to be soft in this region with the anticipation of high levels of project activity in 2008 and beyond.

The Far East region is coming off a record year in 2006 and will return to more typical levels in 2007. We do expect this region to be active in the future as a result of the strong GDP and energy demand in the respective countries in this region and also due to growing LNG exports.

In 2006, we broke out the Middle East as a separate focus region under a new regional vice president. Capital expansion projects are under way at our Ras al Kaimah facility and our Saudi Arabian facility. We believe that with the new focus and the investment program that this region will provide additional growth in the future.

In the research and development area, we've recently commissioned a pilot line at our Thermotite Division. This pilot line will be used to test

and qualify our next generation series of offshore, deepwater products currently under development.

We also began construction of a new concrete laboratory. Initial projects will focus on more advanced heavy-coat products and more efficient plant application technology. Additional scientists and technicians have recently been added to the advanced concrete technology group.

Finally, I'd like to add one comment. We believe that our strong balance sheet provides us with the ability to take advantage of growth opportunities in 2007 and beyond and to provide additional returns to our shareholders as we have done today with the announced 28-per-cent dividend increase.

I will now turn the floor over to the operator for questions.

OPERATOR: Thank you. Ladies and gentlemen, we will now conduct the question-and-answer session. If you have a question, please press the * followed by the 1 on your touchtone phone. You will hear a tone acknowledging your request. Your questions will be polled in the order they are received. Please ensure you lift the handset if you are using a speakerphone before pressing any keys.

Once again, ladies and gentlemen, if there are any questions at this time, please press the * followed by the 1. As a reminder, if you are using a speakerphone, please lift the handset before pressing the keys.

The first question comes from Angela Guo, from RBC Capital Markets. Please go ahead.

ANGELA GUO: Hi guys. Congratulations.

WILLIAM BUCKLEY: Thank you.

ANGELA GUO: My question is can you just go through what's your average utilization rate by region in Q4 and at current stage?

WILLIAM BUCKLEY: I guess broadly, Angela, in the Americas we're operating at above 80-per-cent utilization rates in our large-diameter facilities. And our small-diameter facilities, we're also running at those levels through 2006, though we do expect that to come off a little bit.

In the European region, the North Sea region in particular, we're running at utilization rates that are in and around the 10 to 20-per-cent level on the large-diameter plants. Very lightly loaded.

Also in the North Sea area is our Thermotite deepwater insulation plant. It's running at about 60-per-cent utilization rate. So it's more heavily loaded as we serve that market.

In the Far East region, our plants in Malaysia and in Indonesia, they're running at levels today that are about 50-per-cent utilization.

And in the Middle East, we're just facing a ramp up in Saudi Arabia as we tool up to serve the Khurais project. And in Ras Al Kaimah, we've just come off the KOC project, so we're in the process of converting that factory right now from asphalt enamel capability to three-layer polyethylene

capability. So we're not running any production as we go through the conversion process. And that covers it all.

ANGELA GUO: And is that a similar level you expect for throughout 07?

WILLIAM BUCKLEY: Without getting too specific, you know...

ANGELA GUO: (Inaudible).

WILLIAM BUCKLEY: I'm sorry, Angela?

ANGELA GUO: Other than the small diameter in North America.

WILLIAM BUCKLEY: Now, if you looked at... if we just restricted the answer to large-diameter activity, the profile that we see is that Americas should remain strong through 2007 and also 2008, when we look at our order backlog and also look at the orders that we're working on, you know, converting to firm orders.

In the North Sea region, we don't expect that we're going to be heavily loaded throughout 2007, but the large projects in the North Sea and in the Baltic Sea that are going to require execution in 2008 could have us operating near full capacity in the 2008 timeframe, and that would likely continue for at least 24 months after.

In the Middle East region, we see opportunities to expand our facilities and our Saudi Arabian facility will become more busy as we get into the second half of 2007. Also there may be some mobilization opportunities for us in the region in 2008.

And in the Far East region, we see sort of the current level of activity that we see now continuing through 07 and then strengthening in the latter half of 08 and 09.

So, you know, basically in summary, Americas stays strong over the next two years, North Sea comes up in 2008 and the Far East region comes up in late 2008 and 2009.

ANGELA GUO: That's great. Thank you very much.

OPERATOR: Gentlemen, there are no further questions at this time. Please continue.

WILLIAM BUCKLEY: All right, thank you, Operator. I'd like to take this opportunity to thank everyone for participating with us today. Thank you and we'll talk to you again next quarter.

OPERATOR: Ladies and gentlemen, this concludes the conference call for today. Thank you for participating. Please disconnect your lines.
