

Boart Longyear Ltd (BLY.AX)

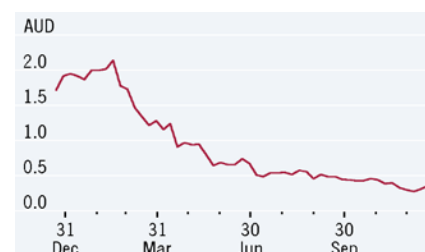
Market Update – It's Still Tough Out There

- **FY13 guidance materially in-line with consensus** — BLY today provided a market update. Management expects FY13e revenue and EBITDA to be materially in-line with current Bloomberg consensus estimates of revenue of \$1.24bn and EBITDA of \$107m. In addition, BLY indicated previously announced cost reductions of \$70m in FY13e and ~\$60m in FY14e are on track. With demand yet to stabilize and net debt remaining elevated, near-term catalysts for the stock appear limited.
- **FY14 earnings visibility remains low** — Rig utilization at mid Dec is 40% vs 45% in mid Sep, but should recover towards 45% in 1H14 as BLY exits the shutdown season. BLY indicated CY13 drilling services price pressure is high single digit and likely to increase in 1H14 given weak rig utilization. We model Drilling Services volumes down 35% in FY13 and 7% in FY14, and pricing down 9.5% in FY13 and 5% in FY14. This leads to group EBITDA of \$104m in FY13 and \$108m in FY14.
- **Limited headroom in 1H14e under interest cover covenant** — Net debt at mid Dec is \$535m vs \$540m at mid Sep. In the absence of asset sales or an equity raising, net debt is likely to remain elevated until demand recovers. We forecast FY13 net debt of \$525m and \$454m in FY14 vs \$564m at 1H13. Despite less onerous covenants following BLY's debt restructure in Sep 2013, 1H14e headroom vs. minimum interest cover of 1.55x is likely to be tight (Citi 1H14e forecast 1.60x).
- **Canadian Revenue Agency Update** — The CRA has completed its review of BLY's 2007-2009 tax returns, notifying BLY of a \$C59m tax assessment which will require BLY to provide up to \$C46m in security in 1Q14, as well as a potential penalty of up to \$C11m. BLY will appeal the 2007-09 assessment, with the worst case BLY outcome likely limited to the penalty and interest given likely MAP relief.
- **Lower TP to \$0.47, maintain Neutral** — We change our EBITDA forecasts by -1% in FY13, -6% in FY14 and -12% in FY15 due to our more conservative view of the demand outlook. Our forecast changes lead us to lower our target price to \$0.47 from \$0.51. With the inflexion point in global drilling services rig utilisation likely some way off and net debt remaining elevated, near-term catalysts appear limited.

- Estimate Change
- Target Price Change

Neutral/High Risk	2H
Price (23 Dec 13)	A\$0.41
Target price	A\$0.47
	from A\$0.51
Expected share price return	14.6%
Expected dividend yield	0.0%
Expected total return	14.6%
Market Cap	A\$189M
	US\$169M

Price Performance
(RIC: BLY.AX, BB: BLY AU)



BLY.AU revisions (Y/E Dec)	2011A	2012A	2013E	2014E	2015E
Sales (US\$m)	2,020.3	2,011.5	1,199.9	1,084.7	1,160.6
% revision	0.0%	0.0%	-0.4%	-0.5%	-6.6%
EBIT (US\$m)	245.6	194.6	-38.4	-27.9	3.0
% revision	0.0%	0.0%	-2.8%	-33.0%	-86.1%
Core Net Profit (US\$m)	159.9	114.4	-137.1	-84.4	-36.0
% revision	0.0%	0.0%	6.8%	20.0%	-11.2%
Core EPS (US¢)	34.8	24.9	-29.8	-18.4	-7.8
% revision	0.0%	0.0%	6.8%	20.0%	-11.2%
EPS Growth (%)	88.1	-28.6	-219.9	38.4	57.4
PE Ratio (x)	1.1	1.5	-1.2	-2.0	-4.7
Dividend Yield (%)	28.4	20.2	0.0	0.0	0.0

Source: Company Reports and dataCentral, Citi Research.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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BLY.AX: Fiscal year end 31-Dec						Price:\$0.41; TP:\$0.47; # Shares: 461m; Market Cap: A\$189m; Recomm: Neutral/High Risk						
Profit & Loss (US\$m)	2011	2012	2013E	2014E	2015E	Per share data	2011	2012	2013E	2014E	2015E	
Sales revenue	2020.3	2011.5	1199.9	1084.7	1160.6	Reported EPS (¢)	34.8	14.9	-95.2	-18.4	-7.8	
Cost of sales	-1456.0	-1499.1	-959.4	-839.4	-883.1	Core EPS (¢)	34.8	24.9	-29.8	-18.4	-7.8	
Gross profit	564.3	512.4	240.4	245.3	277.5	DPS (¢)	10.4	7.4	0	0	0	
EBITDA (Adj)	356.3	322.0	104.1	108.1	137.6	CFPS (¢)	43.1	14.0	9.0	26.4	25.8	
Depreciation	-110.6	-127.4	-142.5	-136.0	-134.6	BVPS (¢)	247.1	246.9	151.7	133.4	125.6	
Amortisation	0	0	0	0	0	Wtd avg ord shares (m)	459	460	460	460	460	
EBIT (Adj)	245.6	194.6	-38.4	-27.9	3.0	Wtd avg diluted shares (m)	459	460	460	460	460	
Net interest	-18.8	-26.9	-35.1	-51.5	-49.0	Valuation ratios	2011	2012	2013E	2014E	2015E	
Earnings before tax	226.8	167.6	-73.5	-79.4	-46.0		PE (x)	1.1	1.5	-1.2	-2.0	-4.7
Tax Recurring	-66.9	-53.2	-63.6	-5.0	10.0		EV/EBIT (x)	1.7	3.2	-20.3	-28.9	nm
Non-op/Except/Extraord	0	-46.1	-300.6	0	0		EV/EBITDA (x)	1.2	1.9	7.5	7.5	5.7
Minority interests	0	0	0	0	0		FCF yield (%)	-12.1	-107.1	2.1	42.6	28.9
Reported net profit	159.9	68.3	-437.7	-84.4	-36.0	Dividend yield (%)	28.4	20.2	0	0	0	
Core NPAT	159.9	114.4	-137.1	-84.4	-36.0	Payout ratio (%)	30	30	0	0	0	
Half year data (US\$m)	1H12	2H12	1H13	2H13E	1H14E	Growth rates	2011	2012	2013E	2014E	2015E	
Sales revenue	1098.8	912.7	718.9	481.0	484.8	Sales revenue (%)	36.9	-0.4	-40.3	-9.6	7.0	
EBIT (Adj)	148.3	46.2	8.9	-47.3	-22.7	EBIT (Adj) (%)	91.2	-20.8	nm	27.3	nm	
Core NPAT	98.0	16.4	-60.4	-76.7	-53.2	Core NPAT (%)	89.2	-28.4	nm	38.4	57.4	
Core EPS (¢)	21.4	3.6	-13.1	-16.7	-11.6	Core EPS (%)	88.1	-28.6	nm	38.4	57.4	
Balance Sheet (US\$m)	2011	2012	2013E	2014E	2015E	Operating performance	2011	2012	2013E	2014E	2015E	
Cash & cash equiv.	82.3	89.6	71.8	143.3	192.0	Gross margin (%)	27.9	25.5	20.0	22.6	23.9	
Accounts receivables	320.8	260.5	216.6	195.8	225.7	EBITDA margin (%)	17.6	16.0	8.7	10.0	11.9	
Inventory	400.4	533.7	373.3	328.3	283.8	EBIT margin (%)	12.2	9.7	-3.2	-2.6	0.3	
Net fixed & other tangibles	663.6	832.6	728.2	700.6	635.9	Capex to Sales (%)	10.8	12.1	3.2	4.6	6.0	
Goodwill & intangibles	423.9	418.9	208.0	208.0	208.0	Working capital to sales (%)	20.0	25.4	34.7	33.9	27.8	
Financial & other assets	53.8	115.3	107.2	132.2	132.2	Operating ROA (%)	8.76	5.45	-6.93	-4.95	-2.13	
Total assets	1944.7	2250.7	1705.1	1708.3	1677.6	Operating ROE (%)	14.57	10.08	-14.96	-12.88	-6.05	
Accounts payable	316.7	284.3	173.3	156.7	187.0	Operating ROIC (%)	13.1	10.2	-3.9	-2.5	1.1	
Short-term debt	0	0	0	0	0	Net debt to equity (%)	20.1	45.1	75.3	74.0	70.2	
Long-term debt	310.3	601.7	597.2	597.2	597.2	Debt to total capital (%)	21.5	34.6	46.1	49.3	50.8	
Provisions & other liab	183.3	229.3	236.9	341.2	316.2	Interest coverage (x)	18.9	12.0	3.0	2.1	2.8	
Total liabilities	810.3	1115.3	1007.4	1095.0	1100.4							
Shareholders' equity	1134.4	1135.4	697.7	613.3	577.3	Segmental sales (US\$m)	2011	2012	2013E	2014E	2015E	
Minority interests	0	0	0	0	0	Drilling Services	1,447.9	1,516.2	901.4	802.2	858.4	
Total equity	1134.4	1135.4	697.7	613.3	577.3	Products	572.4	495.3	298.5	282.5	302.2	
Net debt	228.1	512.1	525.4	453.9	405.2	Sales - total segments	2,020.3	2,011.5	1,199.9	1,084.7	1,160.6	
Cashflow (US\$m)	2011	2012	2013E	2014E	2015E	Segmental EBITDA (US\$m)	2011	2012	2013E	2014E	2015E	
EBITDA	356.3	322.0	104.1	108.1	137.6	Drilling Services	296.0	290.0	120.9	118.1	135.2	
Working capital	-122.0	-147.9	-29.0	70.0	20.0	Products	132.0	107.0	38.1	46.0	60.4	
Net interest paid	18.8	26.9	35.1	51.5	49.0	Corporate	-71.7	-75.0	-55.0	-56.0	-58.0	
Tax paid	66.9	53.2	63.6	5.0	-10.0	EBITDA - total segments	356.3	322.0	104.1	108.1	137.6	
Other	-122.3	-190.1	-132.2	-113.0	-78.0	Segmental EBITDA margin	2011	2012	2013E	2014E	2015E	
Operating cashflow	197.7	64.2	41.5	121.6	118.6	Drilling Services	20.4	19.1	13.4	14.7	15.8	
Capex	-218.0	-244.4	-38.0	-50.0	-70.0	Products	23.1	21.6	12.8	16.3	20.0	
Net acq/disposals	0	0	0	0	0	Corporate	-3.6	-3.7	-4.6	-5.2	-5.0	
Other	0	-35.1	-4.4	0	0	EBITDA margin - total	17.6	16.0	8.7	10.0	11.9	
Investing cashflow	-218.0	-279.5	-42.4	-50.0	-70.0							
Dividends paid	-37.8	-55.3	-4.6	0	0							
Financing cashflow	14.8	223.6	-9.1	0	0							
Net change in cash	-12.7	7.3	-17.9	71.6	48.6							
Free cashflow to s/holders	-20.3	-180.2	3.5	71.6	48.6							

Forecast changes

We change our EBITDA forecasts by -1% in FY13, -6% in FY14 and -12% in FY15 to reflect our more conservative view of the outlook for global mineral exploration drilling volumes and pricing.

The changes to our EPS forecasts relative to our EBITDA forecast changes reflect changes to our assumptions around BLY's tax expense.

Figure 1. BLY forecast changes (USD)

	Unit	EBITDA			Unit	NPAT			Unit	EPS		
		FY13e	FY14e	FY15e		FY13e	FY14e	FY15e		FY13e	FY14e	FY15e
BLY - new	[\$m]	104	108	138	[\$m]	-137	-84	-36	[\$/share]	-0.298	-0.184	-0.078
BLY - old	[\$m]	105	115	156	[\$m]	-147	-105	-32	[\$/share]	-0.320	-0.229	-0.070
% change	[%]	-1%	-6%	-12%	[%]	7%	20%	-11%	[%]	7%	20%	-11%
BLY - Citi	[\$m]	104	108	138	[\$m]	-137	-84	-36	[\$/share]	-0.298	-0.184	-0.078
BLY - consensus	[\$m]	107	118	145	[\$m]	-118	-49	-10	[\$/share]	-0.265	-0.110	-0.023
% var	[%]	-3%	-8%	-5%	[%]	16%	74%	271%	[%]	13%	67%	240%

Source: Citi Research, Bloomberg consensus

Valuation

Our valuation is based on the weighted average of our EV / EBITDA valuation (80% weighting) and our DCF valuation (20% weighting).

Our EV / EBITDA calculation is based on 6x our FY14 EBITDA of US\$108m, a discount to global peers trading on 7-8x, to reflect BLY's high level of net debt.

In calculating our target price, we apply a 15% discount to our BLY valuation to reflect the risk to BLY's earnings and balance sheet from further weakness in commodity prices and exploration spend, as well as BLY's high level of net debt.

Our forecast changes lead us to lower our target price to A\$0.47 from A\$0.51 previously. With an ETR of 14%, we retain our Neutral High risk rating.

Figure 2. BLY target price calculation

	Value (A\$)	Weight	Target
EV/EBITDA	A\$0.46	80%	A\$0.37
DCF	A\$0.92	20%	A\$0.18
Weighted Average valuation			A\$0.56
Discount			15.0%
Target price			A\$0.47

Source: Citi Research

Boart Longyear Ltd

Company description

Utah-based Boart Longyear is an integrated provider of exploration drilling services and products to predominantly the mining sector as well as environmental/infrastructure and energy (oil sands) industries. BLY was owned by Anglo American until bought by private equity firms in 2005, and became public in April 2007.

Investment strategy

We rate BLY Neutral/High Risk (2H). The restructure of BLY's debt likely removes the risk of a breach of balance sheet covenants and a near-term equity rights issue. However, the deterioration in demand due to the fall in commodity prices and a focus by mining companies on cutting operating costs and improving cash flow and margins will likely continue to materially affect BLY's utilisation and margins in the short to medium term. BLY's High Risk rating reflects the lack of earnings visibility and earnings cyclicalities within BLY's business, as well as balance sheet risk.

Valuation

We set our 12-month target price at A\$0.47 based on a 15% discount to our A\$0.56 valuation. Our valuation is based on the weighted average of our FY14e EV/EBITDA multiple valuation (80% weighting) and DCF valuation (20% weighting). In our multiple-based valuation, we apply a 6.0x multiple to our FY14e EBITDA of US\$108m to arrive at our EV, which leads us to fair value of A\$0.46. In our DCF, we use a risk-free rate of 5.5%, risk premium of 5.0% and terminal growth rate of 3%, which leads to our DCF value of A\$0.92. We weight these fair values 80/20 to get a rounded valuation of A\$0.56. We discount our valuation by 15% to reflect the risk to BLY's earnings and balance sheet from a further downturn in commodity prices. This gives a target price of A\$0.47.

Risks

We rate BLY High Risk. In our view, BLY faces the following key risks.

- 1) Global exploration spend falling significantly as a result of global economic concerns.
- 2) Margins dropping sharply as demand for services and products declines.
- 3) Despite BLY's size, its scale advantage seems limited.
- 4) Exploration drilling is highly cyclical.
- 5) The earnings cycle could be tested by a deep global recession.

An upside risk would be that a recovery in the price of gold and copper could see demand recover sooner than expected.

If the impact on the company from any of these factors proves to be greater or less negative than we anticipate, the stock will either likely have difficulty achieving or outperform our financial and price targets.

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Boart Longyear Ltd (BLY.AX)

Ratings and Target Price History Fundamental Research

Analyst: Guy Robinson



	Date	Rating	Target Price	Closing Price
1	23-Feb-11	1H	*5.32	4.43
2	2-May-11	1H	*5.60	4.49
3	26-Jul-11	1H	*5.22	4.08
4	19-Aug-11	1H	*4.80	3.51
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*1	4.80	2.80
7	11-Oct-11	1	*4.19	2.98
8	1-Dec-11	1	*4.23	3.27

* Indicates change

	Date	Rating	Target Price	Closing Price
9	24-Jan-12	1	*4.50	3.48
10	21-Feb-12	1	*4.93	3.93
11	25-May-12	1	*4.60	3.05
12	30-Aug-12	1	*2.25	1.50
13	19-Nov-12	*2H	*1.68	1.40
14	21-Dec-12	2H	*1.79	1.72
15	18-Feb-13	2H	*2.02	1.97
16	5-Mar-13	2H	*1.85	1.53

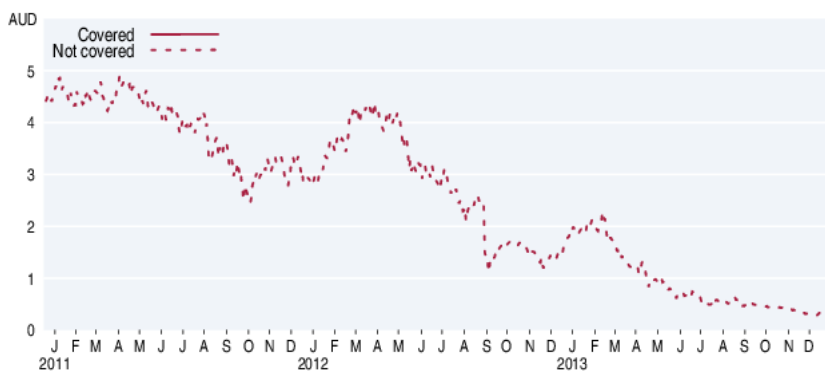
	Date	Rating	Target Price	Closing Price
17	23-Apr-13	2H	*1.09	0.92
18	21-May-13	2H	*0.90	0.78
19	1-Jul-13	*3H	*0.55	0.63
20	26-Aug-13	3H	*0.40	0.49
21	12-Sep-13	*2H	*0.55	0.50
22	23-Sep-13	2H	*0.51	0.46

Rating/target price changes above reflect Eastern Standard Time

Boart Longyear Ltd (BLY.AX)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Guy Robinson



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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<i>% of companies in each rating category that are investment banking clients</i>	55%	50%	43%	64%	51%	48%

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Citicorp Pty Ltd	Guy Robinson
Citigroup Global Markets India Private Limited	Vidhya Palaniswamy

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