FINAL TRANSCRIPT

ShawCor Ltd.

Second Quarter Results

Event Date/Time: August 10, 2012 – 10:00 a.m. E.T.

Length: 38 minutes

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PRESENTATION

Operator

Good morning. My name is Andrea (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the ShawCor Ltd. Second Quarter Results Conference Call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, please press the # key.

Thank you. I would now like to turn the call over to our host, Mr. Gary Love, Vice President of Finance and Chief Financial Officer. You may begin your conference.

Gary Love - Vice President, Finance and Chief Financial Officer, ShawCor Ltd

Thank you, and good morning. Before we begin this morning's conference call, I would like to take a moment to remind all listeners that today's conference call includes forward-looking statements that involve estimates, judgements, risks, and uncertainties that may cause actual results to differ materially from those projected.

The complete text of ShawCor's statement on forward-looking information is included in Section 3 of the second quarter 2012 earnings press release that is available on SEDAR, and on the Company's website at shawcor.com.

At this point, I'll turn the call over to Bill Buckley.

Bill Buckley - President and Chief Executive Officer, ShawCor Ltd

Thank you, Gary, and thank you, ladies and gentlemen, for participating in this morning's conference call. By the way, we're conducting this call remotely from Alberta today, as we've been touring our Board of Directors through several of our Western Canadian plants this week.

Well, yesterday we released our second quarter 2012 financial results. These showed a good improvement over the second quarter 2011.

Revenues were up 24 percent to 327 million, and earnings per share improved by 43 percent to $0.30 per share. But the most significant news was, first, we continued to have success booking major global pipe coating contracts, and I'll comment on that a little later. And second, we completed preparations, and have now moved into the production phase on some key large complex projects which have attractive margins.

With respect to major new project bookings, on May 18th, we announced we had secured the coating for the Julimar Project Development with a value of over 45 million. And on June 29th, we announced we had secured the Ichthys LNG flow line coating project at a value in excess of 100 million. And finally on July 24th, we announced that we had secured the coating contract for the Linea 5 project, which is offshore Mexico with a value in excess of 40 million.

These additional project wins have increased our backlog billable over the next 12 months to 749 million, which is up 11.5 percent from the end of the first quarter. The major projects in our backlog have now entered into the production ramp-up phase.

In the second quarter, product quality validation tests for the Wheatstone and the Ichthys gas export lines were completed, and also in the second quarter, we completed the installation of two mobile concrete coating plants at our Trinidad site for the Technip project, and these projects are now in the production phase.

With these important milestones complete, we now expect to report improvement in both margins and earnings in the second half of the year as we capture the benefits of the attractive margins on these projects, as well as the utilization in the facilities that are now ramping up activity.

I'll comment further on our outlook, but first I'll ask Gary Love, our CFO, to provide you with other key details on our second quarter financial results. Gary?

Gary Love

Yeah. Thanks, Bill. Revenue in the second quarter of 2012 of 327 million increased by 24 percent over the second quarter 2011, and was also up 5 percent from the first quarter of this year.

The increase over the second quarter of the prior year was due to year-to-year growth of 14 percent in our North America Pipelines segment. That was the result of stronger small diameter pipe coating, and a near doubling of revenue from Flexpipe, our composite pipe business. Also contributing to the year-over-year growth were significant pickups in activity in Mexico, and in our EMAR region at our pipe coating facilities in both the Emirates and in Norway.

In our Petrochemical segment, revenue increased by 10 percent over the second quarter of the prior year on higher North American volumes of heat-shrink tubing and wire and cable products. On a consolidated basis, reported gross margins are 34.8 percent, down 1 percentage point from the second quarter of the prior year, and down 3.1 percentage points from the first quarter of this year. The margin decrease is fully attributable to the Pipeline segment gross margins, which decreased to 35.1 percent this quarter from 36.9 percent a year ago, and versus 39.3 percent in the first quarter of this year.

Now the decline from the first quarter was a result of the shift in pipe coating activity away from higher-margin work in Canada with the onset and extension of spring breakup, plus the impact of a single large project in Asia Pacific that was booked over a year ago at relatively low gross margins, combined with the buildup of labour at our Asia Pacific facilities and in Trinidad in advance of the large project launches that are now underway.

In contrast, the Petrochemical segment gross margins continued to improve, reaching 30.5 percent, up from 28.2 percent a year ago, and that was primarily on a number of wire and cable projects that we executed for the oil sands, mining, and utilities markets during the quarter.

The year-over-year increase in consolidated gross profit of $19 million resulting from the revenue growth was partially offset by higher selling, general, and administrative expenses. SG&A increased by 14.5 million or 24 percent from the second quarter of 2011, as a result of an increase in salaries and incentive compensation accruals totalling 11.6 million, coupled with higher property rental costs of 1.8 million. Now the higher salaries and rental costs are directly related to growth at businesses that are launching new facilities, such as Guardian and Flexpipe, and at our pipe coating locations, which are now rapidly ramping up volumes.

The Pipeline segment EBITDA margin was in line with the prior year at 13 percent, but did pull back from the first quarter level of 17.6 percent, in line with the reduced gross margin and higher SG&A expense. We continue to expect a very significant improvement in the Pipeline segment EBITDA margin as revenue ramps up in the second half of this year.

The Petrochemical and Industrial segment EBITDA margin came in at 15.5 percent, a solid improvement over both the first quarter and prior-year level.

One additional factor in our second quarter operating results was the change in foreign exchange gains and losses, which moved from a gain of 4.4 million a year ago to a small loss of 399,000 this quarter. Below operating income, we have reported income from the investment in Socotherm of $1.5 million, a significant improvement over the loss of 3.6 million in the second quarter a year ago.

For the first six months of this year, the income from the Company's investment in Socotherm is 2.7 million. That compares with a loss of over 5 million that we recognized a year ago.

During the second quarter 2012, the Company has recorded an effective tax rate of 17 percent, and this of course is well below the Canadian statutory rate of 27 percent. The improvement over the expected Canadian statutory rate was the result of the contribution of operating income from low tax rate jurisdictions, as well as the reversal of various tax reserves following our successful settlement of certain items that had been in dispute with tax authorities.

During the second half of this year, we expect the Company's tax rate to increase over the level we reported in the second quarter, but should remain well below Canadian statutory rates as a result of the increasing percentage of the Company's profits that we expect will be generated in jurisdictions with tax rates below Canadian rates.

Before changes in working capital and deferred revenue, the cash flow provided by continuing operations was $33.6 million. That was basically unchanged from both a year ago and the first quarter of this year.

The net change in working capital and deferred revenue was a net cash outflow of 53.2 million, and that was a result of higher accounts receivable of 19 million, higher inventory of $20 million, and lower deferred revenue of $11 million.

Cash flow used in investing activities in the second quarter totalled 103.5 million. This consisted of investments in highly liquid short-term investments of $25 million, the loan receivable relating to the Socotherm developments that we disclosed on April 18th, that amount was 61.5 million, and capital expenditures of 17.8 million.

The major capital expenditures in the second quarter were continued capacity additions and upgrades at our pipe coating facilities in Malaysia and Indonesia as well as capacity expansions at Flexpipe.

Cash flow used in financing activities included dividends of 6.9 million, and the repurchase of 575,000 Class A shares under the Company's normal course issuer bid at a share price of $33 per share, and a total cost of $18.9 million.

And with that, I will now turn it back to Bill Buckley for his comments on our outlook.

Bill Buckley

Thank you, Gary. Over the past nine months, ShawCor has announced new contract awards with a combined value in excess of $900 million. As a result of these new contracts, our reported backlog, which is work we expect to complete and bill over the next 12 months, has reached a new record level of 749 million as of the end of the second quarter.

We expect that ShawCor's growth over the next 18 months will be led by our Asia Pacific and Latin America regions. And specifically in Asia Pacific, we have commenced production of the Pearl Energy, Wheatstone, and Ichthys projects in the third quarter, and in the fourth quarter the Ichthys project will ramp up to full production.

In Latin America, the Dragon Cigma project will ramp up production in the third quarter, and increase even further in the fourth quarter.

Now the major risks to our outlook lies in North America where we're exposed to any deterioration in well drilling and completions if oil and natural gas commodity prices weaken. While this would impact us modestly in the short term, we will continue our efforts to gain market share, and here the focus will continue to be on Flexpipe composite pipe business, where we see further potential for share gain as the market converts to composite pipe to take advantage of the better economics, reduced schedule, and improved corrosion performance of this product.

This potential extends beyond North America, as witnessed by our second quarter success in supplying over 200 kilometres of composite pipe to Australia. Additionally, we will also be expanding our Guardian division OCTG pipe inspection and refurbishment business, and in July we completed a small acquisition in Texas to allow us to set up a full service branch now in the Eagle Ford area.

So in summary, we are of course concerned by the potential for global economic downturn, but our record backlog and solid organic growth potential should allow us to deliver strong revenue and earnings growth in the quarters ahead.

And at this point, I'll turn the call over to the Operator for questions.

Q&A

Operator

At this time, I would like to remind everyone, in order to ask a question, please press *, then the number 1 on your telephone keypad.

Your first question comes from the line of Dan MacDonald with RBC Capital Markets. Your line is open.

Dan MacDonald

Good morning, guys. Just looking at North America here, wondering as you finish the Jack/St. Malo project if there's a potential drag on margins there from the Brigden facility being obviously less busy or really not busy at all here in the interim or the back half of the year? And maybe what your Gulf of Mexico outlook is here for the second half of the year and then into '13 if that's changed from your last call?

Gary Love

Yeah. Dan, it's Gary. Just on the margin question, I don't expect with the completion of Jack/St. Malo to have an ongoing negative impact on margins. We will at the conclusion of the Jack/St. Malo project temporarily demobilize the Brigden plant, and the people who are working on that will be reassigned to other work.

We are very active in bidding work in 2013 and beyond. There are several projects in the Gulf of Mexico that we've targeted, and I think we will be reactivating Brigden in 2013 at its current location in Beaumont.

Dan MacDonald

Thanks. And then just looking at Flexpipe, do you have a sense or can you give us a sense, I guess, of where you think the composite pipe market's market share is overall in North America? And then maybe what portion of that Flexpipe has?

Bill Buckley

Yeah. We can give you some metrics around that. The flexible pipe market is really addressing smaller diameter pipelines, 2, 3, 4, and 6 inch, to some extent. And in that range of product composites have captured in North America, if you look at both Canada and the United States, Mexico, composites have captured perhaps 30 to 40 percent of the potential market. And that conversion continues at a fairly rapid rate.

So the potential for growth continuing over the next three or four years at a higher rate than the market is quite strong. And then of course, there's getting to the increasing opportunities as the product technology rolls out into the international markets as well, and I think the focus we put on Australia is an example of that.

If you look at Flexpipe's business and market share, we don't disclose those numbers precisely, but in Canada, Flexpipe enjoys sort of a leadership position in composites, and in the United States a second position, and that balances out to give it a fairly strong position in North America.

Dan MacDonald

And how much, if you look on a year-over-year basis in '12 versus '11, how much capacity have you added to your Flexpipe manufacturing?

Gary Love

Yeah. In our plant in Calgary, earlier this year we added a third production line, and the third production line was designed with an output that's approximately 50 percent higher than the existing line, so quite a significant increase in capacity with the addition of the new line.

So what we now have in Calgary is we have one production line that's dedicated to our steel-cored, highly cyclic load product, and it has a fairly low production throughput because of the nature of the product. And we have two lines dedicated to the fiberglass-based product, and we're not certainly running at full capacity, but we expect to be moving in that direction as the year progresses.

Dan MacDonald

Thanks. That's all I have for now. Thanks, guys.

Operator

Your next question comes from the line of Sarah Hughes with Cormark Securities. Your line is open.

Sarah Hughes

Hi, guys. First, Gary, do you expect any residual ramp-up costs in the third quarter?

Gary Love

I think in the third quarter we will see the beginning of an uplift in margins. There will still be costs associated with volume ramping up, but the benefit of the higher margins on the work that we will be ramping up, I think, should offset any continuing sort of start-up costs.

So the third quarter is going to be a transition for us. We are expecting a solid improvement in margins, and I think we'll certainly be monitoring it month by month, and by the end of the quarter I think we're going to be really hitting full stride.

Sarah Hughes

Okay. And then, Bill, just for you. In terms of where your backlog is, obviously a really strong outlook for you guys through 2012, 2013, and going into 2014. But can you provide us just an update and kind of visibility as we go into 2014 as maybe the Chevron Wheatstone contract and the Ichthys slow down a little bit, kind of what growth opportunities you see for ShawCor post-2013 here?

Bill Buckley

Yeah. Sure, Sarah. Looking forward, there are some projects that we've mentioned in the past that are coming towards FID decision, and are in the early stages of budgetary bids, and then they'll move into the formal bidding process. But some of those that we might want to remark upon are the Woodside Browse project is out there, and we would expect that the timetable right now is that we would be bidding that before the end of this year, FID coming next year, and that in the series of northwest shelf projects will be the largest in its current configuration compared to the ones that we've already booked.

There's the South Stream project, which now looks like it's got some momentum behind it, which will be going out for bid. There's a very large project in Norway that Statoil is progressing quite rapidly right now that will be coming out for bid. We expect we'll be bidding that as well before the end of the year.

And then in our bid backlog of projects we've bid right now and that are moving into the award phase, a couple highlight projects there I could mention. One is, the Guara Lula Norte project in Brazil. That's now moving into award phase, and that is a large project, 140 million in its total configuration in this phase.

And then there's another project in Peru, the Kuntur project that, again, is moving towards FID and award, and then that's likely to happen over the next two or three quarters.

Sarah Hughes

Right. And then just wondering in terms of kind of acquisition opportunities, I know you've really increased your focus on that end. If you can just provide an update in terms of how things are going in that end? And maybe just a general idea of kind of what type of opportunities you're looking for?

Bill Buckley

Yeah. Certainly. As we've mentioned in the past, we have strengthened up the acquisition department; brought in a senior executive to head that department up. He and his department have been active and busy.

We have made bids on a number of opportunities, some small tuck-unders, but to get at our major targets right now, we have decided that with our resources we are focusing in on projects that would have ideally minimum revenue of value of 100 million, maybe maximum 300 million right now, which we feel we could digest and integrate well.

And we're—have looked at that versus the alternative of going out and getting five $20 million acquisitions to get to the 100 million mark. And decided that from a risk perspective and from a resource perspective and from an impact on the company perspective, we're looking at that target range of 100 million to 300 million, in addition to tuck-under acquisitions that we might do to give us access to new market areas and new platforms.

And a case in point would be the Guardian acquisition that we did in Texas, a small company that we acquired, and we're now going to expand the yard space and bring our capabilities that we have in Canada down to that location and expand it quite rapidly.

Sarah Hughes

And just lastly, can you give us an indication of where your bid book stands currently?

Bill Buckley

Yes. It's in a state of flux. The projects that we—the major projects that we have outstanding bids for is in that 500 million to a billion plus range, but as I said, very shortly we're going to be bidding the Woodside Browse project and the South Stream project and the major project for Norway called the NGSI project. And with those, once those are bid, our bid book will be back over the $1 billion mark.

Gary Love

Yeah. Sarah, just to sort of further comment on that. During the, I guess, during the quarter we decided even though the bid is technically speaking still outstanding to pull Shtokman from our bid list, just given the obvious developments that have happened with the Shtokman consortium.

So that's out, that’s no longer in our numbers, and that's obviously taken us down below $1 billion, but I think based on what we're likely to officially tender in the third quarter, we'll be back above that level probably at the end of the quarter.

Sarah Hughes

Okay. Great. That's it for me. Thank you.

Operator

Your next question comes from the line of Bert Powell with BMO Capital. Your line is open.

Bert Powell

Thanks. I'm wondering if you could just share with us the backlog—so the backlog of 749 million is the next 12 months. What is the backlog for the 12 months following that? Where does that currently stand?

Gary Love

Yeah. There's probably—in addition to what's in the backlog, there are booked orders that will be executed beyond the next 12 months, and that would add another 200 million to 250 million to the backlog.

So if you took our total value of booked contracts, it's in the sort of 900 million to billion level. Actually, it would be—I think it would be actually slight over a billion with kind of the difference being in the beyond 12-month category.

Bert Powell

Sure. And then I know this stuff is—the stuff that's coming, especially the Ichthys stuff as you start to work on that, that's pretty—that's relatively more complex coating. Is there anything in there in terms of executing that contract that is new frontier for you guys in terms of the complexity of the coating, changing, and manufacturing processes? Or is it it's complex, but it's all stuff you've done before and the execution risk there is de minimis?

Bill Buckley

No, Bert, this is work we have done before. When we refer to these projects as being complex, it really is the projects themselves and their size and scale. In terms of the coating products that we're applying, the size, diameters of the pipe, this is all work that we've done before.

Bert Powell

Okay. And then, just lastly on the Petrochem side, cautionary statements there and I read around the auto side of it…

Bill Buckley

Yeah.

Bert Powell

That's the relatively more profitable side of that business?

Gary Love

No, I wouldn't say…

Bert Powell

No. Okay.

Gary Love

It's relatively more profitable. I think we've been very, very pleased with the performance our wire and cable business this year. They've had some really great projects. That business has—it's a mix. They tend to do a lot of work through distributors, but then we'll get these larger projects, and the ones that we've been doing, particularly in the oil sands, have been particularly attractive for us.

So that business is doing really well, but our heat shrink tubing business is the business that's exposed to the global automotive industry, and one would have some caution, given the general condition of the global economy.

Bert Powell

Okay. So this is really just a revenue/volume issue, not necessarily a mix issue?

Gary Love

Yes. It's—correct. If there is a pull-back in automotive vehicle production, that will impact both our European and North American heat shrink tubing business. It's just the volumes will diminish if—or not, depending on what happens with global automotive production.

Bert Powell

Okay. Thank you.

Operator

So again, if you would like to ask a question, please press *, 1, on your telephone keypad.

Your next question comes from the line of Dana Benner with AltaCorp Capital. Your line is open.

Dana Benner

Good morning, guys.

Bill Buckley

Good morning.

Dana Benner

I wanted to start with the question of how we assess your—the competitive strength of ShawCor with some of the major projects you just rattled off? I think you used the term that you've kind of run the table here recently in terms of major projects, and obviously kudos to you and the corporate project for doing that. But if we think about a Woodside Browse, for example, Alliance relationship, South Stream, we all remember what happened in Nord Stream and how ultimately the lack of other factors came into play in terms of how Nord Stream was awarded a large project in Norway. So you're sitting there as a highly, highly competitive company in the major project space. Is there any reason to think that that good competitive position would not hold you in equal stead with these projects? Of course, nothing is ever guaranteed, but—or are these projects where some other things may start to come into play?

Bill Buckley

Well, Dana, if you look at the Woodside Browse project, the size and scale, location, the same factors that allowed us to win 100 percent of the INPEX Ichthys project and the Chevron Wheatstone project are going to be at play there. So we should be in a strong position.

We also have a relationship with the Woodside organization that should allow us to be in a very, very strong bidding position, and as you say, they're not secured until the contract is awarded to us.

Looking at the NSGI project for Statoil, that project may take advantage of some of our technology to reduce logistics costs, and that specifically could be our portable concrete plant technology. And we're doing work now at looking at various sites where we can set up to take the logistics costs down to the minimum. That's a technology that we have uniquely, and is a strategy that should put us in good stead.

As you know, we have a plant in Orkanger, Norway that provides flow assurance products, and we have a very close relationship with Statoil. They know us very well. We've been a reliable supplier, so I would think all of that would allow us to have a strong bidding position there.

With respect to South Stream, that's a project that could take advantage of technology that we have today that we did not have at the time of Nord Stream, and that is our Brigden technology, which may be deployed in combination with our portable plant concrete technology as well. But that will likely be a portable plant solution that we come up with, and on that, as I said, we're in sort of the early discussions with the client on options and alternatives.

So that gives you a little colour on how we think we're positioned, but our track record over the past couple of years in securing these projects, the capital upgrades that we put in place particularly in Asia Pacific to accommodate 100 percent of the two major projects we have now, and those are upgrades to our wharf facilities and upgrades to our plant coating facilities.

And then the development of the Brigden technology are all kind of new factors that will come into play on the next projects, and I think will put us in a good position. But we're still going to fight very hard to get—we'll be going for all of that business, and we'll be fighting very hard to get it.

Dana Benner

So that's a natural lead in to my second question. You've mentioned that you're targeting additional Gulf of Mexico projects for the first Brigden plant for next year. You've spoken on these calls about the potential to eventually look at a second plant; maybe build it this year, maybe next year. Do you have an updated sense as to when you could move forward with the second Brigden plant?

Gary Love

I think we are—we have not initiated the second Brigden plant yet, but we certainly have resources poised to proceed based on how some of the work that we're bidding plays out.

There are several large projects that are in the bid stage, which would be the catalyst—securing those projects would be the catalyst to kick off a second Brigden. So if we see the order book coming together we can move very quickly to initiate a second Brigden, but as of this moment we have not pulled the trigger on that.

Dana Benner

Okay. My next question relates to Socotherm. The company's now making money. Any additional colour you could provide in terms of whether their backlog is rising in the same manner yours is? Obviously probably not to the same extent, given your major project profile, but any additional colour that may help us assess if and when you choose to exercise the—or move on the buy/sell agreement that kicks in early next year?

Gary Love

Yeah. Socotherm has really shown I think some solid improvement, and we've literally seen it quarter over quarter. The second quarter of 2012 was Socotherm's best quarter in many years; really outstanding performance right across the board in all their operations. Their facility in Italy had solid EBITDA, their facility in Brazil is very busy, their facility in Argentina is picking up activity, and they continue to also be very busy in the Gulf of Mexico.

So second quarter was, I think, a glimpse of what the newly restructured and focused Socotherm should look like going forward. It was really, really good to see. And I think they're well positioned in Latin America to benefit fully from the pickup in activity in Latin America, and the activity in Latin America is growing.

It's not just one particular basin. It's very broad, and I think it's going to be something that will extend for a number of years. So activity in Brazil and Argentina and Venezuela and Colombia and even in Peru, Socotherm has a role to play in each of those markets, and they're well positioned to do so.

So yeah, very encouraging. It was very encouraging to see their performance in the second quarter. It's taken a while, but I think ultimately the wait will have been worthwhile.

Dana Benner

Okay. Final question, are there any natural impediments now to you moving forward on that? So with that type of colour to inform you and to help us, you've identified over time regulatory and tax issues, which slowly have been getting solved, et cetera. Are there any natural issues such that on Jan 1 if you wanted to move forward—whatever the date is in early '013 that would prevent you should you—if you have a desire to move on it, anything that would necessarily prevent you at this point? Or is it now fully up to you?

Gary Love

No, I think we—nothing's changed and we will—we're not going to speculate at this point on what will happen in the future. We continue to see our role as helping, as a strong investor helping guide Socotherm and continue to help Socotherm focus on the areas that they have an inherent strength in, and that's what we're doing.

And it seems to be working, so beyond that I really can't speculate on what might happen in the future.

Dana Benner

Okay, guys. Thank you very much.

Operator

So again, if you would like to ask a question, please press *, 1 on your telephone keypad.

And there are no further questions in the queue. I pass the call back over to Mr. Bill Buckley for any closing comments.

Bill Buckley

Okay. Thank you, Operator. I'd like to thank everyone for your participation this morning, and we look forward to having another conference call after we report our third quarter results.

So thank you very much.

Operator

Ladies and gentlemen, this concludes today's teleconference. You may now disconnect.

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