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Incitec Pivot Limited

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Incitec Pivot Limited today reported a net loss of A$179.9 million for the year ended September 2009 compared with net profit of A$604.6 million in the previous year. The result included individually material items totalling A$527.7 million after tax, compared with A$42.9 million in the previous year. Excluding individually material items, Incitec Pivot booked net profit of A$347.8 million, down 46 percent, primarily reflecting the impact of the fall in fertiliser prices, partly offset by the contribution from the Dyno Nobel explosives business acquired in June 2008. Can you comment on current trading conditions and where we are in the fertiliser and explosives cycles?

MD & CEO James Fazzino
Trading conditions in 2009 were the toughest I've seen in my 20 years in the chemical industry, with unprecedented reductions in global fertiliser demand and the consequent volatility in global fertiliser prices, and the recession in the US impacting volumes in our North American business.

We can't control trading conditions but we can control the way we run our business. What was pleasing about 2009 was that we executed well and acted quickly to mute the impact of the tough trading conditions on both our income statement and balance sheet.

In US dollar terms, our global explosives sales declined 15 percent compared with 2008 proforma sales. Notwithstanding this, EBIT was up 27 percent versus proforma primarily due to our Velocity efficiency program, and we've delivered in full the first year improvements planned at acquisition.

In North America, volumes in all business segments were down, most significantly in the Quarry and Construction (Q&C) segment where volumes were down 29 percent. This is more than the market average due to our market exposures in Florida. The segment is driven by new housing and highway construction. Since 2007 our volumes in this segment have fallen by over 40 percent.

We're likely to continue to experience challenging conditions in Q&C in 2010 as there's still an excess of new homes and new housing estates in the US. It won't be until this is cleared that we'll see new estate developments and the return of demand for construction aggregates. On the positive side, the federal stimulus package should support new highway development.

The medium term outlook is more positive, and we have significant leverage in this segment. Accordingly we've been very careful in the Velocity program to maintain our skill base to ensure we're business-ready for a US economic recovery when it occurs.

Volumes in the coal segment were down 5 percent from 2008. The decline in coal occurred late in the US downturn, with a flat first half followed by volume reductions in the second half. Coal inventories at power stations are currently at historical highs with coal-based power generation impacted by both the US recession and a switch to gas-fired power as gas prices bottomed out during the year.

Looking forward, the US coal industry is predicting flat volumes for the 2010 calendar year with the key variable being the severity of the weather which drives electricity consumption for heating and cooling.

Finally mining and metals volumes were down 22 percent, consistent with North American metals production, particularly iron ore. Our expectation is that this segment will recover at the same pace as the US economy.

Pricing came under pressure in the second half as the North American market became long ammonium nitrate (AN) by around 600,000 short tons. A recovery in explosives volumes, and firmer pricing, is largely dependent on the timing of a general recovery in the US economy.

Australian mining, by virtue of its exposure to China, came through the global financial crisis very well. Australian mining volumes and, therefore, explosives demand, have been very resilient and our Asia Pacific volumes grew by 26 percent in 2009.

In the medium to longer term, the outlook for Australian explosives is strong, since Australian miners are well placed to supply the inputs required for the expected growth in the Asian region, particularly China and India.

In our Fertiliser business, we experienced a 68 percent reduction in earnings to A$276.4 million compared with the record high of 2008.

Our Australian domestic distribution business, Incitec Pivot Fertilisers, experienced a 29 percent contraction in sales volumes on the east coast. In broadacre, while the area planted was flat year on year, fertiliser application rates declined as farmers drew down in-soil nutrients. In pasture, the combination of a collapse of milk prices and poor seasonal conditions drove a 38 percent decline in sales volume. Despite these conditions the Incitec Pivot

Fertilisers' value proposition remained intact and the business maintained market share in 2009.

We'd expect farmers to begin rebuilding nutrient levels in 2010 in broadacre and the recent improvements in milk prices in New Zealand suggest conditions in pasture may begin to improve. We see this as directionally more positive for volumes in 2010.

In our Southern Cross ammonium phosphate business, we experienced a significant contraction in margins in line with the 60 percent decline in realised global phosphate prices. In addition, we once again experienced rail line outages during the Queensland monsoon season which impacted production by 100,000 tonnes.

In March 2010 we have a planned maintenance shut-down, and accordingly production volumes will be around 900,000 tonnes, however our exposure to rail line outages during the Queensland monsoon season remains.

Globally, fertiliser prices are driven by soft commodity prices, and movements in the forward price curves of wheat, corn and soybeans will be lead indicators. Fertiliser prices now appear to have stabilised albeit on thin volumes. We don't expect to have further clarity around fertiliser prices until well into the first quarter of calendar 2010, when buyers, in particular from North America, Latin America, India and Pakistan, come back into the market.

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Incitec Pivot's major individually material item was the A$490.6 million write-down of Dyno Nobel goodwill to A$2.9 billion. This reflected changes in the weighted average cost of capital (WACC) in the assessment of goodwill carrying values and the current cyclical softness in the North American explosives market. In the absence of recovery in the North American market, are further write-downs likely? Will there be any impact on your compliance with your banking covenants?

MD & CEO James Fazzino
The largest factor contributing to the write-down was the requirement in accounting standards to revise the WACC consistent with current debt and equity risk premiums, which have increased following the global financial crisis. The 50 basis point increase in the WACC used to discount the forecast cash flows of the Dyno Nobel business resulted in approximately A$320 million of the A$491 million write-down.

The remainder of the write-down related to adopting a more conservative view of the near term cash generated by the business. This reflects the current cyclical softness in the US economy. We've been conservative in our cash flow assumptions and are comfortable with the carrying value on the September 2009 balance sheet.

As the write-down was a non-cash accounting entry it doesn't impact our compliance with banking covenants.

It's important to note that the write-down does not reflect any change in our view of the medium term outlook for the Explosives business. The fact that our earnings were up by 27 percent in US dollar terms (55 percent in Australian dollars) in the middle of the worst financial market dislocation since 1930 reflects the quality of the Explosives business's market position, assets and people, and our ability to improve efficiency via the Velocity program.

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What impact has the Dyno Nobel acquisition had on the risk profile of the company and are you generating the synergies you expected from combining fertilisers and explosives?

MD & CEO James Fazzino
We've transformed the company over the last four years and we now have a better balanced business, both in terms of our exposure to end markets and our geographic spread.

In terms of end markets, in 2009 over half our revenue was generated in explosives, one third in fertiliser sold into the Australian market and the balance in fertiliser traded into global markets. Looking at geographic spread, around 40 percent of our sales were in Australia, 40 percent in North America and the balance in Asia, India and Pakistan. In 2009, approximately half our EBIT was from explosives and half from fertilisers. In comparison, in 2005 100 percent of our sales were from fertiliser distributed in Australia.

We'll continue to build on this progress in 2010, with the formation of the Quantum Fertiliser joint venture, which we announced today. Quantum is headquartered in Hong Kong and will further expand our geographic spread.

Our increasing diversity should enhance our ability to generate more stable, higher quality cash flows and earnings going forward.

What binds fertilisers and explosives together is that both are underpinned by nitrogen chemistry and this is the main way we generate synergy in the group.

In 2009 we saw the benefit of our global focus on manufacturing under our President of Global Manufacturing Bernard Walsh, with record production at our Gibson Island plant in Australia and at St Helens in the US. Our Phosphate Hill plant broke a production record in the last quarter. We also saw the benefit of our shut-down team at the October 2009 St Helens planned shut-down. The team successfully got the plant back on line in 10 days to supply November sales.

Synergy is also generated in the supply chain. Working capital was at record lows at September, a result driven by the common sales and operations planning process we've implemented throughout the group. We're only at the beginning of this process in the Explosives business.

Finally, we have a common approach to business improvement across the group through the Velocity program office which is led by Chris Trotter. In 2009 the program delivered cumulative benefits of US$71 million in EBIT plus a further US$73.5 million in cash from asset optimisation.

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EBIT in the Fertiliser business was A$276.4 million, down 68 percent, primarily due to the impact of lower DAP prices on the Southern Cross manufacturing business, with an average DAP price of A$518 per tonne, down from A$951 per tonne. The 2009 DAP price was higher than the average of A$448 per tonne in the 2007 year when fertiliser EBIT was A$312.5 million. What were the other factors in the softer 2009 fertiliser result and how do you expect these to trend in future years?

MD & CEO James Fazzino
Southern Cross made EBIT of A$200 million in 2007 and A$186 million in 2009, with the difference being reduced volumes in 2009 of 100,000 tonnes due to rail line outages, partially offset by improved prices. However, to put the 2009 result in context, it represents a 128 percent return on our investment in the Phosphate Hill and Mt Isa assets.

A number of factors have contributed to the reduced earnings in the remainder of the business since 2007, most notably the contraction in volumes and margins in the Incitec Pivot Fertiliser distribution business. The business incurred an operating loss of approximately A$30 million in 2009 compared with profit of approximately $30 million in 2007. This is consistent with other Australian and international fertiliser distributors. The primary driver of the difference was volume, with circa 1.9 million tonnes sold in 2007 compared with 1.4 million tonnes in 2009.

Globally we experienced nutrient demand contraction, with the 29 percent reduction in Australian sales volume consistent with Latin America, North America, Europe and Asia. Over and above this was the cumulative impact of persistent drought conditions in Australia.

Clearly, 2008 was a boom year in global fertilisers but 2009 was not a normal year either, so it’s not meaningful to extrapolate from either year. It’s important to remember that the outlook for fertiliser remains positive in the medium term, with global food availability an ever increasing concern.

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Explosives business EBIT was A$299.2 million, up from proforma EBIT of A$192.5 million in the previous year, and included benefits of A$95.6 million from the Velocity program. Under your revised targets for Velocity, the cumulative target of A$204 million in savings won’t be reached until 2012, a year later than originally planned. To what extent does the new time line factor in a recovery in the North American market?

MD & CEO James Fazzino
The Velocity program is made up of four streams. The overhead reduction stream has no volume dependency, while the plant efficiency, cost to serve and supply chain optimisation streams have various exposures to volume. For example, plant efficiency includes the volume benefit from improved up-time at our plants and of course this is totally dependent on the market being able to absorb these extra tonnes.

In terms of the revised time line, we’ve assumed a slow recovery in the US economy from 2011 onwards and accordingly a push back in some benefits from 2010 and 2011 into 2012. If the US market further deteriorates or doesn't recover at all, it could impact outer year savings.

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Explosives revenue was A$1,827.6 million, up 6 percent on proforma 2008, partly reflecting a 10 percent lift in Asia Pacific AN sales with first deliveries of 41,000 tonnes to the coal segment under the Moranbah foundation contracts. To what extent is delivery under these contracts impacting margins?

CFO Frank Micallef
We incurred A$43 million in cash costs in supplying the Moranbah foundation contracts. We provided for these costs at acquisition and accordingly the Moranbah sales are recorded in the income statement at a zero margin.

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You've indicated there has been no change to your plans around the Moranbah AN project, mechanical completion of which you've delayed by 12 months. What will be the key considerations in deciding the final timing of the project?

MD & CEO James Fazzino
We slowed the project and stopped mechanical progress earlier this year because we didn't want to bring new AN capacity on-line before it was required by the market.

The delay was announced at the height of the global financial crisis, when there was no visibility on how the dislocation in the financial system would impact global growth and therefore the outlook for planned new mines and expansions in the Bowen Basin. However, it's always been clear that metallurgical coal deposits in the Bowen Basin are world class in terms of scale, quality and cost, and have geographic proximity to the fast growing Chinese market, so AN from Moranbah would be required to support this growth longer term.

There's no change to the 12 month delay announced to the market in February 2009. We continue to talk to our customers and will update the market in the first quarter of 2010.

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Incitec Pivot booked net operating cash flow of A$337.4 million for 2009, down from A$822.6 million in the previous year, primarily reflecting the drop in earnings, higher interest and tax paid, and Moranbah customer contract costs. This was partly offset by reduced investment in trade working capital. What scope is there to further reduce trade working capital and what is the outlook for Moranbah cash costs through to mechanical completion?

CFO Frank Micallef
The 2009 trade working capital result in Fertilisers was very good, falling as it did by A$38 million from 2008, and these absolute levels will be difficult to consistently improve on. Trade working capital in Fertilisers can also be significantly impacted by factors like the timing of fertiliser export shipments.

In Explosives, trade working capital improved by a more modest A$12.5 million. The current average ratio of trade working capital to sales in the Explosives business is 19 percent, and we'd aim to see that fall a couple of percentage points over time. We'll work on this through our implementation of more effective sales and operations planning as part of the Velocity program. However, trade working capital in the Australian Explosives business won't consistently improve until we're able to supply all our Moranbah contract requirements locally.

We've previously advised that our forecast of the cash cost to complete the Moranbah project is A$935 million. To date, we've spent A$340 million, so we have about A$595 million to go. This should be incurred roughly evenly over the 18 or so months it would take us to complete and commission the project from recommencement.

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Net debt was A$1,463 million as at 30 September 2009, down from A$2,030 million a year earlier. Net debt to EBITDA was 1.97 times, largely flat on 1.98 times a year earlier. What is your level of comfort with gearing at this level in light of your capex commitments in relation to Moranbah and continuing uncertainty in your key markets?

CFO Frank Micallef
Our net debt position improved significantly in the second half of 2009. We target a net debt to EBITDA ratio of 2.5 times or less through the cycle to maintain our investment grade credit profile.

We're comfortable we can maintain these credit metrics and fund Moranbah. We have carefully managed our capital expenditure and investment in working capital over the last year, and will continue to do so. Our close management and financial discipline, together with the operating cash we expect to generate from our businesses, should position us to hold our credit metrics within our target range over the next year, even factoring in Moranbah construction recommencement.

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Incitec Pivot has recently obtained three investment grade credit ratings: BBB stable outlook from Standard & Poor's and Fitch; and Baa3 stable outlook from Moody's. At present the majority of your debt comprises a A$1.7 billion syndicated facility that matures in September 2011. What are your intentions with regard to sourcing debt funding going forward?

Frank Micallef, CFO
We've been explicit about our capital management strategy, which includes increasing the average maturity of our debt and diversifying the sources of our funding in order to minimise refinancing risk to the business now and in years to come. This is prudent financial management, to which we're committed.

We're very well supported by our banks, and the three investment grade ratings will open global debt capital markets to us. For this reason, we're confident we can make good progress over the next year on our strategy to significantly increase the average tenor of our debt and diversify our sources of debt funding.

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Incitec Pivot has announced an unfranked final dividend of 2.3 cents per share for 2009, bringing the full year dividend to 4.4 cents, 48 percent franked. This compares with a fully franked dividend of 29.7 cents for 2008. Your policy is to return all available franking credits to shareholders, and you've indicated there are unlikely to be sufficient franking credits to pay a fully franked 2010 interim dividend. What's the rationale for paying an unfranked dividend and will you continue to do so?

Frank Micallef, CFO
We revised our dividend policy at the half year by lowering our payout range to 20 to 40 percent of NPAT before individually material items, from 55 to 65 percent. The lower payout range is based on our need, over time, to fund more of our growth from internally generated cash flows and to ensure our balance sheet remains strong and consistent with our target investment grade credit metrics and credit ratings.

At 2.1 cents per share, our 2009 interim dividend was at the bottom of the new payout range and fully franked. The final dividend for 2009 is unfranked as we didn't have any further franking credits available. The lack of franking credits reflects the increased proportion of our Explosives earnings generated outside Australia and tax losses that occurred in 2009, some of which will carry over into the 2010 financial year.

We have a variety of shareholders on our register, and many retail shareholders in particular rely on the dividends they receive. Because we couldn't frank the final dividend, we've kept it to the bottom of our stated payout range, at around 20 percent. We'll continue to be cognisant of balancing the needs of our different shareholders and the needs of the company when considering future dividends, even if we can't fully frank them. This will be particularly relevant until at least the 2011 financial year, a period during which we're unlikely to be in a position to frank dividends.

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Thank you James and Frank.

For more information about Incitec Pivot, visit www.incitecpivot.com.au or call Simon Atkinson, Executive Vice President Finance & Investor Relations, on +61 405 513 768.

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