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Emeco Holdings Limited
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Emeco Holdings Limited (ASX: EHL) today reported NPAT of $67.5 million down 9.6 percent from the previous year. NPAT in the second half was up 21.4 percent to $37 million. Can you explain the contrasting performance in each six-month period?

MD Laurie Freedman
Whilst we are disappointed with the lower earnings in 2008 compared to 2007, we characterise the 2008 performance as a tale of two halves and consider this result a factor of adverse short term events impacting the business over the first nine months of the year. We are pleased to deliver a full year result within guidance provided to the market in February.

During the first six to nine months of the year, profitability was affected by some weather related one-off or special events including the drought in south east Queensland which affected the Tarong power station, flooding in the Bowen Basin in Queensland and the Hunter Valley and Newcastle in New South Wales, and a cyclone in the Pilbara region in Western Australia. Offshore, there was a change in conditions in Indonesia and continuing start-up losses in the US that also impacted our results. All these events had a negative impact on our asset utilisation in the first six to nine months of the year, but we finished very strongly.

The second half was particularly encouraging and especially the last quarter's contribution with our second half profit increasing 21.4 percent to $37 million reflecting a step-up in Australia, Indonesia, Canada, and US. The contribution of profits on the sale of our rental fleet continues to form part of our core earnings arising from our continuous asset management cycle. Profits on sale were $7.3 million in the second half compared with $2.2 million in the first half. Some of this variance is attributable to equipment shipping delays that straddled the half year.

As indicated to the market in February, the US became profitable in the second half and we continue to re-orientate Canada towards mining, which is now performing very well. The lead times on the delivery of some classes of new large earthmoving equipment lengthened considerably and along with increased volumes in the mining and infrastructure industries we are witnessing strong demand for our equipment overall as we move into 2009.

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Revenue was $617.9 million up 11.5 percent from the year before, but your EBITA margin was down to 19.5 percent from 23.2 percent in FY07. What were the factors contributing to the lower EBITA margins? Do you expect similar margins in the current year ending June 2009?

CFO Stephen Gobby
We entered 2008 with the expectation of continued revenue growth by way of investing further growth capital whilst maintaining high utilisation. This growth in funds employed in rental fleet and sales inventory together with general business growth led to higher direct and indirect costs. Due to the impacts of weather and offshore factors that Laurie has mentioned, we experienced lower asset utilisation which impacted top line revenue growth with a growing cost base. Furthermore, high valued assets sitting idle and not contributing revenue, whilst continuing to attract minimum monthly depreciation charges further impacted EBITA margins. These factors translated through to overall margin compression.

However, with utilisation trends strengthening through the end of the year, and with our cost base remaining relatively stable into FY09, we expect a return to higher margins going forward.

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EBITA ROFE was down to 14 percent for the full year from 17.3 percent in the previous corresponding period. Can you detail the trend through the year?

MD Laurie Freedman
This ROFE trend is a combination of a small decline in FY08 earnings together with a growth in funds employed through targeted growth capex and a short term spike in working capital. Firstly, the utilisation issues experienced in the first

three quarters of 2008 had an adverse impact on the earnings component of ROFE. Secondly, funds employed increased through the well documented increases in working capital and additional investment in rental fleet. The combination of these items had a negative impact on ROFE.

It is important to note that reported ROFE is calculated on a 12-month rolling basis which is somewhat of a lagging indicator. When you calculate ROFE at 30 June 2008 on a six month or three month rolling basis, the trend is positive showing ROFE of 14.7 percent and 16.1 percent respectively. This further underscores the positive finish to 2008 and reflects improving earnings through higher utilisation and the fact that some of the working capital and capital management initiatives we focused on in the second half started to bear fruit. We expect that trend to continue to 2009.

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What has been the trend in plant and equipment utilisation though the year? Can you give some insight into performance by region?

MD Laurie Freedman
There has been substantial improvement in all regions in the second half. Across all the business units in Australia, Indonesia, Canada and the US, the combined utilisation by written down book value rose from 68 percent in December 2007 to 82 percent by year end. We are encouraged by this trend continuing in July to 84 percent.

In Australia, utilisation increased from 75 percent in December to 89 percent in June. Indonesia was the strongest performer from December to June, going from 57 to 95 percent. The US and Canada also improved dramatically. The US increased utilisation from 43 to 71 percent and has continued to improve through July and August to 80 percent. In Canada, utilisation went from 47 to 56 percent over the half. As we are re-orienting our fleet mix in Canada from a civil to a mining fleet, we expect our utilisation will continue to improve over time as mining applications tend to be more all weather protected compared to civil work which is subject to weather conditions.

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US operations contributed profitability in the second half. Have you established critical mass in the US and do you expect profits to be sustained?

MD Laurie Freedman
In the second half, at the EBIT level the business produced a $1.2 million profit excluding a one-off write-down of slow moving parts inventory of $1.1 million. This was an acceptable outcome, particularly compared to the first half year's performance and recognising the business is still in its development stage and needs a little time to deliver its potential.

We're getting more recognition as our brand equity is building in Eastern USA. Our enquiry levels have increased significantly and we're working on a number of new opportunities that will build further critical mass and in turn enhance the ROFE contribution of this business. We expect the US to continue building its profitability as the business matures.

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What is the outlook for your other international operations?

MD Laurie Freedman
Indonesia looks particularly strong with continuing organic growth of existing mines and a string of opportunities with new mines being brought into production. In Canada, we're migrating towards mining applications from civil. We're building new facilities in Fort MacKay in the middle of the Athabascan oil sands and we're getting significant pull-through due to increased brand awareness. We're starting to market our services into other areas of Alberta Province and penetrating the metalliferous sectors in British Columbia and other projects in Saskatchewan.

Whilst the European businesses are a small component of our global operations, both in terms of capital invested and earnings contribution, the strength of the Euro and the generally soft economic environment in Europe has been hampering the trading business. We're continuing to explore trading opportunities in the former Russian States, the Middle East and Africa and looking to leverage currency movements by changing from procuring and selling in Europe to procuring internationally and selling into and through Europe.

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What impact did the severe weather conditions in Australia have on the FY08 results?

MD Laurie Freedman
As I mentioned earlier, the weather-related one-off events were significant and impacted our earnings performance especially in the first half and into the third quarter.

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What is the underlying demand trend in Australia? Are there any signs that demand for your services is peaking? Where are we in the cycle?

MD Laurie Freedman
There are three key market factors which are driving demand for our rental offering: the short supply of mining equipment, the contraction of global capital liquidity and the underlying strength in earth moving activity in bulk commodities.

As I mentioned earlier, certain classes of mining equipment are experiencing extensive delivery lead times which is resulting in an increased demand for our rental fleet. Furthermore, our global procurement capability of low hour used equipment is also leading small and large companies to Emeco for equipment supply solutions.

Furthermore, in the current economic climate where capital is in short supply and there's less preparedness by our customers to buy long-life assets for their short term needs, we find there's an increased level of enquiry towards the rental model.

With respect to mining activity, our key exposures are in coal, gold, iron ore and oil through the oil sands patch in Canada. In our view, the medium term outlook is very robust for coal, iron ore and oil sands. We're continuing to increase our exposure to the respective coal markets in Australia, Indonesia, US and Canada. Oil sands activity is significant now and expected to continue over the next decade with an estimated C$120 billion of capital to be invested in Alberta Province alone. From a concerted strategic effort to increase our exposure in iron ore, we have been quite successful in FY08 and as a result of the penetration we have effectively diluted the importance of the gold sector to our Western Australian rental business. We're targeting further penetration into the iron sector in FY09.

While the future is somewhat unpredictable, we feel comfortable that all of these factors put us in a sound position to deliver an improvement in the next 12 months compared with FY08.

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Working capital was $254 million at the end of June down from $299 million at the end of December. Can you explain the swings in working capital through the year? What is your target level for working capital going forward?

CFO Stephen Gobby
The key driver of the working capital increase through the middle of the year related to some unique buying opportunities for our Australian sales business due to the strength of the Australian dollar and the relative weakness in the US market for various types of gear. We undertook a significant amount of used equipment purchasing in the first half, which increased our inventory levels. Delays in shipping the inventory to Australia exacerbated the level of working capital we would ordinarily be comfortable with. However, in pursuing this strategy, we achieved strong sales at acceptable margins in the Australian sales business in the second half making it a valuable contributor to the business over 2008 and more than justified the temporary higher level of working capital.

We indicated to the market in our half year result a targeted reduction of $50 million in working capital from December to June. As part of our renewed focus on balance sheet efficiency and quality of earnings, we successfully reduced working capital by $49 million after excluding cash movements. This reduction included a reduction in sales inventory and tyres by $71 million. This was partly offset by an increase in receivables of $22 million. Going forward, we'll be targeting to keep general working capital relatively flat into 2009 despite our expectation of business growth. This is a reflection of our continuing focus on working capital initiatives to ensure we're using our balance sheet as efficiently as possible. We're also expecting some small growth in working capital for sales and parts inventory over the year. However, that will be subject to stock turn in the respective businesses and close management scrutiny.

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Growth capex was $106.8 million, and net maintenance capex was $77.8 million, what has been the focus of your capex initiatives and what is the outlook for growth and net maintenance capex?

MD Laurie Freedman
Firstly, the majority of our growth capex during 2008 was directed towards the Canadian and US businesses, and that was part of our strategy to build some scale in those businesses. We started to see the benefits of that investment towards the end of June 2008. There was also some organic growth capex in our Australian and Indonesian business. We continue to generate significant free operating cash flow which is available for reinvestment in growth capex. However, our primary focus is on increasing the returns on funds employed back to historical levels. We expect some continuing growth capex into 2009, mainly organically based, but not ignoring any strategically sensible acquisition opportunities.

Net maintenance capex is a combination of both expenditure to replace or overhaul existing equipment and the disposal of equipment that's getting to the end of its life cycle. As the fleet size grows, as it has done over the last two to three years, the requirements for maintenance capex will grow accordingly. We expect maintenance capex to remain at similar levels over the coming years, subject to the timing of certain pieces of equipment reaching the end of their life cycle.

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You've recently announced a refinancing and upsizing of your senior debt facility from $515 million to $630 million, which comprises a $595 million three-year senior bank facility and $35 million renewable one-year working capital facility. How much head room do you have within your existing and new facilities and to what extent have finance costs risen?

CFO Stephen Gobby
Firstly, I must say we are very pleased with the support we received from the eight banks in the syndicate during an extremely volatile and uncertain time in global capital markets. Having increased the facility size and with a number of new banks joining the syndicate, this was a positive sign of support for the Emeco business. This funding certainty allows the Company to now focus on short term performance improvement and medium term strategy without the distraction of capital market volatility.

At 30 June, we had net debt of approximately $350 million. The new senior facility together with existing finance lease facilities of $36 million provides us with head room of approximately $280 million. In 2008, we generated free cash flow of $90 million after net maintenance capex. We expect to use free cash flow to reinvest in the business alongside utilisation of our debt facilities.

As is well known, borrowing costs have gone up significantly in the current economic climate and we haven't been immune from this trend. We're estimating our effective borrowing cost to increase about 130 basis points as we move into using this new facility which has been factored into our guidance to the market.

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Net debt was $347.8 million up from $305.1 million from the year before. Gearing increased 5.8 percent to 49.7 percent. What are your expectations for the trend in net debt levels in FY09?

CFO Stephen Gobby
When you look at gearing levels in this business, it is important to recognise the asset backed nature of our balance sheet. The mobility and relative liquidity of our tangible asset base enables us to readily convert assets into cash permitting higher gearing levels. Relative to our global peers and our high cash flow coverage ratios, we consider current gearing levels to be conservative.

Whilst we are very conscious of maintaining relatively conservative gearing levels during this period of uncertainty, future growth capex will be funded through a combination of our free cash flow and debt. But when you bring it back to both Laurie and my earlier comments about our primary focus on returning ROFE to historical levels, we expect any increase in debt to equity gearing levels to be supported by strong cash flows through higher earnings.

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You've announced a fully franked dividend of 2.5 cents per share bringing the full year dividend to 4.5 cents. This brings the dividend payout ratio to 42 percent compared with 30 percent in the previous year. What is the outlook for dividends in the current year?

MD Laurie Freedman
We're still in a growth phase, and we consider our dividend levels on the basis of providing shareholders as much income as we prudently can, whilst continuing to fund growth, which is in the long-term interest of shareholders. Our ability to reward shareholders is expected to be maintained in the current year.

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You expect NPAT of $75 million to $81 million in the current year ending June 2009, an increase of 11 percent to 20 percent from the current NPAT of $67.5 million. How confident are you of achieving this target with the current market conditions?

MD Laurie Freedman
We expect the second half recovery to be continued into FY09. We're comfortable in guiding the market to the levels you have indicated, but with the caveat that we are operating in unprecedented times of significant uncertainty and the future is less predictable than in more usual periods in history. Notwithstanding this uncertainty, the relatively strong demand we are witnessing, and our lead

indicators suggest we can improve on last year's performance. It is worth reiterating that the increase in funding costs will have an unavoidable impact on 2009 earnings. To minimise this impact, our focus will remain firmly on extracting more value from our installed asset base and managing working capital levels rigorously.

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Thank you Laurie and Stephen.

For more information about Emeco, please visit www.emecoequipment.com or contact Stephen Gobby, Chief Financial Officer, Emeco Group, telephone + 61 8 9420 0222.

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