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**Date of lodgement:** 26-Aug-2009

**Title:** Open Briefing® . Emeco Holdings. FY09 Results & Outlook

**Record of interview:**

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Emeco Holdings Limited (ASX:EHL) today reported NPAT before impairment and restructuring charges of \$57.7 million for FY09, down 14.5 per cent from the previous year. You experienced an average utilisation rate of 83 per cent in the first half of the year. What has been your experience during the second half in utilisation rates? Has there been any change in utilisation rates over recent months?

**CEO Laurie Freedman**

All our businesses performed well with very strong utilisation up until December 2008. Within a period of weeks at the end of 2008 the mining and construction sectors effectively ground to a halt as commodity prices came under extreme pressure as the stress on the global financial system intensified. This unique environment led to a decline in utilisation primarily across our businesses that were exposed to coking coal, iron ore and oil sands. Pleasingly, utilisation and earnings in the NSW and Indonesian rental businesses continued to grow through this volatile period given their significant exposure to thermal coal and gold.

We briefly touched a utilisation low of 55 per cent in March 2009 and averaged 68 per cent across the second half to June 2009. Coming out of the 3rd quarter we

expected utilisation to trend above 70 per cent in the 4th quarter as enquiry levels remerged. However this did not happen as most opportunities did not convert until after 30 June as general market uncertainty at the time was delaying decisions.

The second half NPAT of \$18.7 million is not a reliable indicator of earnings for FY10 for a few reasons. Firstly, utilisation of 55 per cent was a historical low recorded during a period of unprecedented volatility that the industry has not experienced before. Secondly, Europe and Canada contributed second half EBIT losses of \$3.2 million and \$1.6 million respectively which are not expected to recur in FY10 due to a downsizing in Europe's case, and a return to a more stable market environment in Canada. Finally, utilisation in August is touching 70 per cent with enquiry levels across the business significantly higher than at any point through the second half of FY09.

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Operating cash flow was \$175 million for the full year ending June 2009, up 14.2 per cent from the previous year. Free cash flow after capex and dividends was \$46 million. What is the minimum level for capex to sustain the business going forward and what is the expected trend for cash flow in the current year ending June 2010?

#### **CFO Stephen Gobby**

We've continued to deliver strong cash flows which is a function of the strong EBITDA generated by the business model and a flexible capex program which varies in line with utilisation, enabling us to manage the balance sheet through the earnings cycle. As a result, debt reduced by \$73 million in the second half. The reduction came in two ways; we paid down debt by \$35 million and the appreciation of the Australian dollar reduced foreign currency debt on translation by another \$38 million.

Capex for FY09 was down about 50 per cent on FY08 for three reasons. Firstly, the useful life of our machines is determined by operating hours. When utilisation comes down the machines are operating less and major component capex requirements are postponed.

Secondly, and more importantly, a large part of our sustaining capex is the replacement of machines at the end of their useful life. We can therefore naturally contract certain asset classes within our fleet where we see lower demand for them over the medium term and use the cash to retire debt. I refer to this as "right sizing" the balance sheet to the earnings of the business through the cycle.

Finally, we have constrained growth capital over the past 6 to 12 months while we focussed on improving returns on existing invested capital.

As we establish greater visibility on the demand outlook we have the balance sheet capability to reinvest in the optimum asset classes to meet demand and drive earnings higher and ultimately enhance the return on capital for our shareholders. Our cashflow and balance sheet strategy is positioning the company very well to

pursue some attractive investment opportunities that will emerge as the markets improve over the next six to twelve months.

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A key feature of the Emeco business model has been an expected resilience in demand for heavy earth moving equipment despite changes in commodity prices. Do these results put in question this aspect of the business model?

**CEO Laurie Freedman**

On the contrary, the recent economic downturn has provided testament to our business model that we've achieved a creditable result at the operating NPAT level. Notwithstanding that, like many other companies we've been severely impacted by the rapid and immediate decline in activity in the mining and construction sectors, but generally speaking, we have withstood the effects of the global financial crisis quite commendably.

It would be safe to say that the activity decline during this recent period was not solely related to commodity price movements. The near collapse of the global financial system during this last year drove particularly irrational behaviour which impacted most businesses across the industry.

We are now seeing emerging signs of returning to a more stable environment where we expect resumption of volume growth in our key commodity exposures. In this context, the virtues of the business model are expected to become evident once again.

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Emeco has adopted a geographic expansion strategy over recent years. What is your strategic outlook for the next two to three years?

**CEO Laurie Freedman**

One of the most important success factors for Emeco is its global footprint that facilitates the procurement of low houred quality used equipment which underpins the rental, parts and sales divisions of our highly integrated business model.

Our international growth strategy has largely been to provide this capability. This focus affords us the luxury to protect our significant presence in the Australian market and take advantage of any value creating organic or M&A opportunities that may arise. In addition to developing the procurement flexibility, we also receive a free option as to whether we pursue other elements of the model. As markets change we need to remain flexible about investment levels throughout our global presence. With these factors in mind it is worth looking at each region separately.

In Indonesia, there are significant opportunities which continue to provide a very positive earnings outlook and we will continue to invest in Indonesia in a responsible and disciplined manner.

In keeping with the focus to maximise returns on our capital, we recently completed a strategic review of the underperforming European business. This review has resulted in a decision to materially downsize this business.

In terms of North America, whilst we're disappointed with the Canadian performance over the last six months, the board and management remains very enthusiastic about the medium to longer term prospects that Canada provides. We have committed some new capability into the Athabaskan oil sands region, in the form of a major workshop and people and we believe the underlying fundamentals for oil sands remains intact. We're increasing our focus on other commodities and markets throughout Western Canada to diversify away from the established Edmonton and Fort McMurray base. When considering Canada we operate in a market structure similar to Australia, and an important part of our vision requires the continued strategy of re-orientating the current fleet of predominately small civil gear into larger mining gear.

While the USA business has now become profitable, the return on capital remains below Emeco's hurdle rates. We are currently undertaking a review of the business and the market to determine the most appropriate way to achieve an acceptable return on the existing invested capital. We are conscious that the USA is in a very deep recession and need to look beyond the immediate operating environment. However, the Company is equally committed to maximising returns on shareholders' funds.

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To what extent are you seeing pricing pressure from competitors amid the slower business conditions?

**CEO Laurie Freedman**

As a result of the substantial contraction in demand, there has been more attention to pricing in the market. We've been able to defend our market share on the basis of our value proposition.

We are a global business and have relationships across various regions. Our geographic spread enables us to procure very efficiently; we provide geographic coverage for our multi-nationals customers that our locally based competitors cannot. Size and sustainability matters, particularly for the larger end of the industry and that's what we provide. We also manage equipment residual value risk better than most. Lastly, the high mechanical availability of our equipment translates into real cost savings for our customers as they measure their costs through productivity efficiency rather than hourly hire rates. These elements allow us to transact on a value basis, avoiding the competitive tension of price alone.

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Net debt was \$331 million down from \$411.7 million six months ago. To what extent can you continue to reduce debt in FY10?

**CFO Stephen Gobby**

We remain focused on managing our debt to comfortable levels and creating as much flexibility in our balance sheet as possible. Given our cash flow capability and balance sheet flexibility we remain comfortable with debt around the existing levels. Depending on how the operating environment unfolds over the next 6 to 12 months and what opportunities arise, we may use the free cash flow to reinvest in value creating opportunities, rather than reducing debt. If this scenario does not occur, then it is logical that debt will be further reduced.

We continue to operate with significant headroom under our debt covenants, even after taking into account some of the impairment charges in this period. Our interest cover is at 8.1 times and gearing is 1.8 times debt to EBITDA. Our debt facility doesn't mature until August 2011 and we remain very comfortable with the support from our banking syndicate.

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You've announced a fully franked final dividend of 2 cents per share bringing the full year dividend to 4 cents per share. What is the outlook for dividends in the current year?

**CFO Stephen Gobby**

Our fully franked final dividend of 2 cents per share reflects a pay-out ratio of about 43 per cent, which is within our stated policy of 35 to 45 per cent. We have significant retained earnings and franking credits, as well as continued strong cash flow and the balance sheet to continue to execute our dividend policy into the foreseeable future.

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In June you announced that you would be stepping down as CEO once a successor was appointed. How is the search for a new CEO progressing?

**CEO Laurie Freedman**

As we announced in June, the Emeco board has commenced a search for a new CEO and that search is well underway. I have agreed to remain as CEO until the right candidate has been found to ensure a smooth transition. In the meantime it's business as usual for Emeco and me.

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You recently received a takeover proposal for Emeco. Can you comment further?

**CEO Laurie Freedman**

As announced on 13 August we received an unsolicited, indicative non-binding and highly conditioned proposal to acquire 100 per cent of the shares in the company from a financial investment firm. The proposal is preliminary and incomplete and shareholders are advised that this approach may or may not lead to a formal proposal being put to Emeco. As yet the company has had no engagement with the investment firm.

The Emeco board will consider any offer or proposal it receives having regard to all alternatives available to the company. We'll keep the market informed of any material developments and we have retained UBS and Baker & McKenzie to assist in relation to this matter

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Is your second half performance in FY09 indicative of the expected level going forward?

**CEO Laurie Freedman**

The second half was a challenging period and our performance was below what we achieved in the first half. Whilst it is impossible to know exactly how the global economy will unfold and how it will affect business opportunities in the medium term, we, like a lot of other business leaders expect to see a modest and steady recovery in the first half of 2010, with an accelerating pick-up in the second half.

Beyond 2010 we are expecting a return to more normal economic conditions that will drive our earnings higher over the medium term. It is important to note we have a lot of capacity to leverage earnings over the next eighteen months from our existing installed asset base without requiring significant additional capex.

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Thank you Laurie and Stephen.

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For more information about Emeco, please visit [www.emecogroup.com](http://www.emecogroup.com) or contact Stephen Gobby, Chief Financial Officer, Emeco Group, telephone + 61 8 9420 0222.

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