Emeco

Earthmoving equipment solutions

Market Release
24 February 2010

Executive Summary

- Interim operating NPAT of $13.6 million, in line with guidance
- One-off non-cash impairment charges of $14.3 million
- Slower than expected recovery in market activity in 1H10
- Interim dividend on hold until expected recovery confirmed
- Equipment demand improving across all key markets with group utilisation at 78%
- Action taken to close unprofitable European operations and rationalise North America
- Management confirm operating NPAT guidance of $40–$44 million for FY10

Financial Performance

Emeco Holdings Limited (ASX: EHL) today reported an operating net profit after tax of $13.6 million for the 6 months ended 31 December 2009 representing a 65.1% decline on the prior corresponding period (pcp) in line with previous guidance.

Chief Executive Officer of Emeco, Keith Gordon said, "The operating environment in the first half has been challenging, but we are now seeing a turnaround in all our core markets and increasing demand for our mining equipment as our customers look to take advantage of the improved outlook for commodity prices."

"Although a number of mining projects that have committed to utilising Emeco's fleet have incurred short term delays, momentum has been building towards the end of the half and these projects are now coming on line."

A$ million	1H09	2H09	1H10	% change pcp
Revenue	309.8	218.4	208.5	(32.7)
EBITDA	128.6	82.3	82.5	(35.8)
EBIT	69.5	36.4	32.1	(53.8)
Operating NPAT	**39.0**	**18.6**	**13.6**	(65.1)
Statutory NPAT	**39.0**	**(25.7)**	**(0.6)**	(101.5)
R12 ROC (%)	**11.7%**	**9.1%**	**6.0%**	(5.7)

The Company incurred one-off non-cash impairment charges totalling $14.3 million (after tax), mostly attributable to the North American operations, resulting in a statutory NPAT loss of $0.6 million for the interim period.

The impairment charges comprised the following:

- $7.8 million (pre-tax) of Canadian small civil equipment arising from the decision to accelerate the fleet reconfiguration strategy in conjunction with the North American restructure;
- $5.5 million (pre-tax) of USA rental, sales and parts assets;
- $4.5 million (pre-tax) in respect of inventory in the Australian Sales and Parts businesses due the appreciation of the Australian dollar over the past 6 months;
- Offsetting these items was a combined tax effect of $3.5 million.

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The Company's return on capital (ROC) for the last 12 months was 6.0% excluding significant items at 31 December 2009.

Mr Gordon said "There are a range of external factors which have affected our quality of earnings; however our current ROC performance is not acceptable."

"We need to ensure we are managing the things within our control and taking decisive action on underperforming businesses and assets. These are the first important steps in improving our return on capital to acceptable levels."

Net tangible assets at 31 December 2009 are $0.71 per share after adjusting for the impairment charges.

1H10 Business Performance

The key features of 1H10 business performance are:

- 1H10 operating earnings lower on pcp basis across all businesses
- Early stages of recovery in 1H10 reflected in utilisation improving from 60% in July 2009 to 73% in December 2009 however some project delays impacted earnings – utilisation in February 2010 sits at 78%
- Rebound in Australian mining activity in later part of 1H10 driving Emeco's core business into 2H10 although earnings are still dependent on the trajectory of the recovery
- Depressed levels of equipment investment across the industry has significantly impacted Australian Sales revenue
- Indonesian thermal coal volumes have remained robust
- Canadian Oil Sands recovery underway with Emeco gaining momentum towards the end of the half

The Australian Rental business generated $27.3 million EBIT, down 37.8% pcp, representing approximately 85.0% of the group's EBIT for the period. The pickup in customer activity was slower than expected with a number of delays experienced. In addition, equipment preparation costs increased due to the high volume of equipment being redeployed after the low utilisation levels during most of CY09. However, the business was experiencing accelerating momentum in the later part of 1H10.

The Australian Sales & Parts business contributed $0.4 million operating EBIT for the year, down 94.1% pcp. The significant earnings declines in these businesses were a reflection of reduced activity generally, and of customers' focus on containing their operating and capital expenditure during the economic downturn. The appreciation of the AUD also impacted the value of aged inventory relative to market in the first half, affecting margins as a result.

Underlying USD earnings for the Indonesian business were up 23.8% on a pcp basis. However, the higher AUD resulted in a reduced EBIT contribution after translation of $6.4 million down 31.7% pcp. Activity in the Indonesian coal sector remained buoyant throughout the economic downturn. Despite some customer churn during the period the business achieved average utilisation of 74%.

The Canadian Rental division delivered EBIT of $1.0 million in 1H10 down 91.9% pcp, however there was an improvement on the $1.6 million loss in 2H09. As a result of the financial crisis all development and some production activity ceased in the Alberta oil sands in early 2009 which severely impacted the entire mining services industry. The recovery profile has mirrored that of the Australian mining industry over 1H10. This has been reflected through a step-change in utilisation from 37% in July 2009 to 75% in February 2010.

The United States and European businesses produced a combined EBIT loss of $2.6M in 1H10.

Cash Flow & Balance Sheet

- 1H10 operating cash flow of $66.0 million despite challenging earnings environment
- Investment in fleet of 190 tonne and 240 tonne trucks at the commencement of the market recovery
- Short term increase in gearing ratio to 2.66 times due to historical earnings and strategic fleet investment
- Available debt headroom of $301.5 million
- Improving earnings, cash realisation from business closures and constrained capex will enhance balance sheet over the course of 2H10
- Net tangible assets per share down 4.1% to $0.71 as a result of 1H10 impairments

Emeco generated strong operating cash flow before net capex of $66.0 million, representing 10.5 cents per share. The operating cash flow included $7.3 million of further working capital reductions during 1H10.

Offsetting the strong operating cash flow, the Company incurred net capex of $90.6 million comprising purchases of $105.2 million less disposals of $14.6 million and paid dividends of $12.6 million. The result was a net cash outflow of $37.2 million which was funded via existing debt facilities.

The Company managed its capex program tightly throughout 2H09 at the height of the financial crisis to preserve cash flow and maintain balance sheet flexibility. In the early stages of 1H10, the Company took advantage of its balance sheet position to make a long term investment in 190 tonne and 240 tonne truck fleets to meet emerging demand in Australia and Canada. The Company invested approximately $62 million in these fleets during 1H10 with the balance of approximately $25 million to be incurred in 2H10 when the remainder of the fleet is delivered.

Keith Gordon said, “This investment is central to Emeco’s strategy to migrate its fleet profile further towards larger mining equipment to meet its customers’ needs, and the entire fleet acquired to date has been successfully deployed.”

Net debt increased by $21.1 million to $352.4 million in the six months to 31 December 2009. The increase comprised a cash drawdown of $35.4 million offset by a reduction of $14.3 million due to the translation effect of the AUD appreciation. Net debt comprised $354.6 million of senior debt, $8.1 million of finance leases, less cash of $10.3 million. The Company has undrawn headroom of $301.5 million via its $595 million 3-year revolving debt facility (maturity August 2011), $33.2 million working capital facility and $25.6 million of finance leases.

The combination of the lower earnings over the past 12 months and the large truck investment has resulted in a short term increase in operating gearing to 2.66 times (Net Debt : EBITDA). Gearing is expected to return to below 2.0 times before 30 June 2010 through higher EBITDA in 2H10, lower capex than in 1H10, and execution of the asset disposal program.

Interim Dividend

Despite encouraging signs, the trajectory of the resources sector recovery remains subject to a number of external factors. In this environment the Board considers it prudent to preserve cash and maintain balance sheet flexibility until the recovery is confirmed and the benefits are directly flowing to the mining services sector and hence has resolved not to pay an interim dividend. The Board intends to resume payment of dividends assuming the expected earnings recovery is delivered over the balance of FY10.

Review of Operations

Since Mr Gordon joined the Company in December 2009, a review of existing operations has been completed. The two key outcomes of this review are the decisions to exit the European operations and significantly downsize Emeco's presence in the USA.

In August 2009 Emeco announced that it was in the process of downsizing its European operations. Following continued underperformance, Emeco has now decided to exit this business. This decision has been taken after determining that the European operations were unlikely to meet the company's required rate of return in the foreseeable future and a presence in Europe offered no material advantage in terms of Emeco's international procurement activities.

In November 2009 Emeco announced the commencement of detailed review of its US business. The outcome of this review has resulted in the consolidation of the USA and Canadian operations into a single North American business unit. This business unit will be led by Mr Ian Testrow, previously President of Emeco Canada.

Emeco will close its current USA headquarters in Houston, Texas and will cease to operate from its facility in London, Kentucky reflecting the decision to exit the Central Appalachian coal market.

Mr Gordon said, "Emeco remains committed to pursuing profitable growth in North America which we see being achieved by complementing our presence in the Canadian oil sands with customer led projects in other geographies. While we continue to see opportunity in the US, we will only pursue these markets where we are confident that a low cost business model can be applied to deliver value".

The closure of the European business and the comprehensive restructure of the North American operations will result in restructuring charges of up to A$9.5 million and A$20.0 million respectively to be incurred in 2H10. These costs primarily relate to lease termination costs, employee redundancies and costs associated with asset disposals.

Outlook

Operating conditions across all core markets continue to improve. Emeco's businesses in Western Australia, Queensland and Canada were the hardest hit in the economic downturn, however these markets are all demonstrating improving levels of activity moving into 2H10. Utilisation continues to increase across all geographies, with global utilisation currently at 78%.

Mr Gordon said, "Our full year NPAT guidance of $40 - $44 million prior to restructuring and impairment charges assumes a steady ramp up of activity, particularly in the Australian market where in recent months a number of mining projects have incurred delays."

"Nevertheless, we have seen steady improvement in utilisation of our existing fleet over the past few months and the early benefits of the investment in three significant mining truck fleets in the last half are starting to flow through."

"We are dealing with our underperforming businesses so that we can focus on growing our core businesses in Australia, Indonesia and North America. These businesses are well positioned with immediate earnings leverage to the mining industry recovery. In addition to second half operational imperatives such as delivering earnings growth and converting our surplus assets into cash, management will complete a thorough strategic planning process. Through this planning, we need to deliver satisfactory returns to Emeco's shareholders over the long term."

While further work is under way on the strategic direction for Emeco, it is not expected to give rise to further restructuring or impairment charges. The Company will provide an update once this work is completed.

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About Emeco

Emeco is a leading global provider of heavy earthmoving equipment with offices in Australia, Indonesia and North America. Emeco has integrated rental, sales, parts, maintenance and procurement into a single business for high reliability, low-houred heavy earth moving equipment for the mining and civil construction sectors. Emeco is not aligned with any earthmoving equipment manufacturer and has a global fleet approaching 2,000 machines including equipment manufactured by Caterpillar, Hitachi, Komatsu, Liebherr and Volvo.

Emeco's ordinary shares are traded on the Australian Stock Exchange under ASX code EHL.