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CEO and Chairman on Outlook & 2011 Remuneration Report

Open Briefing with MD & CEO Keith Gordon and Chairman Alec Brennan

Emeco Holdings Limited
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Emeco Holdings Limited (EHL) is an independent supplier of heavy earthmoving equipment solutions for the mining industry across the globe. Its primary operations are in Australia, but it also has a major presence in Indonesia and operations in Canada.

Current Market Capitalisation: $619 million

In this Open Briefing®, MD & CEO Keith Gordon and Chairman Alec Brennan discuss

- **Strengthening utilisation levels over Q1**
- **Growth and underlying improvements in Indonesian and Canadian business**
- **Capital management and strategy post restructure**
- **AGM voting on the FY11 remuneration report**

Open Briefing interview:

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Emeco Holdings Limited said at its recent AGM that average rental fleet utilisation had increased to 90 percent over the first four months of the current year ending June 2012, up from 79 percent at the start of the year. This compares with average utilisation of 89 percent in FY2011. How does current utilisation compare with your expectations and how indicative is it of expected utilisation for the full year?

CEO Keith Gordon
At 90 percent, we're close to full utilisation. The increase over the past three or four months has come on the back of improvements in Indonesia and Canada; Australia has been consistently strong over the course of this financial year.

For the balance of this financial year, we expect utilisation to remain strong taking into account the seasonal thaw period in Canada, which is our fourth quarter, when we expect utilisation in that market to drop off for a period of time as the ground becomes saturated.

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Emeco booked EBIT of $101 million in FY2011, up 21 percent. On year-to-date indications, is continuing growth of this level sustainable in the current year?

CEO Keith Gordon
Our growth in 2012 is predicated by our capital investment program, where we're bringing in significant additions to the fleet, particularly in Australia and Canada. Based on the deployment of this new capital and maintaining strong utilisation levels in our existing fleet, we do expect continuing EBIT growth in 2012.

However because of the phasing of our growth capital spend in FY2012, we expect a step-up in earnings in the second half of the year, with roughly 60 percent of our full-year earnings coming in the second half and 40 percent in the first half.

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In FY2012, Emeco has committed $165 million to organic growth capex in large mining equipment, with $95 million allocated to the Australian business. The additional Australian fleet will be deployed by the start of the 2012 calendar year, with the remainder deployed in Canada by the end of the third quarter. What implications will this have for FY2012 utilisation levels and EBIT return on capital (ROC) given the new equipment won't make a full-year contribution to earnings?

CEO Keith Gordon
We expect most of the equipment will go to work promptly after we take delivery, so we expect utilisation levels will not be diluted significantly over the year.

However, return on capital will be affected due to the lag between when we pay for equipment and when we put it to work. That lag is due to the time needed for transportation and preparation of used equipment before it can be rented. So whilst there will be some ROC accretion from the growth capital in FY2012, the full benefit will be realised in FY2013.

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Given increasing pressure on capital and operating costs, as well as increasingly tight labour markets, what scope is there to maintain ROC growth in the medium term?

CEO Keith Gordon
We're experiencing significant cost pressures, particularly in labour and other operating costs. Despite this, we operate with customers who understand and operate in the same environment, so we've been able to pass additional costs through to them. We expect margins to be maintained over the next 12 months and as we add growth capital into the business, we expect further ROC improvement in the medium term.

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You've indicated that utilisation in Indonesia has improved to 83 percent, up from an average of 76 percent last year, and that you have plans for organic growth capex of $30 million in this market next financial year. Given customer issues and sub-optimal returns from Indonesia in the past, what is the rationale for renewed investment in this market?

CEO Keith Gordon
We have a very positive view on the fundamentals of the Indonesian market as a thermal coal producing region. It's a low cost producer in close proximity to its end-use customers. We've always believed Indonesia has the characteristics of a good market for a rental business.

We had some customer issues and poor returns last year in Indonesia and have taken action to ensure we don't have the credit issues we've had in the past. We've renewed the management team and that team has worked to ensure we have the right customer base of effective miners, who use the equipment efficiently and achieve high monthly operating hours.

Given this work and the strong fundamentals in the market, we're comfortable investing further in Indonesia and expect returns to improve from the growth capital and from improvements in the underlying business.

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In Canada, Emeco has experienced a slow start to the year with utilisation averaging 44% in the first quarter. What issues have affected first quarter utilisation and how can you improve this going forward?

CEO Keith Gordon
We've had a mining fleet in Canada for only about 18 months now and achieved encouraging utilisation and returns in FY2010. The problems experienced in recent months are not in-line with the usual activity cycles we expect in this market.

However, all service providers in that market have been impacted by a major reorganisation of one of the oil majors and extensive bush fires across the region. These events had a short term impact on activity through the Canadian summer, however in recent weeks utilisation has recovered to more acceptable levels and is currently at 72% as preparation for the winter program has now commenced. Winter has historically been the stronger period of utilisation and underlying hours for Emeco so expect the remainder of this year to be much stronger in Canada.

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You've identified Chile as a possible target for geographic expansion but stated that entry into that market would be predicated on a low-infrastructure model. This appears contrary to Emeco's model in other markets, where it has made relatively heavy up-front investment. Why are you taking this approach to Chile? Will the low-infrastructure model lead to lower returns?

CEO Keith Gordon
We think this is a sensible approach to a new market as it effectively de-risks our market entry. Our strategy, should we go ahead with entry into Chile, is to build the business to a critical mass and follow that up with investment in infrastructure and people. We're able to do this because we'll have a fleet comprising almost exclusively large mining equipment with a relatively small number of pieces relative to the total capital value. This will allow us initially to outsource the labour requirement to support that equipment.

In the first year or two we will be able to concentrate on getting equipment into contracts with customers, and not be concerned about other sunk capital and costs in the business.

This is logical compared with our previous entry into the US, for example, where we had high up-front costs and never generated the revenue stream to support those costs.

We don't believe this approach will lead to lower returns over the long term. The equipment we plan to deploy into Chile is our core mining equipment and we know it can generate strong returns for us. Even though we won't have some of the additional margin we have in other markets with in-house labour, we also won't have to deploy capital into workshops. In the long term we would aim to build the full-service model in Chile that we have in our other markets.

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In FY2011, Emeco had net cash flow of $145 million after stay-in-business capex and asset disposals. Growth capex of $106 million and dividends of $57 million were therefore covered largely by cash flow. With the asset restructuring cycle completed, what are your medium-term capital management priorities given ongoing investment in growth?

CEO Keith Gordon
We continue to look at both our investment and capital management opportunities in light of our balance sheet structure, with a view to ensuring we have a comfortable level of gearing across the cycle. Our target debt to EBITDA range remains at 1.5 to 2 times. We currently sit below 1.5 times and looking out over the next year or two, we're very comfortable with our balance sheet position and gearing. With that in mind, we've committed to significant organic growth capital in FY2012 and FY2013 which we think will generate good returns.

We have a number of options for any surplus capital. These include further investment in organic growth, geographic step-outs, potential acquisitions and/or, if we don't find sufficient investment opportunities for the capital, returning it to shareholders. In terms of returning capital to shareholders, we have a lot of surplus franking credits, so we could pay special dividends as we did in FY2011. Alternatively, if we think our share price is trading below what we see as fair value, we could buy back shares. In considering any of these options, we'd first look at the relative return the respective use of funds would achieve versus investing capital in an operational asset such as a truck.

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Following the restructure of the business, how is Emeco positioned to respond to future swings in the resources cycle?

CEO Keith Gordon
Our business model is quite resilient now that we've finished the restructuring. Post the restructuring we're now focused almost exclusively on production. The businesses we've exited were largely focused on civil construction. We've also reduced our exposure to activities such as mine development. Our experience during the last downturn was that production activity continued and wasn't as severely affected as civil construction or mine development.

By having large mining equipment focused on production we're well positioned, particularly in Australia, to achieve good tenure on our contracts and manage any short term downswings in the resources cycle. We continue to see a positive outlook in all of our markets. Notwithstanding current macro uncertainty, our customers remain committed to their planned expansions and new projects.

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Your 2011 remuneration report attracted a vote of 73.6% in favour. What do you think were the main reasons that led to this outcome?

Chairman Alec Brennan

After engaging with our major shareholders, the key issue raised on the remuneration report was around the change to payment of dividends on unvested shares on the Long Term Incentive plan. Although the advice we received confirmed this is market practice, some of our shareholders are concerned that management are being rewarded before performance hurdles are achieved. We have taken on board the feedback from shareholders on this matter and will review this remuneration practice in the coming months.

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How will the board respond to this first strike on the remuneration report?

Chairman Alec Brennan

We are obviously disappointed with this outcome, however it is important we listen to our shareholders concerns. In particular, the key issue raised by the shareholders was around payment of dividends on unvested shares and hence this is where we will focus our attention. Overall we believe our remuneration practices are in line with market and designed to attract high quality management, however we may need to address this issue to ensure we don't have a repeat of this outcome again next year.

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Thank you Keith & Alec.

For more information about Emeco Holdings, visit www.emecogroup.com or call CFO Stephen Gobby on +618 9420 0222.

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