

## ASX ANNOUNCEMENT: 25 August 2011



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### MD on FY Results & Outlook

Open Briefing with MD Guy Roberts

Penrice Soda Holdings Limited  
Solvay Road Osborne  
South Australia 5017

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#### In this Open Briefing<sup>®</sup>, Guy discusses:

- Debt reduction strategy
- Basis of asset carrying values
- Outlook for FY2012 and beyond

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#### Open Briefing interview:

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Penrice Soda Holdings Limited had gearing (net debt/net debt + equity) of 53 percent as at 30 June 2011, up from 42 percent a year earlier. According to your accounts “restoring the Group’s financial position to a longer term sustainable debt profile is critical to the ability of Penrice to continue as a going concern.” Your board is conducting a strategic review which is considering options to reduce debt, including asset sales and equity raising. What is the outlook for debt levels over the current year ending June 2012 and which assets are being considered for sale?

##### MD Guy Roberts

Debt levels are forecast to increase in the first half of FY2012, particularly to fund planned annual maintenance. But on the back of our strategic initiatives to improve operating performance, we expect to be in a position to pay down our new working capital facility by September 2012, which is the commitment date.

We expect the high exchange rate and higher than normal coke prices to continue through the first half. But, we also expect our announced initiatives and further outcomes from the strategic review to begin to provide benefits in the coming months, with the full benefit in the second half, which is typically our stronger half. Given we won’t see a repeat of the difficulties we experienced from the plant shut-down in FY2011, we expect to improve cash flow in the second half and pay down the new debt.

The imperative is to reduce our overall debt from current levels and that’s why the strategic review is important. The board is considering all options in relation to asset sales. One

option we'll pursue is selling our Quarry & Mineral inventory assets, which have a book value of approximately \$30 million post-impairment.

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Penrice reported a normalised loss of \$1.4 million for FY2011, against net profit after tax of \$5.3 million in the previous year. Normalised EBITDA was \$15.7 million, down 33 percent from FY2010, with EBITDA in the second half deteriorating 49 percent from the previous corresponding period. Are the trading conditions of the second half expected to continue in the current year? What capacity is there to improve earnings in such an environment?

**MD Guy Roberts**

The outlook is for continuing tough trading conditions. The unprecedented strength of the Australian dollar is making it very difficult for manufacturers and we're seeing soft underlying demand in the consumer-led economy.

Clearly, the glass industry is also struggling in the high Australian dollar environment, which is making imported glass more competitive and curtailing exports of products like wine. On top of that, demand for flat glass from the building and construction sector is subdued and isn't expected to improve any time soon.

In raw materials, we've seen unusually high coke prices on the back of Australia's floods last summer. Increased coke pricing impacted our costs by \$2 million in FY2011, and is expected to have a further \$1.6 million detrimental impact in FY2012, taking our expected spend on coke to \$15 million.

While some commentators believe the Australian dollar has peaked and that coke prices will soften if world economic growth slows, a great deal of uncertainty remains. As such, we're focused on the things we can control. We'll continue to increase our use of alternative kiln fuels. Our staff cuts have now been completed and will be effective from 1 October. We're expecting a benefit of \$2 million from those cuts in FY2012, and more on an annualised basis.

The price increases we've recently announced in our export book from 1 of October should generate another \$2 million uplift to our profitability in FY2012, and more on an annualised basis. Those price rises leverage the strong demand for our proprietary export product range.

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To what extent do you see Penrice's earnings decline as structural rather than cyclical? What are the parameters of your current strategic review and is it attempting to address these structural/cyclical issues?

**MD Guy Roberts**

It's not our business to make the call on whether the strength of the Australian dollar and commodity prices are cyclical or structural. The Australian dollar is trading US\$0.30 higher than its long term trend and most commentators believe that's temporary. Certainly our business fares a lot better if the Australian dollar is under US\$1. We see similar characteristics in the coke price, with the fall in Queensland coal production due to weather events having a very inflationary, but temporary, effect on price.

Structurally we still believe we have competitive advantages as an Australian manufacturer: we're advantaged in two of our key raw materials, limestone and salt, over our Chinese competitors; our total manufacturing costs are on a par with the Chinese; and we're close to main customers in southeastern Australia and our exports go to some of the world's most attractive growth markets.

Our strategic review encompasses the funding ability of the company – its ability to sell assets and to raise equity – and its key operational parameters. Operationally, we're looking at trying to build profitability back into the Chemicals business at an extraordinarily difficult time. In addition to the initiatives already underway, the review is evaluating a number of productivity projects. They include looking for ways we can buy and process our kiln fuels cheaper and package our product more efficiently.

In FY2011 our plant performance was obviously hit by the unprecedented failure of our steam supplier and that created a series of production problems, mainly in the kiln section, that persisted through the year. We've been able to fix those problems and we've completed a reline of our worst affected kiln and plan a reline of a second kiln in the second half of the current year. We're confident this work will materially improve plant efficiency.

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Penrice reported a statutory loss of \$26.2 million for FY2011, with significant items after tax totalling \$24.8 million, including impairment charges of \$14.7 million in the Chemicals business related to a lower cash flow outlook and \$7.0 million in the Quarry & Mineral business related to the carrying value of landfill inventory. Why was the aggregates inventory not impaired and do you see further impairment charges given the Australian dollar remains strong and your major markets in Australia remain subdued?

#### **MD Guy Roberts**

We've taken an impairment charge against our landfill inventory, recognising that the landfill sales opportunities we'd previously identified simply didn't materialise or have been deferred. At the time we began booking the landfill as inventory, we had a clear marketing plan identifying expected opportunities for landfill sales of around 30 million tonnes. In the aftermath of the global financial crisis and the ending of the government stimulus package, many of those projects have been cancelled or deferred.

We've now built an underlying sales run rate of 200,000 tonnes per annum of landfill. It's important to note that most of the cash cost of our current landfill inventory was incurred years ago, so those sales are strongly cash positive. By the same token, the landfill inventory impairment is not an issue for the cash earning potential of the company. Our forecasts do not rely on those sales.

In contrast to our landfill business, aggregates is a business that has tripled in size over the last five years. We now sell in excess of 1 million tonnes per annum of aggregates, comprising around 30 diverse materials. That product is used for concrete manufacture, pavements, building construction and as road base. Each of these sales segments is profitable and at our current sales rate we'll have substantially sold down our existing aggregates inventory within five years. We're very comfortable with the carrying value of our aggregates inventory.

In our Chemicals business, the impairment charges reflect a more conservative view of future currency levels and demand in the Australian chemicals market. This better reflects the reality of our current situation and we've written down goodwill attached to the business accordingly. If the current circumstances change, clearly we'll revisit those assumptions.

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Chemicals booked a normalised EBITDA of \$14.0 million in FY2011, down 8 percent, on revenue of \$127.6 million, down 6 percent. EBITDA margin contracted to 11.0 percent from 11.2 percent. What is your ability to improve margins in the domestic market without loss of market share given weakening domestic demand and import competition?

**MD Guy Roberts**

We've optimised the factors we can control as much as possible, and putting supply problems related to the plant shutdown aside, and given the difficult demand environment, we think the Chemicals result demonstrates our progress in implementing productivity improvements.

We've made improvements to our kiln performance, we've started using cheaper kiln fuels to address the coke price spike and we'd cut labour costs even before we announced a 10 percent reduction in staffing numbers. There were also price increases in the year for sodium bicarbonate and soda ash. In total, we've been making a lot of incremental gains around productivity, cost reductions and through pushing price increases as best as we can.

Over FY2012 we're seeking to expand our margins largely through further plant productivity gains in addition to further price increases.

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You've indicated revenue from sodium bicarbonate export sales was down despite a 4 percent rise in volumes and a 5 percent rise in US dollar prices. What ability do you have to grow export revenue given a continuing high Australian dollar and sodium bicarbonate production at capacity?

**MD Guy Roberts**

It's important to understand that our Chemicals export business is a US dollar denominated business, in which the continuing high Australian dollar is irrelevant to our customers and their demand for our product. We're a major producer of food and pharmaceutical sodium bicarbonate in Asia and the value proposition of our product is based on its performance, packaging attributes and the fact that it's a premium product, rather than around its price. As long as we continue to innovate around the packaging and continue to build value with a high quality product, we should be able to extract higher prices.

Certainly the demand is there to support an expansion of our sodium bicarbonate production, and we'll consider this once we've addressed our more pressing funding priorities.

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The Quarry & Minerals business booked EBITDA of \$5.3 million, down \$6.2 million or 54 percent, with operating costs increasing \$7.0 million, primarily due to lower inventory credits. However, mining cash operating costs fell \$0.9 million and free cash flow improved

by \$2 million, reflecting a \$5.3 million decline in inventory build. How is this business positioned to generate improved earnings performance going forward?

**MD Guy Roberts**

We've focused very hard on turning this business cash positive. Three years ago it had negative cash flow of \$9 million and we were on target to break even in FY2011 but a softer civils market at year end meant we didn't quite make it. We expect to do better than break even in FY2012.

To improve the outlook for this business we're focused on optimising the mine operation and selling as much inventory as possible. We reduced extraction in FY2011 by 50 percent to 1 million tonnes, and inventory build was restricted to aggregates, a product on which we can make up to a 30 percent gross margin.

We're now the No 2 supplier to the civils market in South Australia, coming from a small position five years ago. Given our product portfolio and a track record of supply, we can now tender for jobs for which we previously didn't have the credentials. For example, we're currently the major civils supplier to the South Road Superway project in Adelaide, the largest road project in South Australia. Beyond that we're looking at opportunities driven by government investment over the next three years, as well as growing our industrial minerals sales to existing customers such as Adelaide Brighton as it expands.

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Net operating cash flow declined to \$5.0 million in FY2011 from \$7.1 million in the previous year due to earnings decline. Capex of \$13.2 million resulted in negative net free cash flow of \$8.2 million, versus negative \$5.8 million in FY2010. What is your expected capex in FY2012 and will your investment plans be curbed by your lenders? What is the outlook for net free cash flow?

**MD Guy Roberts**

We had some additional investment in FY2011, including a requirement to purchase buffer land around the Angaston mine. Our expected capex for FY2012 is \$10.5 million.

Clearly we've maximised our debt leverage but there are a number of smaller projects that we're looking at and our lender group are encouraging us to focus on modest projects that will generate free cash quickly. While there's no prohibition on capital, the board's priority is to get a better return on capital already employed and to generate a positive free cash flow. As I mentioned earlier, we expect to see cash flow improving in the second half.

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What ability will you have to grow the business with the focus now necessarily on debt reduction?

**MD Guy Roberts**

Our immediate focus is to build some margin back into the business to generate positive free cash flow. In the longer term, our growth agenda for the Chemical business revolves around the coal seam gas industry and treating its waste water to make soda ash, sodium bicarbonate and sodium chloride. We won't be lending our balance sheet to those projects, but we'll be deriving fee income from selling our technology, operating the water treatment plants and marketing the coal seam gas waste water by-products.

In respect to sodium bicarbonate, as conditions permit we'll look to further expand our plant to 130,000 tonnes per annum from 100,000 tonnes today, as we've previously flagged to the market. We're producing food and pharmaceutical grade sodium bicarbonate, for which demand is growing strongly in our Asian export markets. We think that demand growth will continue in the long term.

In the Quarry & Mineral business we see growth in line with Adelaide building construction activity. In this business we're focused on continuing to improve the free cash generating potential of the assets. We think we can generate more free cash from the business.

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Thank you Guy.

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For further information on Penrice Soda Holdings Limited visit [www.penrice.com.au](http://www.penrice.com.au) or call CFO Frank Lupoi on (08) 8402 7280

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