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Incitec Pivot Limited
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Record of interview:

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Incitec Pivot Limited today reported net profit after tax (NPAT), excluding significant items, of $27.5 million for the first half ended March 2006, up 60 percent from the previous corresponding period. EBIT was $40.7 million, up 54 percent. The consensus forecast for EBIT for the current full year ending September 2006 is $106 million, up 38 percent, and for NPAT, $67 million, up 43 percent. Can you comment on the consensus forecast?

CEO Julian Segal
We've made a good start to the year, and we're positioned well for the second half. I'm aware of analysts' forecasts, and naturally they're subject to the normal caveat of adequate rainfall during the winter cropping period and reasonable water allocations in the cotton market.

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Fertiliser volumes were down 21 percent in the first half, with 10 percent of the decline attributed to market factors and 11 percent to competition. What's the outlook for demand and the competitive environment heading into the critical winter cropping season?

CEO Julian Segal
The second half of our financial year is dominated by the winter cropping season, when we sell over one third of our volume. Conditions going into the 2006 season

are generally positive, in fact better than 2005. Although as usual, we're watching developments on the rainfall maps very closely.

The Southern Oscillation Index is encouraging. It was positive for the first three months of 2006, whilst it was negative for the same period in 2005. Recent rains across the southern broadacre region have established a reasonable sub-soil moisture profile and improved farmer confidence. But, follow-up rains are now required before planting can commence. Across the central broadacre region, the winter break is yet to occur although we'd expect some dry sowing of canola to commence in some areas soon, irrespective of the timing of the break.

The other key market for us in the second half is cotton, where we'd expect water allocations to be similar to 2005, and therefore demand for our premium Big N fertiliser to be at similar levels to last year.

In terms of the competitive environment, in addition to the new channel recruited in 2005, we'll receive a major boost in volume in the second half due to sales under our supply agreement with ELF, the Elders-Landmark fertiliser distribution joint venture. That agreement commenced from March 1 and we expect it to result in a net volume increase of around 10 percent, or about 300,000 tonnes, over a full 12-month period. In the first half we had only one month's benefit from the agreement, so we're looking forward to a full six months' contribution in the second half.

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To what extent might factors such as high fertiliser prices continue to curb demand even if weather conditions are favourable?

CEO Julian Segal
In the first half, a combination of weather conditions and high fertiliser prices impacted demand, particularly in the extensive pasture segment. In some respects, we were the victims of our own success, in that we had the decade's best sales into pasture in 2005 but with above average rainfall in spring, farmers saw excellent pasture growth leading up to Christmas. With their sheds full of hay, they reacted to the low average rainfall in the second quarter and the higher fertiliser prices by simply not buying the normal level of superphosphate. This reflects the fact that fertiliser application in the extensive pasture segment can be variable, year on year, depending on seasonal conditions.

Our key market in the second half is the winter crop segment, where fertiliser application is not discretionary. We'd therefore expect farmers to react to the higher prices by being conservative in their fertiliser application at planting time, and then compensate with side and top dress applications later in the season. We're looking for good rainfall in June and July to underpin this.

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In the first half, Incitec Pivot's restructuring program reduced costs by $11 million compared with the previous corresponding period and you now expect total

program benefits of $34 million per annum before tax, up from an initial target of $25 million. Where are the additional cost reductions expected and when will the full benefits be achieved?

CFO James Fazzino
To date we've been extremely successful in driving a step-change in our cost base under our cost reduction program. The savings are above plan in terms of both timing and quantum and we'd expect to deliver $25 million in cost reductions in the current year, up from our initial target of $20 million.

The program comprises 74 individual projects, of which 35 are complete. The balance are in progress, although many of these are already delivering benefits. We keep track of the program's status daily, and run it like a funnel into which we're continuously adding new initiatives to deliver both targeted and additional savings.

As you've noted, the program is now expected to deliver $34 million in savings across the cost bar, and that's up from the $30 million we forecast in November. The extra $4 million relates to the Nauru phosphate rock initiative, under which we're expecting to receive our first deliveries of rock in the last quarter of 2006. That means the full benefits will be reflected in the 2007 financial year.

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Is there further potential upside in the cost reduction program?

CFO James Fazzino
Continuous cost improvement is a way of life for us, and we talk about that internally in terms of achieving an unassailable lowest cost base position. The cost reduction program you see today is just the first in a series of step-change opportunities in the business. For example, we see a large opportunity to improve the efficiency of our supply chain, and that will be our next program. Of course, we already have a very large step-change in our cost base locked in at Gibson Island in 2008, when we switch over to a new gas supply contract, which will reduce cash costs by $15 million per annum.

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Incitec Pivot booked significant items of $17.4 million after tax in the first half. The majority of the charges related to the closure and remediation of the Cockle Creek single superphosphate plant. Does the Cockle Creek closure represent the last of the major restructurings to emerge from your asset review?

CFO James Fazzino
We're closing Cockle Creek in order to remediate the site, and the first step is to demolish the plant. We expect the closure to be earnings neutral as the fixed cost savings from Cockle Creek, combined with volume efficiencies at our Geelong and Portland plants, will largely offset the costs of transporting product into the Cockle Creek footprint from the south.

In terms of our asset base, we're comfortable with our balance sheet. However, we'll continue to review and restructure assets in the future. This is an ongoing process which will inevitably result in both gains and losses.

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You've indicated that improved manufacturing margins reflecting a recovery in domestic nitrogen and superphosphate prices to import parity levels made a positive contribution to EBIT of $14 million in the first half. What's the outlook for prices in the current second half?

CEO Julian Segal
The outlook is positive, with industry forecasters predicting global prices will remain well above trend for the medium term. For us, the impact of the price upturn has been partially offset by first, the high Australian dollar and second, under the current Gibson Island gas contract where we share 25 percent of the benefit of the high prices with our gas supplier.

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Incitec Pivot will take its first deliveries of phosphate rock from Nauru in the September quarter. What costs have been incurred in restarting this source of supply and what are the anticipated benefits to earnings?

CFO James Fazzino
The cost incurred to date has been $3.5 million of a total spend of $6 million. We get that back in kind, in the first few shipments. Because the $3.5 million is a pre-payment, it's been booked in other debtors rather than as part of our capex.

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At the beginning of the current financial year Incitec Pivot had $30 million of Australian dollar hedging at US$0.68 for 2006 and a further $15 million at US$0.68 for 2007. Can you comment on your current hedging position and the expected impact on earnings?

CFO James Fazzino
The $30 million of cover was spread equally over the year, which means $15 million of cover rolled off in the first half, and $15 million will roll off in the second half. The impact of reverting to the 2007 level of cover will be less than $1 million.

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The business had net operating cash out-flow of $90.5 million in the first half compared with $115.1 million in the previous corresponding period. Capex was $16.8 million, up from $14.3 million, and included sustenance capex of $13.4 million as well as spending of $3.4 million relating to the February 2007 shut-down of the Gibson Island urea plant. What are the operating and cash flow risks associated with the shut-down?

CEO Julian Segal
The shut-down, "Reset 2007," is the largest capital project we've had in recent times. The budget for the project is $43 million, $20 million of which will be spent this year, with the balance in 2007. We started planning for the shut-down in 2005 and that work has been ramping up since then. The plant will be off-line for about 30 days in February 2007, at which time around 1,000 people will be employed in shut-down related activities.

We're pleased with progress in the project to date, and are confident we can deliver it safely, on time and on budget. The Reset 2007 team has done an outstanding job in developing "value improvement" activities, which will ensure we minimise spend while delivering the benefits safely and on time.

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Trade working capital stood at $263 million at the end of March 2006, down $71.7 million on a like-for-like basis compared with a year earlier. Net debt at the March seasonal peak was $137.9 million, down from $199.6 million. Is the reduction in trade working capital sustainable and what's the outlook for debt levels at year end?

CFO James Fazzino
We're very proud of the working capital result, in terms both of the quantum of the reduction, and also because it continues the year-on-year improvements we've made since the Incitec-Pivot merger. Based on our track record, we're confident the reduction is sustainable. What's most pleasing about the result is that it reflects the team effort in the business. For example, our sales and credit teams achieved trade debtor compliance of 95 percent in March and our procurement and finance teams have worked with our suppliers to negotiate longer payment terms.

Our debt is at its peak at half year, reflecting the build-up of stock ahead of the winter cropping season. Debt is rapidly paid down in the second half as working capital is converted into cash.

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Incitec Pivot announced a fully franked interim dividend of 22 cents per share, up from 21 cents previously. Why did the increase in the dividend fail to match the growth in earnings and what's the outlook for the full-year dividend?

CEO Julian Segal
EPS before significant items were 47 cents per share, up 60 percent. EPS including significant items were 17 cents per share, and consistent with our policy of maximising returns to shareholders, we've paid a fully franked dividend that substantially returns to shareholders the balance of retained earnings at half year.

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Thank you Julian and James.

For more information about Incitec Pivot, visit www.incitecpivot.com.au or call James Fazzino on (+61 3) 8695 4498

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