Water, the Liquid of Life

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# TRADING AND EARNINGS UPDATE

Waterco advises that following a preliminary review of its half year trading position in Australia and overseas it expects its half year result to be substantially down from the previous year.

Waterco expects to report a break even after tax result for the six month to 31 December 2006 (before Foreign Exchange adjustments). This is in contrast to the $3.1million after tax result (before Foreign Exchange adjustments) for the previous corresponding period.

## Trading Update

The expected downturn in half year earnings has occurred as a result of two principal factors. Firstly, the impact of unseasonal weather conditions on sales and gross margin in Australia and, secondly the lower than anticipated orders from the Northern Hemisphere and its direct flow on effect to our S.E Asian manufacturing operation.

Our business in Australia was impacted in November and December by lower revenue and gross margins partly as a result of the cooler Australian summer and nationwide water restrictions. Gross margins were also lower as a result of price competition in certain product categories.

Our sales of product in the Northern Hemisphere, reflecting the back end of the summer season, were below expectations. In the USA, sales were impacted by the loss of the Waterpik business and timing delays in re-order by existing customers. As a result we were unable to replace this lost business prior to end December 2006, however forward orders currently on hand are higher than last year.

In the European markets our sales results were below expectation, compounded by a delayed delivery of early purchase orders by distributors in Europe and key customers in Canada and USA. Distributors, six months earlier in the Northern Hemisphere summer had experienced an unseasonably cool summer and had been left with surplus stock. While they remain committed to Waterco products and have placed new and increased level of purchase orders for the coming summer, the distributors are not prepared to accept stock earlier than January and February 2007, leaving our first half year financial result below expectation.

An indirect impact of the lower than forecast sales in the Northern Hemisphere was felt on the production and overhead recovery of our Malaysian manufacturing plant. Waterco Far East under-utilized capacity will exist for the rest of the year until the relocation of our other manufacturing lines are complete, expected to be towards end of June 2007.

The Waterco Canada cost saving initiatives were not fully realized in the first half because of the delay in shifting part of the manufacturing line to Waterco Far East and higher costs associated with product warranties sold by previous management. There is no intention to close Waterco Canada's production line, as confidence in the product has returned and large heat pumps will continue to be made in Canada, with the smaller units to be made in Malaysia.

**Impact on Full Year Result**

At this stage we expect that the under performance of the group in the first half will directly flow through to the full year result. Our previous full year guidance of net profit after tax (before foreign exchange adjustments) of $6.5million should therefore be adjusted accordingly down to approx $3million after tax (before foreign exchange adjustments).

**Further Update/Initiatives**

We are obviously extremely disappointed with the current trading position and as a result the directors have commenced a full internal cost review and restructuring. We expect this review to identify cost savings and operational efficiencies.

At the time of this announcement, forward orders for USA and Europe are significantly ahead of last year, reinforcing our view that part of the impact in the first half year were caused by order timing differences.

We will advise shareholders of the outcome of our cost and operating review details and provide a further trading update at the release of our half year results.

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