

ASX Release

13 August 2014

PROFIT GUIDANCE DOWNGRADE

The Waterco Group (ASX: WAT) is scheduled to release its financial results by the end of August 2014. While these results remain subject to audit, Waterco expects the results to significantly differ from previous guidance.

The Waterco Group experienced an unexpected loss in its Canadian entity, Waterco Canada (WCI) of \$784,000, largely made up of \$417,000 in trading loss arising from a commitment last year to supply heat pumps to the Canadian market at a price when the Canadian Dollar was at parity with the US Dollar. The loss was recognised principally at the peak of WCI's trading season, in the last quarter of the financial year. Local management had kept the impact of the extra cost in abeyance to discuss whether the manufacturing entity WUSA should absorb the excess costs due to the unfavourable foreign exchange rate as well as the increase in the manufacturing costs, resulting in failure to report the variance in a timely manner. The discrepancy was discovered during reconciliations and analyses of variances conducted subsequently and the Group immediately set about to investigate and quantify the impact. The effect was a previously unforeseen reduction of profitability in WCI by \$955,000 reducing the previously-projected small profit to a loss of \$784,000. This is the main reason for the reduction of the Group's Net Profit After Tax from the previous profit guidance provided.

Waterco USA'S (WUSA's) losses for the year were \$982,000, resulting partly from inventory write down in May and June amounting to \$169,000. The increase in manufacturing activities during the year, coupled with an unfavourable turnover of stock resulted in an unexpected level of stock discrepancies and production wastages, which were realised after WUSA's peak season from May to July this year. This sudden increase in manufacturing activities also caused inefficiencies in the heat-pump manufacturing division, manifested by excessive overtime and air-freight expenses amounting to \$298,000, in order to meet delivery schedules needed in the narrow Canadian season. The Group has also written off a further \$98,000 in inventory cost, for surplus products shipped to Waterco Far East in Malaysia, where a second heat pump line was set up to cater for markets in Europe and Australia. This measure enables the Group to obviate excessive overtime and unnecessary air freight expenses in future.

The Waterco Group now expects Net Profit After Tax to be \$1.0 million, reduced from the previous profit guidance of \$2.4 million. Losses in both entities, WCI and WUSA, amounting to \$1.8 million are not tax-effected, accentuating their impact on the Group's profitability.

The management believes that the Group's long-term underlying profitability is preserved and is confident that the Group can return to normal profitability in the following year. Losses of WCI and WUSA, amounting to \$1.8 million, are not expected to be repeated to the same extent.