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CEO and CFO on Half Year Results and Outlook

Open Briefing with MD & CEO Keith Gordon and CFO Stephen Gobby

Emeco Holdings Limited
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Emeco Holdings Limited (EHL) is an independent provider of heavy earthmoving equipment solutions for the mining industry. Its largest operations are in Australia and it also has operations in Indonesia and Canada.

Market Capitalisation: $710 million

In this Open Briefing®, MD & CEO Keith Gordon and CFO Stephen Gobby discuss

- **Step-up in earnings expected in the second half of 2012**
- **Improving outlook for Indonesia**
- **Growth opportunities and expansion in to Chile**

Open Briefing interview:

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Emeco Holdings Limited (ASX: EHL) reported net profit after tax of $29.2 million for H1 2012, down 1.1 percent from the previous corresponding period (pcp). EBITDA was $119.9 million, up 5.5 percent and revenue increased 7.7 percent. For FY2012, the consensus forecasts for NPAT and EBITDA are $70 million and $260 million respectively. This implies second half NPAT of $41 million and EBITDA of $140 million, up 58 percent and 28 percent respectively from the pcp. Are these results achievable in the current environment?

CEO Keith Gordon
We expect a step-up in earnings in the second half of 2012 as growth capital brought into the business during the first half provides a full six months of earnings. Additionally, we'll continue bringing growth capital into the business in the second half which will also contribute to earnings and we expect improvements in our Canadian and Indonesian businesses. These businesses had a relatively soft first quarter but utilisation in both is now performing well.

In an environment of long lead times for new equipment, we have strong demand in all regions and expect market fundamentals to support ongoing strong utilisation. In the second

half, we face a strong Australian dollar and some contracts rolling off towards the end of the half. Despite this, we believe we can deliver increased earnings in second half.

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Over H1 2012, Emeco's global fleet utilisation averaged 85 percent and is currently at 92 percent. Utilisation in your Australian fleet is currently 93 percent and in Canada, rising earthmoving activity and the commencement of the winter program has driven utilisation up to 96 percent. What are the key risks to maintaining these utilisation levels? Given that these businesses are near full utilisation, what opportunities are there for further improvement?

CEO Keith Gordon
Delivering returns to shareholders is our primary objective and utilisation is a key driver of earnings and returns. To optimise and improve in an environment of high utilisation we'll focus on delivering high mechanical availability which is dependent on us continuing efficient maintenance programs. It also gives our teams the space to plan for future fleet redeployments and to work with customers to understand their mining operations and help them achieve consistently high monthly utilisation levels.

Our view is that the mining cycle will remain strong in the near future so we're confident of maintaining utilisation. The visibility on growing and sustained activity levels in Australia is good and we are confident utilisation will remain at around current levels.

In Canada, utilisation is currently high given increased activity levels over the winter period in the oil sands. The risk to utilisation is through the summer period, as we experienced in the last Canadian summer. The growth in the relationship with Syncrude, one of the large oil producers in that market, is a key focus of ours to achieve more consistent utilisation across the entire year.

In Indonesia we expect utilisation to increase from the current level of around 75%. We believe this is achievable due to the expected increase in mining activity in that market over the next few years.

Overall, we're cognisant of utilisation across the mining cycle and have worked on our fleet mix over the last couple of years to protect against this risk. We're working hard to ensure that the assets that comprise our fleet are assets that are in demand from miners. As we move forward, we're continually looking at ways for value adding to our customers.

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In the Indonesian business, R12 ROFE was 5.4 percent in the first half, down from 14.8 percent pcp, primarily because of the redeployment of the fleet that was off-hired toward the end of FY2011. EBIT was $5.0 million, down 20.6 percent, and average utilisation was 73 percent, down from 83 percent. What are the opportunities to improve returns in Indonesia? What is the rationale for committing an additional $30 million in growth capital to this market in FY2013?

CEO Keith Gordon
Our Indonesian business has been in a recovery phase over the last 6 to 9 months. The fleet off-hired towards the end of financial year 2011 is now back at work, and on a run rate basis, the business is achieving historical ROFE levels. The new management team in that business has made a number of improvements which includes some additional senior resources in the

areas of business development and maintenance.

We've also reoriented our customer profile and now deal with customers with modern and advanced mining practices. This leads to higher utilisation and hours on machines which ultimately drives returns. We have also been targeting more project sites that involve on-site maintenance, which is also accretive to returns.

Having stabilised the business we were comfortable to commit a further $30 million in growth capital to Indonesia as we believe the market has strong fundamentals and a strong future, particularly for thermal coal. This investment will help us build scale in our Indonesian business, which together with our business development focus, will allow us to take advantage of demand and achieve returns above our cost of capital.

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Emeco's EBITDA margin decreased to 43.9 percent in H1 2012, down from 44.8 percent in the pcp due to rising input and labour costs in Australia and increased first quarter repair and maintenance in Canada and Indonesia. With ongoing pressure on capital and operating costs as well as tighter labour markets, what is the outlook for EBITDA margins for the full year and beyond?

CFO Stephen Gobby
In Indonesia and Canada, margin pressure was a result of short term factors. Firstly we had an increased volume of maintenance work on a large part of our fleets which were idle in the first quarter in readiness for redeployment in the second quarter. So repair and maintenance costs were higher than usual however this has moderated now the equipment has been deployed. The second factor impacting margins was the fact that overheads remained fixed, despite revenue being down in the first quarter in both businesses. However, as revenue picks up margins are recovering as we move in to the second half.

In our Australian business, a number of fleets of equipment are at end-of-life, however we have kept those assets going to finish existing contracts over this year. Unfortunately this comes with higher maintenance cost to keep the equipment working. As those contracts complete and the equipment is disposed of and replaced with younger assets, maintenance costs will reduce and that will come through in FY2013.

We're also seeing continued pressure around labour rates, particularly in Australia. As we move into FY2013 we expect to start passing on higher labour costs through either new contracts or through 'rise and fall' arrangements in our existing contracts. Therefore, we expect margins to move back toward 2010 levels as we move into FY2013.

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EBIT return on capital (ROC) was 11.4 percent in H1 2012, up from 11.0 percent in the pcp. The improvement was subdued due to a lag between the payment and deployment of two large used equipment fleets in the first half. With further growth capital investment flagged for the second half and FY2013, when do you expect to deliver the full ROC benefits of the recent investment?

CFO Stephen Gobby
We expect to see improvements in returns in the current half and that will continue into FY2013. Growth capital investment over the last six to 12 months has been predominantly on used equipment, for which there is a lag of between two to four months between paying

for the asset and having it working and generating revenue. Given the size of the investment in the first half, this has limited the improvement in ROC in the underlying asset base. As we move into the second half, that equipment will be working and we'll see a material pick up in returns as a result.

As we look to future growth capital, the equipment we've committed to Canada, Chile and Indonesia over the next 6 to 12 months is predominantly new equipment, so there won't be the same lag effect that we've seen with some of the used equipment we've brought in. However, for all equipment investments there is an inherent return profile that increases over time given rental rates remain broadly flat and the asset value declines through depreciation.

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Emeco had total debt of $329.2 million at 31 December 2011, up from $297.0 million six months earlier. Debt to EBITDA (rolling 12 month) was 1.44 times, slightly below your target range of 1.5 to 2.0 times. What capacity do you have to pursue growth opportunities and fund further geographic expansion?

CFO Stephen Gobby
We retain headroom of approximately $160 million under our existing facilities and that is after having invested over $125 million in growth capital over the past nine months. We still have ample capacity under our existing facilities and our gearing is at a very comfortable level. The growth capital we've announced recently will be adequately funded from our existing debt facilities. We'll continue to manage our debt maturity profile and ensure we have sufficient access to funding sources, be it debt and/or equity, but at this stage we're very comfortable with our funding capacity.

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Operating cash flow for the first half was $114.0 million, up from $105.2 million in the pcp. After growth capex of $65.6 million and dividends of $18.9 million, free cash flow was negative $20.2 million. This compares with positive $21.3 million in the pcp. What are your expectations for free cash flow in the second half and can future value accretive growth be funded out of operating cash flow?

CFO Stephen Gobby
As a general rule, if the utilisation of our existing asset base sits in the 80 to 90 percent range, and taking into account sustaining capex and dividend payments, we generate roughly $100 million of free cash flow per year to reinvest in growth capital or utilise for other purposes.

We have another $40 million of growth capital to be delivered in the second half as part of our FY2012 program, and an additional $80 million of growth capital to be invested in Indonesia and Chile in FY2013. While a large part of that will be funded out of cash flow, we'd expect debt to increase slightly over the next six months but remain within our existing funding capacity. Importantly, our gearing will remain at the lower end of our target range.

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Emeco declared a fully franked interim ordinary dividend of 2.5 cents per share, up from 2 cents last year. You now plan to distribute to shareholders 40 to 60 percent of annual NPAT. This is an increase from the previously stated payout range of 35 to 45 percent. Given your growth aspirations, what is the rationale for increasing the payout range? What are your expectations for full year dividends?

CFO Stephen Gobby

There were a number of factors we considered: the outlook for earnings and operating cash flow growth continues to be positive; our gearing level is relatively low; and we have sufficient headroom under our existing debt facilities, together with significant surplus franking credits. This all lead to the conclusion that we could lift the payout ratio, to return additional funds to shareholders while still being able to sufficiently fund growth capital.

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Emeco will commence rental operations in Chile in early FY2013 and plans to invest $50 million into that market. Why do you consider Chile as an attractive growth opportunity, how do you intend to control costs and what are the expected returns from the initial investment?

CEO Keith Gordon

Over the past 12 months we've conducted a lot of due diligence around the Chilean market and based on this work we believe we can make good returns for our shareholders in this market over time. The Chilean market has characteristics similar to Australia, being a low cost commodity producer with very efficient miners, and we believe that over time we'll achieve returns exceeding our hurdle rate.

In addition, our entry into Chile will provide us with an opportunity to diversify our commodity exposure, given copper is primary mining commodity in that market. Chile also provides us an additional market where we can either source or redeploy equipment as part of our global fleet optimisation program. And it provides with some geographic leverage in that the end-markets for Chilean copper are quite different from those of the commodities produced in the other countries we're active in.

Given we are now firmly committed to the market, we have equipment available, and the delivery timing of that equipment is confirmed, we are confident based on the discussions we've had with a broad section of the market in Chile that we will secure contracts for this fleet in the coming months.

With respect to our entry strategy, we'll initially resource the Chilean business largely with new equipment, which we believe will be important in managing maintenance costs with our suppliers. We are also limiting our overhead and infrastructure investment in the first instance until we have established some key contracts. We will be working with one of the large OEM dealers in that market to provide our maintenance support. Once we have bedded down the early part of the strategy, we will work on building up our capabilities to reflect what we have in our other businesses today.

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In the nearer term, what are Emeco's key growth opportunities and what are the key challenges to growth?

CEO Keith Gordon

There are three key areas where we can grow our business: growing our existing businesses; expanding our geographic footprint; and growing via acquisition.

On organic growth, we continue to look at opportunities to invest additional capital where that makes sense and where we believe we can generate returns. Our planned $30 million investment in Indonesia is an example of that. We are also continuing to look at

opportunities to optimise our core businesses through initiatives aimed at ensuring we operate efficiently, we control our costs and foster a culture of continuous improvement.

On geographic expansion, our expansion into Chile as an example of where we identify a market where we believe our rental model can generate good returns.

On acquisitions, we continue to scan the market for suitable opportunities but we're very conscious of maintaining a disciplined approach to ensure that any acquisition would generate returns for our shareholders.

Our key challenge to growth is attracting and retaining good people. We're operating in a very tight employment market, particularly in Australia, and we're continuing to work toward making sure that Emeco is a preferred employer in the sector.

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Thank you Keith & Stephen.

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

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