



Company announcement

GrainCorp Limited ABN 60 057 186 035

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To: The Manager
Announcements
Company announcements office

PUBLIC ANNOUNCEMENT

GRAINCORP 2012 HALF YEAR RESULTS

Open Briefing Q&A with CEO and CFO

A handwritten signature in black ink, appearing to read "A. Horne".

Andrew Horne
Company Secretary

GrainCorp Limited
Level 26, 175 Liverpool Street, Sydney NSW 2000
PO Box A268, SydneySouth NSW 1235
Telephone: (02) 9325 9100 Facsimile: (02) 9325 9180
www.graincorp.com.au



ASX Announcement : 22 May 2012

MD & CFO on H1 Result & Outlook

Open Briefing interview with MD & CEO Alison Watkins &
CFO Alistair Bell



GrainCorp

GrainCorp Limited
Level 26
175 Liverpool Street
Sydney NSW 2000

In this Open Briefing®, Alison and Alistair discuss:

- Positive earnings impact of record grain carry-in and large receival, export and marketing programs
- Grain processing update, including sales growth and value creation in malt supply chain
- Strong balance sheet and dividend growth

Record of interview:

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GrainCorp Limited today reported underlying net profit after tax of \$122.0 million for the first half ended March 2012, up 39 percent from the previous corresponding period (pcp). Underlying EBITDA was \$235.1 million, up 36 percent, primarily reflecting strong performances by the Country & Logistics and Ports businesses. You've increased your EBITDA guidance for the full year to September 2012 to \$385 million to \$415 million, up from \$350 million to \$380 million, implying second-half EBITDA of \$150 million to \$180 million, potentially down from \$177 million in the second half of FY11. After the strong first half, where do you see the key variances in business performance in the second half versus the pcp and what are the risks to achieving guidance?

MD & CEO Alison Watkins

In an absolute sense, our FY12 second half is going to generate strong earnings, but there are a number of factors that may lead us to a lower outcome versus the FY11 second half. We started the current second half with carry-in of 11.1 million metric tonnes (mmt), more than 1 mmt lower than the 12.4 mmt we had going into the pcp. This means that year on year, storage revenues will be lower in the current second half.

In terms of export volumes, we exported 5 mmt of grain in our FY12 first half. This is an extraordinary volume for our system, but due to the high level of grain available for export and good international demand, we're expecting to export a further 5 mmt in the second half. This compares with 4.9 mmt exported in the pcp.

In our Marketing business, we did a lot of our selling activity in the first half – through physical delivery of 3.9 mmt versus 2.9 mmt in the prior year, and sale of grain that as at 31 March was not yet delivered, which generated earnings in the first half in the form of unrealised mark-to-market gains. When this grain is delivered in the second half the unrealised gain becomes realised. Also, as we explained last year, our FY11 Marketing profit per tonne was well above the historical average and we expect our marketing activity in the second half to be at a more normal level of dollars per tonne than the FY11 second half.

Risks to achieving guidance remain predominantly around grain storage and handling volumes. There's still some uncertainty over receival volumes because we're receiving the sorghum harvest in central Queensland and it's difficult to predict how much winter crop is

still to be received from on-farm storage. We expect our country receivals will rise from the current level of 11.9 mmt towards our full year guidance of 12 mmt. The other risk is potential supply chain disruptions impacting our export plan, particularly weather-related or rail-capacity related disruptions.

In Malt, foreign exchange rates always have some influence. Also, the timing of sales can have an impact, particularly around the new harvest. There's also an element of risk around barley crop quality for malting purposes.

For Marketing, there are risks around the availability of grain for marketing activities. Entering the FY11 second half, eastern Australian growers had a lot of warehoused or uncommitted grain, a lot of which was subsequently sold in the second half. We're seeing less grain available this year, which may limit our marketing opportunities.

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You've attributed the strong first half performance to your Grains businesses (Country & Logistics, Ports and Marketing), which were driven by this year's record grain carry-in of 6.0 mmt and strong country receivals of 11.6 mmt. What portion of the first half earnings increase is attributable to the grain carry-in and what portion is attributable to other factors?

MD & CEO Alison Watkins

It's hard to break them out. Certainly the carry-in of 6 mmt was double our long-term average of 3.0 mmt and created a very positive dynamic. Compared with the prior year carry-in of 2.6 mmt, the FY12 carry-in generated additional storage fees from the beginning of the year, additional out-load fees because more grain was out-turned to domestic or export customers, and generated higher port handling and elevation fees due to higher volumes. We also saw the benefits in our Marketing business, given we owned a proportion of the carry-in grain and were able to execute trade of that grain.

Another factor that contributed to the strong first half storage and handling result was lower variable harvest costs due to the less disrupted harvest this year.

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Country & Logistics booked EBITDA of \$73 million in the first half, up 87 percent, on revenue of \$311 million, up 10 percent. Carry-in was 6.0 mmt, up from 2.6 mmt, and country receivals were 11.6 mmt, down from 14.4 mmt. Margins increased to 23.4 percent from 13.7 percent. To what extent was the improvement in margin due to lower costs on the back of a less disrupted harvest? What scope is there to improve margins from these levels?

MD & CEO Alison Watkins

Certainly in the pcg we incurred one-off costs of around \$10 million that we didn't incur in the FY12 first half. While we had some weather disruptions, they were nothing compared with those in the pcg. However there was some offset because we chose to reinvest \$2 million to \$3 million into safety upgrades and additional maintenance at some of our sites.

Also, the high proportion of carry-in versus receivals assisted us, given that once the cost of receival has been incurred, the grain in our system earns us a higher percentage margin.

We're pleased with the progress we've made on improving rail productivity, and while that's also been a factor in improving margins, we're aware there's more to do. We remain focused on improving the efficiency and productivity of the supply chain but we're also mindful that we need to pass on benefits to growers because for us the best thing is to put the growers in the most competitive position so they'll be motivated to grow more grain. We'll be talking in more detail at our investor day about some of our specific initiatives to improve supply chain efficiency and the attractiveness of our network.

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Ports EBITDA was \$74 million for the first half, up from \$52 million in the pcg reflecting an increase in grain export volumes to 5.0 mmt from 3.2 mmt. Your full year export volume guidance has been upgraded to 10 mmt from 8.8 to 9.8 mmt. Can you comment on your port utilisation at these export levels? Where are you in your non-grains strategy given first half non-grain exports were 0.7 mmt, flat versus the pcg?

MD & CEO Alison Watkins

We have about 16 mmt of bulk grain port capacity. So even in a large export year like this one, we still have excess capacity, although certain ports get close to capacity in certain months. We're very comfortable with our capacity and our ability to manage it.

An important factor for us has been that more rail capacity has come into the system which means greater volumes of grain can get to port. Export supply chain bottlenecks tend to be around getting grain to port rather than getting grain out of port. We've been able to increase the capacity at some of our key ports, including Newcastle, Geelong and Port Kembla, by a cumulative 635,000 tonnes, due to our better confidence in the supply chain's ability to bring grain to port and growing global demand for Australian grain.

Part of our strategy is to continue to diversify our earnings. We know that in some years our ports will be quiet, so as well as exporting non-grain commodities we're also importing them. In the first half we imported around 200,000 tonnes of non-grain commodities including fertiliser, meal and sands. We continue to explore complementary non-grain export opportunities that allow us to leverage our port assets. To this end, we're focused on growing non-grain exports to a minimum of 2 mmt per annum.

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The Marketing business had profit before tax of \$26.6 million in the first half, up from \$25.1 million, on revenue of \$936.8 million, up 41 percent, and marketed volume of 3.9 mmt, up 34 percent. Can you explain the relationship between the strong volume increase and the much smaller increase in profit?

MD & CEO Alison Watkins

Marketing's FY11 profit per tonne was unusual and we wouldn't expect to repeat it. The business has a relatively modest risk appetite; its targets are set around the longer-term profit per tonne level, which averages around \$4 to \$5 per tonne. This compares with our FY11 result of \$8.5 per tonne.

We're very comfortable with the way Marketing has performed. It's very focused on buying grain from growers and delivering it to end-users such as flour millers in the Middle East and Asia, rather than trade per se. In the first half about 60 percent of the grain we bought was from growers and 90 percent was sold to end-users.

CFO Alistair Bell

It's worth noting that the accounting standards require our reported results to reflect contracted tonnes rather than delivered tonnes, which requires us to mark-to-market. The tonnes we report in our investor presentation are delivered tonnes, which in the FY12 first half were 3.9 mmt, reflecting our large carry-in at the beginning of the year and the subsequent strong harvest.

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The first-half result included a net gain on derivatives and commodity inventory of \$55.0 million, up from \$40.4 million in the pcg. How much of this is attributable to the Marketing business? How much of the gain was realised in the first half and what are the risks to realising the remainder?

CFO Alistair Bell

The majority of the \$55 million related to Marketing, with a small element relating to Malt. For the Marketing component, about \$39 million, or 75 percent, was realised, and \$14 million unrealised. The unrealised portion represents the mark-to-market value of our commodity inventory and hedging positions at the end of the period. As Alison mentioned, the Marketing business focuses on buying and selling grain by linking growers and end-users via our supply chain capability. We manage the risk related to holding that grain in our supply chain by hedging our grain positions with physical or derivative contracts. As a result, the mark-to-market value reflects these positions as well as our positions in unsold and hedged grain, and sold but not yet delivered grain.

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The Malt business reported EBITDA of \$59.2 million for the first half, up from \$57.0 million in the pcp, on revenue of \$467.7 million, up 12 percent. EBITDA margin was 12.7 percent, down from 13.7 percent in the pcp, but up from 9.4 percent in the second half of FY11. While processing margins softened, you captured value from barley procurement and efficiency improvements, and increased your sales volume by 39 percent to 669,800 tonnes. Are you taking malt market share at the expense of margins? What further scope do you see for efficiency gains? Are there any signs the malt cycle is bottoming?

MD & CEO Alison Watkins

This was a pleasing performance from our Malt business in the face of still quite difficult market conditions. We certainly do not have a strategy around taking market share at the expense of margins: but we've added around 250,000 tonnes of malting capacity to our portfolio in the last six to nine months through the acquisition of Schill Malz, the German malt business we acquired effective 2 October, and the commissioning of our new Pinkenba malt house in Queensland. Schill Malz added 190,000 tonnes of capacity, and Pinkenba 86,000 tonnes, albeit partly offset by the closure of our small malt house at Toowoomba. It's pleasing to see our capacity well utilised despite this significant increase.

While we've seen a softening in malt processing margins, our EBITDA per tonne (excluding Port of Vancouver compensation receipts of \$5 million), at around \$80 in the first half, has been better than we originally expected. Certainly it's better than the levels of around \$65 we saw at the beginning of the half. That improvement reflects the value we've been able to create around effective barley procurement and around utility and other processing cost savings. We still see processing margins being quite challenging.

We're very pleased with the progress we've made in our strategy of creating an integrated global malt proposition that leverages our expertise and insight into the barley market and malt production. We're well placed to benefit from our ability to serve the global brewers who have rapidly consolidated in the last couple of years and centralised their procurement activities.

We also have a number of significant operational improvement initiatives in the pipeline for our Malt business, and we plan to provide more detail on those at our investor day.

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The first half statutory profit of \$133.7 million included a significant item, a gain of \$11.7 million after tax, on the adjustment of a defined benefit pension plan provision. What is the rationale for this adjustment and will further such adjustments be required in future?

CFO Alistair Bell

At the time we acquired United Malt Holdings, now GrainCorp Malt, the acquisition accounting required us to make provisions for defined benefit pension liabilities. Subsequently we've been able to resolve those liabilities at substantially less than we provided for, so the gain in the first half reflects a write-back against the original provision.

Following the adjustment, the remaining defined benefit provision is in the order of \$25 million, down from nearly \$40 million at the time of the UMH acquisition. We're comfortable with the current provision. Full details of the adjustment will be set out in our year-end accounts.

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Allied Mills, your 60-percent owned joint venture associate, contributed \$4.2 million after tax profit to the first half result, up from \$1.6 million in the pc. Allied has decided to replace its flood-damaged Toowoomba milling facility by expanding its existing Tennyson mill in Brisbane. What level of capex will be required, what are the funding sources and what is the expected return?

MD & CEO Alison Watkins

In closing its Toowoomba facility, Allied will invest about \$42 million to expand and upgrade the Tennyson mill in Brisbane. The capex at Tennyson will be substantially offset by insurance proceeds in respect of the Toowoomba floods. The net capital requirement will be funded within Allied's balance sheet, which is quite conservatively geared; no additional contribution from shareholders will be required.

Certainly Tennyson is an attractive investment proposition: the Queensland market is growing and the market structure and position of Allied is such that we're very confident of generating returns above our cost of capital. The Allied strategy is to have a network of mills around Australia, and in the important growth market of Queensland we'll have leading edge capability, a lower cost structure and a very strong ability to serve the national customers we focus on.

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Operating cash flow for the first half was \$42.2 million, versus \$133.7 million in the pc. This largely reflected a reduction in commodity inventory funding inflow to \$107.7 million, versus \$560.4 million in the pc. How does this reconcile with the relatively high levels of marketing activity in the first half and what is the outlook for operating cash flow over the remainder of the year?

CFO Alistair Bell

The main reason for the decline in operating cash flow relates to the additional tax of \$81 million we paid in the half, reflecting the lagged effect of our increased earnings in the prior year.

Our cash flow over the year reflects the seasonal nature of our business. In storage and logistics, we have a large build-up of working capital in the first half that unwinds in the second half. In Malt, we have seasonal fluctuations as well, and as we highlighted earlier, barley procurement has been an area of opportunity for us, so we've applied some working capital there. We'd also expect that to reverse in the second half. Our commodity inventory associated with Marketing is funded by a short-term trading facility that matches the life of those assets and so typically varies from period to period.

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GrainCorp had net debt of \$605.5 million at 31 March, down from \$755.6 million a year earlier. Excluding grain inventory held by your Marketing business, which is funded with short-term financing facilities, core debt was \$218.8 million, down from \$227.2 million, and core gearing was 13.3 percent, down from 14.6 percent. An increase in debt for the acquisition of Schill Malz was offset by higher cash. How directly does your short-term debt relate to the value of your Marketing inventory? What balance sheet capacity do you have for further acquisitive growth?

CFO Alistair Bell

Our strategy is to match funding with asset life, so as inventory turns over within one year, we fund that with short-term facilities. We use core debt for our long-term planning and while

it fluctuates somewhat, we aim to keep core gearing below 25 percent. Our gearing ratio of 13 percent as at 31 March indicates we'd have capacity in excess of \$200 million before we hit our 25 percent cap. Even at that level we'd remain well within our banking covenants.

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GrainCorp has announced a fully franked interim dividend of 15 cents per share, unchanged from last year, plus a special dividend of 15 cents, up from 5 cents. This represents a payout ratio of 49 percent, at the mid point of your dividend policy range of 40 to 60 percent through the business cycle. Why have you chosen to increase the special dividend while maintaining the ordinary dividend? What is the outlook for dividends for the full year?

MD & CEO Alison Watkins

Our aim is to pay our shareholders dividends each year, and recognising the cyclicity of our business, we use special dividends as a way to flex our dividends in a year like this one, when results are strong. Recognising the strength of the first-half result and having regard to our conservative balance sheet and the availability of franking credits, we thought it was appropriate to reward shareholders with an increased special dividend.

It's too early to comment on dividends for the full year, but we'll certainly have regard to the full-year result in considering our final dividend.

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Thank you Alison and Alistair.

For more information about GrainCorp, visit www.graincorp.com.au or call Reid Doyle, Investor Relations Manager, on +61 2 9266 9217.

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