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# MD & CFO on FY Outlook

## Open Briefing with MD Gordon Davis & CFO Philip Gentry

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**In this Open Briefing®, MD Gordon Davis & CFO Philip Gentry discuss:**

- Reasons for maintaining guidance, expecting stronger second half
- Progress in reshaping the business, balance sheet
- Growth strategy

### Open Briefing interview:

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AWB Limited yesterday reported profit before tax and non-recurring items (PBT) for its continuing businesses of $32.8 million, down 42 percent, with growth in the earnings contribution from Landmark Rural Services overshadowed by earnings declines in Australian Commodity Management (ACM) and to a lesser extent AWB Geneva. You've retained your PBT guidance of $85 million to $110 million for the full year ending September 2010, implying second half PBT of $52 million to $77 million, up from $40.7 million in the pcp. What assumptions underlie your expectations of a stronger second half?

**MD Gordon Davis**
We've maintained the guidance based on a range of factors. First, in our Rural Services business we traditionally have a stronger second half and we're also seeing more favourable seasonal conditions than we saw in the first half. We had a very weak first quarter but the second quarter was stronger and that momentum is continuing.

Second, in ACM our Grain Marketing business is seeing Australian wheat becoming more competitive globally: we're now seeing more sales of Australian wheat into markets where it was previously priced out. In Logistics we're seeing good seasonal conditions on the east coast where our GrainFlow assets are based. Both GrainFlow and our Melbourne Port Terminal assets should benefit from an increase in export activity. Our Pool Management business continues to perform well, in terms of both management fees and also the Harvest Finance offer. We've invested in the commodity management space and increased our rail capacity which should also benefit from increased export activity on the east coast of Australia.

Third, in International Commodity Management our activity is more focused on Geneva, where we expect a solid result, although not at the level of last year's very strong performance.

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ACM booked EBITDA of $47.2 million, down 60 percent, primarily due to Grain Marketing falling to a loss of $0.7 million from profit of $29.9 million in the pcp. To what extent was the drop in Grain Marketing earnings due to the absence of "trading profits" and to what extent was it due to margin reduction and loss of market share?

**MD Gordon Davis**
It was mainly due to margin reduction from increased competitive pressures, both domestically and globally. In part this meant our appetite to accumulate Australian wheat was also somewhat reduced, and decreased volatility also limited our ability to enhance margins. Non-wheat volumes were also down, falling to 0.5 million tonnes from 1.0 million tonnes, mainly because of a smaller sorghum harvest: last year's relatively large sorghum crop generated strong margins for us in the pcp.

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Rural Services booked EBITDA of $24.9 million in the first half, up from $19.0 million in the pcp and you've indicated that cost reductions have contributed to this improvement. Are you on track to meet your $25 million cost reduction target for the full year and are the savings sustainable in light of improved seasonal conditions?

**CFO Philip Gentry**
As I explained at the time we announced the target, the $25 million of savings was set against Landmark's prior year fixed cost base. That target was always going to be offset by incremental inflation in the remainder of the cost base, reducing it by about half. So the net cost savings we realised in the first half are essentially on track and the business continues to focus on ongoing productivity improvements.

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How much of Rural Services' improved result flowed from initiatives such as improved category management and the ongoing SAP implementation and when are the full earnings benefits of these initiatives expected to flow?

**CFO Philip Gentry**
The first three to four months of the first half had quite low activity levels right across Australia so there was limited opportunity for those benefits to be evident. We saw activity levels pick up in February and particularly in March, and have started to see benefits from these initiatives in the second half. However, particularly in the case of SAP, the full benefits won't flow until 2011 given implementation won't be completed until September this year. We expect the benefits from SAP to include improving productivity by for example buying better, reducing revenue leakage, improving the service experience for customers, and improving transparency which should lead to more sustainable returns in the business.

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With Grain Marketing's weaker performance, and AWB Geneva booking EBITDA of $19.7 million, down 25 percent, what is the expected impact on your ongoing negotiations to sell the Geneva operations and a stake in the ACM business to Gavilon?

**MD Gordon Davis**

The negotiations are proceeding to plan: we executed a memorandum of understanding on 30 March for the sale of AWB Geneva and a 50:50 joint venture in our ACM business which includes Grain Marketing, Pool Management, Harvest Finance and Logistics but excludes most of our other investments in that space. It's worth noting that the MOU was signed after we provided the market update highlighting our slower than expected first half performance, particularly in respect of ACM.

The proposed transaction remains strategically important for us: a joint venture between ACM and Gavilon will have a market footprint that's unique and will strengthen both businesses considerably. The transaction would reduce our exposure to the volatility of earnings inherent in the commodity management business, further reduce our debt and release significant equity that we can use to grow our business.

Due diligence and negotiations are currently proceeding and we continue to target a 30 June completion.

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You're aiming to become a regional agribusiness with scale and the ability to achieve sustainable, profitable growth. To what extent will this be driven by organic growth opportunities and to what extent by acquisition?

**MD Gordon Davis**

We believe there are two basic building blocks for us to produce sustainable, profitable growth as a regional agribusiness with scale. First is a focus on enhancing operational performance, which we're working on through initiatives that include strengthening our Australian grain marketing position with the addition of non-wheat crops, organic expansion within Landmark and commodities, and an investment in sustained improvement in Landmark, particularly through SAP implementation and cost reduction.

Second is the reshaping of our existing portfolio which we've been working through with the sale of the Landmark Financial Services loan book, the Gavilon MOU, our exit from Brazil and the review of the Hi-Fert ownership.

We believe we now have a solid foundation for growth in terms of organic opportunities around our existing business. We've already launched growth initiatives such as the recent expansion of our rail capacity and the establishment of Landmark Global Exports, and we see opportunities to participate in parts of the agribusiness value chain that we weren't traditionally able to participate in as a statutory entity.

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What investment return hurdles will you apply in relation to any organic growth or acquisition opportunities?

**MD Gordon Davis**

We've put a lot of work into getting to the position we intend to get to with the Gavilon transaction of having a strong balance sheet and being able to take advantage of the opportunities we see to grow and build a regional agribusiness. We're well aware of the need to invest wisely and understand the risks involved, and for that we're using a risk adjusted return on capital (RAROC) framework.

There are a range of criteria that are important and with that in mind we'd be looking for opportunities that would be EPS accretive, be positioned in an agri-sector with a favourable structure, be complementary to our existing operations, and provide some diversification on a geographic basic and also along the value chain. It hasn't been appropriate to discuss these criteria until we got our foundation right, but we're now beginning to look at the opportunities available to us.

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Net corporate debt was $543.5 million at the end of March and gearing was 43 percent, down from $981.1 million and 82 percent a year earlier. What balance sheet capacity do you have to grow the business and where do you see debt and gearing trending over the remainder of the year?

**CFO Philip Gentry**
Today we have moderate capacity to undertake growth initiatives but our first priority is completing the JV with Gavilon and the sale of AWB Geneva. Until that's complete other initiatives of substance will be secondary. Subsequent to the completion of that transaction we'll be in good shape and likely debt free, so we'll have significant capacity to grow the business or otherwise deploy the funds to best advantage for our shareholders.

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Assuming completion of a transaction with Gavilon at a premium to book value, AWB could have net cash. How would you seek to utilise these funds? Would you consider returning the funds to shareholders in some form?

**CFO Philip Gentry**
Our ambition with the joint venture is to grow market share and performance in Australia, and we'll be reinvesting a significant sum, commensurate with our shareholding, to give the JV capacity for growth. Even so, we'll have a very strong balance sheet position and certainly we'll be assessing capital management initiatives alongside investment and acquisition opportunities. But our first priority is to get the transaction done.

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AWB has not declared an interim dividend this year, and no dividend was paid last year. What's the likelihood of a final dividend for the current year?

**MD Gordon Davis**
Our dividend policy remains as stated: 40 to 65 percent of net profit after tax and significant items which has meant that we won't be paying a dividend for the first half. We'll make a decision about a final dividend at the end of the financial year once we know the full year result.

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Thank you Gordon & Philip.

For more information about AWB, please visit awb.com.au or call Belinda Seal on (+61 3) 9209 2887.

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