

**ASX Announcement :** 25 January 2013

## MD on Soda Ash JV



Open Briefing interview with Managing Director Guy Roberts

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### In this Open Briefing®, Guy Roberts discusses:

- Restructure to return soda ash business to profitability
- Cash flow and capex advantages
- Next steps in turning around and growing the company

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### Record of interview:

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Penrice Soda Holdings Limited (ASX: PSH) recently announced that it plans to stop production of soda ash at its Osborne plant in Adelaide, and form a joint venture with SASS Victoria Australia Pty Ltd (SASS), a subsidiary of Dutch company Soda Ash Holding BV, the world's largest distributor of soda ash. The joint venture will import soda ash from US company American Natural Soda Ash Corporation (ANSAC) and sell to existing and new customers. What is the rationale for this decision?

#### **MD Guy Roberts**

A range of factors led to the steps we have taken. The strong Australian dollar which has made imported soda ash much cheaper and severely damaged our glass, detergents and other industrial customers. Rising costs, especially for energy and labour, have made manufacturing in Australia less competitive. Increasing compliance and regulatory costs, and increasing taxes have added to the cost burden. These factors seem unlikely to change and are more structural than cyclical.

Simply put, it is cheaper to import soda ash than to manufacture it in Australia and this will continue to be the case. Customers will be supported by the same high quality product, backed by the world's lowest cost supply chain to Australia. In the JV, Penrice will not face the significant fixed costs it currently bears and will move to a variable cost model which can flex with customer demand.

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What is the expected cost of closing soda ash production in terms of redundancies, plant closure costs, asset impairment charges and site remediation costs?

#### **MD Guy Roberts**

We've carefully considered the expected costs of closing soda ash production and plant modifications necessary to accept imported ash for sodium bicarbonate production. We've also carefully considered the cost of redundancies and the final cost will be subject to consultation processes as prescribed by the relevant employment agreements. The cost to the company of redundancies and plant modifications to enable the JV to commence will be funded from an \$8 million loan from our JV partner. A second phase of plant modifications to enhance the efficiencies will be funded from internal cash flows.

Any consequential impairment charges will be properly evaluated and taken once the JV is formed. No remediation costs are likely to be incurred as a result of soda ash plant closure.

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Penrice will have 33 percent ownership of the JV with SASS taking 67 percent. Why was the JV structured in this way? How will Penrice's income from the JV be structured?

**MD Guy Roberts**

Our ownership share was an agreed outcome, reflecting the respective contributions of the partners. We'll receive distributions of profits in line with our JV share and this will be subject to the repayment of our \$8 million loan over the term of the JV, which will be a minimum of six years. Subject to satisfying our JV partner that we are market best practice on price and quality, we'll also receive fee income as the incumbent logistics and packaging service provider – we'll provide inbound logistics, warehousing and transport to customers, and provide packaging, briquetting and blending services as our Osborne operation.

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The soda ash business made a loss in FY2012, but is expected to be profitable in FY2014 under the JV. To what extent will the profitability of the JV depend on the Australian dollar remaining around its current levels? What are your expected earnings from the JV in 2014?

**MD Guy Roberts**

The soda ash business continues to make a loss through FY2013 under the existing high fixed cost model with declining demand. Under the new business model, two features are different. Changing demand will be matched by changing the import plan and JV logistics costs will be largely flexible to accommodate those changes in demand.

Selling prices will ultimately reflect import costs in Australian dollars. All competing imports from the US and China also originate in US dollars and get translated into Australian dollars. The JV is confident of sourcing competitively priced soda ash, which together with a compelling service proposition, should see it succeed with its customers.

The key determinant of future profitability will be demand, although the new model allows Penrice to be profitable right down to the lowest levels of demand.

Current demand conditions for soda ash continue to deteriorate as the decline in national construction activity continues, meaning less flat glass. Beer demand continues to decline meaning less glass packaging.

Nevertheless the new business model means we'd expect EBIT from the JV to be positive in FY2014. That includes Penrice's share of the estimated profit of the JV, plus expected fees from providing logistics, packaging and other services to the JV.

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In the absence of locally produced soda ash, why would major customers source the product through your JV rather than importing directly themselves?

**MD Guy Roberts**

ANSAC is the export arm of a number of leading US producers and the largest reseller of soda ash globally. US soda ash producers are the lowest cost producers in the world and the SASS supply chain to Australia is also low cost, giving us access to a competitive cost structure. As we will demonstrate to our JV partner, our own local soda ash logistics, packaging and delivery systems are highly efficient and we're confident we can offer our customers competitive pricing. The JV's offering will also offer a high quality product, backed up by reliable and flexible delivery. We think this will be an attractive proposition for customers.

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Penrice plans to continue its sodium bicarbonate production as usual, using imported soda ash as feedstock. How will the profitability of the sodium bicarbonate business be impacted? Can the sodium bicarbonate business remain internationally competitive if it is reliant on imported soda ash?

**MD Guy Roberts**

Trialling has demonstrated that our sodium bicarbonate production will run successfully on imported soda ash from ANSAC. The supply agreement with the JV will ensure competitive pricing for the duration of the JV.

Penrice's export book of US-dollar denominated sales will more than offset the cost of imported soda ash (in US dollars) and therefore the imports will provide a natural hedge. Our premium sodium bicarbonate product has seen growing demand from Asian customers in recent years. We're confident that growth will continue and that we can maintain our product advantage in this region.

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You've indicated that the restructure of the soda ash business will mean that the Osborne plant's requirement for limestone from your Angaston mine will be reduced, resulting in reduced costs from less extraction and overburden stockpiling. How will this impact mine planning and cash flows, and the book value of the mine?

**MD Guy Roberts**

Our Angaston mine business will continue as usual, marketing a range of products to industrial, civil and other markets. Our extraction will reduce substantially and lower extraction and overburden stockpiling costs will provide a net cash benefit. There will be no job losses at Angaston. The mine will remain a valuable long-life asset and its value will be assessed at the appropriate time when the JV is formed.

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Penrice has a long term agreement with Ridley Corporation for the supply of brine to the Osborne plant for soda ash production. The agreement started in 2005, and you've indicated you're in discussions with Ridley about the agreement. What are your obligations under the agreement and what is the potential liability if you break the contract prior to the end of the agreed period?

**MD Guy Roberts**

We're party to a long-term "take or pay" supply agreement with Ridley. If Penrice doesn't take salt it has to pay for it anyway. If the plant is closed as planned, our requirements for salt will cease. We're in discussions with Ridley regarding the proposed JV and the impact of the soda ash plant closure on the supply agreement.

We note that Ridley has previously announced its intention to develop the land on which its salt operations are conducted and may benefit in this regard from an early release from the contract. Both parties are working constructively to manage the proposed change in a manner that advances the best interests of both parties, as evidenced by Ridley's announcement on Friday, which reinforces our position. Further announcements will be made as and when the JV is formed.

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As at 20 June 2012, Penrice had net debt of \$94.1 million and net debt to net debt plus equity was 74 percent. Under the JV agreement with SASS, the JV will lend Penrice \$8 million to cover the cost of transitioning your operations to imported soda ash feedstock. What are the terms of this loan and will it have any impact on your current banking arrangements or debt covenants?

**MD Guy Roberts**

The precise terms of the SASS loan are commercial in confidence; suffice it to say that the loan is being provided at a competitive interest rate. The repayment of this loan is planned to be over the initial six-year term of the JV and will be serviced from Penrice's share of the distributions from the JV.

The plan for proposed soda ash plant closure and JV has the in principle support of our bankers, subject to final transaction documents.

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Penrice had net operating cash outflow of \$8.1 million in FY2012, and after sustenance capex of \$9.8 million, net free cash outflow was \$17.9 million. How will your cash flow and capex needs change under the new operating structure?

**MD Guy Roberts**

We maintain our policy of not providing specific earnings guidance other than to note that this transaction is planned to turn the soda ash business unit from a loss-making entity, as it stands in FY2013, to a profitable one in FY2014.

The sustenance capital needs of our chemical operations at Osborne, which has been in the range of \$6 million to \$8 million over recent years, should reduce under the proposed new soda ash business model by more than 50 percent, since most of our sustenance capex to date has been allocated to the larger, older soda ash plant.

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Following the restructure of the soda ash business, what are the next steps in turning the Penrice business around and progressing your strategy?

**MD Guy Roberts**

After the restructure of the soda ash business, our priorities will be: expanding our sodium bicarbonate export business; winning contracts to build and operate Selective Salt Recovery (SSR) plants for the coal seam gas (CSG) industry; and growing our quarry business as the construction sector rebounds.

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Thank you Guy.

For more information about Penrice Soda Holdings, visit [www.penrice.com](http://www.penrice.com) or call Guy Roberts on +61 8 8402 7239.

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