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## Title

Open Briefing with CEO James Fazzino and CFO Frank Micallef

Incitec Pivot Limited

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**In this Open Briefing®, CEO James Fazzino and CFO Frank Micallef discuss**

- The trend in trading conditions over the first half and the outlook for the second half
- Progress in the Velocity efficiency program
- Outlook for returns from the Moranbah AN plant

### Open Briefing interview:

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Incitec Pivot Limited today reported net profit of A$132.4 million for the first half ended March 2010, up from A$99.6 million in the previous corresponding period (pcp). EBIT before individually material items was A$230.1 million, down 15 percent, on revenue of A$1,236 million, down 28 percent, with growth in earnings from the Explosives business partially offsetting a drop in Fertiliser earnings. Can you comment on trading conditions in the first half and how they differed from the previous corresponding period? What is the outlook for trading conditions over the remainder of the current year ending September 2010?

**CEO James Fazzino**
Trading conditions for the first half of this year were certainly different from the conditions we faced in the first half of 2009. Global fertiliser prices on average were significantly weaker in the first half of 2010, with prices towards the bottom of the current cycle in the first quarter and recovering in the second quarter. This contrasts diametrically to 2009 where prices were close to record highs in the first quarter and declined in the second quarter.

For example, DAP prices averaged US$519 per tonne in the first quarter of our 2009 financial year and were close to their historic highs at US$1,080 per tonne in October 2008. In contrast, prices averaged US$315 per tonne in the first quarter of our 2010 financial year and were close to the bottom of the current cycle at around US$280 per tonne in October 2009. In the second quarter of the 2009 financial year, DAP prices dramatically declined and averaged US$351 per tonne, while in the 2010 year, prices recovered and averaged US$449 per tonne in quarter two.

This augurs well for the second half of this year, with spot DAP prices currently over US$450 per tonne compared with an average price of US$310 per tonne for the second half of 2009.

Domestic demand for fertilisers in Australia recovered significantly in the first half of 2010 from the depressed levels of 2009. In total, volumes were up by close to 60 percent on the pcp. While we expect conditions to continue to recover versus 2009 in the second half, we're cautious as the winter plant is being pushed back by a locust plague in southern Australia. Further, there has been a switch out of wheat to pulses and livestock reflecting the combined impact of a decline in global wheat prices and the strong Australian dollar. Both of these factors will reduce post-emergent nitrogen application in 2010.

In explosives, trading conditions were flat in the Asia Pacific business and impacted by the continued weakness in the US economy in the Americas business.

The Americas certainly had a tough first half with volume declines in all of our key markets. For example, in coal, volumes declined by 8 percent, with de-stocking at US power stations. Coal stocks reached record levels of 83 days consumption in September 2009 – 33 days above the three-year average of 50 days. A positive impact of the severe winter in North America, particularly the widespread snow storms in December 2009 and January 2010, was a shortening of the de-stocking cycle. By March/April 2010, stocks should approach average levels. This means that demand from the coal miners should start to stabilise and return to normal levels in the second half of this year, which would be positive for explosives sales.

In the quarry and construction segment, our volumes were off by around 23 percent on the pcp, which is consistent with the decline in stone volumes reported by our key customers. We suffered most of the decline in quarter one, with explosives volumes off 35 percent from the pcp, followed by flat sales in quarter two. This sector has declined over the last three years due to the collapse in housing and commercial construction in the US, with the impact exacerbated this year by the snowstorms. I'm pleased to report that we've seen a pick up in volumes in March and April, coinciding with the start of the construction season; an increase reportedly fuelled by infrastructure spending funded by the US economic stimulus program. Accordingly, we're hopeful that this market has bottomed and will gradually start to recover in line with the US economy in general.

The outlook for the Asia Pacific business is favourable as we expect to continue in the second half to source ammonium nitrate (AN) for Moranbah foundation contracts at a lower cost than last year.

Finally, across the business we were faced with a much higher Australian dollar in the first half. This reduced Australian dollar returns from our Gibson Island and Phosphate Hill fertiliser plants and reduced reported earnings in the Americas business. The Australian dollar averaged 90 US cents compared with 70 cents in the pcp. This had a negative impact of approximately A$75 million on EBIT in the first half. Provided the Australian dollar holds at its current level for the remainder of 2010, and given the hedge cover we already have in place, we'd expect the effective exchange rate for the second half to be around 90 US cents, which is consistent with the exchange rate that applied in the second half of 2009.

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EBIT in the Explosives business was A$133.2 million in the first half, up 3 percent. EBIT margin improved to 19.3 percent from 12.8 percent. To what extent did the margin improvement reflect the benefits of the Velocity efficiency program and to what extent were the benefits diluted by the softness in volumes in the Americas?

**CEO James Fazzino**

The Velocity program is definitely having a positive impact on the efficiency and quality of our Explosives business, particularly in the Americas where the program is primarily focused. Margins, especially in the Americas segment, are certainly improved by the permanent efficiencies from Velocity. Velocity helped to cushion the impact of the recession in the US economy and partially offset the reduced volumes in this business.

However, it's also true that due to volume declines the results don't fully reflect the step-change in business profitability that the Velocity program initiatives will deliver. For example, many of the processes and efficiencies that Velocity has addressed have volume leverage. So the real impact of Velocity won't be evident until the US economy recovers from recession – something we're confident will occur as the current slow-down in the economy is cyclical and not structural.

In the medium term this means we'll see compelling earnings momentum from the business.

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The US$25.9 million benefits in the first half from the Velocity efficiency program are equivalent to 43 percent of your full year target of US$60 million. In light of the soft markets in the Americas, is the current year target at risk? Are you on track to achieve the targeted US$204 million cumulative benefits of the program in 2012?

**CEO James Fazzino**

It's certainly true that soft markets in the Americas have had an impact on the delivery of the Velocity benefits. It was for that reason that last year we announced the deferral of the timing of some of the US$204 million benefits targeted from the total program. During the first half, the program office, lead by Chris Trotter, did an outstanding job of ensuring that there's a bank of initiatives we can draw on to ensure we continue to meet our revised targets.

As volumes in the Americas business are traditionally seasonally skewed to the second half, we're very confident we'll deliver the remaining US$35 million in 2010 targeted efficiencies and that the program will remain on track.

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Within Explosives, growth in Asia Pacific, where EBIT was up 62 percent to A$75.2 million, offset a 41 percent fall in EBIT from the Americas to A$56.0 million. A large part of the improvement in Asia Pacific reflected an A$11.9 million increase in the write-back of the Moranbah provision. What was the trend in volumes in Asia Pacific and is the EBIT growth sustainable?

**CFO Frank Micallef**

The Moranbah provision was established when we acquired Dyno Nobel to reflect the fact that we inherited some large, long-term, fixed-price AN supply contracts that would need to be serviced by imports at a loss. The provision reflected the expected cash outflow from this liability, as required by the accounting standards.

The accounting for this liability requires the provision to be released to the profit and loss on a pre-determined basis that matches expected sales under the contracts with the expected loss on supplying the contracts, as estimated at the time of the acquisition. This half, the

provision release was A$47.2 million, A$11.9 million more than the pcp. This entry is a non-cash increment to accounting earnings, which offsets the cost of supplying AN under the contracts.

While the provision release is a non-cash item, the cost of importing AN is a real cash outflow, so we challenged our global procurement team to minimise this cost. I'm delighted to report that the team, led by James Whiteside and assisted by our Quantum trading business, took full advantage of the softer global nitrogen markets and higher Australian dollar to reduce the cost of supplying the contracts by A$6.2 million compared with the first half last year, as this represents a real cash saving to the business. This outcome was made possible by implementing a global supply chain solution involving buying AN from a number of sources including our own plants in the US, and various third party overseas suppliers.

This is an example of the benefits we're achieving in the Asia Pacific Explosives business from merging back office activities with our Fertiliser business and also highlights the expertise we've built up over the years in supply chain management and procurement and the enhanced capability the Quantum business brings to the Group.

The non-cash provision release only accounted for A$11.9 million of the A$28.7 million improvement in the earnings of the Asia Pacific Explosives business. In addition to the A$6.2 million real cost savings on AN for the Moranbah contracts, there were incremental benefits from the Velocity program of A$3.8 million and a significantly increased contribution from our QNP joint venture of A$5.2 million, which reflects the benefit of the 2009 plant expansion and more reliable production at the Moura plant. Underlying volumes were flat in the first half.

In terms of earnings from the Asia Pacific business, the main step-change will occur when the Moranbah plant comes on line at the end of the first quarter of 2012.

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EBIT in the Fertilisers business was A$96.9 million in the first half, down 32 percent, primarily due to the adverse impact of lower global ammonium phosphate prices and the higher Australian dollar on the Southern Cross International (SCI) manufacturing business and lower urea prices in the Incitec Pivot Fertilisers (IPF) distribution business. This offset the positive impact of an increase in volumes across the Fertilisers business. What evidence is there that volumes are recovering to normal levels after years of drought and how have volumes been impacted more recently by heavy rain in eastern Australia and the locust plague in south eastern Australia?

**CEO James Fazzino**

While EBIT was down A$46.4 million in the Fertiliser business in the first half of this year, A$29 million of the reduction reflected an inter-segment profit in stock elimination, so underlying profit was down A$17.2 million.

Profit in stock reflects the sale of Phosphate Hill AN from SCI to the IPF business. The negative movement occurred because Phosphate Hill product, which is normally mostly exported in the first half when domestic demand is low, was instead diverted to meet an expected rebound in domestic demand for the winter crop. Most of this product will be sold in the second half, at which time the profit in stock will be reflected in earnings. This is

therefore a timing issue. If we adjust for this profit in stock, earnings were down by around 12 percent rather than 32 percent.

As you rightly note, most of the decline in earnings reflects lower global fertiliser prices for DAP and urea and the higher Australian dollar.

While fertiliser volume has recovered in 2010, there has been little or no rebuilding in soil nutrients so this still remains a volume opportunity in future years. This is consistent with what is happening globally. For example, in the US it looks like demand has recovered from last year but is still around 90 percent of normal levels with no major investment by farmers in increasing nutrient levels.

East coast Australian demand in 2010 is shaping up to look a lot like 2008 which was considerably below pre-drought levels – around one million tonnes below the volumes we sold in 2002/2003.

Looking forward, seasonal rainfall has so far been much better this year. The winter break was shaping up to be almost perfect, given widespread rainfall on the east coast and excellent subsoil moisture. The impact of the locusts has been to push the planting season back as farmers wait for the onset of cooler weather and frost to control the insects before planting. Additionally, some crops will need to be re-sown after locust attack.

The impact of the later planting is to compress growing windows, which reduces a crop's ability to take up nutrient and therefore reduces nitrogen demand.

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In February you announced approval of the 330,000 tpa Moranbah ammonium nitrate project, which is due to re-commence construction this month, with beneficial production in the March quarter of 2012. You've indicated 90 percent of the off-take is now contracted. To what extent do the contracts include take-or-pay arrangements and price flexibility? Would return on net assets (RONA) reach the target of 18 percent in year three of operation at current gas and AN prices?

**CEO James Fazzino**
As is typical with industry contracts, our Moranbah contracts are written to allow customers to nominate, usually annually, the tonnes they will require within a range. The minimum, or take or pay element, is usually about 75 percent of the maximum commitment, and the 90 percent level represents our estimate of the actual demand from customers, not the take or pay. Generally, pricing is on a fixed base plus CPI basis, which mirrors our production cost profile and specifically our gas contract. If customers seek higher than the maximum amount contracted, this is supplied on new terms.

Customer inquiries continue for uncontracted Moranbah output and we're very confident the plant will be fully sold out in footprint from the commissioning date, scheduled for the end of quarter one, 2012.

This is a fantastic project that fits our strategy of directly leveraging the urbanisation and industrialisation of Asia – in particular China. It will achieve 18 percent RONA in 2015, its third full year of operation.

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Incitec Pivot booked net operating cash inflow of A$79.2 million for the first half, compared with operating cash outflow of A$112.8 million in the previous corresponding period. Net free cash flow was negative A$11.1 million, versus negative A$322.1 million. Given that traditionally first half operating cash flow has been negative, what were the factors that played into the positive result? What is the outlook for free cash flow as Moranbah construction ramps up?

**CFO Frank Micallef**
The turnaround in net operating cash flows of A$192 million is a very pleasing result. It reflects the impact of our continued focus on cash flows across the business.

Our working capital performance in the Explosives business has been very good. In the Americas explosives business, the implementation of our Sales Operations and Planning process, developed and used with good effect over a number of years in the Fertilisers business, is reaping benefits on inventory control and will continue to help drive improvement over the next couple of years.

Other initiatives are also helping improve our working capital performance in the Americas. The Lazer project, a part of the Velocity efficiency program, allows our blasters to invoice our customers at mine sites post-blasting which has improved debtors days and collections.

In our Asia Pacific explosives business, inventory control has been helped by the lower cost of purchased AN and the successful resolution of some legacy debtors issues.

Working capital movement in Fertilisers has also been pleasing given we exported less tonnes in the first half – cash is collected on exports as the product crosses to the ships from rail. Obviously, lower fertiliser prices have helped in reducing the cost of inventories, but this was largely offset by a reduction in creditors.

We also paid A$21.4 million less in interest in the first half which is the earnings benefit of strong balance sheet control.

In terms of capital spending, we hope to keep annual spending this year and next to somewhere in the vicinity of A$220 million, which will cover sustenance spending, our spend on major turnarounds at Phosphate Hill this year and Gibson Island and Cheyenne next year, and the Global Risk and Reliability program, introduced as a Velocity initiative.

We have approximately A$600 million cash to spend to complete the Moranbah project. The profile of this spend will be approximately 15 to 20 percent in the second half this year, 70 to 80 percent in the 2011 financial year, and the balance in the 2012 financial year.

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Net borrowing costs fell to A$31.2 million from A$59.3 million in the previous corresponding period, reflecting reduced net debt and lower interest costs. How sustainable is net borrowing cost at this level? What will be the impact on borrowing costs of your issue in December 2009 of US$800 million of 10-year US bonds?

**CFO Frank Micallef**

Lower net borrowing costs are the result of significantly lower net debt and from our strategy of holding US debt.

In terms of net debt, this will obviously increase somewhat as we progress with Moranbah, putting upwards pressure on borrowing costs.

Turning to the cost of our borrowings, our average interest rate in the first half was 5.1 percent, which is excellent when you consider that the average tenor of our drawn debt is around 7 years. We've also benefited from interest rate swaps, which have swapped approximately US$300 million of our obligation to pay 6 percent interest on the 10 year bonds to floating rates, which are significantly lower. These swaps mean our interest rate exposure is approximately 50 percent fixed and 50 percent floating, which balances current borrowing costs with exposure to long-term interest rate rises. Given our current funding arrangements, there should not be significant upward pressure on our effective interest rate over the next year.

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Net debt was A$1,277 million as at 30 March 2010, down from A$1,464 million six months earlier. Gearing was steady at 1.9 times net debt to EBITDA. What is the outlook for net debt and gearing given the planned investment in Moranbah and do you plan any further restructuring of your debt?

**CFO Frank Micallef**

Our net debt result was exceptional, as historically our debt increases in the first half of the year due to seasonal inventory build. However, the positive results we've achieved on trade working capital and operating cash, our tight control on capital expenditure, and our US debt strategy has enabled us to decrease net debt by A$187 million this half.

We manage our gearing in order to maintain our investment grade credit rating profile, which means that we target a net debt to EBITDA of 2.5 times or less through the cycle. We believe this is manageable even through the Moranbah construction period, where we have approximately A$600 million to spend between now and early 2012. Of course, when Moranbah is complete, there will be a big positive turnaround in free cash flow.

Our debt book structure is now very strong. In addition to the US$800 million 10-year US bond, we've reduced our bank borrowings significantly by repaying and cancelling our A$420 million working capital facility and reducing the drawings under our Syndicated Facility Agreement by A$720 million. We now have A$1.28 billion of committed lines under the Syndicated Facility Agreement, and over A$1 billion of un-drawn committed facilities.

The Syndicated Facility Agreement doesn't mature until September 2011 and, given the size of our bank group, our close relationship with them and the amount of collateral business we provide them, we're confident this amount can be refinanced comfortably.

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Incitec Pivot has announced an unfranked interim dividend of 1.8 cents per share, compared with 2.1 cents, fully franked last year. This represents a pay-out ratio of 20 percent of NPAT excluding individually material items, which is at the low end of your pay-out policy range of 20 to 40 percent. What's the outlook for dividends and franking in the current year and beyond?

**CFO Frank Micallef**
We've set the dividend pay-out level at the bottom of our range to ensure we prudently manage our net debt and credit profile to accommodate the construction of Moranbah.

The short-term outlook for franking of dividends is uncertain but, all other things being equal, as the Australian fertilisers and explosives businesses grow their profitability, we should be able to at least partially frank dividends in future years.

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What is the expected impact on Incitec Pivot of the federal government's proposed resources super profits tax (RSPT)?

**CEO James Fazzino**
I'm extremely concerned about the negative impact on our customers in Australia's mining industry from the double taxation that's proposed under the RSPT.

We shouldn't forget that Australia's mining industry, through its links with Asia and in particular China, had a key role in preventing the Australian economy from falling into recession during the global financial crisis. So all Australians already benefit from our mining industry, regardless of whether or not they are directly involved or hold shares in the mining companies themselves.

It's a mistake to place the prosperity of Australia at risk by introducing a double tax regime that significantly increases the cost base of our mining industry, reduces its competitiveness and negatively impacts the future prospects of not only the industry directly but also the Australian suppliers to the industry.

It's clear that if this proposed double tax is implemented, it will make overseas mining operations more attractive and future investment by our mining customers will be more focused offshore than in Australia. If that happens, we'll follow our customers and invest offshore, moving the benefit of employment, spending and our broader contribution to Australia to communities, offshore.

With regard to our Phosphate Hill operations, until we know the detail of the government's proposal, we can't be clear about the potential impact. However, I'd note that our phosphate rock is of a low grade and therefore of low value. Phosphate Hill is principally a chemical complex that includes a phosphate mine and it is through the chemistry that we create the vast majority of the value. This was specifically recognised in the Henry Review which recommended that low value commodities, including phosphate rock, be excluded from the tax.

In the meantime, pending clarity on the implementation of the tax, we've stopped our Phosphate Hill drilling program which was to have been the first step in our potential expansion of the phosphate rock extraction at the site.

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Thank you James and Frank.

For more information on Incitec Pivot, visit www.incitecpivot.com.au or call Lyn Shalless, General

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