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Incitec Pivot Limited (ASX code: IPL) has today reported net profit after tax (NPAT), excluding material items, of A\$169.8 million for the half-year ended 31 March 2009. This was 1% down on the previous corresponding period (1H FY08: A\$171.1 million). What were the main drivers behind this result? What were some of the challenges?

**Acting CEO James Fazzino**

We recorded a solid result in tough market conditions in the first half. The result demonstrates the benefits of bringing together two complementary business - fertilisers and explosives.

Challenging market conditions prevailed in both the fertiliser and explosives businesses. In fertilisers we experienced a 43% reduction in earnings on the previous corresponding period, which was offset by the more stable earnings stream from explosives for the first time following the acquisition of Dyno Nobel in June 2008.

On a prior year comparative, or proforma basis, explosives earnings were up 78% to A\$128.9 million with the Velocity business efficiency program benefits of A\$54.3 million (US\$ 36.5 million) and the Cheyenne expansion offsetting volume declines in North America.

The Velocity program outcome was particularly pleasing; with 54% of the 2009 target delivered in the first half. We're on-track to delivering US\$204 million in benefits by 2011.

Underpinning the results has been the refinancing of the Balance Sheet. Since September 2008 we have secured A\$2.68 billion in committed facilities with an average tenor of 30 months. We have debt maturing on three different horizons being October 2010, September 2011 and September 2013. Our work in this area is not yet complete and we will continue to pursue increased tenor and further diversity of funding.

Our Balance Sheet position remains sound with investment grade credit metrics of Net Debt to EBITDA of 1.9 times and interest cover of 11.5 times.

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Can you comment on the current state of and outlook for the global nitrogen and phosphate fertiliser markets?

**Acting CEO James Fazzino**

The last six months has seen an unprecedented collapse in global fertiliser demand. From late 2008 we saw Latin and North American demand contract as the impact of the global financial crisis took hold and this has continued in Europe and Asia.

We see continued reductions in fertiliser application rates for the balance of our financial year and consequently weak pricing for Urea and Di-ammonium phosphate (DAP).

Looking at the causes, the global financial crisis was significant. Volatile forward-traded soft commodity prices, combined with high input costs and contracting credit lines caused already conservative farmers in Latin and North America to become even more risk averse, resulting in the deferral of purchases and a contraction in application rates. This trend has also been repeated in Australia.

In phosphates, global production was initially curtailed but has more recently returned as cash flow has become an issue for some producers. With a lack of soft commodity price conviction and a continued risk aversion by farmers, demand remains weak.

In urea, soft industrial activity has dampened demand for gas in North America and Europe and falling gas prices across both continents has flowed through into lower urea prices.

However, the outlook for fertiliser consumption remains positive in the medium term and arguably has been strengthened by events this year. There is “no free lunch” in nutrients and we are likely to see both a reduction in yields and a reduction in soil fertility as a result of the under-application of fertiliser this year. Farmers will need to compensate for both impacts in future years, meaning that we have seen demand deferral rather than demand destruction in 2009.

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Has the purchase of Dyno Nobel been a success – strategically and culturally and has the performance been what you expected? In hindsight, did you overpay for Dyno Nobel?

### **Acting CEO James Fazzino**

The strong results from our explosives business, Dyno Nobel, speak for themselves and confirm our investment thesis.

The combination of fertiliser and explosives has greatly improved the quality of earnings of the IPL group. The relatively more stable earnings from the explosives business provided a balance to the fertiliser business in the first half, when each business contributed around 50% to our earnings.

One of the attractions that we saw in Dyno Nobel at the time of acquisition last year was that we were buying principally a US\$ asset and a US \$ cash flow at the top of the A\$ trading range. With the fall in the A\$ to more normal levels in 2009, this not only enhances earnings, but acts to preserve the acquisition value. Additionally, the timing of the transaction also preserves the acquisition value for IPL shareholders as it was based on 75% scrip at a A\$7.36 IPL share price.

In terms of the numbers, year to date 2009 earnings in Australian dollars are 78% above pro-forma earnings for the previous corresponding period, which is an outstanding result given the difficult market environment and a tribute to our people led by Don Brinker globally, Brian Wallace in the Americas and Steve Dawson in Asia-Pacific.

Market conditions were particularly difficult in North America, where volumes in the Quarry and Construction and Metals and Mining segments were off by around 20%. Volumes in the coal segment were largely flat in North America.

The stand-out in the explosives business was the US\$36.5 million in benefits from our Velocity business efficiency program. This provides us with considerable momentum and confidence in reaching our 2011 target of US\$204 million and is a credit to our people.

Strategically, the logic of combining fertilisers and explosives around a common nitrogen manufacturing core – what we called “fit” - has proven valid. We established our Global Risk and Reliability team in June 2008 on the acquisition date. The remit of the team, which reports to our President of Global Manufacturing, Bernard Walsh, is to dramatically improve plant operating performance through increased reliability.

The team consists of a small group of engineers who are specialists in pressure systems and rotating machines and to date they have conducted reliability risk assessments to understand the areas of operational risk so that maintenance and capital expenditure is well spent. The team works closely with the shutdown planning teams so that the opportunity provided at shutdowns to inspect equipment condition is maximised. The team's remit is also to set common engineering standards across all sites.

In the first half, the team quickly completed reliability risk assessments of all plants and focused shutdown and capital expenditure on high reliability risk areas. Early gains have been made. For example, in the Louisiana, Missouri plant, a specialist review of one critical machine saved US\$1 million in reduced overhaul and operating costs this year with ongoing savings forecast.

We have also established a Global Process Technology team which is focusing on improving plant efficiencies and is looking to implement similar initiatives to those successfully completed at the Gibson Island (GI) and the Phosphate Hill ammonia plants.

We have a compelling opportunity to improve the reliability of our manufacturing assets in both North America and in Australia. The size of the prize is demonstrated by our G I plant where we have concentrated on Risk and Reliability over the last few years. Year to date ammonia volumes are up 23% this year at GI and on 7 May 2009, the urea plant set a new Maximum Sustainable Production Rate Record of 907 tonnes per day which is an outstanding achievement for a 42 year old plant. However, improvement doesn't happen overnight and the process will take around 2 years to have the maximum impact.

The cultural fit between the two businesses has also been strong and has allowed us to quickly focus on getting things done. We will be building on this in the coming months by combining the distinctive "DNA" of each business to enhance the overall IPL group culture.

We have already seen the explosives team living two of the fertiliser business's values as part of the Velocity program - "treating the business as your own" and "challenge and improving the status quo". The fertilisers team is also learning from the explosives business's "customer focus" mindset in meeting farmers' concerns.

Of course our joint commitment to "zero harm" (health and safety) and "caring for the environment" will remain and I will personally champion these.

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Can you elaborate on the details and initiatives behind the Velocity program and your progress on delivering US\$204 million in EBIT benefits and US\$200 million in cash by 2011?

**Acting CEO James Fazzino**

Following the acquisition of Dyno Nobel, we developed and implemented the Velocity business efficiency program. Velocity aims to make a step-change in business profitability.

The program is run by Chris Trotter out of our Salt Lake City office. Chris, as you are no doubt aware, also led the Tardis efficiency program in the fertiliser business over recent years. Chris has always reported to me and will continue to do so in my role of Acting CEO.

The Velocity program involves multiple initiatives across five streams, being overhead reduction, plant efficiency, cost to serve, global supply chain and asset optimisation. We currently have 167 initiatives delivering benefits and an additional 61 projects are being developed. We are targeting EBIT benefits of US\$204 million within three years and the release of US\$200 million in cash through capital optimisation initiatives.

In the first stream, overhead reduction, we have delivered US\$19.3 million as of March 2009. The key focus of this stream is the restructuring and optimisation of the North American business, consolidation of the corporate office into IPL and integration of supply chain and back office functions for Dyno Nobel Asia Pacific and IPL. In total, 193 positions have been removed from the organisation. Additionally, the Dyno Nobel corporate office in Sydney has been closed and the new structure for the America's business is in place.

Our plant efficiency stream has delivered US\$3.7 million to date and is focused on optimising our global manufacturing capability and delivery. There are 52 process, cost and asset utilisation initiatives across the ammonium nitrate, initiating systems and packaged explosives assets. I also spoke about the work of the Risk and Reliability team and Process Technology team earlier and their wins are captured under this heading.

Our cost to serve stream covers logistics and site optimisation. To date we have delivered US\$11.5 million in benefits, with key initiatives being improving transport utilisation and replacing third party carriers in the USA for specific routes; utilisation of rail versus truck movement and optimising using low cost models, e.g. barges versus truck movements, negotiation of freight contracts in Australia and selected routes in the USA.

To date, 32 of the 46 retail operating sites have been optimised resulting in a reduction of 64 positions. A total of 64 bulk trucks plus 137 other vehicles have been identified as excess to requirements.

Global supply chain optimisation is focused on the sales and operations planning process (S&OP) across Dyno Nobel. To date US\$2 million has been delivered. The global planning team has been formed and S&OP process has been initiated across Dyno Nobel. A success to date has been the movement of 26,000 tonnes of ammonium nitrate from the USA to Australia to service local demand which would otherwise have been sourced from third parties.

Finally the Asset optimisation stream has delivered US\$15.2M to date primarily flowing from asset sales. Additionally reviews of terms for Debtors and Creditors have been completed and changes implemented with benefits expected to flow through in the second half.

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What progress have you made on the Moranbah project during the first half?

**Acting CEO James Fazzino**

In February 2009, we announced that we would slow the construction of the Moranbah plant to align the start of beneficial production with the demand for Ammonium Nitrate from our customers in the Bowen Basin.

By the end of 2009, we will have invested A\$300 million in the project which aligns to the "earned value" estimate of the construction completed on site to date. While construction has paused momentarily, all equipment items have been procured or are ready for order placement for when we decide to re-start.

We continue to work closely with our customers to determine the right time to re-commence construction and commission the plant. Detailed Engineering continues and is estimated as 63% complete as at end March 2009.

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You gave guidance in February 2009 of around A\$450 million Net Profit after Tax, excluding individually material items for the 2009 year based on the spot prices and exchange rate at that time. What is the impact of current spot prices and the strengthening A\$/US\$ exchange rate?

**Acting CEO James Fazzino**

Given the current volatility in the markets in which we operate, in particular global fertiliser prices and exchanges rates, forecasting is challenging. So our approach is to update the market on the key variables and provide earnings sensitivities to movements in these variables. This allows investors to form their own views on our likely earnings.

Spot fertiliser prices have declined since March and the A\$ against the US\$ has strengthened. Directionally, both these movements are negatives for IPL.

In February 2009, we noted that, assuming the then current market conditions prevailed and taking into account the difficulty in forecasting full year earnings, we expected our earnings would be adversely impacted. At that time, taking the spot DAP price of US\$360/t and spot urea pricing of US\$300/t and the then A\$/US\$ of 70c, we expected 2009 NPAT (excluding individually material items) of approximately A\$450 million.

If we were to do the same calculation today, substituting current spot prices and exchange rate (DAP US\$310/t, urea US\$250/t and A\$/US\$ exchange rate of 75c) as at 11 May 2009, then NPAT would be A\$380 million.

The key earnings sensitivities, for the remaining six months of 2009 are:

+/- US\$10 DAP price = +/- A\$5.7 million EBIT  
+/- US\$10 Urea price = +/- A\$6 million EBIT  
+/- A\$/US\$ 1 cent = +/- A\$2.9 million EBIT

These are the variables on our earnings. Therefore our focus must be on those matters we can control; safety and environment, customer relationships and business efficiency, such as that being achieved under our Velocity program.

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As at 31 March 2009, IPL's gearing on a Net Debt to EBITDA basis was 1.9 times compared to 1.0 times a year earlier. Interest cover has declined to 11.5 times from 13.3 times a year ago. Are you comfortable with this level of gearing and what are the internal gearing measures you use?

**Acting CEO James Fazzino**

Our credit metrics are strong and reflect a very bankable Balance Sheet. They are well within our internal target of less than 2.5 times Net Debt to EBITDA and greater than 6 times interest cover. Of course, these levels are well inside our covenant levels, and quite conservative.

They are consistent with a solid investment grade credit profile, which we intend to continue to target. More importantly, our financiers are also very comfortable with this profile.

We will continue to look for the right opportunities to complete the process of increasing average tenor and diversify the sources of our debt book.

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IPL had cash outflow from operations of A\$112.8 million, compared with inflow of A\$21 million in the previous corresponding period. Going forward, how will the seasonality of cash flows be impacted by the more diversified business following the Dyno Nobel acquisition?

**Acting CEO James Fazzino**

The seasonality of the explosives business is similar to that of the fertiliser business with earnings weighted to the second half of our financial year, which ends on 30 September. As a rule of thumb, first half earnings will generally be in the range of 30 to 40% of full year. Similarly we expect cash flow to be weighted to the second half as we build stocks in both businesses in the first half to sell in the second half.

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IPL has traditionally had a dividend payout policy of 55-65%. Why have you chosen to change your policy position? Does this have any impact on your recently announced fully underwritten Dividend Reinvestment Plan? What is your franking forecast?

**Acting CEO James Fazzino**

We review dividend policy and distributions bi-annually when finalising the half year and full year results. We have reviewed our dividend policy and revised the normal pay-out range from 55–65% of NPAT to 20–40 % of NPAT.

The new range balances three factors:

First, a prudent approach to gearing, particularly post the Global Financial Crisis combined with our commitment to maintaining an investment grade credit profile (which ensures access to long-term debt markets).

Second, cash retention in the business to fund business improvement and growth opportunities which exceed our minimum investment criteria of 15% IRR.

Finally, maintaining a competitive dividend yield, particularly for retail investors and ensuring distributions are tax effective. We will also use other mechanisms such as special dividends to distribute excess funds and franking credits to shareholders, where appropriate. The first half dividend pay-out is at the bottom of the new range, and as announced in March, will be fully underwritten.

The pay-out is appropriate as it returns 100% of available franking credits to shareholders while minimising the dilution and potential share price volatility of the underwrite.

In terms of franking, 2009 is a transition year where franking has been impacted by deductions arising on the Dyno Nobel acquisition. Post the 2009 financial year, we would anticipate being able to substantially frank dividends paid in the new range.

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You have disclosed A\$70.2 million in individually material items for the half year being above your guidance of A\$50 million for the full year. Can you comment on the nature of these costs?

**Acting CEO James Fazzino**

The unprecedented collapse of the Single Superphosphate (SSP) market in Eastern Australia has driven A\$45.6 million after tax in asset write downs and one-off costs. Dairy prices collapsed during the period and SSP sales were down 60% or 221kt on 2008 to record lows as a consequence.

Impacts were:

- A\$34.6 million in mark-to-market revaluation of phosphate rock on hand (including rock in finished SSP product) in accordance with accounting standard requirements. It is expected that most of this product will be sold in our 2010 financial year.
- A\$11 million charge on early closure of the Cockle Creek plant.
- In addition on 11 May, it was announced that the Geelong SSP plant would close and an additional A\$2million in costs would be incurred in the second half.

We remain committed to providing farmers with SSP for use in intensive and extensive pastures. We have acted to ensure product is available at competitive prices when it is required. Our current stocks, together with the continued operation of our Portland facility, will ensure we can meet market demand.

Finally, as previously flagged we expensed A\$20.5 million in Dyno Nobel integration and restructuring costs as part of the Velocity program.

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What are your expectations for product demand in each of your fertiliser and explosives end markets for the balance of 2009?

**Acting CEO James Fazzino**

We are expecting to see a decline in both planted area and application rates in the Australian broadacre cropping segment which will translate into softer volume demand for our third quarter. Final quarter nitrogen topdress will be dependent on the broadacre plant and in season rainfall. We expect that international fertiliser markets will remain soft.

As for explosives demand, in Australia we remain vigilant to changes in demand from the major miners and will calibrate our supply lines to adapt to changes. In North America the coal sector remains flat, base metals will remain soft until domestic industrial activity resumes; while in quarry and construction, the proposed federal stimulus packages are not expected to flow through to demand until 2010.



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IPL results are sensitive to foreign currency exchange rate movements, specifically the Australian dollar appreciating against the US dollar. Can you explain how this exposure arises and whether IPL hedges any of this exposure?

**Acting CEO James Fazzino**

The exposure to an appreciating Australian dollar against the US dollar arises from two sources. First, IPL's fertiliser sales, whether in Australia or the export markets, are directly or indirectly priced in US dollars, so the lower the Australian dollar against the US dollar the more Australian dollars we receive.

We call this 'transactional exposure'. Secondly, the earnings of our Dyno Nobel US business are impacted in the same way - the lower the Australian dollar versus the US dollar, the more Australian dollars those earnings translate to. We call this 'translational exposure'.

IPL has a hedging policy that allows us to try to manage the impact of transactional exposure. We do this by using bought options and collar structures that enable us to limit the impact of an appreciating Australian dollar while still being able to capture the benefit of at least some of any favourable movements, or depreciation of the Australian dollar. For the rest of 2009, our transactional exposure is covered using collars at approximately 70 cents up to 75 cents. At above 75 cents, we will realise a rate that is about 5 cents better than spot. This collar structure has allowed us to put cover in place at minimal cost. Importantly, the cover is taken using average rate options, which means that the rate that we achieve is based on an average for the period, not just the exchange rate on the last day of the period.

In relation to our translation exposure relating to our Dyno Nobel US business, these exposures are harder to manage because accounting standards do not allow hedge accounting treatment for instruments that could be used to manage this exposure.

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Thank you James.

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