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MD & CFO on Outlook

Open Briefing with MD & CEO James Fazzino and CFO Frank Micallef

Incitec Pivot Limited

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In this Open Briefing®, James and Frank discuss

- Outlook for trading conditions
- Impact of Moranbah beneficial operation delay
- Longer term leverage to urbanisation and industrialisation of Asia

Open Briefing interview:

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Incitec Pivot Limited today reported net profit of A$165.6 million for the first half ended March 2011, up 25 percent from the previous corresponding period (pcp). EBIT before individually material items was A$273.8 million, up 19 percent, with Fertiliser EBIT up 30 percent and Explosives EBIT up 12 percent. Can you comment on trading conditions currently and the likelihood of the earnings momentum continuing over the remainder of the current year ending September 2011?

MD & CEO James Fazzino
Trading conditions in our Fertilisers business look set to remain favourable in the second half compared with the pcp, strengthening the normal seasonal skew in our Fertilisers earnings to the second half.

Rainfall during the last six months has improved soil moisture and water catchment levels in eastern Australia which should provide favourable conditions for the coming winter and summer crops. At the same time, current favourable soft commodity prices, particularly for wheat and cotton, should support increased fertiliser usage. This should underpin momentum in our domestic Fertiliser business, notwithstanding the negative impact of the high Australian dollar on farm exports and continuing highly competitive conditions in the domestic fertiliser market.

In our international Fertiliser business, current strong prices for wheat and corn should also support demand for di-ammonium phosphate (DAP), and our realised DAP export prices should continue to be an improvement over last year. Partly offsetting this are increasing costs pressures in this business, in terms of both inputs like sulphur and people costs.

Earnings from the Explosives business are also normally skewed to the second half in both Asia Pacific and the Americas. In the first half, Asia Pacific results were negatively impacted by weather. While many mines are now back to full operation, others continue to be impacted, and this could depress volumes for a while longer. However, as mines come back on line we're seeing some switching to higher value products, such as emulsions which cope better with the wetter conditions, and this should partly offset the lost volume.

In the Americas, we expect the first half's modest recovery in demand to continue, subject to demand in the coal sector. Explosives demand from the coal sector is somewhat dependent on seasonal weather conditions – we need a normally hot summer in the US. Nevertheless, earnings from the Americas Explosives business will continue to be adversely impacted by the higher Australian dollar, as we translate US dollar earnings into Australian dollars.

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Construction of your 330,000 tpa ammonium nitrate (AN) plant at Moranbah is 75 percent complete to date and on track to be within the expected budget of A$935 million. However, beneficial operation is now scheduled for the June quarter of 2012, a delay of a quarter versus the original plan. What has caused the delay, how will it impact economic returns from the project, and what is Incitec Pivot doing to manage the project to budget and to the revised timeline?

MD & CEO James Fazzino
As I said in our last Open Briefing, this is a fantastic project that fits our strategy of directly leveraging the urbanisation and industrialisation of Asia and will transform the Asia Pacific Explosives business. Notwithstanding the delay, we're confident this project will achieve 18 per cent RONA in 2015, its third full year of operation.

We're pleased with the overall construction to date, which has been challenging with a difficult engineering and construction landscape as well as the wettest season in 50 years in Queensland. The weather, including Cyclone Yasi, has hampered activity on site as well as causing delays to material deliveries with major transport interruptions. Nevertheless, our construction partners have achieved more than 1.5 million man hours without a lost time injury, which we believe is an industry leading performance.

We bring to this project the same focus and disciplines around cost control that we bring to every aspect of our business. We're closely managing the construction effort with our construction partners as well as ensuring our own directly run components of the project are well executed and on time. These include the commissioning of the power station, construction of site buildings, provision of new housing in Moranbah and most importantly, the recruitment of an excellent operations team who will reside in Moranbah, as opposed to being a fly in/fly out team. Our strong cost focus allows us to forecast completion within the original budget, notwithstanding the delay.

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How will the longer construction time line impact the Moranbah provision and its release schedule over the period to beneficial production?

CFO Frank Micallef
As disclosed in our 2010 full year Open Briefing, the release of the provision is governed by Australian Accounting Standards (AAS). At the time of our acquisition of Dyno Nobel AAS required us to recognise a liability reflecting our estimated losses on supplying AN under the previously agreed Moranbah foundation contracts over the period 2008 to 2019, discounted

to net present value. AAS require the liability to be unwound as we fulfil our obligations under the foundation contracts and the amount released each year won't vary, irrespective of the date beneficial operation is achieved. As a reminder, the provision release schedule is reproduced below.

Financial Year	Provision Unwind $m	Actual Cost Incurred $m	EBIT Impact	Discount Unwind (Interest Exp) $m	PBT Impact	Tax effect $m	NPAT Impact $m	Net Provision Unwind $m
2008	9.0	(9.0)	(0.0)	-	(0.0)	-	(0.0)	9.0
2009	61.6	(43.2)	18.4	(1.8)	16.6	(5.0)	11.6	59.8
2010	85.4	(24.0)	61.4	(9.7)	51.7	(15.5)	36.2	75.7
2011	83.9	TBD	TBD	(16.0)	TBD	TBD	TBD	67.9
2012	81.1	TBD	TBD	(21.1)	TBD	TBD	TBD	60.0
2013	66.1	-	66.1	(21.4)	44.7	(13.4)	31.3	44.7
2014	68.8	-	68.8	(26.3)	42.5	(12.8)	29.8	42.5
2015	73.6	-	73.6	(32.1)	41.5	(12.5)	29.1	41.5
2016	80.5	-	80.5	(39.0)	41.5	(12.4)	29.0	41.5
2017	89.2	-	89.2	(47.2)	42.0	(12.6)	29.4	42.0
2018	100.2	-	100.2	(57.1)	43.1	(12.9)	30.2	43.1
2019	16.1	-	16.1	(9.8)	6.3	(1.9)	4.4	6.3
Total Liability recognised	**815.5**			**(281.6)**				**534.0**

Of course, the actual losses incurred in meeting customer contracts until the Moranbah plant comes on line will vary, and will continue to be charged against profit. We'll continue to separately disclose these costs.

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Today you announced IPL's plan to develop a 100,000 tonne per annum AN emulsion plant at Port Hedland in the Pilbara. What is your view of the outlook for AN demand and supply dynamics in the Asia Pacific region over the medium term given this new plant, Moranbah going into production in 2012, expansions of AN production by others in Asia Pacific, and the likelihood of AN capacity expansion in Western Australia in 2014?

MD & CEO James Fazzino

Our emulsion plant at Port Hedland, which will cost A$40 million, will be operational in the last quarter of 2012 and is in response to and will support the growth in our customers' demand. The outlook for the mining sector in the Asia Pacific region, including Australia, is positive and we continue to see growth in explosives demand being driven by strong demand for resources from developing Asian economies. While there may be some short term imbalances, we believe the growth in explosives demand will quickly soak up the additional capacity.

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EBIT in Explosives was A$146.9 million in the first half, up 12 percent, driven primarily by growth in Americas EBIT to A$67.1 million, up 20 percent, mainly reflecting volume recovery and the impact of the Velocity business efficiency program. How sustainable is the Americas demand?

MD & CEO James Fazzino

Demand for explosives in the Americas improved by 9 percent versus the pcp. We saw a 9 percent improvement in coal volumes off the cyclical low of the pcp, following the normalisation of coal inventories held by power generating utilities. The recovery in coal started in the second half of 2010, so we wouldn't expect the same level of improvement across the whole year.

Volumes into the quarry and construction sector improved 4 percent on the pcp. The improvement, despite no increase in demand from US housing and construction, was due to private infrastructure activity such as pipeline work. As such, the recovery in this sector will continue to be patchy and somewhat difficult to predict.

Volumes in the metals and mining sector picked up by 12 percent and momentum in this segment is likely to continue as long as hard commodity prices remain strong.

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Benefits in the first half from Velocity totalled US$14.8 million versus your full year target of US$33.8 million. Is there upside in the targeted Velocity benefits if recovery in the Americas continues at the current pace? What are the key risks to achieving the targeted US$204 million per annum cumulative benefits of the program in 2012?

MD & CEO James Fazzino
Our Project Office team continues to do a great job on Velocity, and had delivered cumulative benefits of US$155.0 million as at the end of March 2011. We remain on track to deliver US$33.8 million in 2011, and to complete by the end of the year the majority of project milestones to deliver the targeted benefits, although the remaining benefits won't be fully delivered until the 2012 financial year.

It's hard to see significant upside in the benefits we can deliver in the short term, as volumes and market supply dynamics in the Americas remain relatively challenging. However, as recovery in the Americas gathers pace, we should get some additional leverage by way of improved margins in future years.

The next phase of our business efficiency program will be based around adopting lean principles as a way of doing business, an evolutionary step from our current project-based approach. We're in the process of establishing a number of pilot sites for the new approach, with a view to beginning a roll-out across the Group in February next year.

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DAP prices averaged US$588 per tonne in the first half, up 59 percent from the pcp, and prices have continued to rise since the end of March. How sustainable are these prices? Are there any signs another short-lived price bubble is developing, such as we saw in 2008?

MD & CEO James Fazzino
The price bubble in 2008 was fuelled by speculative buying of soft commodities and a 'perfect storm' of circumstances that impacted the input costs of non-integrated DAP producers. Currently, the DAP price is less than half of the high it reached in 2008, and it looks like the strength in soft commodity prices is backed more substantively by low underlying grain stocks rather than by the speculative soft commodity positions that existed in 2008.

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Incitec Pivot booked net operating cash flow of A$85.3 million for the first half, up from A$79.2 million in the pcp, with increased EBITDA offset to some extent by higher outflow into trade working capital. To what extent did the increase in trade working capital reflect higher prices and to what extent higher volumes? How do inventory volumes compare with those of "normal" seasonal conditions?

CFO Frank Micallef
The increase in Fertilisers trade working capital of A$187 million since September 2010 was largely due to higher inventories of A$261 million, offset by favourable movements in accounts receivable and accounts payable. The higher inventory balance was attributable to higher volumes on hand (A$178 million) and a higher average cost per tonne of inventories held, reflecting higher import prices (A$83 million). Higher inventory volumes reflect our expectation of stronger fertiliser demand in the second half of 2011, coupled with higher inventories in certain products as a result of delayed domestic sales caused by weather conditions on the east coast of Australia.

In our Fertilisers business, working capital will vary from one season to the next, and the concept of a 'normal' year is increasingly difficult to define. At the end of March this year inventory volumes were 233,000 tonnes higher than a year ago. However, in light of our expectations of domestic and export demand in the second half, we're comfortable with our current inventory levels.

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Net debt was A$1,356 million as at 30 March 2011, up from A$1,097 million six months earlier. Net debt to EBITDA was 1.6 times, up from 1.4 times. The increase in debt primarily reflected increased investment in the Moranbah project. What is the outlook for net debt and gearing given the longer Moranbah project time line? How comfortable are you with gearing at the first half level?

CFO Frank Micallef
We're very comfortable with both our debt and gearing levels. We have a disciplined approach to capital management and a strong commitment to our investment grade credit ratings: we closely monitor our key credit metrics and set targets at levels appropriate for an investment grade entity. We regularly apply stress testing to our credit metric forecasts to understand how they will react to certain market forces. Based on these forecasts, we're confident we'll remain within our targets for all our key credit metrics, including gearing, throughout the construction phase of the Moranbah plant.

When the Moranbah project is completed and in the absence of any other significant growth projects, we expect net debt to reduce significantly. We'll only pursue growth options that fit our strategy and, importantly, meet our financial hurdles. In the absence of growth opportunities, we'll look at ways of increasing returns to shareholders through dividends and capital returns.

Our US dollar debt strategy also has a major impact on managing our credit metrics. Our earnings are negatively impacted by an appreciating Australian dollar. However, our strategy of holding the majority of our debt in US dollars means we benefit from a favourable revaluation of our debt when the Australian dollar strengthens. As a result, our gearing remains relatively stable regardless of foreign exchange movements. We also benefit from low US dollar interest rates and from the natural hedge impact of the lower US dollar interest expense that results from a higher Australian dollar.

It's worth noting that during the first half we successfully completed a five year, US$500 million 144A/Regulation S bond deal and also refinanced our bank syndicated facility for a further three year term. These transactions have further strengthened our funding structure by increasing the average tenor of our facilities and adding diversity to our funding sources. The terms on which we were able to do these deals reflects our standing in the various debt markets and the confidence those markets have in our business and debt management strategy.

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There is speculation in the media that Incitec Pivot will be a participant in the administrator-run sale process for Burrup Fertilisers. What is behind your interest in this asset and what investment hurdles have you set in relation to it?

MD & CEO James Fazzino
It won't be until the process begins that the parameters of the sale and its potential terms will be understood. As IPL produces ammonia for use in its production of urea and DAP and in its Explosives business, we have a natural interest in any related assets that become available. However, any investment we look at, such as the Port Hedland plant announced today, has to stack up not only on strategic grounds, but also against our strict financial criteria. Those criteria include being able to achieve a 15 percent internal rate of return, and providing superior shareholder returns relative to other opportunities to deploy capital, including returning capital to shareholders .

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The IPL Group emits 2.8 million tonnes per annum of CO_2 equivalent. What is the expected earnings impact on the group of the Australian Government's recently proposed carbon tax?

MD & CEO James Fazzino
In introducing the proposed carbon tax, the Australian Government is moving ahead of the international community. Clearly, in the absence of similar action impacting our international competitors, any scheme design must provide appropriate compensation to trade-exposed industries in Australia. If compensation isn't sufficient, ultimately Australian jobs and investment will move offshore.

Many of the plants based overseas are not as energy efficient as those in Australia and a perverse outcome of not compensating trade-exposed industries could be to increase global CO2 emissions.

Let me give you an example, we make urea at our Gibson Island plant, using Australian gas, whereas our competitors in China make urea via burning coal - which has a significantly larger carbon footprint. Add to that transportation and the carbon footprint of imported urea is even larger landed in Australia.

So without adequate compensation, the tax would favour the more carbon intensive supplier to Australian farmers. Surely, this can't be what the Government wants to achieve.

In terms of financial impact on IPL, we won't know for certain until we see the details. However, if we use the Garnaut Report's prices of A$20 to A$30 a tonne, the NPAT impact would be up to A$35 million in the first year alone. Without adequate compensation this would impact the long-term viability of some of our manufacturing plants if we're competing against imports from countries where no tax is applied.

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Incitec Pivot has announced an unfranked interim dividend of 3.3 cents per share, up from 1.8 cents, unfranked, last year. This represents a pay-out ratio of 30 percent of NPAT excluding individually material items, which is at the mid point of your pay-out policy range of 20 to 40 percent, and you've announced the dividend reinvestment plan (DRP) remains suspended. What's the outlook for dividends and franking in the current year and beyond and are there any plans to reactivate the DRP?

CFO Frank Micallef
We base our dividend payment decisions on an assessment of a number of factors, including our ability to frank and the need to maintain capital within the company. For last year's final dividend, following improved cash generation and credit metrics, we suspended the DRP as we no longer required additional capital and, concurrently, the dividend pay-out was increased from the low end of the range to the middle, at around 30 percent of NPAT excluding individually material items.

We'll continue to assess the same factors to decide the appropriate level for each dividend going forward. At this stage, we don't expect that franking will be available for the 2011 final dividend, although we expect franking levels will increase once the Moranbah plant becomes operational.

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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 Manager Investor Relations, on +61 3 8695 4511

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