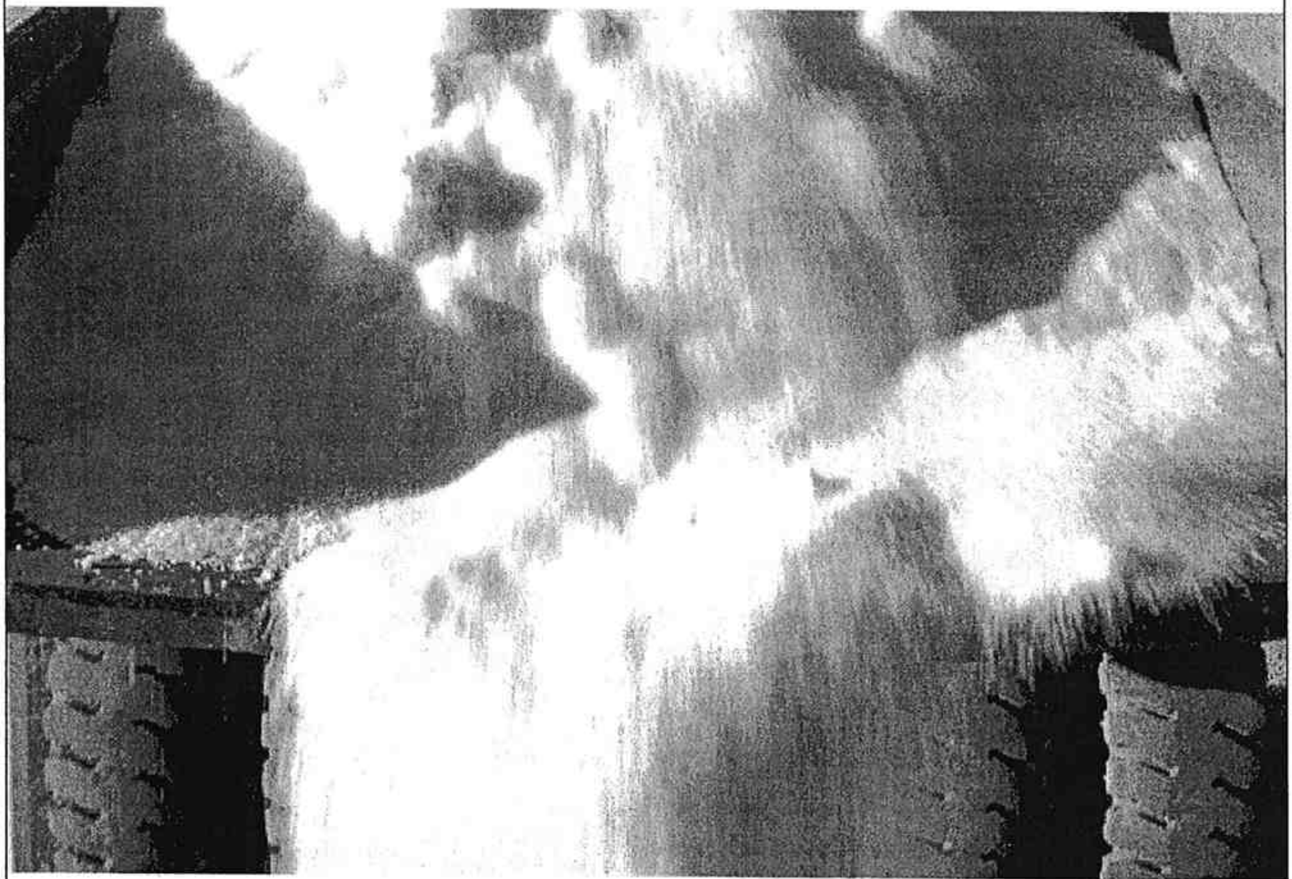
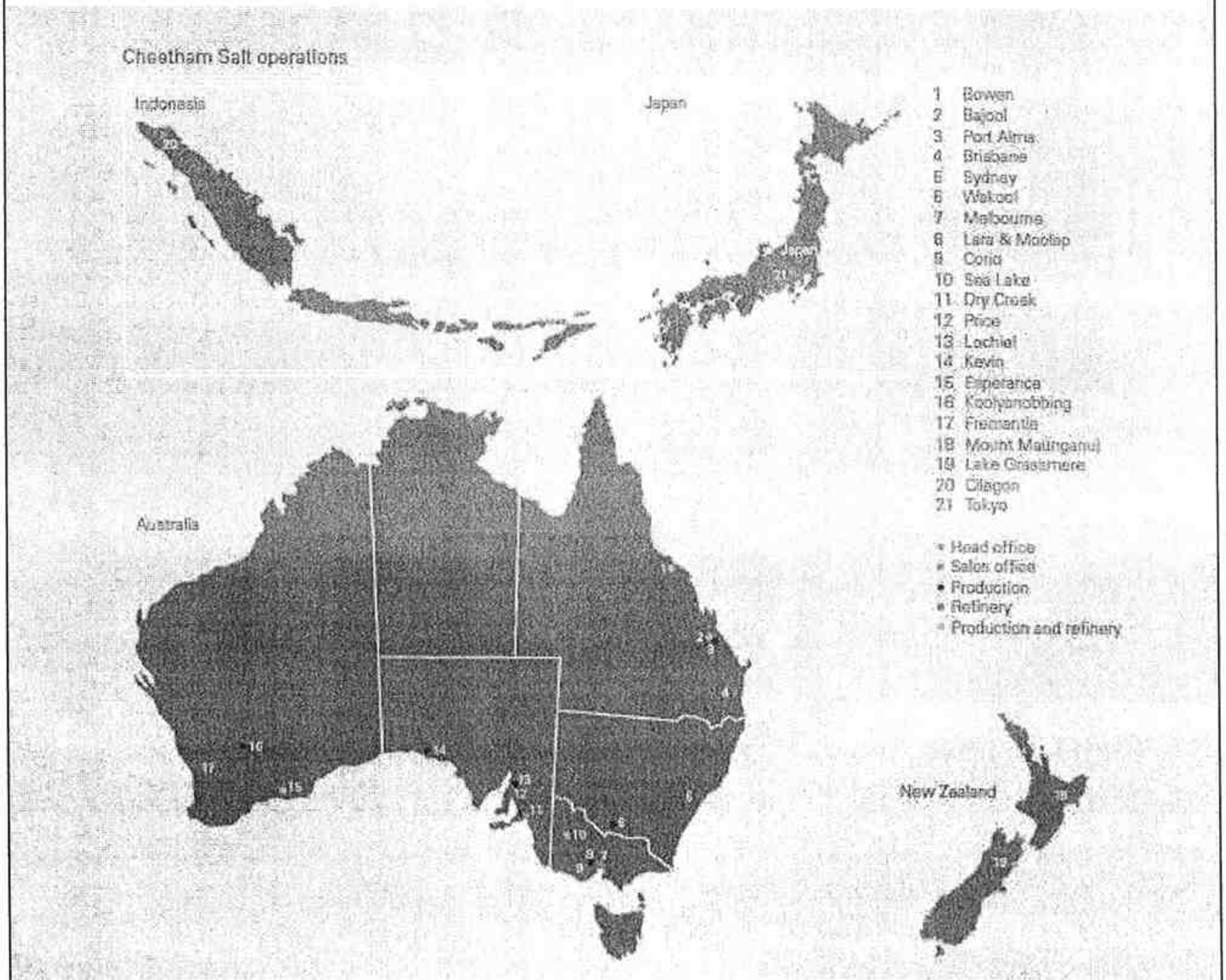
Cheetham Salt

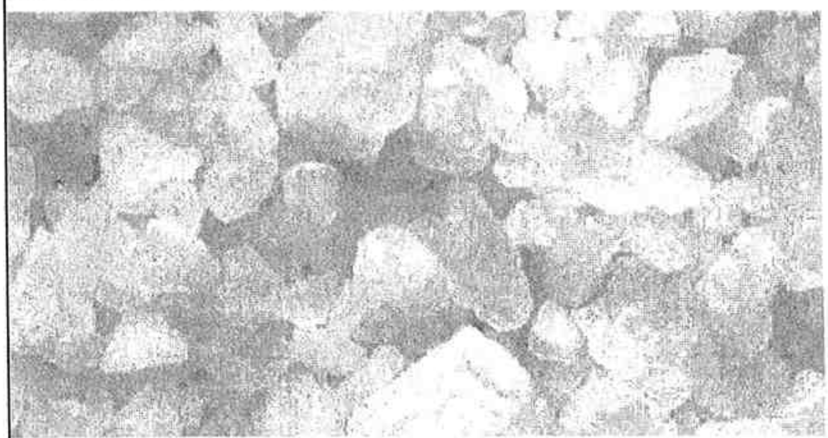
Andrew Speed – Chief Executive Officer, Cheetham Salt

2010 highlights

- Return to historical earnings.
- Stability of joint venture returns.
- Completion of Bajool and Indonesian refineries.
- Reopening of Port Alma salt field.
- Execution of three year transformation strategy.




Cheetham Salt operations
Indonesia
Japan
Australia
New Zealand
1 Bowen
2 Bajool
3 Port Alma
4 Brisbane
5 Sydney
6 Wakool
7 Melbourne
8 Lara & Moolap
9 Corio
10 Sea Lake
11 Dry Creek
12 Price
13 Lochiel
14 Kevin
15 Esperance
16 Koolyanobbing
17 Fremantle
18 Mount Maunganui
19 Lake Grassmere
20 Cilegon
21 Tokyo
Head office
Sales office
Production
Refinery
Production and refinery

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Cheetham Salt

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2011 highlights

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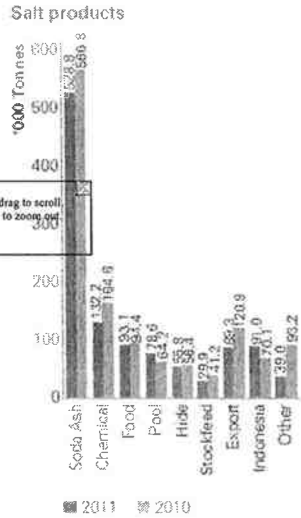
- Dependable joint venture earnings.
- Wet Weather Contingency Plans successfully implemented.
- Implementation of Lean Manufacturing program.
- Strong growth and prospects in Indonesia.



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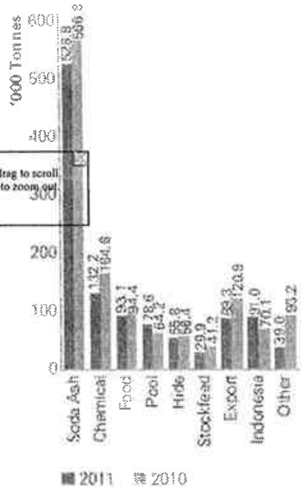
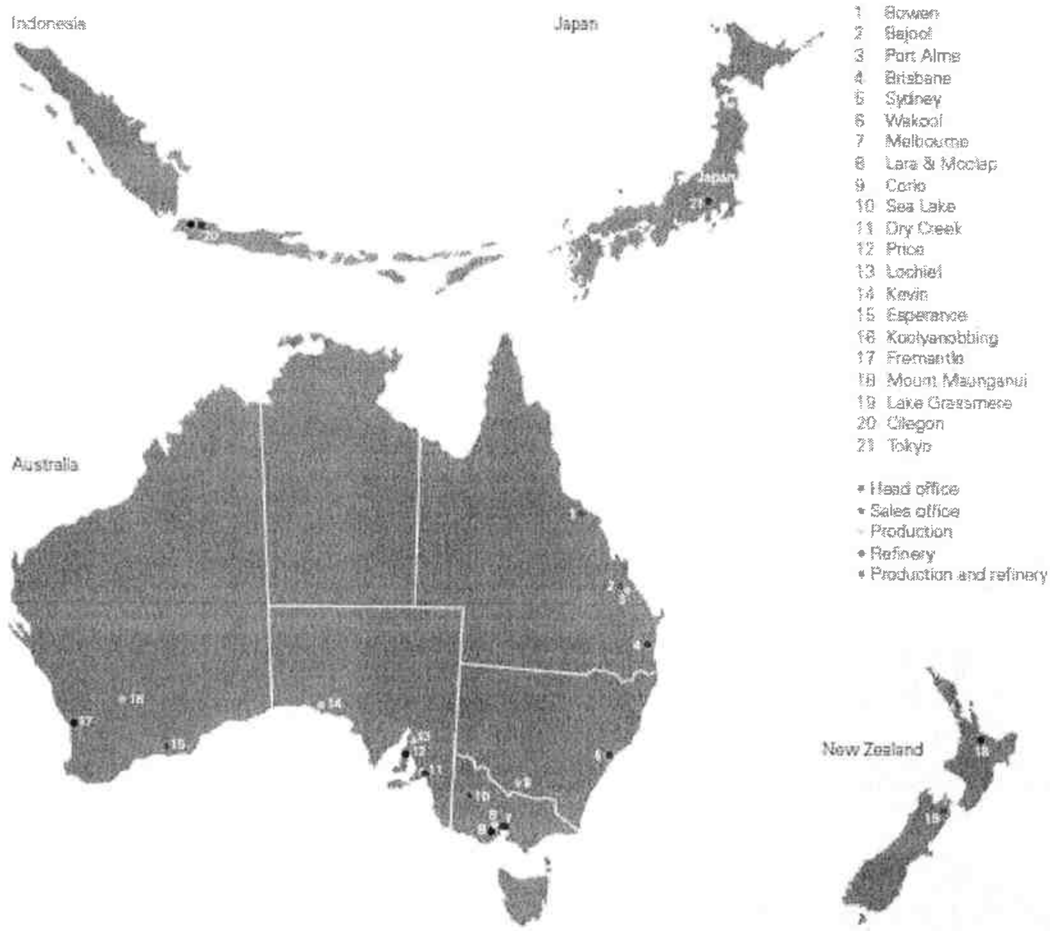
Salt products



Cheetham Salt operations



Operating result

FY11 proved to be an extremely challenging year for the salt business, with divisional profitability of $21.2 million compared with $24.0 million in FY10 and which comprises earnings before interest and tax (EBIT) of $14.2 million plus after tax profits from the joint ventures of $7.0 million.

Despite the harsh trading environment, the Cheetham Salt cash flow before interest and tax in FY11 was $19.2 million, a $0.4 million increase on the prior year and achieved by tight control of working capital and capital expenditure of only $4.8 million, compared to the $10.6 million expended in the prior year to complete the refinery rationalisation program, and to FY11 depreciation of $5.6 million.

The business performance was significantly impacted by the severe adverse weather conditions during FY11, which resulted in widespread and unseasonably high rainfall, and extensive flooding and business inundation. These weather events influenced the demand for Cheetham Salt products, and dramatically affected the efficiency of the salt refineries and the salt production fields. The combined impact of the weather events on the FY11 EBIT has been estimated at $1.9 million.

Sector performance

Whilst Cheetham Salt is a diversified business, the extreme rainfall resulted in subdued demand in many sectors. In the stockfeed sector, sales volumes were 28% lower than the previous year as a direct result of the abundant pasture growth in Queensland, which reduced the demand for supplementary feed products, and in which salt is a key ingredient.

Conversely to the stockfeed sector, demand for pool salt was favourably impacted by the high rainfall. As a result of overflow and loss of salt chlorination within domestic pools in Queensland and New South Wales in particular, significantly more salt was required to maintain swimming pool water quality. While sales volumes in the pool salt sector were 22% above FY10, it is a fragmented market that demands small pack sizes, which results in a more costly and challenging supply chain.

Cheetham Salt continued

The hide sector was flat compared with the previous year, with higher sales into cattle hide pickling offset by softer demand for salt required to preserve sheep skins. This demand profile is likely to continue, with sheep slaughter numbers remaining depressed due to the abundant availability of pasture and high wool prices.

Sales into the food sector remained steady. All of the major food manufacturers have implemented salt reduction programs to reduce the sodium content in their products in response to consumer and health sector demands. While these initiatives are impacting the quantity of salt in their formulations, this reduction is being offset by an increase in overall demand for processed food products and table salt in line with population growth.

Sales into the chemical sector were subdued as a consequence of reduced demand by Penrice, and the timing of some bulk shipments into the chlor-alkali sector. Penrice's brine demand was well down on prior years, as a result of two major operational events as announced to the market by Penrice. During the year, Penrice reported a sudden failure of their third party steam supplier causing an unscheduled plant shut down, and reduction in demand from key soda ash customers due to the flooding on the east coast. This reduction in demand has significantly impacted the efficiency and profitability of our Dry Creek salt field in FY11. Penrice has stated publicly that it considers these events unlikely to recur and expects brine demand to return to more normal levels in FY12.

The Japanese business was slightly behind the FY10 performance, with demand in the second half of the year impacted by the natural disasters experienced in the north of that country. While some of our customers in this region remain affected, demand in the rest of the country had returned to more normal levels by the start of FY12.

FY11 saw the first full year benefit of the new refinery in Indonesia. It is pleasing to report that this investment is exceeding expectations, with volume growth in FY11 of 30% over the prior year. With further and sustained growth anticipated, a capital works initiative has commenced in FY12 to provide additional capacity for that refinery.

Joint ventures

The contribution in FY11 from all four of the joint venture businesses was slightly down on the prior year. The Salpak and Cerebos-Skellerup businesses are currently operating in a challenging retail environment, impacted by the high Australian dollar, the increase in private label products, rising supply chain costs and supermarket discounting. Despite this, we have managed to grow market share and essentially maintain earnings. The launch of some new products in FY11 and a refreshed rebranding and promotional campaign have positioned these businesses well for FY12.

Dominion Salt Limited's (Dominion) volumes remained strong in FY11, however US dollar earnings from the pharmaceutical export business were adversely impacted by the strengthening New Zealand dollar. This sector remains a significant growth opportunity for Dominion, and in FY11 a significant and complex major capital expansion of the vacuum plant at Mount Maunganui was duly completed on time and within budget. Following a short period of commissioning, the new plant is now performing to expectations.

The increased capacity provided by the new vacuum salt plant will enable Dominion to benefit from the growth in demand for pharmaceutical salt in the Asian region. The new business development program supporting this investment is progressing as planned, despite the unfavourable movement in the exchange rate.

In FY11 and FY10, some of the dividends were retained within Dominion to fund the vacuum plant upgrade. With the upgrade now complete, in FY12 a more normal dividend stream will be resumed, whereby Cheetham Salt's 50% share of after tax profits will be wholly distributed in cash.

Weather

In addition to the significant impact on market demand and sales, the extreme weather also delayed progress in getting the upgraded refinery at Bajool to nameplate production capacity, and resulted in significant additional costs being incurred by the business.

The incremental costs include operational expenses associated with accessing the Bajool and neighbouring Port Alma sites during the floods, repairs to roads and infrastructure damaged by the high rainfall and flooding, loss of crude salt inventory at Bajool, and the inability to produce any salt for harvest at Bowen.

With FY11 being the third year in a row that salt has not been available to harvest at the Bowen field, management is currently reviewing the long term viability of the site and examining the various opportunities for its alternative use.

Despite the successful implementation of the Cheetham Salt Wet Weather Contingency Plans during the year, the high and persistent rainfall will impact the yield of next year's salt harvest. While variable salt production costs were actively managed during FY11, the combination of a higher fixed cost base relative to prior years and a lower yield will result in higher per unit salt costs when harvested in FY12. Assuming a return to more normal weather patterns, overall salt costs in FY13 are forecast to revert to FY11 levels.

Throughout this stressful period, the safety and wellbeing of staff and satisfying of customer requirements remained of paramount importance. Although many staff were personally impacted by the flooding in Queensland and Victoria, it is pleasing to report that no associated injuries were sustained by any Cheetham Salt employee.

Satisfying customer requirements during the period of severe weather was extremely challenging. Road and rail transport, warehousing and infrastructure was inaccessible for long periods in many locations, placing significant pressure on the supply chain. This situation was further complicated by shortages in product availability. To maintain supply to critical industries, a number of innovative supply chain solutions were devised and implemented. These initiatives included sourcing supplementary product from the overseas joint venture and establishing third party contract packaging arrangements domestically, one of which was a Ridley stockfeed facility at Wacol. As a result Cheetham Salt was able to maintain uninterrupted supply to essential industries such as food processing and water treatment.

Lean manufacturing

Having completed a period of business transformation and intensive capital investment, the Cheetham Salt focus is now on improving efficiency and effectiveness throughout the business. During FY11, Cheetham Salt commenced a program that will lead to the adoption of Lean Manufacturing principles throughout the business. The implementation program will run over 18 months, and ultimately develop a culture of continuous improvement and elimination of wasteful practices.

Indonesian salt field

The Indonesian Government announced a National Salt Program in FY11 with the aim of making Indonesia more self sufficient in large scale salt production. The Indonesian Government considers salt to be a strategic commodity and the improvement of their national salt production capability a national priority.

As a result of this Indonesian Government initiative, Cheetham Salt has been investigating the feasibility of constructing a salt field in Indonesia, with the same attributes as the Australia salt fields. The technical and commercial feasibility studies for this project are continuing and the preliminary results look encouraging. It is anticipated that these studies will be completed during FY12 and will facilitate the preparation of any investment proposal. Should this project proceed, it will fundamentally change the nature of Cheetham Salt's business in Indonesia and provide an opportunity for significant long term growth in that region.

Alternative sources of salt

Throughout FY11, Cheetham Salt continued discussions with the major coal seam gas producers and water treatment companies. The coal seam gas industry plans to establish a large number of new wells, predominantly in Queensland, to extract the natural gas present in the coal seams. A by-product of this drilling program is the release of large volumes of brackish 'associated water' which contains a mixture of salts, including sodium chloride. The industry is exploring a range of solutions to the associated water problem, one of which is the extraction of the mixed salts for commercial sale. If commercialised, this could provide Cheetham Salt with an additional source of salt. Cheetham Salt's product and market knowledge, combined with the complex and efficient supply chain, uniquely positions the business to contribute to the associated water solution.

Outlook

In the three years leading into FY11, Cheetham undertook an ambitious program of business transformation, including rationalising and upgrading domestic refining capabilities, reopening the Port Alma salt field, implementing a new ERP system, relocating head office to Melbourne, and constructing a new refinery in Indonesia. It was anticipated that the business would benefit from these initiatives in FY11, however the realisation of the efficiency and effectiveness improvements were harshly compromised by the highly unusual weather patterns experienced in the year.

The impact of the weather experienced in FY11 will flow through into next year in the form of higher salt costs, however this impact is expected to be more than offset by the realisation of the benefits derived from the successful conclusion of the business transformation program.

Cheetham Salt continued

Operating result

Cheetham Salt (Cheetham) delivered a solid performance for the 2010 financial year of $24.0 million, which comprised Earnings Before Interest and Tax (EBIT) of $16.8 million plus after tax profits from the joint ventures of $7.2 million. The overall result represents a return to historical earnings levels following a 2009 result which was adversely affected by $4.8 million of abnormally large physical losses of crude salt and Enterprise Resource Planning (ERP) system implementation costs.

The operating performance was favourably influenced by continued volume and earnings growth in Japan and Indonesia, combined with robust sales into the swimming pool, chemical and industrial sectors domestically. In contrast, 2010 sales into the hide market were lower than the prior year as a result of the decline in slaughter numbers and strong competitive activity. Offsetting the strong sales performance were incremental operational and logistics costs associated with unforeseen delays in completing the Bajool refinery upgrade, which are not expected to recur in the 2011 financial year.

The following is an analysis of the key contributors to the operating result for the 2010 financial year and the outlook for the 2011 financial year, referred to as FY10 and FY11 respectively.

Joint ventures

The contribution from the equity accounted joint ventures continues to grow steadily, with higher earnings from Salpak and Western Salt Refinery in Australia and Dominion Salt Limited (Dominion) in New Zealand. The contribution recorded in the operating result is the Cheetham share of after tax profits, which is generally distributed wholly in cash to leave the carrying value of the joint venture investment unchanged. This year, however, in response to a steadily increasing demand for premium Pure Dried Vacuum Salt for supply into food and pharmaceutical applications, Dominion commenced construction of an expanded facility to provide additional vacuum salt capacity.

As a consequence of the above, cash otherwise distributable to Cheetham has been retained to finance the capital expansion program and capitalised to the carrying value of the joint venture in the balance sheet. Further funds will be retained in the first half of FY11, with the additional capacity expected to come on line in early calendar 2011. The new capacity will enable Dominion to satisfy the growing export pharmaceutical salt market which is targeted at end products such as saline drips, haemodialysis, eye washes and contact lens solutions.

Bajool refinery

Throughout FY10, Cheetham was focused on completing the major upgrade of the Bajool refinery, strategically located near Rockhampton in central Queensland to service the growing demand of the Queensland market.

The new facility, which replaces the former 50 year old facility at the Bajool salt field, was commissioned in late FY10 and has significantly improved both the quality of product and the capacity of the plant.

In recent years it has been necessary for Cheetham to satisfy the growing Queensland demand with product manufactured at one or more of the Cheetham refineries located in the southern states. The requirement to freight this product north to satisfy the Queensland market has introduced significant stress in terms of production capacity at the southern manufacturing site(s) and also material incremental costs into the supply chain.

It is anticipated that the successful completion of the Bajool upgrade will enable Cheetham in FY11 to supply the Queensland market from Bajool with all but a few specialised grades of salt, and this will translate into significantly lower supply chain costs compared to FY10 and the prior year.

Port Alma salt field

The Port Alma salt field, located adjacent to the Bajool site, was reopened in FY10 following five years of hibernation and after recording crude salt losses of $3.5 million in the 2009 financial year. Reopening the field presented Cheetham with a number of unique challenges which have been successfully addressed during FY10, with the result that the field is now back in operation on the normal salt production cycle of two years, with new, high quality salt being grown in the crystallisers which will be suitable for refining or bulk despatch.

Following the crude salt losses in 2009 as a consequence of unusually high rainfall events, management developed a Wet Management Plan (Plan) for each of the Cheetham salt fields. The Plan focuses on the security of both stock harvested on the bank and unharvested stock in the crystallisers to prevent a reoccurrence of these losses. In January and February 2010, the Plan was severely stress tested and successfully implemented with minimal losses, despite central Queensland experiencing further significant weather events, including Cyclone Ului.

Cilegon, Indonesia refinery

Construction of a new refinery in Cilegon, Indonesia was also completed towards the end of FY10. The new state-of-the-art refinery is located near the port of Cigading in West Java, Indonesia's deepest sea port. Proximity to a port of this nature provides Cheetham with a major competitive advantage, as imported bulk salt can be efficiently unloaded and transported to the refinery for processing.

Indonesia has a population of around 230 million and this investment uniquely positions PT Cheetham Garum Indonesia, Cheetham's wholly owned Indonesian subsidiary, to supply premium value added solar salt into the West Java industrial market. In particular, the new refinery will enable Cheetham to meet the increasingly stringent

Indonesian quality expectations and provide the refining capacity to benefit from the population and market growth.

Developments with the Government of Indonesia

For some time now, Cheetham has been working with the Indonesian Government to help reduce the nation's reliance on imported salt. Indonesia is a significant net importer of salt, given that much of the local salt is not suitable for industrial applications.

In FY10, Cheetham extended the existing East Java program of salt technology transfer into Central Java, with the same objective of encouraging local subsistence salt farmers to manage their fields using Australian techniques and processes. By adopting higher quality standards in their production processes, the local farmers can significantly improve the quality of their salt, potentially to the level of being fit for industrial applications.

If the quality uplift can be achieved by the local farmers, then Cheetham will have been instrumental in reducing Indonesia's dependence on imported salt. This program has been developed in close consultation with the Indonesian Government, which considers salt to be a strategic commodity and the improvement of their domestic salt production capability a national priority. This initiative has led to Cheetham signing a Memorandum of Understanding with the Indonesian Government to explore the feasibility of constructing a modern salt field in Indonesia.

Business transformation

In the 2009 financial year, Cheetham successfully installed a new ERP system. Throughout FY10, the business worked tirelessly to deliver the benefits offered by this comprehensive business systems solution. During this time, the new system has been leveraged to consolidate and standardise business processes, and this has improved productivity, visibility and controls throughout the entire Cheetham business.

The past three years have been very challenging for Cheetham as it undertook an ambitious three year program of business transformation, including a substantial upgrading of domestic refining capability and consolidation of five refineries down to three. A state-of-the-art refinery has been constructed in Indonesia and at Bajool, the Port Alma salt field reopened, a new ERP system implemented and Head Office relocated from Corio to Melbourne. With the transformation complete and the operating platform now in place, Cheetham is well positioned to benefit in FY11 from the more efficient and effective operating structure delivered by these initiatives.

Salt products