Start of Transcript

Operator: Good day and thank you for standing by. Welcome to the Orica update. At this time, all participants are in a listen-only mode. After the speaker's presentation, there'll be a question-and-answer session, at which time, if you do wish to ask a question, you will need to press star one on your telephone. Please be advised that today's call is being recorded. If you require any further assistance, please press star zero.

I would now like to hand the conference over to your first speaker today, Delphine Cassidy, Chief Communications Officer. Please go ahead.

Delphine Cassidy: Thank you, and good afternoon, ladies and gentlemen. Thank you for joining us at such short notice. We thought it would be best to have a call with Chris and Sanjeev before we go into blackout, and please feel free to ask as many questions as you'd like to.

Sanjeev, over to you.

Sanjeev Gandhi: Thanks, Delphine. Good afternoon, everybody. Thank you all for joining at short notice. I appreciate that. Chris and I will talk you through the announcement that has just been released, and then we'll obviously take questions later.

Now, ahead of the release of our 2021 full year results on 11 November, we wanted to update you on three issues. (1) The expected significant items that will impact the full year results, (2) the impact of the recent changes to accounting for software, and (3) our expectations for the full year FY21 results.

Starting with the four individually significant items, (1) at our 2021 half year results in May, we said that we have started the process to sell our non-core land holdings. In March this year, we sold the Villawood site in New South Wales for a cash consideration of $65 million. This has been followed with the sale of Lot 9 at Botany, New South Wales, in the second half, for a cash consideration of $75 million, bringing anticipated total cash proceeds from land sales for the full year to A$140 million. This will result in an after-tax gain of approximately $70 million in the second half of the year and will be treated as a significant item.

(2) In our half year accounts, we noted that, based on the latest projected cash flows of the Group, the carrying value of both the Latin American and EMEA segments were approximately equal to their value in use.

As part of Orica's periodic impairment testing, and in the context of the ongoing market conditions, a non-cash impairment charge is expected on the goodwill in the EMEA segment. The expected impact is approximately $145 million to $155 million, after tax. There are no impacts expected on the Latin American segment.

(3) The third item relates to the Burrup plant. Following the impairment recognised by Yara Pilbara Nitrates, the joint venture company that operates Burrup, in May this year, we also reviewed the carrying value of our 50% shareholding. This has resulted in Orica recognising a non-cash impairment of approximately $260 million to $270 million post tax.

That includes the full impairment of the goodwill associated with this investment. This also includes the US$113 million entry fee paid by Orica at the start of this project.

The last item relates to our global restructuring project, which has continued in the second half. We expect further redundancy costs in the second half of between $10 million to $15 million.

I will now let Chris talk to the impact of the software accounting changes. Chris, over to you.

Christopher Davis: Thanks, Sanjeev.

In April 2021 the International Financial Reporting Standards Interpretation Committee, otherwise known as IFRIC, provided guidance on how the intangible assets standard should be applied to customisation and configuration costs of cloud computing, or otherwise called Software as a Service arrangements.

Previously, companies capitalised these costs, as did Orica. The new interpretation now requires companies to expense such costs. This is particularly relevant to Orica, as we have been implementing a new SAP system over the last couple of years, and spent material amounts on customising and configuring cloud computing software. It is important to note that this interpretation requires full retrospective application.

Going forward, future costs related to Software as a Service software platforms will be expensed within EBIT, on the basis that these costs will be regularly incurred in future years, and the amounts are not expected to be material.

Configuration and customisation costs related to SaaS elements of the new SAP system incurred in FY20, our previous financial year, amounting to $85 million to $90 million after tax, that are now required to be expensed, will be presented as individually significant items below EBIT, in a restated income statement for FY20.

I need to re-emphasise that this is a restatement and treatment as significant items has no impact on the FY21 results but is a restatement of the prior period as a result of the accounting standard change that occurred in April 2021.

There will also be an impact to retained earnings for FY20, and restatement of the FY20 balance sheet. We have detailed this in the announcement.

For the FY21 results, the reduction in asset value will result in lower depreciation and amortisation by approximately $40 million. This will be partially offset by SaaS-related software costs incurred this financial year of approximately $20 million, which will now be expensed, whereas in the past, these would have been capitalised.

Importantly, after incorporating the impairments announced today, we expect gearing to remain within our targeted 30% to 40% range, and at a level that provides considerable headroom to debt covenants.

The Company maintains a strong liquidity position, underpinned by significant undrawn committed debt facilities and cash holdings.

I will now hand you back to Sanjeev.

Sanjeev Gandhi: Thanks, Chris.

When we announced our half year results in May this year, we expected an improvement in the second half performance from improved volumes for our products and services, and benefits are being realised from several initiatives, which we have initiated which are within our control.

In addition, we now expect to get a net EBIT uplift of approximately $20 million from the software accounting changes that Chris just spoke about. I am very pleased to say that the second half will finish in line with our expectations, and more importantly, the positive trajectories that we have seen in the last quarter gives us confidence for a good start to the next financial year.

I am also very pleased with our progress on the sustainability front, and our decarbonisation efforts. We are in the middle of a planned turnaround at our Carseland plant in Canada. This includes the installation of tertiary abatement technology, which is expected to reduce our greenhouse gas emissions at the plant by around 95%, from unabated levels. We have also recently completed a feasibility study for the Kooragang Island decarbonisation project here in Australia.

I am very much looking forward to taking you through our refreshed strategy in November. This refreshed strategy, which is a capital light strategy, is centred on improving our core business, and refocusing our business on four key business verticals, to deliver future profitable growth.

With that, we are now open for questions.

Operator: Thank you very much. As a reminder, to ask a question you will need to press star one on your telephone and wait for your name to be announced. To withdraw your question, please press the pound or hash key. Please stand by, while questions queue. Once again, it is star one, and wait for your name to be announced. Thank you.

We have multiple questions in the queue. Our first question comes from the line of Richard J Johnson, from Jefferies. Richard, please ask your question.

Richard J Johnson: (Jefferies, Analyst) Thank you very much. Sanjeev, can I just start with the goodwill write-down in Europe? Perhaps, if you could talk through your general level of confidence in that business, overall, and maybe give us a good sense of how it's going, particularly in relation to the civils market in Scandinavia, where I know there was an issue because of COVID?

Sanjeev Gandhi: Thanks, Richard. Thanks for the question.

The business environment overall, has turned positive for us, as we anticipated this, when we spoke in May. This is across the globe, in all regions. In Europe, we did have significant improvements, because the pipeline of projects, particularly in the Q&C area, which were put on hold or cancelled because of COVID - they were revived, and we saw that translate into better business environment for us.

Now, having said that, obviously, during the summer dip, during the holiday times in July and August, we also saw an extended summer dip, because obviously, the European customers were going on longstanding leave, which they’ve not been able to do for the last couple of years, because of COVID.

Now, we've not yet closed September, but since then, post this summer dip that is normally seasonal in Europe, we have seen a recovery in demand, and we do see that the business outlook is, as we have anticipated, constant and continuous improvement across the board there.

Richard J Johnson: (Jefferies, Analyst) That's great. So just to finish off on Europe, there's no reason to be unduly concerned about the business in Russia?

Sanjeev Gandhi: On the contrary, the Russian business and also the business in Africa has been doing quite well. There is this continued impact of COVID, right, but we've all learned to live with this.

Delphine Cassidy: Apologies, all. The phone line just dropped out. I think, Richard, we were up to your question. Can you come back to us on that, please? Thank you for your patience.

Operator: Thank you. Richard, could you please press star one, and we'll get you back into the queue. Thank you very much.

Excellent. Richard, please ask your question once again. Thank you.

Richard J Johnson: (Jefferies, Analyst) Thank you very much. Sorry, I hope that wasn't my question that did that. I think we'd finished off on Russia, Sanjeev. That's very helpful, thank you.

Then just one for Chris, if I may? Chris, can you just remind me on the timing, or if there's been any change on the timing in relation to the Deer Park land sale? Also, where we are with regards to Minova?

Christopher Davis: On the Deer Park land sale, Richard, we expect - probably the first phase will come through in 2023. There's been a slight delay, around really the relevant authorities getting the approvals through. So you'll have 2023 and 2024, the additional $150 million coming through.

Then do you want to comment on Minova?

Sanjeev Gandhi: Richard, everything's on track with Minova. There is just a slight bit of delay for the reason that interested parties would like to do site visits and due diligence, as part of the due diligence, and obviously, because of COVID, there are restrictions in terms of visiting sites. So that's taking a little bit of time, but we are more or less on schedule, and then, in November or perhaps earlier, we will be ready to come up with an announcement.

Richard J Johnson: (Jefferies, Analyst) Great. So just to clarify, Chris, there are no other asset sales, outside of Minova, that we should expect in '22?

Christopher Davis: I'm continuing to look at land, Richard. You won't see the extent of the $140 million in 2022, but we should have other parcels that we're looking at that are smaller - a number of other parcels that cumulatively should be a reasonable number.

Richard J Johnson: (Jefferies, Analyst) Perfect, thank you. That's very helpful. Thank you very much.

Operator: Thank you. Once again, if you wish to ask a question, it is star one.

Our next telephone question is from Mr Scott Ryall, from Rimor Equity Research. Scott, please ask your question.

Scott Ryall: (Rimor Equity Research, Analyst) Hi there. Thank you very much. Sanjeev, I was wondering if you could talk a little bit more to the restructuring costs and redundancy costs? I imagine these are provisions that have been taken, is that correct? Could you just talk to us about what you've actually done on the redundancies? Because I've heard some pretty big numbers coming out of head office. Not from your head office, but people talking about your head office, and what might have happened since you bedded down the Enterprise Resource Planning software implementation, please?

Christopher Davis: Let me take the redundancy costs. We executed on about $22 million, or $20 million in the first half of the year. That's not a provision, that is actually people that have left during the course of the year. The balance of, I think, it was $10 million to $15 million, which would be after tax, the bulk of it is people that have exited. There might be a small part of it, say 30% of that remaining portion, which will be a provision for early exits in the first quarter of next year. But those people would have been identified already and notified of their termination date.

Scott Ryall: (Rimor Equity Research, Analyst) Roughly how many people is that? Or roughly the headcount costs that is associated with that?

Sanjeev Gandhi: Scott, we are not yet in a position to disclose numbers, because people are continuing to leave, having been given notice periods and all of that. So I'm not in a position today to tell you a number, but in November we'll give you a little bit more light on what kind of initiatives we've taken, in terms of taking costs out.

Scott Ryall: (Rimor Equity Research, Analyst) Okay, great. Thank you.

Then, the second one I had was you mentioned the turnaround in Carseland, being able to take 95% of emissions out of that plant. Could you just talk us through that, please? What have you done? Or what will you be doing through the turnaround, to make such a significant change?

Sanjeev Gandhi: Scott, we've invested in a new technology, where we are basically abating NOx emission, so nitrous oxide gas emissions, coming out of our nitric acid plants there. During the turnaround - we've already invested in the capital, and during the turnaround, we have put in an additional reactor, which is basically what is going to tackle the nitrous oxide emissions coming out of the nitric acid plants, and basically avoid that they are being emitted into the environment. That means - as you can imagine, nitrous oxide is much more important in terms of environmental impact than CO2, so that is leading to this kind of significant reductions.

Now that's a proven technology within Orica, and we have implemented this successfully, and that's the technology that we are taking to all our nitric acid plants across the globe. So, we will be able to replicate that technology, and we will have significant capital that we'll be investing there, so that we will continue this abatement measure across all our nitric acid plants, globally.

Scott Ryall: (Rimor Equity Research, Analyst) Okay, great. Thank you. Then, the last question I had, there's been a lot of chatter recently about Glencore potentially building an emulsion plant in the Hunter Valley. I don’t expect you to comment directly on that, but could you just confirm, I would expect that you'd hear noise out of a company like Glencore, at a time of price negotiation with their supplier. Is that a fair assumption to make?

Sanjeev Gandhi: Scott, I don’t want to address any specific customer, obviously, but I can just give you one general remark. Given the market situation today, customers are concerned about supply chains, customers are concerned about reliability of supply, and that's been our major focus, to ensure that we don’t let the customer down, given the very, very tight market situation we are in. That's something that we need to keep in mind.

The application made on this particular issue is now public, in the public domain, so that's something that you can check up on the website, and there's public opinion being asked about it, so there's no decision taken, as much as I understand, and it will be a process that will run for a few months.

Scott Ryall: (Rimor Equity Research, Analyst) Okay. In terms of yesterday there was a very strong ammonia price print globally. I would have expected that that would lead to increases in ammonium nitrate pricing on a global basis. I know there's some regional nature, there's some regional price impacts there that you have to take into account in terms of feedstock costs, and those sorts of things. But in general, the pricing environment, I imagine, would be getting more favourable. Could you just comment on that, please?

Sanjeev Gandhi: Scott, pricing is impacted by two things. One is input costs, obviously, which are going up, at the moment, and the second is supply demand. I already flagged, in May, that we will see increased supply chain costs. We will see increased input costs. We will see inflation across the board. All of that has come true.

At the moment you see this energy crisis that the world is going through, very high natural gas prices, not just in Europe, but also in the US markets, also in Asia. The spot LNG prices are about $20, so obviously, all of that translates, because you know natural gas is the feedstock for the nitrogen volume. All of that obviously translates down the value chain, and we are doing everything we can to pass these down, obviously and maintain our margins and if there are better opportunities also to improve the margin.

The second aspect is supply and demand, and given the fact that we are in a favourable situation, in terms of our customers running full out on most of the commodities that we cater to, obviously that's also helping us in terms of a better balanced market in terms of supply and demand for our products.

Scott Ryall: (Rimor Equity Research, Analyst) Great. Thank you. That's all I had.

Operator: Once again, if you wish to ask a question, it is star one. Once again, audience, it is star one if you wish to ask a question.

We have - multiple questions have just popped up. We have Belinda Moore from Morgans. Belinda, please ask your question.

Belinda Moore: (Morgans, Analyst) Good afternoon, gentlemen. Can I just clarify, in terms of your guidance for underlying EBIT, you're saying you're comfortable where everyone's at? Chris, could you quantify the EBIT you're talking about, please?

Christopher Davis: Listen, I'm not going to say where we think it's going to land. I think consensus is sitting - where's it sitting at the moment, Delphine?

Delphine Cassidy: $383 million.

Christopher Davis: $383 million. That clearly doesn't take into account the uplift as a result of the accounting changes. I'm not saying $383 million is the number that we agree with. I'm just saying, it's $383 million, you've got to add another $20 million to that. We don't officially give out guidance.

Belinda Moore: (Morgans, Analyst) Okay, thanks very much.

Operator: Our next telephone question is from Paul McTaggart from Citigroup. Paul, please ask your question.

Paul McTaggart: (Citigroup, Analyst) Hi. I just want to follow up on Scott's question. Are you able to fully pass through those input prices to AN at the moment? Or are you seeing margins squeezed? I think that's what he was getting at, but you didn’t explicitly answer it in that way.

Sanjeev Gandhi: Paul, yes, in general, we are able to pass on increased margins - sorry - increased costs, which are reflected in our rise and falls, but there's always this one quarter time lag. So we're always catching up, as long as the prices keep going up. Once the price is stabilised, we'll catch up with that. So every quarter, we do pass on all these increased input costs, and that's where we are protecting margins. For me, it is more important to see whether we can improve on our margins, and that's the initiatives that we are putting into place at the moment.

So yes, in short, the answer's yes, we are able to pass them on.

Paul McTaggart: (Citigroup, Analyst) Thank you.

Operator: Our next telephone question is from Nathan Reilly from UBS. Nathan, please ask your question.

Nathan Reilly: (UBS, Analyst) Yes, I was just hoping you could provide a little bit more detail about the impairment at Burrup, just in terms of the triggers there that's prompted the impairment, in terms of the assessment around the future cash flows of that business? Sorry, that plant?

If you could also give us a quick update on operations at that plant, as well, please?

Christopher Davis: Let me deal with the impairment side of it. In May of this year, our joint venture partner, Yara, did a review of the carrying value of that and the future cash flows, and they did an impairment of the asset.

That really prompted us to take a look at this and just see where saw it going. We agree with their forecasts on the future cash flows, and so we've aligned with them, and in addition to which, we've written off some goodwill, which was the entry fee that Orica paid to enter that joint venture.

I don’t think - if you look at the messages that we have given in the past, about the returns from that plant, and the returns generated today, this impairment is not inconsistent with that. We've always maintained the returns from this plant are low in the short term, particularly until such time as some of the major contracts come up for renewal, which is only around about 2025. Then obviously, the short-term cash flows impact your value in use calculations more so than the long-term.

So that relates to the accounting adjustment. Hopefully, that deals with your questions.

Do you want to talk about the future of the plant?

Sanjeev Gandhi: Sure. Nathan, first of all, I'm very pleased that the plant, which has been operating now stably since last October, is achieving high capacities. It's producing some of the best qualities within our network for ammonium nitrate, so I'm very pleased with that.

Most of the teething troubles in terms of starting up such a major capacity are now overcome, and we've achieved a production which is at a stable state. We are operating at high loads.

Some of those investments we had to make, to reach nameplate capacity after start-up have also been now completed. So, in my view, Burrup is now a stably running asset, and is part of our global network of ammonium nitrate, and I'm pretty happy with the performance so far.

Nathan Reilly: (UBS, Analyst) Okay, thanks for that update.

Operator: Our next telephone question is from Andrew Scott from Morgan Stanley. Andrew, please ask your question.

Andrew Scott: (Morgan Stanley, Analyst) Thank you. Good afternoon. Chris, just a couple of quick ones for you. Just to round out on Burrup, could you remind us of where the asset value now sits?

Christopher Davis: Yes. Prior to the impairment it was sitting at about $869 million, and that's Orica's share, so clearly, you'll have to take off the $306 million, post the impairment.

Andrew Scott: (Morgan Stanley, Analyst) That's great, thank you.

Christopher Davis: Again, I want to stress that half of that impairment is goodwill.

Andrew Scott: (Morgan Stanley, Analyst) No, I appreciate that, thank you very much. Then, secondly, for those of us who've followed Orica for a while, where we've seen these announcements, we've often also seen an update on the environmental provision side, and an increase there. Could you just confirm whether you have reassessed those provisions, and whether there's any risk that you see around those?

Christopher Davis: Yes. We look at our environmental provisions almost - well, we look at it all the time, but every six months we look at it from an accounting perspective. We have no reason to believe that there's a requirement for increased environmental provisions on our legacy sites. We believe that we are fully provided, and the biggest one of that is really the Botany groundwater treatment plant, which I think is provided for the next 18 years.

Andrew Scott: (Morgan Stanley, Analyst) Fantastic, thank you.

Operator: Our next telephone question is from Richard J Johnson, from Jefferies. Richard, please ask your question.

Richard J Johnson: (Jefferies, Analyst) Thanks. Just one for Sanjeev. Sanjeev, since you’ve started, the world's kind of turned upside down with the move in global gas prices, and particularly in Europe. I'd be interested to get a sense of what your view on ammonia is, in the short term, and where you think it might go? Not in absolute terms, but just directionally, from here?

As an adjunct to that, is there any reason why higher input costs in AN, globally, won't be reflected in your selling prices, as your book opens up next year?

Sanjeev Gandhi: Thanks, Richard, for the question. First of all, it was not a surprise for us. We were anticipating that. I did flag this, Richard, in May, when I said that supply chain costs are going to go up - and this included everything, right, and that's exactly what happened. Not just shipping costs, but also input costs continued to go up, and we see inflation across the board.

So, that was not new for us. Fortunately, we anticipated that, we prepared for it, and we have mitigation measures in place, in terms of our long-term contracts, in terms of our pricing formulas, in terms of rise and fall.

So, absolutely agree that this energy shortfall that the world is seeing is structural - and please keep in mind that we are just before winter, right, which is where the peak consumption of energy will happen for heating, in the Western hemisphere, so these challenges will not disappear overnight. We are in a pretty good situation here, given our own balance of make and buy, for our feedstocks.

We do see, as you’ve said very rightly, an increase in ammonia prices across the board, an increase in ammonium nitrate prices across the board. We've seen this translate into high urea prices, also. So, yes, it's trickling through the value chain, and we will obviously have to push this down and pass it through our rise and falls to our customers, as the contracts roll through.

Now, obviously, wherever we have an opportunity to either bid for new contracts, or go for renegotiating contracts, we're obviously also going to reset the pricing upwards.

So, yes, it will, and it has to translate into higher pricing for our production.

Richard J Johnson: (Jefferies, Analyst) Yes, so in some ways, it's an irony that the higher input costs should, over time, be a net benefit for your business here in Australia?

Sanjeev Gandhi: Yes, that's my expectation, Richard.

Richard J Johnson: (Jefferies, Analyst) Perfect. Thank you very much. I appreciate all your help.

Operator: I believe we have another question from Scott Ryall. Please ask your question.

Scott Ryall: (Rimor Equity Research, Analyst) Oh, sorry, no, mine got asked - I beg your pardon, that was a mistake. Thank you.

Operator: No problem. There's no more further questions at this time. I would now like to hand the call back to the speakers for closing remarks. Please continue.

Delphine Cassidy: Thank you. Thank you all for joining us today. I hope we've answered your questions. We now go, officially into our blackout period, with our results scheduled to be released to the market on 11 November. So, thank you all for your time. Enjoy the rest of the day.

Thank you, Sanjeev, and Chris, too.

Sanjeev Gandhi: Thanks, all.

End of Transcript