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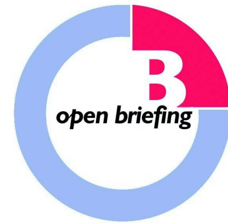

Elders Limited
Level 3
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Record of interview:

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Elders Limited announced on Friday a fully underwritten $400 million conditional placement of shares to institutional investors at 15 cents per share plus a Share Purchase Plan (SPP) to existing shareholders of up to $150 million (underwritten to $75 million). Why have you chosen to raise equity capital in this way?

Chairman Stephen Gerlach
The key to the capital raising is that it was one element of a refinancing and recapitalisation package that we had to deliver to secure Elders' ongoing future.

The refinancing and recapitalisation were mutually dependent: the terms of the refinance with our lenders required a major capital injection and reduction in debt and would-be investors needed assurance that Elders had the ongoing support of its financiers, on satisfactory terms.

The Company's task was to find the structure which would enable equity investors and bankers to make the commitments necessary for the raising of at least $475 million in sufficient time to meet the expiry date for our current short dated debt. For this to be achieved, all parties needed the assurance of underwriting support for the raising.

The final offer structure brought these elements together. We have been very focussed on ensuring certainty and a reasonable opportunity for our existing shareholders to invest. We believe this has been done through the combination of the institutional placement and the $150 million SPP, which allows all shareholders to participate in the offer.

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Why has the Company chosen to not employ entitlements-based issue structures such as rights issues? Wouldn't a rights issue provide a better outcome for the Company's existing and retail shareholders?

Chairman Stephen Gerlach

Throughout this process the Board has been deeply conscious that, while its priority must necessarily be on the delivering of a recapitalisation proposal that gave Elders the absolute certainty needed for its refinancing to proceed, it also has an obligation to ensure the best possible outcome for all shareholders.

For this reason, our starting point as we looked at recapitalisation options was potential rights issues supported by smaller placements. However, these could not provide the certainty of financial outcome that the Company and its lenders required.

The final structure was the one that gave us the required certainty as it could be backed by an underwriting agreement plus the flexibility to ensure that retail holders who wanted to invest new capital in the Company would have the opportunity to do so.

We think the $150 million SPP is a demonstrably better outcome for existing shareholders than your standard entitlements issue, particularly the 99 percent of Elders shareholders who own 100,000 shares or less and are being offered up to $20,000 worth of new shares at 15 cents per share.

For example:

- we are proposing that shareholders approve the SPP on terms that permit individual investors to subscribe for $20,000 and potentially more if they seek oversubscriptions. This is the highest ever subscription level in an SPP, so far as we are aware;
- the first $75 million of the SPP is underwritten so we have the certainty provided through underwriting for the targeted $475 million, but with those extra $75 million of shares being offered to existing Elders shareholders;
- the opportunity to take oversubscriptions if other retail shareholders do not subscribe for the full $150 million being made available under the SPP ensures the shares under the SPP go to existing shareholders in the first instance. In other words, our SPP is a means for the majority of retail shareholders to maximise their participation;
- the closing date for investors to subscribe for shares under the SPP is 23 October. That is much more time than is generally provided to shareholders in a rights issue. The directors believe this is a benefit to our retail holders because of the volume of information we have released on our refinancing, our recapitalisation and on the proposed asset sales.

While the dilution arising from the institutional offer was inescapable in the circumstances we think the final structure we have settled on is one that is in the best interests of the Company as a whole.

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The total offer will involve the issue of shares at 15 cents per share, a 62 percent discount to the previous closing price and a 47 percent discount to the 3 month VWAP of Elders shares prior to the announcement of the Elders QBE insurance transaction. Why have Directors issued new equity at these discounts?

Chairman Stephen Gerlach
The price was set at the level to attract the substantial amount of capital required. We needed to secure at least $475 million of new investment, which was one and a half times our entire market capitalisation before the offer.

The directors are satisfied that the price is a fair price given the near term earnings and the quantity of capital to be raised. It is a discount of around 25 percent to the "theoretical post offer price", which for us means the previous market price adjusted for the proposed new issue. That discount is in line with discounts achieved in this market for issues of this magnitude relative to existing market capitalistion.

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You have advised that QBE will subscribing to a $55 million placement of Elders shares at 15 cents per share. How does this reconcile with the announcement on 31 July that QBE would be subscribing to a placement of Elders shares at a price of 40 cents per share?

CEO Malcolm Jackman
Our announcement on 31 July was that Elders and QBE had reached Heads of Agreement on a $45 million placement and the sale of our insurance operations. This announcement was subject to a number of conditions. These included commitment into a binding sale and purchase agreement by 31 August.

Since that time, our recapitalisation and refinancing evolved considerably.

As we advised the ASX on 31 August, our agreement of a final contract with QBE included provision that QBE's subscription would be on terms consistent with the recapitalisation.

QBE have now committed to subscribe for an additional $10 million of shares compared to the original agreement. They are now investing $55 million in the conditional placement and following the raising will hold between 8.2 percent and 9.6 percent of the Company.

We are absolutely delighted to have QBE as a cornerstone investor. To have them come in for a greater equity stake than originally envisaged reinforces their commitment to Elders.

We are also looking forward to working with QBE to further develop the insurance offering through the Elders network. The sale of the insurance business to QBE is on track and still expected to close by 30 September.

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Under the placement, 3,667 million shares will be issued. Given 819.2 million shares on issue as at the end of December 2008, this represents significant dilution for your existing shareholders. Why should shareholders be supportive of the recapitalisation?

Chairman Stephen Gerlach
The General Meeting on 15 October will give shareholders the opportunity to decide the future of the Company when they vote on the recapitalisation.

The simple fact is that supporting the recapitalisation will deliver shareholders a much better outcome than if it is not approved.

If the proposals were to be rejected by shareholders, the Company would face a very uncertain and very difficult future.

The Company would not have the funds to meet its repayment obligations and accordingly would have to immediately renegotiate with its lenders or secure alternative funding by 31 October 2009. Moreover, proposed asset sales may not proceed in these circumstances, which would mean that the funding requirement is even greater.

It is easy to say these things, but they would be extremely challenging in the limited timeframe available.

On the other hand, approval of the recapitalisation will see Elders emerge a strong, low debt Company with a very promising outlook. Malcolm Jackman and his team have made considerable progress in the refocussing and repositioning of Elders over the last 12 months under the Agenda for Change program.

The refinancing and recapitalisation are the most significant pieces in the turnaround – giving Elders pro-forma net debt of 14 percent assuming they and the expected asset sales complete. The financial and business modelling done, and independently reviewed, as part of the refinance process has confirmed Elders’ expectation of recovering and improving profits and cash flow.

The recapitalisation and refinance are expected to have Elders very soundly set up to deliver on that outlook and deliver improved returns for shareholders.

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You’ve indicated that Elders’ net debt will fall to $178 million, versus $997 million as at the end of December 2008, and gearing will fall to 14 percent, versus 117 percent. Why did debt have to be reduced to this extent?

CEO Malcolm Jackman
There are a number of reasons. First, we recognised that the Company, its shareholders and new investors all wanted a strong and sustainable balance sheet for Elders.

Second we are a company which has large seasonally-driven swings in cash and net debt over the course of the year. As history shows, we are also subject to vagaries of seasonal extremes such as drought and El Nino events.

Third, as we have disclosed in the Offer Prospectus we do have some off-balance sheet debt through securitisation and in relation to our automotive assets.

Finally we wanted to make sure that when we went to the market seeking capital that we did so with a proposition that clearly met Elders' balance sheet needs for the foreseeable future. We wanted the financing position settled once and for all – the last nine months have weighed heavily on our business, shareholders and clients and there's no way we want to go through that process again.

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What are the key features of your new financing package? What are your covenants and how is Elders placed under them?

CEO Malcolm Jackman
The essential features of our new financing structure is that we have gone from a multi-option unsecured facility to a syndicated fully secured term facility with a 3 year duration that expires in 2012. This is supported by ancillary working capital and transactional facilities.

Our existing syndicate of banks remains intact as does our USPP noteholders.

Our financial position will be strengthened beyond that provided by the equity raising through the proceeds of asset sales agreed or in progress and expected. This includes the $370 million anticipated from the sale of Elders Insurance and ITC's Timber processing operations plus the funds expected from the sale of our shareholding in Hi-Fert which is currently subject to a sales process.

We will be subject to three interest and debt covenants which are detailed in the Offer Prospectus and Investor Presentation lodged with the ASX. Our proforma balance sheet is comfortably within the covenants.

Overall, while it has been a protracted and very complex process, the end result is a debt package that sets Elders up well, has the terms which are suitable for the low gearing and strong balance sheet company that Elders will possess as a result of the recapitalisation. I think the new finance package strikes the right balance between the interests of the Company and its lenders and looks like it will serve the interests of all parties well. It's an outcome which both reflects well on both the Company and our lenders given the circumstances.

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Elders has $145.2 million of perpetual, subordinated, convertible, unsecured notes on issue and you've indicated you'll suspend distributions to holders of these "hybrids" for two years. Given the anticipated strength of the balance sheet, and that suspension of the hybrid distribution means you'll also have to suspend dividends on ordinary shares, why was this step necessary?

Chairman Stephen Gerlach
The resolution of a refinance and recapitalisation package that "worked" for shareholders, new investors and financiers required concessions from all parties.

Suspension of hybrid distributions, and as a result, dividends for two years, was necessary to achieve an acceptable combination of earnings, cash and debt management. Essentially we have agreed to manage our capital conservatively for the next few years.

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When do you anticipate Elders will resume dividend payments?

Chairman Stephen Gerlach
Under this package we do not expect to pay a dividend before March 2012.

We are also restricted from paying dividends while hybrid distributions are not being made. The directors intend to place the Company in a position where it can pay dividends to its shareholders as soon as they can, but as we have noted, this is not anticipated in the near term.

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Prospectus forecasts are for Underlying EBIT to increase from $16.8 million in 2009 to $84.2 million in 2010 and underlying profit to shareholders to rise from the loss of $26.9 million to a profit of $55.7 million in 2010. What are the drivers behind this forecast turnaround?

CEO Malcolm Jackman
To a large degree, the improvement is anticipated to result from the removal or abatement of the factors which caused the downturn in 2009.

In our principal business, Rural Services, markets have stabilised, confidence is returning slowly and we have worked through the high priced inventory issues that substantially reduced our margins in 2009. The 2010 results will benefit from a full year of the significant cost reductions achieved during the preceding year.

In Forestry, MIS sales are expected to improve. The market for these products contracted substantially in the wake of the collapse of Great Southern and Timbercorp this year. In 2010 we're anticipating some improvement as investor funds return to the sector and the focus of attention shifts from news about failed business models to successful operators.

Both our Forestry and Rural Services businesses were substantially affected by the negative speculation and uncertainty arising from our refinance process this year. It was a situation which was simply too uncertain for many clients and investors but the recapitalisation and refinancing has put this issue to bed once and for all. We're expecting a bounce back as clients and investors return to the business.

In Automotive, the downturn in build schedules seems to have bottomed. While we are not anticipating material improvement in volume the financial

results will benefit from the fact that we have written down our investment in 35 percent owned associate Thermal Systems to the value of debt associated with the business and accordingly will not be taking up any further losses under equity accounting. The Australian business was EBIT and cash flow positive in 2009, a trend we expect to continue and the China joint venture has turned the corner and is trading positively.

Finally, our Profit to shareholders will benefit from the reduction in interest brought by the recapitalisation. Prospectus forecasts have net interest falling from approximately $51.7 million to $26.7 million in 2010.

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Thank you Stephen and Malcolm.

For more information about Elders, please visit www.elders.com.au or call Don Murchland on (+61 8) 8425 4617

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