Start of Transcript

Operator: Thank you for standing by and welcome to the Nufarm Limited interim results briefing 2019. All participants are in a listen-only mode. There will be a presentation followed by a question and answer session. If you wish to ask a question, you will need to press the star key followed by the number one on your telephone keypad. I would now like to hand the conference over to Mr Mark Keating, General Manager of Investor Relations. Please go ahead.

Mark Keating: Thank you, Lizzie, and good morning, everyone. Welcome to the Nufarm interim results conference call. Earlier this morning we released our half year results to the ASX and a copy of those materials are also available on our corporate website. Just before we do start, let me draw your attention to the disclaimers on slide 2, particularly the section on forward looking statements and the non-IFRS information.

Participating in today's call are Greg Hunt, Nufarm's Managing Director and CEO; Paul Binfield, Nufarm's Chief Financial Officer; and Brent Zacharias, Nufarm's Executive for Nuseed. After the presentation we'll be happy to take questions and at that point I'll hand back to Lizzie to introduce the Q&A process. Now I'll hand you over to Greg.

Greg Hunt: Thank you, Mark, and good morning to everyone joining us for the call. We've announced a half year result today that is in line with earlier guidance. However, it's fair to say that it's been a very challenging period for us.

Underlying EBITDA of $120.9 million is just below the prior year and we reported a statutory net loss of $13.6 million. In recent years, the biggest contributors to our first half results have been North America and Latin America. Both of these regions have again delivered solid growth and market share gains which reflects that our strategy is working. The earnings growth in these regions along with the seed technologies business helped offset weaker performance in Australia and Europe. We're obviously disappointed with the outcomes in Australia and Europe and I will address each of these markets separately.

In Australia, sales and earnings declined as farmers on the east coast dealt with some of the toughest conditions in many years. We reduced our manufacturing output in response to the weaker demand and this led to unrecovered manufacturing overheads that impacted profits.

The issues in Europe are different. It's fair to say that there was a weather impact in the first half; however, supply issues with the vendors of the portfolios that we acquired last year and the impact that this could have in the second half is a bigger issue. I'll have more to say about this later but it's important to emphasise that this challenge is about supply, not demand. These acquisitions are transformational in terms of expanding our product range and the customer relevance in Europe. Our first 12 months of ownership has reinforced that this is a quality portfolio of products that our customers want. The supply challenges are a transitional issue and we are confident that we will deliver full value through financial year 2020.

Our working capital also increased in the half. Let me say firstly that we are a relatively high growth business and we are acutely aware of the need to generate cash to fund our growth. Our net working capital typically peaks around this time of the year and unwinds in the second half. We know the importance of building in some contingency to deal with weather, competitive pressures and unforeseen events. As you know, we raised equity in the first half and that has given us some breathing space.

We've done a lot of analysis on our position and we are comfortable the balance sheet can accommodate the working capital bill, particularly because most of it has come from North America and Latin America as a result of better than expected trading in the first half. This will unwind in the second half and we are actively managing our position. Our banking covenants are also structured to accommodate seasonal swings in the business. We'll continue to take a very conservative approach to managing the balance sheet and that's why the interim dividend has been suspended. We know that this will be a disappointment to some shareholders but we think protecting the balance sheet is the right thing to do for shareholders right now.

We are well prepared for a difficult second half. Managing the sourcing issues in Europe and accelerating the transition of the supply chain to full Nufarm control is our biggest operational priority for the second half. We are well advanced in transferring the product registrations and expect to have full control of the supply chain in time for the autumn selling period.

We are also preparing for a difficult second half in Australia. We are accelerating the next phase of our performance improvement program to remove around $10 million to $15 million of cost from the cost base over the next 12 to 24 months. For the next six months, we'll run the Australian business to optimise cash and that means we'll be making some early calls based on the latest weather outlook and managing our manufacturing aspirations and inventory to avoid the build up that we saw last year.

The unwind of our net working capital and the suspension of the interim dividend will improve cash flow. We are also progressing a review of some non-core assets and that has potential to deliver a small cash benefit in the second half.

Whilst we acknowledge the short-term challenges, Nufarm is ultimately about growth and we're excited about what we will deliver in the medium-term. We have a strong product base that is supporting our growth. We have a strong development pipeline in addition to the European acquisitions that will drive improved margins.

At the same time as we're growing our revenues, we are continuing to invest in the back office to improve our processes and efficiencies. Supply chain improvement, integrated business planning and the cost out in Australia are programs of work that will deliver value over the next 12 to 24 months and help support our growth. And omega-3 is also very close to commercialisation and we believe that over the next few years it will become one of our largest earning growth engines.

I'll now hand over to Paul to take you through the financials.

Paul Binfield: Thank you, Greg.

As Greg mentioned, revenue growth was strong at 8%. There was margin compression caused by increased competition in segments of the Brazilian market and the awful trading conditions in the Australian market.

Underlying EBIT of $39 million includes amortisation associated with the acquired European assets of $27 million. Underlying NPATA, so excluding amortisation associated with the acquisitions, is down $3 million compared with the prior corresponding period.

Net working capital has increased substantially since both January 2018 and year-end. An increase from July to January would be typical for Nufarm but this year due to reasons I will outline shortly, the increase is larger than we've seen in the [past]. A typical July to January ramp would be $200 million to $300 million whereas we saw working capital increase by almost $450 million in the half year period. In the next three slides I'll take you through the detail of how the net working capital has built up but more importantly, how we expect it to unwind in the next six months.

The higher net debt and the poor operating cash flow was a function of the higher net working capital.

Net working capital management remains an important focus for the management teams globally. The successful implementation of our new integrated business planning process or IBP is at the heart of our ability to better manage to sustainably reduce net working capital. We've invested significantly in IBP over the last 18 months both in terms of technology to support the process but also in experienced teams to execute the process. We still have a significant amount of work to do in this area but believe that our investments in a process of actively connecting the demand, supply, products and finance functions of business will pay dividends. We believe the IBP process will enable us to consistently run this business at average net working capital over sales of 35% to 37%.

The higher net working capital has been driven by the regions that have experienced the strongest growth. We have higher receivables in Latin America and North America after a very strong Q2 sales period. We would expect to collect the vast majority of these receivables in the second half. We also have high inventory in North America and Europe in anticipation of a big Q3 trading period and providing we don't get a late start to the season, we would also expect to collect the resulting receivables in the second half as well.

Net working capital in Australia is also higher than expected. We finished in July last year with elevated working capital resulting from the severe drought conditions on the east coast. This is largely inventory and with the continuing drought conditions in this first half we have simply not sold as much as we would have expected.

It is always more difficult to forecast net working capital at a point in time, however given the elevated level in the business we felt that it was important to explain in some detail our assumptions behind the unwind in net working capital. In the next couple of slides, I'll take you through region by region what we expect in relation to this unwind.

By the end of the financial year we expect net working capital in the range of $1.3 billion to $1.4 billion. Firstly, looking at ANZ. The shape of the net working capital profile for ANZ is unusual in that it shows a reduction between July and January and then a further projected reduction in the second half. Due to the drought conditions on the east coast in the second half of last financial year, we ended the year with significant inventory in the channel and in our sheds.

As Greg mentioned, we reduced manufacturing activities at all our Australian sites during the half. Where possible we also transferred raw materials from Australia to other regions. This has helped reduce our inventory levels. However, sales activity in the first half of this financial year has been very slow with summer cropping down a third on the prior year in Australia. Where there have been rain events we've seen buying activity spike which gives us confidence that when the drought breaks channel inventory will rapidly clear. The weak sales activity in the first half has seen a drop in the seasonal inventory and choking of procurement has resulted in payables also falling in the six months to January.

Notwithstanding the uncertainties around the weather outlook we do expect to see sales increase in the second half leading to increased receivables and a significant reduction in inventory. Manufacturing activity however will remain very subdued further contributing to the drop in stock levels and also a fall in payables. We are forecasting net working capital to be back to more normal levels by year-end. However, if the drought continues or worsens then it is likely that we will end the year with higher levels of net working capital in ANZ than we are forecasting here.

The net working capital profile for North America is typical of what we would expect in this region. Strong sales in Q2 have resulted in a significant build of receivables, the primary contributor being the early order program for our turf and ornamental business. This sees a stock channel [unclear] in the November to January period with payment not expected until the second half. These are typically high credit quality customers and we're exposed to minimal credit risk.

With the wet autumn in the US, subsoil moisture levels in key cropping areas is excellent and we expect strong sales to burn down product in Q3. Consequently, we built inventory to meet this anticipated demand. This inventory will be sold into the main planting season March through May and since the terms are generally 60 to 90 days, we expect collections to be largely completed by the end of this financial year.

The downside risk is if we have a late start to the season, that is, the cold weather continues later than expected which pushes sales into April to June and consequently generates elevated levels of receivables at year-end.

Turning to Latin America and Europe. In Brazil, the main selling season is June through to November. The majority of the product going into the two largest crops of soy and corruption and is sold on crop terms which is the industry norm and the collections do not occur until April and June of the following year. Sales were up 18% in Latin America in the half and hence a substantial build in receivables at January.

[Unclear] profitability in Brazil is currently good and credit risk is at lower levels and we do not have major concerns around collections. In the second half, receivables grew significantly as collections rolled in. They are partially offset by sales into the start of the next season which starts to ramp up in the June to July period. We are also planning a non-recourse receivables securitisation program in Brazil in Q3 of approximately $30 million which is a cost-effective way to generate cash and also to mitigate credit risk.

The European summer season started late last year with northern and central Europe then becoming hot and dry. This resulted in sales being pushed from Q3 to Q4 and we typically sell it on longer than average terms. Consequently, we ended last financial year with elevated levels of receivables which have subsequently been collected in the first half of this financial year. Hence the substantial fall in receivables.

The large build of inventory in the first half reflects the slow sales in this period due to the prolonged hot and dry summer combined with a stock build in anticipation of significant second half sales which typically commence in March. In the second half we forecast significant inventory reduction as we sell into the season. Customer terms are generally 60 to 90 days and hence the majority of the receivables will be collected before year-end. If we experience continued supply disruptions this may cause inventory to be at higher than expected levels in July.

In summary, taking the Group as a whole by the end of the financial year we would expect net working capital to be in the range of $1.3 billion to $1.4 billion. In the longer term we remain confidential that average net working capital over sales can sustainably come down to between 35% and 37%.

Turning to operating expenses. Cash SG&AR, that is excluding depreciation and amortisation, has increased in absolute terms driven by the investment that we're making in our European business to support the acquired products. However, the percentage to sales has reduced demonstrating good control.

D&A has increased substantially because of the $27 million of amortisation of the acquired products. It's important to remember that the cash required to keep these products on foot largely relates to maintaining the regulatory dossiers and that would typically average approximately $5 million per annum, materially less than the amortisation that's currently being charged to the P&L. We expect underlying tax expense for the full year to be approximately 32%.

Turning to net debt and interest. Net debt is substantially higher than the prior year due to the high net working capital. This level of leverage is above our target range and we are actively working to manage this down to average leverage across the year of 2 times. I have already outlined our plans regarding net working capital reduction and we're also taking further measures to actively manage our leverage. We are reviewing our portfolio of assets and where our non-core assets that may be worth more to someone else than to

Nufarm, we are investigating divestment. We are also temporarily suspending payment of the dividend.

We are comfortable that the balance sheet can accommodate near-term leverage pressure as working capital unwinds over coming months and our banking covenants are structured to accommodate seasonal swings in our business.

Interest expense is brought in line with the prior year at $44 million and our net FX expense is less than $6 million compared with the $14 million in the prior corresponding period.

Key drivers of a lower net foreign exchange loss and the lower volatility of the Brazilian real since the presidential election in October and also the switch to USD functional currency in Argentina, which has reduced the cost to hedge our FX exposure in this reason and to finance our business.

We expect net financing expenses so that's net interest expense, plus net foreign exchange loss and hedging costs to be approximately $120 million to $130 million for the full year.

Operating cash flow for the half is poor due to the net working capital build that we've discussed in detail. We expect future cash flow improvements to be driven by improved profitability, better net working capital management arising from better execution of the IBP process and also improved cash flow conversion coming from high margin products such as the recently acquired portfolio in Europe.

We expect capital expenditure, PPE and intangibles for the full year to be approximately $200 million. This includes the development of the new manufacturing site in the US which involves a CapEx of approximately $30 million and the acquisition of a new seed treatment product of $10 million. We expect depreciation and amortisation for the full year to be approximately $165 million to $175 million.

I'll now hand you back to Greg who'll take you through the regional results in some more detail.

Greg Hunt: Thanks, Paul. I'll start with the regions that have contributed most significantly to the half year result.

First to Latin America. We saw an improvement in the overall market with increased soybean plantings in Brazil and a return to more normal weather in Argentina. Our revenues are up 18% which reflected both the stronger market and a number of new product introductions. EBITDA increased 5% on the prior period. We are still seeing a very competitive market for glyphosate in this region which has impacted margins, however this is offset to some extent by higher margin differentiated products.

We have a healthy pipeline of new product launches over the next two to three years. The team are particularly excited about a new commercial agreement that we've just signed with Sumitomo for a fungicide mixture to address Asian soybean rust in Brazil. This is one of the largest challenges facing growers in Brazil with the market estimated to be worth around $2 billion and this product is due for launch in 2022 and will be a very important addition to our portfolio.

I can also confirm whilst we're on Brazil that Anvisa the Brazilian regulator confirmed that glyphosate will continue to be registered for use in this market.

To North America. We also delivered very strong earnings growth for the half. Sales were up 19% with the majority of the increase coming from the higher margin turf and ornamental segment. We've lifted EBITDA by 27% in the half and we are continuing the momentum that we have delivered in this business over the past two to three years.

We've strengthened our portfolio with the acquisition of a new proprietary seed treatment product from BASF called Trunemco, which is expected to receive final regulatory approval and be launched later this year.

The investment that we're making in our new Greenville production facility will enable us to better serve our customers in the southern United States whilst also delivering value for us through better logistics costs when it comes online in financial year 2020.

Health Canada also completed its review of glyphosate and re-confirmed the registration for glyphosate use in the Canadian market.

Whilst on glyphosate, there is information coming through this morning on the glyphosate trial against Monsanto in California. What I'd say about glyphosate is that like all crop protection products it is subject to stringent regulatory controls. Glyphosate is the most widely used herbicide in the world and farmers rely on it to protect the health of their crops. It's been used for 40 years and there is a large body of scientific studies that support it is a safe product when used in accordance with label recommendations. We'll continue to monitor this case, however decisions relating to the continued use of glyphosate are ultimately a matter for the regulators.

Turning now to Europe. Weather was an impact on the first half result. Channel inventories were high coming into the year and dry weather in central and northern Europe delayed purchases. Weather conditions have improved and we are starting to see demand pick up. Supply issues are a key concern coming into the second half.

We mentioned Prochloraz at the AGM; however, the situation in relation to that molecule has deteriorated and it is now also impacting additional products. The issue here is that we are operating on transitional supply agreements with the vendor of our acquired portfolio. Their supplier base has had issues with supply mostly out of China as a result of increased environmental controls. Whilst there was some impact on product availability in the first half, we were largely able to manage it and it hasn't been that material.

What is becoming evident now is this issue has the potential to significantly impact our second half result. The majority of our volumes in Europe are sold in the second half and we are progressively being notified of delays and supply chain disruptions. We are continuing to negotiate and mitigate our positions on a case-by-case basis. In some cases we are working on alternative sourcing solutions but these will be most costly and in some cases we may miss sales if delays are realised and the products don't reach us in time for the selling window.

We have estimated the EBITDA impact for the year to be around $30 million with a large proportion of this likely to relate to Prochloraz.

We're addressing the supply issues by expediating the transfer of product registrations and we will have full control of our own supply chain in time for the autumn selling season. We are confident that this will resolve the underlying issues. Around two or three years ago we shifted our procurement team from Melbourne to China to be closer to important suppliers in this region. We undertook an extensive audit of our supplier base and implemented an accreditation program that includes an assessment of supply chain risks such as those that have impacted our supply through the vendor companies. That work has paid dividends and we have had minimal disruptions to our own portfolio supply.

Let me finish on Europe by reiterating that despite the current supply challenges we have no regrets about this acquisition. We have secured quality portfolios, customer demand is strong, and it's a good strategic fit. There is strong brand loyalty and we believe that customers that use an alternative this year will switch back to our products next year. Acetamiprid is providing to be a jewel in the crown of the portfolio. It is outperforming our expectations and has the potential to do even better as we get more registrations. The supply issues are transitional and we have confidence that we will deliver the full business case through financial year 2020.

In Australia we came off a very dry winter with high channel inventory into one of the hottest summers on record. Sales fell by 26% and EBITDA fell to $4 million. We have a large manufacturing footprint and full service offering here in Australia. When industry demand falls to the levels that we've seen in recent times we are structurally exposed to high manufacturing overheads that has impacted profitability.

Our previous earnings guidance for Australia assumed a return to normal weather conditions this year. We know that subsoil moisture conditions are very poor and we will be reducing our manufacturing output in the second half relative to what we produced last year so that we can run inventories down and optimise cash. As a result, we've revised our earnings guidance for Australia down by $30 million for the year and expect EBITDA to be below last year.

In spite of this gloomy near-term outlook Australia remains an important market for us. We are a proud Australian manufacturer and we continue to see value in servicing Australian farmers from an Australian base. We have a very valuable business here that will deliver a lot of upside when we see a return to normal weather patterns.

We've done a lot of work over the past few years to address our fixed cost base through the rationalisation of our manufacturing footprint and the consolidation of the crop care and Nufarm sales and marketing businesses. We believe that we can do more and we're targeting our SG&A costs and rethinking our logistics and procurement processes. The analysis that we've done so far tells us that we can drive a further $10 million to $15 million improvement over the next two years and that will go a long way to getting us back to, at a minimum, a $50 million EBIT business when the weather conditions improve.

One phase of the program has just been announced internally with more than 50 roles removed from the Australian business structure. That phase is focused mostly on SG&A cost reduction and the remainder of the program focused on the supply chain and operations will be delivered over the next 24 months.

With that I'll hand over to Brent to cover the seed technology segment.

Brent Zacharias: Thanks, Greg.

Seed technologies has had an excellent first half particularly within our core seeds business. Although the first half is still a relatively small selling period for seed technologies sales were up 12% to $68.7 million and EBITDA increased by 46% to $15 million. We had a strong contribution from European sunflowers with our pipeline investment generating new sunflower products and registrations that are providing access to top tier markets and margins both in high-yielding oil type products with stacked traits and in proprietary categories of hybrid confection sunflowers with beyond yield applications. We expect strong continued growth in the European sunflower market over the next five to 10 years.

Nuseed's performance in Latin America was also strong driven by new leading products in sorghum, sunflower and canola in the region. Our first full year owning 100% of our Brazilian seed business is very positive with strong share gains and margin growth as a top two sorghum and canola player in the country.

Despite dry conditions in Australia, canola endpoint royalties from grain deliveries increased in the first half. We are experiencing very good demand for canola hybrids in Australia but final sales will depend on adequate planting rains in the next several weeks.

Our seed treatment business continued to strengthen with new products launched in Brazil and additional seed treatment offerings associated with our European portfolio acquisitions.

Assuming adequate rainfall events in Australia in the next several weeks, seed technologies is poised to have a strong growth year with potential to increase the gains established in the first half.

Now moving to omega-3. We have achieved all our key first half milestones necessary to advance this opportunity. Following the United States Department of Agriculture's approval for cultivation last August, regulatory submissions to FDA relating to food and feed approval in the US were also progressed with approvals anticipated well before the upcoming 2019 crop harvest. Regulatory approvals for cultivation, food and feed in Canada are continuing through the review process as are applications already filed in China and Japan with applications to be filed imminently in Europe, Mexico and Korea.

The omega-3 platform has advanced significantly towards commercialisation. We've successfully completed 15,000 acres of field production in 2018 under the highest stewardship protocols and then moved across through commercial-scale crushing, quality assured DHA oil specification verification and export and import logistics. Our proprietary omega-3 oil marketed as Aquaterra for use in aquaculture has been validated as a convenient drop-in feed formulation solution in commercial-scale facilities and is now successfully being used in multiple large-scale feeding trials which will continue over several months.

Interim results further validate the initial results generated in the independent [Nufema] trials reported last year with respect to effective fish oil replacement, growth rates and quality. There has been strong interest in Aquaterra from major feed and salmon farm producers. The aquaculture industry accounts for 65% of global omega-3 fish oil demand with continued strong growth rates.

Nuseed's intellectual property estate has continued to stand with new patent claims secured in financial year 2018 being extended across multiple geographies. Nuseed and partners are now asserting their patent estate against others for infringement in the USA. Court actions regarding the infringements and validity will be heard in the US Federal Court in October 2019.

The global fish oil supply and demand balance continues to develop in line with previous expectations of an expanding deficit in availability. As previously outlined, we estimate that each point of market share of a fish oil deficit in 2028 is expected to generate approximately $8.5 million of EBITDA with the majority of the benefits of scale to our cost of goods being secured incrementally over the first four years of commercialisation. This project remains a major opportunity for our business as we move to commercial status in 2019.

I'll now hand back to Greg.

Greg Hunt: Thanks, Brent.

To the outlook. As I said earlier, we are preparing for a difficult second half in Australia and Europe and we have revised our earnings outlook accordingly. In Australia, we have moved away from our assumption of normal weather conditions in the second half. We are forecasting that the impact of lost margin on sales and under-recovered overheads from lower manufacturing levels will reduce earnings by around $30 million for the full year compared to our previous earnings guidance.

In Europe, we are managing uncertainty around supply-related impacts and we believe that this will impede our availability to meet customer demand for our acquired products during the second half selling period. To the extent we can make alternative sourcing arrangements, there will be additional cost involved and this would also impact on margins. We have estimated the potential earnings impact to be around $30 million less than our previous guidance.

The combined impact is to reduce our original EBITDA estimate for the full year of $500 million to $530 million to $440 million to $470 million. We are also forecasting net working capital to be between $1.3 billion and $1.4 billion at year-end. Paul has already discussed the assumptions and risk factors for that forecast so I won't revisit them now.

Importantly, the anticipated second half unwind in working capital will improve cash flow and bring year-end leverage down to below 3 times.

We've spent most of today talking about what we're doing to managing earnings in the balance sheet for the second half of the year. Before I hand over for questions, I'd like to spend a couple of minutes to talk about what is going to drive shareholder returns in the medium-term.

We have a business that is growing quickly in the regions in which we operate. That growth is being driven by strong commercial teams on the ground but also by improving our product portfolio. We are increasing our sales presence in higher margin products and we have a strong pipeline of new products that will be launched over the next two to three years. These are higher margin products which is great for earnings but it also improves our cash conversion.

At the same time as we are growing our commercial offering, there is a lot that we are doing back of the house. In the next six months, transferring the European supply chain to be under our full control is our main priority. Our supply chain improvement program and the integrated business planning and a renewed focus on our cost base in Australia will also deliver value over the next 12 to 24 months and help support and fund our growth.

The omega-3 canola platform is an exciting opportunity and each milestone we deliver is bringing us closer to realising the step-change in the value of our seeds business. We have a difficult six months ahead of us but I am confident we are focused on the right priorities and well prepared to meet the challenge. The changes that we have made to this business in recent years gives us a strong foundation for profitable growth and improved shareholder returns.

I'll now hand back to the operate to take your questions.

Operator: Thank you. If you wish to ask a question, please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star two. If you are on a speaker phone, please pick up the handset to ask your question.

Your first question comes from Richard Johnson with CLSA. Please go ahead.

Richard Johnson: (CLSA, Analyst) Thanks very much. Paul, thank you for all the detail on working capital. I just wanted to step back from the detail a little bit and just think about what was behind all the progress you made 2016 and 2017 in this regard. Correct me if I remember incorrectly but it was really around the European and the Australian businesses which were heavy manufacturing or heavier manufacturing and we're finding ourselves there again.

I was just wondering whether you could talk around the structural position of those businesses and whether the working capital challenges you find you have in those two regions are more structural than cyclical.

Paul Binfield: I think, Richard, it's fair to say that they are cyclical issues. If I look at ANZ and I look at inventory levels, for example, at 31 Jan in the Australian business this year compared to last year compared to the prior year and essentially, we're looking at about a $200 million increase over that 24-month period, roughly about $100 million between each of those years. That is largely or exclusively a climatic event.

If I look at the situation in Europe, [unclear] having a situation there where we've had significant additional complexity thrown into our supply chain by the introduction of the transitional supply agreements with those three vendors and frankly, Richard, I think they have struggled to meet our needs and our demand simply because their supplier base, their suppliers in principally China have run into some pretty severe environmental issues.

It's really pleasing - I guess it's the silver-lining side. You look at the hard work that we did a number of years ago in terms of looking at those environmental issues in our supplier base. We made a significant decision about three years ago to shift many of those supplier relationships to folk that we thought were simply more reliable and more dependable. Whilst it's cold comfort that has paid dividends in terms of the base Nufarm business in Europe and it's clearly what we're aspiring to in terms of those acquired products.

That process is well underway in terms of shifting those registrations over from the vendors of those portfolios under our full control. The majority of that work will be done by probably April but that will not give us any benefit for the current financial year but will set us up nicely for the autumn selling season going forward.

Richard Johnson: (CLSA, Analyst) Great, that's helpful, thanks. Then when I think about the leverage ratio targets you've got, obviously where you're going to get to at the end of this year is only the first part of the journey. What gives you confidence you can get it back below 2 times just purely through trading given the volatility of your book?

Paul Binfield: I think it's fair to say, Richard, that we are looking at a 2 times multiple because we're seeing other activity that we're doing through the Group. As I said, we've absolutely strengthened our supply chain management process through IBP. We're looking at a far more active review of non-core assets and again the ability to transfer [unclear] on that front as well. The key really here is around process improvement and again I think we have confidence that we can see a line of sight through to an average of 2 times through that cycle.

The issue we have is managing that peak to trough and that's where our focus needs to be in the immediate future.

Richard Johnson: (CLSA, Analyst) Great, thanks. Then just a couple of things on Europe. Can you just clarify whether any pre-selling by the vendor was an issue in the half?

Paul Binfield: I think there was always some elements of that. I think it's fairly minor. I think the primary issue for us really has been the long hot dry summer in north and central Europe which basically resulted in a very slow start for the first half of the financial year in Europe this year.

Richard Johnson: (CLSA, Analyst) Okay, got it. Then the $30 million drop in guidance. Is it as simple as saying that you just take that off the $110 million you were expecting from the acquisitions which would then leave the legacy business roughly unchanged? Is that the right way to think about it?

Paul Binfield: That's the right way to think about it, Richard, yes.

Richard Johnson: (CLSA, Analyst) Okay, perfect. That's it from me. Thanks very much, Paul. Appreciate it.

Paul Binfield: Thanks, Richard.

Operator: Thank you. Your next question comes from Mark Wilson with Deutsche Bank. Please go ahead.

Mark Wilson: (Deutsche Bank, Analyst) Thanks very much, Greg and Paul. Just coming back to Europe, just wondering how extensive these supply issues are. Is it just Prochloraz or has it impacted other active ingredients as well? Just touching upon the seasonal conditions there, Europe looks as though it has broken and maybe contrast that with the US as it currently stands.

Greg Hunt: Thanks, Mark. Certainly, seasonal conditions in Europe are looking more positive.

On the supply issues, I've spent the last two weeks in Europe and we've done a complete review of the supply outlook and I think it's fair to say that the issues are still fluid. It certainly is subject to significant management effort and negotiation but the ultimate impact and conclusion is not yet absolutely clear. Hence the range in the guidance.

What we did manage to do was to secure our requirements for the first half and as I said in the prepared notes, the second half is a greater challenge. Specifically, in relation to Prochloraz the factory that produces that molecule has come back into production but it is well below where we expected those levels to be. It is a global plant, we are on allocation and as production increases, which it will do as we move into the second half, so will our allocation. But the reality is we won't get what we need to meet the demand over the second half but we are comfortable that as we move into the new financial year that we will get our full allocation of Prochloraz.

Mark Wilson: (Deutsche Bank, Analyst) Great, thanks. Paul, just with average net leverage at 3.65 times, granted I know your covenants change throughout the year, how much room do you have under your covenants at that time?

Paul Binfield: Thanks, Mark. The real focus here is the unwind of our working capital. We stepped you through a very logical path to take that working capital and then leverage it down over that timeframe. The shape of the working capital profile that you're seeing this year to be frank is very similar to prior years. The issue is because we're carrying excess inventory principally in ANZ and to a lesser degree in Europe it seems a bit exacerbated at this point.

Again, we have a clear path through to winding that working capital back. Our banks are familiar with our working capital cycle and we're confident we've got their full support.

Mark Wilson: (Deutsche Bank, Analyst) Okay, thank you.

Operator: Thank you. Your next question comes from Daniel Kang with Citigroup. Please go ahead.

Daniel Kang: (Citigroup, Analyst) Good morning, everyone. Just wondering, Greg, if you can just talk about channel inventory levels around the region, particularly in ANZ and Europe. Just wondering if you see a risk to the working capital unwind from the channel inventory levels. That's number one.

The second question I had was in regard to Europe. You've obviously quantified a $30 million impact for the second half and the supply issues. With the initiatives and actions that you have in place do you expect that $30 million to be recovered in FY20? Are you still holding on to the EBITDA guidance for the acquisitions of $110 million to $115 million? Thank you.

Greg Hunt: Let me just tackle the second one first. Yes, we are confident that the contribution from the acquired portfolio through 2020 will deliver on the full balance case. Again, as we said in the address, a large proportion of the $30 million [gap] if I can put it that way, is Prochloraz. We have a clear line of sight as we move into the second half of this calendar year that that production will come back on line. There are a couple of other alternatives that we are investigating as well so I have a high degree of confidence around Prochloraz.

There are a smaller number of other products that in aggregate probably come up to about $10 million or $12 million of that impact and we have actions in place for each of those products and we are confident that once we bring under our control and we're trying to do that as fast as we can, that we are confident we will have under our control prior to the autumn selling season and therefore will deliver on the base case through financial year 2020.

Paul Binfield: In response to your first question, Daniel, in terms of the channel, in terms of ANZ I think it's fair to say that the channel is very full throughout Australia and certainly our sheds, I'd imagine a number of our peers as well, have significant inventory too. That's been very much factored into our expectations as working capital unwinds as well. Also, too, our view around manufacturing. Again, you've heard Greg talk about scaling back the very significant level of manufacturing activity in the second half as well.

In terms of Europe I think it's fair to say that at the end of last financial year so July last year, there probably was excess inventory in the channel, again caused for climatic reasons. We think the majority of that has pretty much worked its way through apart from a few spot areas that we're aware of up in Europe. Principally we're not starting this season with significant channel inventory.

Greg Hunt: I'll come in on the other two. In Latin America we are seeing inventory levels there back to what we would say is more normal. In North America there are elevated inventories and some of that related to the view that tariffs would be implemented so we did see an increase in inventories in North America. We would expect that to move once the season breaks.

Daniel Kang: (Citigroup, Analyst) Thanks gents.

Operator: Thank you. Your next question comes from Niraj Shah with Morgan Stanley. Please go ahead.

Niraj Shah: (Morgan Stanley, Analyst) Hi guys. Just a couple of questions from me. Just firstly to be 100% clear, your earnings guidance obviously reflects a below normal second half in Australia and the supply disruptions in Europe. To what extent is that reflected in the $1.3 billion to $1.4 billion working capital target that you've put out?

Paul Binfield: Yes, so in terms of ANZ there is an expectation that the drought will continue and that's factored into the net working capital forecast going forward. If it worsens, it's hard to see how it can worsen too much more, that might end up with further excess inventory as at 31 July. I think the risk - we've pretty much de-risked the ANZ second half I would hope.

In terms of Europe again as Greg said, this is an unfolding situation in terms of supply disruption. We have a view as to how that will pan out and that's obviously reflected in the $30 million downgrade to the previous guidance. If that were to worsen through circumstances that we can't currently foresee, obviously that may have an impact in terms of our working capital held at the end of the year. Essentially the reduced earnings guidance has been factored into the working capital guidance.

Niraj Shah: (Morgan Stanley, Analyst) Understood. My second question just switching gear, you've obviously spent $40 million in North America across organic growth and also the acquired portfolio. How should we be thinking about the returns on that spend over time?

Greg Hunt: The principal obviously is the Greenville plant development. That's progressing very nicely and we expect that to come on line towards the end of the current financial year so in the next few months. We would expect to start to see benefits coming out of that plant flowing through into FY20. It will take a while to ramp up but we absolutely expect that to be in full swing within 18 months of commissioning.

In terms of the seed treatment product, this has not been commercialised as yet. There will be a product launch for this when the season starts to open up in about - well, this time next year. Again, that has substantial potential albeit it's not been tested yet. That has potential to deliver very high returns albeit low volume and very high margins.

Niraj Shah: (Morgan Stanley, Analyst) Okay and just to clarify on the plant, what's the business case for that one? Is it to meet growing demand or is it a logistical…

Greg Hunt: It's a combination of the two, Niraj. You know that our existing plant's up in Chicago so essentially the northern part of the corn and soy belt. The Greenville plant's obviously in the south and therefore able to tackle the south end of that soy and corn belt but also helps get us active into the cotton growing areas in the south as well. It's part of the logistics plan in terms of just having to move the product around less so significant logistics savings but also too there's some upside on the sales front too simply because of the ability to be more responsive to our customer base in the southern part of the States.

Niraj Shah: (Morgan Stanley, Analyst) Got it. Thank you.

Operator: Thank you. Your next question comes from Philip Pepe with Blue Ocean Equities. Please go ahead.

Philip Pepe: (Blue Ocean Equities, Analyst) Hi guys. Thanks for taking my questions. Some have already been asked and answered. Just quickly on the Australian target of getting back to $50 million EBIT, the last time you guys did that it was a pretty strong winter crop. Are you relying on a peak crop to get back to here or is [the impact] a cost out story to get back to somewhere close to $50 million?

Greg Hunt: It really is. We believe that we could get back to that number in a normal season, whatever a normal season is. If we take the impact from two years ago, reduced sales and reduced margins impacted our business by about $30 million and we had the $10 million impact of the plant closedown. If you look at our sales and margins for the last four or five years prior to the drought last year, they've been relatively consistent. We see no reason why we can't get back there.

The additional $10 million to $15 million of savings that we believe that we will deliver on simply by a bit more freeboard. But it is absolutely still our target to get back to that $50 million, $60 million EBIT contribution from our Australian and New Zealand business.

Philip Pepe: (Blue Ocean Equities, Analyst) Excellent. Thanks. Just with the glyphosate concern last year you mentioned where the weather has broken demand has come back pretty strongly. Has there been some concern amongst your customers that it still might be an issue or have they just shrugged it off and just buying when weather conditions justify it?

Greg Hunt: I'm not sure they're shrugging it off. These things are clearly a concern to farmers because glyphosate is a very difficult product to replace. We saw the issues in Brazil last year and as I mentioned, Anvisa have come out and have continued to support the registration of that product in the Brazil market. We're not seeing any indication from North America that that will change at all.

There continues to be discussion in Europe. It's not a big product for us in Europe but there does continue to be discussion without any specific resolution about the re-registration of glyphosate in the European market. It is fluid, it is changing but ultimately as we said, the decision for the continued use of glyphosate ultimately is a matter for the regulators.

Philip Pepe: (Blue Ocean Equities, Analyst) That's fair enough. Thank you. Last one from me. If I heard correctly earlier, you've extended some credit terms in certain regions. Are bad debts starting to become an issue particularly in Australia or is it too early to tell?

Greg Hunt: No, they're not.

Paul Binfield: They're not. Essentially you see extended credit terms simply because of very competitive environments and essentially a bit of grab for the sales that are out there. We're not in the situation of worsening credit conditions. We don't have concerns on that front at all.

Philip Pepe: (Blue Ocean Equities, Analyst) Great, thank you very much.

Operator: Thank you. Your next question comes from James Ferrier with Wilsons Advisory. Please go ahead.

James Ferrier: (Wilsons Advisory, Analyst) Morning, guys. Thanks for your time. First question's on Latin America and the competition pressure around glyphosate you mentioned. Is that applicable across the whole range of glyphosate products or are you more seeing it on those high load, higher margin products like Crucial?

Greg Hunt: It's really across the board. It impacts us on Crucial and it has impacted on our margins but as a general statement we are seeing more activity in Brazil on glyphosate products across the range.

James Ferrier: (Wilsons Advisory, Analyst) Thanks, Greg. On the working capital, references you made on slide 8 around working capital were all off the base of July 2018. Paul, perhaps with respect to the receivables in LatAm, I think sales there were up 18% year-on-year, what did receivables do year-on-year and therefore have we seen debtor days increase or decrease in that region?

Paul Binfield: I can't tell you off the top of my head, James, about the receivables specifically in LatAm over that timeframe. Certainly, I can tell you though that we're not seeing any significant change in terms in Brazil right now. As I say, we don't have concerns around credit quality. One of the key drives of the growth we're seeing down there is obviously a bit of a response to the US/China trade tariff issue and the potential for increased demand for Brazilian soy into China. Frankly that helps to underwrite the credit quality of the Brazilian soy farmer.

James Ferrier: (Wilsons Advisory, Analyst) Thanks, Paul. On to Europe. You spoke about the fact that you'll see some customers switching to competing products given their raw material availability has not seen disruptions that Nufarm has seen. To what extent does that switching benefit the existing Nufarm business or is the product suite just so different that there really is no benefit to Nufarm's existing European business?

Greg Hunt: Well certainly with the customers that I've spoken to over the last couple of weeks they understand that there are supply chain issues out of China. This is not just a Nufarm impact clearly. Other crop protection supplies have been impacted by these supply issues.

Specifically, in relation to the products that we haven't been able to deliver, there are no substitution products in our current portfolio. They are competitor products that have filled the gap but in the majority of cases, James, they are not of the quality and they are not as effective as the products that we acquired. As long as we get those supply chain issues under control, and I have a high degree of confidence that we can do that, then I'm also very confident certainly the customers that I spoke to will buy those products from Nufarm.

James Ferrier: (Wilsons Advisory, Analyst) On that topic, Greg, if I understood your comment correctly, if you're able to switch all of the supply arrangements across to Nufarm suppliers, if I can call them that, in time for the northern hemisphere autumn selling season you're confident that the supply issues and the $30 million earnings impact you've talked about for this year, you're confident that that will be a non-event in FY20? It all hinges on your ability to internalise the supply registrations, is that correct?

Greg Hunt: That's correct. The only other issue does relate to Prochloraz and the factory that I mentioned earlier. That factory is meeting the regulatory requirements so we again have confidence that we will get supply but there are another couple of potential suppliers that we are investigating that in essence gives us a backup if we do run into some problems with that factory. I'm confident to the degree that we have a number of alternatives and I am also very confident that we will do a much better job of those supply chain issues under our control.

To answer your question specifically I am confident that we will deliver on the full business case in next financial year.

James Ferrier: (Wilsons Advisory, Analyst) Thanks, Greg. Final question from me around omega-3. Obviously, the next important regulatory step is that FDA approval. Let's just assume you get that and you're talking about positive earnings contribution in FY21. When do you expect to be selling material volumes of the product? I'm assuming it's going to be before FY21.

Brent Zacharias: Yes, that's right. Our intentions coming into 2019, the latter part of our financial year 2019 but if you think about the full calendar year, we will plant our first commercial crop here in the next 60, 80 days in the US. Obviously with that being our first commercial crop, we'll start to crush that crop late in calendar year 2019 and be selling that into calendar year 2020. There will be revenues that will start and then our guidance that we have suggested of getting to EBITDA positive for this business as we start to scale up into 2021 is still absolutely our target.

James Ferrier: (Wilsons Advisory, Analyst) Great. Thanks for your time.

Greg Hunt: Thanks, James.

Operator: Thank you. Your next question comes from John Purtell with Macquarie. Please go ahead.

John Purtell: (Macquarie, Analyst) Good morning guys. Just had a few questions. Just to pick up on Prochloraz there, Greg. Are you able to just comment, are those backup potential suppliers, are they China-based or is there a potential local sourcing option in Europe?

Greg Hunt: One of them is China-based and the other which is probably more difficult to achieve but is still an option is European-based. I think it's fair to say, John, that the current supplier as long as we can maintain the commercial terms and we have confidence around delivery we will see no reason to switch. However, we just want to know that we have an alternative.

John Purtell: (Macquarie, Analyst) Thank you. The other products outside of Prochloraz, what specifically are they? Are they also fungicide-related?

Greg Hunt: There's a mix. As I said there's about seven or eight that on their own are relatively small but in aggregate probably add to the $10 million to $12 million and in every case there we are very confident that under our control that we will be able to deliver those products to our customers.

John Purtell: (Macquarie, Analyst) Okay, thank you. Just a question for Paul. Just in terms of working capital and specifically North America, you've obviously given us the breakdown there of expectation for the second half. You flagged some risk around the late start to the season which the season does appear to be already running late. I do note that the main driver of the reduction in working capital is inventory and not receivables. Are you implicitly factoring in already some degree of lateness in terms of where we stand today? I just wanted to understand those risks a bit better.

Paul Binfield: John, the real [build] behind the inventory is an expectation that we're going to have a very strong Q3. If you look at what happened in terms of the US season, they had a particularly wet autumn period that actually reduced the amount of spray. Whilst the US [unclear] result's very strong for the first half, in fact our expectation was it could even be stronger still, we actually had a number of sprays missed towards the end of that period. That means that you've got a huge amount of subsoil moisture bank so actually as they do warm up, we do have expectations it's going to a very strong with multiple sprays.

There is some risk that you end up having a shift of sales going from Q3 to Q4 because the season runs a little bit late and that might result in a few more receivables on the balance sheet at the end of July but that would be a very short-term issue with them being collected quickly in the August/September period. Certainly, our outlook for the US season is very positive.

In terms of timing of the break, John, you're right, it would be nice to see the break already but frankly, if we don't get - we need something really in the next few days so essentially before the end of March. The short-term forecast is actually looking relatively positive so we're not too concerned at this stage.

John Purtell: (Macquarie, Analyst) Thank you and just last question for Brent just on omega-3 again. The timing of the approvals re the FDA and the US and Canada, you're expecting those over the next six months just to be clear?

Brent Zacharias: Yes, that's right. We anticipate having FDA approval prior to crop harvest of the commercial crop we're about to plant and we also anticipate the Canadian approval sometime within calendar year 2019.

John Purtell: (Macquarie, Analyst) Thank you.

Operator: Thank you. Your next question comes from Richard Johnson with CLSA. Please go ahead.

Richard Johnson: (CLSA, Analyst) Thanks very much. Greg, I just wanted to clarify in relation to the change in guidance the extent to which that change is a function of you needing to manage the balance sheet. If that's the case is there a reasonable argument that you should do the same again next year in order to get the debt down as quickly as you can and therefore, we shouldn't necessarily add back some of the impact this year?

Greg Hunt: Richard, it's fair to say that the change in guidance is not being driven off the need to manage the balance sheet. I think if we look at Australia specifically the outlook is increasingly uncertain but probably looking less good than better. We've made the decision that because there is so much inventory already sitting in the channel that we will dramatically line back manufacturing activity at all of our plants such that if we were in fact to get a good season completely coming out of the blue, there is a prospect that in fact we would lift sales and lift profitability.

The decision that we've taken is because we feel that the focus seems to be on optimising cash in the Australian business given the weather outlook and the climatic conditions.

Richard Johnson: (CLSA, Analyst) Great, thanks very much.

Operator: Thank you. Your next question comes from Annabelle Diamond with Credit Suisse. Please go ahead.

I apologise. The next question comes from John Campbell with Avoca Investment Management. Please go ahead.

John Campbell: (Avoca Investment Management, Analyst) G'day guys. Greg, just given that disappointing outcome for the European portfolios in the first full year, with hindsight obviously would there have been a way the transactions could have been structured to mitigate the risk that has eventuated?

Greg Hunt: I guess when we look back now it is very difficult where you get a force majeure event. A large part of the supply issues was a factory that was closed in China and I think that would have been very difficult to predict in due diligence.

John Campbell: (Avoca Investment Management, Analyst) Right, okay. Why the confidence that future supply issues are not going to arise again?

Greg Hunt: Because that specific factory has now been accredited by the authorities and it is operating. Without giving too much detail, what actually happens is that the factory is able to increase its production as it deals with the waste that is produced as part of the production. For every tonne of product that they produce there's a couple of tonnes of waste. Once they start to deal with the waste, the regulators then allow them to increase the base production. That is why over the next six months it's difficult for us to be very clear about how much product that plant will produce but we are confident that as we move into the second half of this calendar year the plant will get back to full production.

John Campbell: (Avoca Investment Management, Analyst) Right, but nonetheless you're developing an alternate supply to be 100% certain that you won't be hit with supply issues in FY20?

Greg Hunt: That's correct.

John Campbell: (Avoca Investment Management, Analyst) Right, okay. Thank you.

Operator: Thank you. Once again, if you wish to ask a question please press star one on your telephone and wait for your name to be announced.

We are showing no further questions at this time. I'll now hand back to Mr Keating for closing remarks.

Mark Keating: Thanks, everybody, on the line for your interest today and we'll be available in the next few days for one-on-one meetings and lunches. By all means, any further remaining questions you can contact myself for follow-up. Thanks, everybody, for your interest again today. Thank you.

End of Transcript