austinengineering LTD

ABN 60 078 480 136

ASX ANNOUNCEMENT

Acquisition of VR Steel South Africa and trading update

Overview

- Orders expected in second half not realised due to continued deferred procurement by major miners and longer than expected contract administration lead times
- Current full year EBITDA now expected to be in the range of $15 – 18 million
- Board believes Company's business model and strategy remains robust and that disappointing current year earnings reflect cyclical factors
- Significant improvement expected in FY15 EBITDA due to contribution from recently announced crane contracts, repair and maintenance contracts and receipt of major orders originally expected in FY14
- Objective of acquisitions strategy unchanged - to acquire quality synergistic businesses in major mining provinces. Current market conditions are presenting opportunities.
- Binding MOU signed to acquire 74.9% of leading non-OEM South African mining attachment business, Van Reenen Steel Pty Ltd (**VR Steel**), subject to satisfactory due diligence and shareholder approval. Minority shareholder is a local South African Black Economic Empowerment (**BEE**) partner.
- Scrip consideration **-** 12,663,876 shares at $1.70 per share, subject to shareholder approval – and $300,000 cash from existing cash resources
- Forecast FY15 EBITDA for VR Steel of [1]$5.8 million and immediately EPS accretive (not including synergistic benefits)

Proposed Acquisition of VR Steel South Africa

The Directors of Austin Engineering Limited are pleased to announce the signing of a binding memorandum of understanding (**MOU**) to acquire 74.9% of the shares in South African mining attachment business, Van Reenen Steel Pty Ltd (**VR Steel**).

The minority shareholder is VR Steel's Black Economic Empowerment (**BEE**) partner, a trust known as the Building Exciting Education Trust, which is chaired by VR Steel principal, Mr John Van Reenen. It is a requirement of the Mining Charter of South Africa, issued under that country's mining development laws, that all suppliers to the South African mining and minerals industry, such as VR Steel, have a BEE partner which has minimum ownership in the supplier of 25% plus one share.

Acquisition rationale

The proposed acquisition is consistent with the Company's long standing stated acquisition strategy and objective to have operations in every major mining region of the globe. This includes China.

It provides:

- a low risk entry into the African mining products market
- exposure to the China market and manufacturing capabilities
- exposure to the US/South American/Indonesian market for draglines, dippers and shovels
- potentially significant opportunities for Austin and VR Steel to cross sell their product to each other's customers in their traditional markets.

It also creates a significant IP rich business and positions the company to take advantage of increased in spending by its mining clients.

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[1] Based ZAR / AUD exchange rate of R9.67 to $1.00

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Managing Director Michael Buckland stated "the combination of Austin Engineering and VR Steel will see a clear market leader on a global basis delivering a range of non-EOM products second to none within the industry. VR Steel has been approached for acquisition in the past by significantly larger companies than Austin but has chosen Austin as its partner going forward due to the synergies and potential of the combined entity. The fact that the principal of VR Steel, Mr Van Reenen, has taken the consideration in shares highlights his and Austin's faith going forward.

About VR Steel

VR Steel started business in 1992 as a specialist steel distributor and service centre. It has since grown to be one of the world's largest non OEM mining attachment design and manufacturing companies, second to Austin Engineering.

VR Steel designs, manufactures and repairs all loading tools and truck bodies with its principal manufacturing and office facilities in Alrode, Gauteng, South Africa and representative sales offices in Australia, China, Chile and the USA.

VR Steel is also the exclusive marketing agent of Taiyuan Heavy Industry Co Ltd's range of heavy mining machinery into the South Africa/North American market. VR Steel also licences its truck body and bucket designs under a commercial arrangement with a Chinese manufacturer to supply one of the leading coal mines in China.

The acquisition offers Austin an ideal entry point principally into the South African mining products market where VR Steel is currently the only mining attachment business with their own design IP and manufacturing facilities. It also provides exposure to the China market for its truck body designs and to the US market for its buckets.

Design and manufacture of customised mining attachments

VR Steel has developed strong relationships with the major multinational mining companies in Southern Africa, which it leverages to sell its existing range of products and imported products and which creates a solid platform for new sales into new mining product markets in the north and west of the African continent.

Their experience in the custom design of mining attachments for open cast mining covers a broad range of commodities from coal to iron ore, copper, platinum and diamond mining.

Repair and maintenance

VR Steel's maintenance division leases a facility from one of its multi-national customers in the Middleburg coal fields region where it offers a unique maintenance contract. These maintenance contracts offer a regular flow of repair work through the facility as well as an opportunity for VR's engineering team to trial and monitor innovative new concepts and modifications to their bucket designs. The facility provides repair and maintenance services to a range of customer in the area for all open cast mining attachments including buckets and truck bodies.

Synergies and benefits of a combined product range

There are excellent global synergy opportunities between VR Steel and Austin.

Both Austin and VR Steel have successful truck body designs. Austin's Westech business has 45 years of experience since it first began designing off highway truck bodies in 1969. The VR Steel truck body design has also been very successful, particularly in hard rock environments in South Africa and Australia.

By adding the VR Steel truck body design to the product range Austin is now able to offer global customers a variety of body design options to best suit their individual requirements. Immediate opportunities also exist for VR Steel to introduce the Westech and JEC body designs into Africa, particularly in the expanding coal market where Westech's new flow control design is outperforming expectations and competition.

In addition, VR Steel provides Austin with experience in a wider range of buckets and shovel dippers and a new product line in equipment jewellery such as rigging chains and attachments manufactured from high strength steel plate. Its extensive knowledge and experience in dragline buckets, dippers and face shovels will complement Austin Engineering's current range of mining attachments and complete the full suite of mining attachment products for the business.

The additional product range acquired from VR Steel will enhance Austin Engineering's product offerings across its global operations. This will increase workflow through Austin's operations increasing recoveries and profits.

There are significant opportunities for VR Steel's products, in Australia, South America, Indonesia and USA in particular, where larger digging tools are more common. A number of Austin facilities across the world already manufacture larger equipment for others and with the introduction of the VR Steel designs; Austin will now be able to sell a more competitive product direct to the end user on the back of VR Steel's knowledge and experience as a world leader in this product category.

Benefits of VR Steel designs

VR Steel's equipment offer a unique design in that they are fully fabricated from plate materials and do not require large castings which are typical of most OEM designs. The fabricated designs reduce overall weight offering improved digging performance as well as significantly improved manufacturing lead times and reduced cost.

VR Steel's innovative tapered bucket design also improves filling time and reduces weight by eliminating the need for a spreader bar and associated rigging. The industry feedback on the tapered bucket design has been very positive.

Engineering capability

Both Austin and VR Steel differentiate themselves in the mining attachment market through their custom engineering capabilities. VR Steel has a highly qualified and experienced engineering team using the latest software for engineering design and analysis. Their software is compatible with Austin's software which allows for seamless sharing and integration of engineering IP and the opportunity to share engineering resources.

Exposure to China market and manufacturing capability

VR Steel has an exclusive license to sell TZ heavy equipment into the South African market which gives significant cost benefits to the end user. To date they have been successful with orders for a major African miner and expect a further order shortly. VR Steel will also provide accessory equipment for each of the machines sold as well as maintenance services. This form of revenue contributes excellent returns and is expected to increase over the years.

VR Steel also licences its truck body and bucket designs to a Chinese manufacturer under a commercial arrangement to supply one of the leading coal mines in China that has a fleet of over 250 trucks and numerous digging equipment. The agreement with the manufacturing partner is based on VR providing design packages and technical support in return for a share of the net profits earned on all equipment manufactured through the facility. The manufacturing partner owns the workshop facility and provides all of the labour, management, administration, materials and consumables.

There is potential for additional sales of VR Steel products to new customers in the Chinese domestic mining product market and also for sales of the existing Austin product range.

The manufacturing facility of VR Steel's manufacturing partner could potentially also manufacture truck bodies for supply into the Australian market.

Exposure to US market for draglines, dippers and face shovels

VR Steel LLC is a relatively new entity which has been established to grow the dragline, dipper and face shovel business in the US and Canada. The US business has had some excellent success in a fairly short space of time with the receipt of 5 new dragline bucket orders to be completed in FY15.

Proposed acquisition terms

- Completion conditional on Austin shareholder approval, due diligence satisfactory to Austin, South African regulatory approvals and shareholders agreement with minority BEE partner
- Forecast FY15 EBITDA of [1] $5.8 million and immediately EPS accretive (excluding synergy benefits)
- Written down value of total assets of [1] AUD$21m
- Agreed purchase price of AUD$21.8m for 74.9 % of VR Steel and controlled entities, based on multiple of 5.0 times forecast FY15 EBITDA of [2]AUD$5.8m. The forecast FY15 EBITDA is attributable to VR Steels existing ordinary business revenue, together with incremental revenue from the distribution of Chinese equipment into Southern Africa and US dragline sales. A large part of the forecasted earnings is supported by existing orders.

[1] Based ZAR / AUD$ exchange rate of R9.67 to $1.00

- Funded by issue of 12,663,876 Austin Engineering Ltd shares at issue price of $1.70, plus A$300,000 cash
- Consideration shares to be escrowed
- Austin has the right to place/buyback shares becoming available for sale
- The Managing Director of VR Steel, Mr John Van Reenen, will continue in his current capacity for a minimum of 3 years and in each financial year from FY15 – FY17, will be entitled to receive a bonus equal to the amount by which VR Steel EBIT exceeds [1] $5.3 million. Austin will receive and retain the benefit of revenue synergies from the sale of VR Steel equipment or products in existing Austin markets.
- Land and buildings are not included and will be leased. An option to acquire the land is being negotiated
- Completion is expected by the end of July

Industry Consolidation

In addition to VR Steel, the company can confirm that it has been in discussions with two other companies that operate in the mining equipment market.

Commenting on the discussions Managing Director Michael Buckland stated:

"We have seen the need/opportunity for consolidation of the mining equipment/services industry over the last 12 months during a time in which the mining companies have been delaying significant amounts of expenditure, despite increases in production levels.

We consider the current cycle to be at the bottom, and the right time to make strategic acquisitions/mergers, to position Austin as the dominant global player as the market picks up. The companies that we are in discussions with are very highly respected companies in the mining equipment/services market and have specialised IP and products which, when added to Austin's existing range, provides the market with an unparalleled range/choice of customised equipment.

The principal aim of these acquisitions will be to achieve significant synergies and efficiencies. "

Due diligence is underway on the other two potential targets. The Company expects that if discussions prove to be successful, further announcements will be made over the next two months. Investors and shareholders should be aware however that there no assurance that any discussions with be successful or that any transaction will eventuate from the current or any future discussions. Conjecture about the outcome of these discussions or a resulting transaction is premature.

Revised earnings guidance

The earnings guidance provided by the Company was based on expected orders. These have not been received in the expected timeframes due to continued deferred procurement by major miners and longer than expected contract administration lead times,

As a result, the Directors have been required to review their assumptions and, based on the revised assumptions, the Company provides revised guidance for FY14 of $15 - 18 million EBITDA.

While there can be no denying that this is a very disappointing and unexpected result, the Board continues to believe that the overall strategy remains fundamentally correct. We are established in the major mining centres of the world, with a reliable and trusted product range and have not seen a diminution of our market share. We continue to see increasing use of customised design equipment over standard OEM equipment. This encourages Austin to believe that the current downturn is due to cyclical factors. It is about timing; while the miners continue to dig they require our product. That the experienced owners of VR Steel are willing to take almost all scrip consideration represents some independent validation of the Company's view.

Many of Austin's operations are based on 2 - 4 week turnover of orders i.e. Cor Cooling (6 operations), Austbore, Pilbara Hire, Calama maintenance and the two crane operations in Chile. Orders of this nature can contribute $2 - 3 million of EBITDA per month. The larger Austin operations generally need 4 - 6 weeks for order processing and orders of this type can contribute $5 million of EBITDA per month. The company was of the view that if the expected combination of smaller and major orders were received, the Company was capable of producing a result not materially lower than earlier guidance.

Amongst the major projects that the company anticipated, but are still delayed, are the following:

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- Vale – The Company has been waiting on the Vale corporate office to complete registration of part numbers against Austin products in Vale purchasing systems. The delay has been caused by changes within the Vale organisation handling the Austin contract and a major transition to a new enterprise management system. Vale has assured Austin that the first order will be issued before the end of June as the new system begins processing.

  The Vale contract Is a 3 year supply agreement and although the precise value of this contact is not predetermined, Vale has informed the company that the previous contract was for a total of USD 200 million and that the current contract will be split between two companies, with Austin receiving the larger part of the contract. Vale has confirmed that no orders have been placed with either Austin or the other supplier due to the above issues.

- Collahausi – A very significant contract for the supply of all new and replacement truck bodies and the maintenance of the entire truck body fleet. Site services will also be included. Collahausi is Chile's second largest Copper mine and is planning a doubling of the mine over the next 2-5 years. The Company believes it will be awarded this contract soon but planning and administrative issues are delaying the finalisation of the agreement. The length of the contract will be a minimum of 3 to a maximum of 9 years

- Codelco –Chile's major client deferred all tray replacement in March (usually 30-50 trays) until 14/15 financial year

- East Coast – Two major tenders have been submitted and subsequently negotiated over the last 6 months. Contract awards are expected in the next month

- Indonesia – Awaiting a major contract for a new mine. Austin believes it is likely to be the preferred supplier of over 20 trays

- Colombia – Awaiting awards of equipment for the Cobre Panama project ($5 billion mine)

- West Coast – Major clients of our operations had initially deferred scheduled production for one year, this has now been deferred a further 6 months. The West Australian operations have seen the biggest decline to prior periods

A number of new 3 year contracts have been announced but these will have minimal impact on second half FY14 numbers as contributions will only impact 2 - 3 months in FY14. These contracts will have a full 12 month impact on FY15 and beyond.

Commenting on the results Managing Director Michael Buckland stated "despite a good start to the second half and expectations of some major contracts the miners have continued to delay purchases of all equipment. This has now continued for 12 months despite maintaining or increasing production levels. Whilst equipment can be maintained for a period beyond its normal life, the costs increase rapidly making it uneconomical to keep persevering with repairs. We have seen an increase in the number of enquiries but as yet these have not been converted into orders.

Based on its recently announced multi-year contracts and the expected award of new contracts, Austin is expecting to see a significant turnaround in FY15 compared with the forecast FY14 result, especially from January 15 onwards (excluding the contribution from VR Steel and other potential acquisitions).

Bank facilities

The reduced earnings may potentially result in technical breaches of Austin's banking facilities. Austin is working constructively with its senior lenders to address these issues proactively and the senior lenders are supportive of the Company.

The Company believes that it will not need to raise additional capital to meet its debt service requirements.

For further information on the above, please contact Managing Director Michael Buckland, or Chief Financial Officer Scott Richardson, on +61 7 3271 2622.