18 June 2010

Chairman's presentation at AGM

1. Welcome slide

It is good to see you all here at North Harbour Stadium where we also met last year. I recognise a few familiar faces. I know that some of you have been shareholders in Wellington and attending our AGMs for some time.

I know that none of you will be surprised when I begin by saying that the last 18 months of global recession have been amongst the most challenging times that businesses have faced in many years. Shortly I will take you through what this has meant for Wellington in more detail. But I want to note first that in terms of the company's own history we have been able to weather the worst of this storm. And, more importantly, the year we are reporting on today also marked a real turning point for our company.

Before I go through the company performance, however, let me introduce you to the members of your Board here today. I will ask each to stand briefly while I introduce them. Ross Green, who has been Wellington's CEO since 1998. Shawn Beck, a director since 1994, who is also an Executive Director of Pencarrow Private Equity. Dr Ray Thomson, a director of several companies, including Industrial Research Limited and Manuka Health New Zealand, and a director at Wellington since 1988. Simon Mander, who is General Manager of Rapak, a specialist packaging export business, and has been a director since 2004. And, joining us most recently, Tony Nowell. Tony is Deputy Chair of Leadership New Zealand, formerly the Chief Executive of Zespri, Managing Director of Griffins Foods, and before that a senior Vice President of the Sara Lee Group in Asia. Tony brings us extensive senior management experience in global organizations, with a particular focus on Asia. He joined the Board in March.

Also with us today are Steven Hodgson, our Vice-President Corporate Services, formerly with Macquarie New Zealand, our Company Secretary, Ron Jackson, Wellington's General Counsel, Paul Gillard, and Paul Clark, audit partner with PriceWaterhouseCoopers.

We have a diverse and experienced Board and management team. On a personal note, I'd like to thank the board members for the strong contribution they have made, and for their support to me in my role as chair, during a defining year for the company.

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2. Agenda…

Today I plan to go through where we have been over the last 18 months or so and where we see the company going in the coming years. There have been some set-backs and delays, particularly in taking up opportunities as quickly as we would have liked. However, what I want you to take away from this is that we have now reached a point where the company is firmly established on a strong growth path. This is shown in rising sales, improving margins and declining losses. This growth path will lead to breakeven and to profitability.

3. Overview…

The key objective we have always had at Wellington is simply to build a highly profitable business, by being leaders in designing, making and selling efficient electric motors. Getting to this point has taken some time - but over the last year sales revenue rose by 54% to $22.4 million, up from $14.5 million in 2008. We built, sold and delivered over 600,000 motors last year – all in the two core areas of Commercial Refrigeration and Ventilation that are our key focus areas. Good sales growth is set to continue.

This growth was recorded despite the difficult conditions in 2009, which caused many customers to delay placing orders and understandably adopt a "wait and see" approach. However, 2009 is behind us and we have come out of it with Wellington positioned for future growth.

Customer demand is strong for Wellington's commercial refrigeration products. These are used in efficient fans for supermarket, convenience store and vending machine refrigerators, and we have concentrated on satisfying this demand as it offers us the best and most immediate returns. In 2009, and despite the recession, our sales of motors for commercial refrigeration rose 105%, while ventilation sales remained largely flat.

Today we are also better positioned for profitability because of actions taken to make Wellington an improved and stronger company. Some good savings in operating expenses began to come through towards the end of 2009. We expect to see further significant savings in operating expenses in the 2010 results.

To ensure we continue to be well funded, last year we raised $22 million. Significantly, Australasia's largest ethical fund manager, Hunter Hall Investment Management Limited, who have been shareholders in Wellington since 2004, moved to a shareholding of a little over 30% in November. This was a real vote of confidence in our company.

Six new motors, three for refrigeration and three for ventilation, were completed and brought to market. These motors embody proprietary Wellington technology and software in designs that have built on customer feedback. They are on sale now, with no further costs to be incurred in their development. The focus for these new products is ease of adoption and reliable performance - the two crucial factors for getting energy-saving motors actually out into the market and reducing energy bills for our customers – which in turn improves our sales.

So, the upshot is that 2009 was both a tough year financially and yet a positive watershed year for our future business growth.

4. Performance highlights

You will see these gains I just mentioned summarised on the Performance Highlights slide. This also shows total sales were up 54%, driven by the strong growth in refrigeration sales, as I've mentioned. And you can also see on the slide some of the drivers for this improved performance.

Our business with Imbera, part of the Coca-Cola system, has grown. We reorganised our manufacturing plants in Singapore and China to drive some good savings as production volumes increased.

The revenue graph shows how sales have grown over the last five years at a compound rate of 50%.

As an indication of the scale we had achieved by the end of last year, during 2009 we made 13,000 motors a week and sold one every minute. I know that you will be interested to hear that, from next week, we begin building over 20,000 ECR motors per week in response to demand.

Within the overall commercial refrigeration sector our biggest success has been with bottle coolers for point of sale display of soft drinks. Demand continued to grow despite the difficult overall conditions last year. In fact, we believe we are the volume leader in supplying new-generation refrigeration motors for bottle coolers.

This puts us in good shape to build on strengthening sales opportunities.

5. Financial results

You can see from this slide on our financial results that our sales were well up, but the other financial metrics for the business were disappointing.

Some of our customers cancelled or delayed orders. We had to fight hard to grow sales during the global recession, providing high levels of sales support and keen pricing. At the same time the business incurred substantial costs for product development and from the reorganisation of manufacturing and logistics. Despite the effects of the global recession, some input costs rose as suppliers reduced component production levels too aggressively.

Introduction of our new products that I mentioned previously was delayed, adversely affecting our sales and margins.

Some of these actions and events affected Wellington's reported gross margin, which was below where we want it to be and where it will be as our new products work their way through the supply chain and into the market. Improved gross margin is a key financial target for 2010.

On the other side of the ledger, growth in operating costs was held to a low level in 2009. Some of the reductions which took effect in the second half of the year will flow through fully into results in 2010.

For the same reasons I mentioned earlier, our EBITDA loss for 2009 of NZ$12.7m was worse than expected. We focus on EBITDA as this is the best reflection of the operating cash flow of the business, before taking account of working capital and capital expenditure requirements. Getting to EBITDA breakeven is the key target for Wellington.

Clearly the overall financial results for the past year are not acceptable to me, the rest of the Board, or the management team. I will be talking a little later about how the current year is going. But I can assure shareholders that the Board and management are intent on a rapid improvement in results.

6. Growing through major customer partnerships…

The sector we are selling our motors in is historically and understandably risk-averse. New motors are a strategic purchase. However, once a customer commits to moving to new motors they will usually repeat the initial order – often for several hundred thousand units – every year. Most of the customers we have targeted and won are large international organisations with literally millions of commercial refrigerators in service. This equipment is being progressively updated for improved efficiency. Demand levels are not expected to peak for a number of years, and routine replacements and future upgrades for these large fleets should ensure a good level of demand longer term.

Winning business on that scale takes time. But we are starting to see the benefits now of many years work to establish strong and growing partnerships with some of the world's largest users of small motors.

These include Imbera, part of Coca-Cola FEMSA, the world's No 2 bottler of Coca-Cola, along with other major US and European suppliers of commercial refrigeration to supermarkets and for bottle coolers and, in Europe, one of the world's leading suppliers of ventilation motors and fans.

7. We are in a growing market…

[8.Our motors are used here (Commentary covers both slide 7 and slide 8 on applications)]

The sector we are selling into is itself growing as customers, consumers and government authorities all move towards more efficient power-use options. In fact, we are only at the beginning of an industry-wide shift that is being driven by new energy imperatives. I know many of you are familiar with the difference Wellington motors are making in saving power. But this is really such a central part of where our growth is coming from that I am going to briefly review with you how this helps drive growth for us.

The current 'incumbent' technology in our markets – the 'AC Induction' motor - was invented in 1893. It has not changed appreciably in the last 50 years and is a simple, electrical-mechanical product. While it has been a successful workhorse through the 20th century it is now well past its use-by date. The main reason is that, in the motor sizes that we target, an induction motor is only about 15-20% efficient – that is, more than 80% of the power it uses is wasted as heat and noise.

>>>>>>>>>>Flow to slide 8

By contrast, new generation electronically commutated (EC) motors, like Wellington's, use only one-third the power to do the same job.

The commercial refrigeration market, and especially bottle coolers within that as I've mentioned, appears to be at the beginning of the major switch-over to EC motors, with many larger customers only now taking their first full volume shipments of these products. This is one of the first major market segments to make the move to EC motors, and the first to do so with our motors.

We are seeing increasing levels of commitment from major companies to change to high-efficiency motors. Coca-Cola, for example, has decided to move to using 100% high-efficiency motors in the Mexican market and this is one driver of our strong current demand position in Mexico, and a major source of the new opportunities that we have throughout Latin America.

This is significant in itself. Mexico alone is a market of 110 million people, and as an added indicator of the scale of the opportunity in Mexico we believe that the number of bottle coolers per head of population there is around three times the number in the United States. However, we also believe that the Mexican market is being used as a "trial run" for a move to high efficiency worldwide by Coca-Cola, as supported by recent public statements by them.

The overall process of change is being helped by regulatory agencies such as the US Department of Energy. In Europe, the EU has set increasingly tough efficiency targets for all new motors sold between now and 2017. FIDE, Mexico's Department of Energy, is leading the way in Latin America and we understand it is now preparing to invest several hundred million dollars in energy efficiency initiatives.

In meeting this growing demand Wellington's motors have some important advantages, particularly as regards ease of adoption, as I mentioned earlier.

9. Focus on motors for commercial refrigeration…

The rapid growth in sales of motors for use in commercial refrigeration has been the outstanding success for Wellington in the last two years. With sales up 105% last year and growing, this has become Wellington's leading business.

As I mentioned earlier, the motors we sell in this sector are mainly used to drive fans for the refrigerated display cases you see in supermarkets, for bottle coolers and for vending machines.

Our most rapid growth has been in North and Central America, but now we are also seeing sales acceleration beginning in Europe.

You'll see on the slide there a comment from Juan Carlos Christy, Imbera's Marketing Manager. I think this sums up well how our customers see the benefits that Wellington brings in helping cut energy costs and deliver their product at competitive prices.

10. Building our ventilation business

While refrigeration will remain our key focus for driving profitably in the near future, we also had a good year in establishing the platform that will see our ventilation business return to growth after a period of flat sales. As mentioned in the Annual Report, our partner, to whom we supply Wellington motors on an OEM basis, is Ziehl-Abegg AG of Germany. They are a major supplier of ventilation motors and fans worldwide, and in several areas of the high performance industrial fan market they are the world leader.

Following some solid groundwork and a development programme that spanned three years it was good to see the first volume sales of ventilation motors through Ziehl-Abegg begin earlier this year; these products went to drive the air filters in an advanced materials facility in China.

However, it is important to note that our ventilation motor sales today are largely denominated in Euros, so that the recent decline in the Euro has had a negative impact on actual and projected margins. Therefore price discussions with customers are currently underway; inevitably, these are delicate discussions and the outcome of these will have a material impact on the near- and medium-term performance of Wellington's ventilation business.

11. R&D completed in 2009

To keep growing and keep ahead of the competition we have to ensure our products remain at the forefront of the sector. At the moment, however, we are in the position of having completed significant development programmes in the last year - which we can now seek more immediate financial returns from.

Our engineering and manufacturing teams registered a major achievement in completing development of our two new product ranges, the ECR 85/95 and ECR One motors in late 2009, with both entering production in recent months.

Earlier this week the important approval from Underwriters Laboratories was received for the ECR85/95 motor, enabling sales in the United States. The ECR One motor received approval last month.

The 85/95 series has three times the power of today's ECR motors, which means it is opening up new markets for us in chill rooms and medium size cold storage facilities in supermarkets. At the other end of the scale, the new ECR One series is optimised for smaller refrigerated cabinets, stand-alone freezers and automatic vending machines.

These motors have been on sale over the last few months and are meeting with excellent customer response, including a good level of pre-orders for the first time. Pursuant to the distribution agreement announced recently, we have received our first small orders from the A O Smith organization in the United States for these products.

While the process of product development and research is on-going – to preserve and extend our market lead - we are confident that these new motors will enable us to maintain our leadership position for some time. This means we can grow without the need for the concentrated development efforts, and associated R&D spending, of the recent past.

12. Rationalised manufacturing and logistics

At the same time as we advanced our new motors we also completed a reorganisation of our manufacturing plants in Singapore and China in tandem with growth in production levels. This is helping generate some good savings.

We also concluded a new global logistics contract with a single supplier to speed up delivery to the international markets we serve – again with some useful cost savings.

By year’s end we had reduced inventory by 30%. We also achieved substantial reductions in operating expenditure as the business was realigned to support the focus areas of commercial refrigeration and ventilation. Most of the ‘heavy lifting’ associated with readying our new products for market was completed, and this will help our performance as the new products reach customers and the supply chain stabilizes around them. We expect most of these gains to show up in our 2010 figures.

13. Outlook for 2010…

We are 5 months into 2010 and already we are seeing a more positive picture than we did last year.

The most obvious difference is the very strong demand, particularly for commercial refrigeration motors. The switch to EC appears to be gathering pace and we are seen as the market leader.

This position means that we are asked to bid on most of the major opportunities that come available in the industry. As a result our sales efficiency is rising and we are seeing less time required before new customers start using our products in volume.

The new range of ventilation motors for Ziehl-Abegg has also seen better than expected orders in the first months of this year.

However, the overall environment is not without its challenges.
The sharp bounce back in global demand for manufactured products, as global recessionary sentiments ease, has led to a constrained supply situation for electronic components. Electronic components are used in computers, cell phones, television sets – and also in EC motors, like Wellington's. This has had a significant impact on Wellington's ability to supply all the demand it is seeing. Our competitors appear to be similarly affected.

While this situation is easing somewhat at the moment, it has meant that over the first half of the financial year, our sales growth has been less than would have been possible if we had been able to access all the components we wanted.

As I mentioned earlier, our efforts to secure component supplies have met with a measure of success and, from next week, our production levels are lifting to more closely match current demand.

A further complication has been the recent fall in the Euro/US$ exchange rate. We have some sales – particularly of ventilation motors – denominated in Euros, and the decline in the exchange rate reduces the margins on these sales in the short term, given that our products are manufactured in Asia with costs denominated in US$. We also have some foreign exchange cover, but this is obviously only a temporary and partial solution. Over time this can be remedied, as prices can be raised; but customers never welcome price increases.

14. Outlook for 2010

So where does this leave us overall?

Even with the constrained supply situation in the first half of the year, we will still see solid revenue growth – particularly in US$ terms. Sales growth in New Zealand dollars will be blunted by the higher exchange rate. As the supply constraint eases in the second half of the year, and some of our new customers start to take delivery of more substantial volumes, we are expecting a further acceleration in sales growth.

Most significantly, in the first four months of the year, we have also seen a welcome lift in gross margin compared to the low levels of last year. Margins are still below satisfactory levels and below where they will be, but the trend is encouraging.

I have commented already on the reductions in operating expenditure that took place in 2009 and which are flowing through into the current financial year. The combination of this reduction in operating expenses, together with the improvement in gross margins, will result in substantial reductions in our EBITDA loss over the course of the year.

A lot of shareholders ask us if we will need to raise more capital.

Our cash burn is forecast to reduce significantly in the second half of the year as losses diminish and working capital investment slows. We monitor cash consumption and our projected cash balance regularly – and the question of how much cash is 'enough' is kept under constant review.

The Directors' will continue to seek to take Wellington to profitability without further equity capital raising. The Company is currently forecasting that this will be achieved but there is a low level of buffer for unexpected events.

15. Summary…

So, to summarise where we are today, we believe we are the market leader in the rapidly growing business of high efficiency commercial refrigeration motors. We have established some excellent and strategically important customer relationships and our product line is unequalled by any competitor.

We have re-launched our ventilation motor business via our partnership with Ziehl-Abegg and the products developed through that cooperation are being well received in the market.

Our profit position is, frankly speaking, far from where we need it to be and we are not satisfied with it. Nevertheless, the business is trending in the direction we need: we are seeing strong sales growth, improving margins and reducing losses. Even though every year will throw up its own new challenges the track to profitability for Wellington is now very clear. Our products are at the forefront of the market, and our order flow is strong and growing.

It is taking considerable time – longer than probably all of us here today wanted or expected – but I am satisfied that we are well positioned to become a profitable company that is the leader in our segment of energy efficient motors.

Earlier, I recorded my thanks to the Board. I would also like to take this opportunity to thank our senior management team and our staff, several of whom are also here today. The dedication, talent and commitment that they have shown are major factors in getting the company to the good position we are in today.

Thank you.

Before we move on to the business of the meeting I would like to open the floor to any questions.

Ends