



Orbital Half Year Report

31 December 2002



ORBITAL
ENGINE CORPORATION LIMITED

ABN 32 009 344 058

Highlights

- After tax result of \$2.9 million loss compared with \$20.7 million loss for corresponding period last year.
- Revenue of \$29.9 million, 29% up on corresponding period last year.
- Net cash out flow for the half-year of \$7.1 million, including non-recurring amounts of \$5.1 million.
- Overheads down by 28% compared to corresponding period last year.
- Synerject profitable, \$0.7 million profit compared to \$2.7 million loss for corresponding period last year.
- Synerject loan restructure completed with Siemens retaining 50% equity.
- Manufacturing alliance finalised with UCAL as a precursor to entering the Indian motorcycle market.
- New York Stock Exchange listing retained.

Summary

Orbital Engine Corporation incurred an after tax loss for the half-year ended 31 December 2002 of \$2.9 million compared to a \$20.7 million loss in the corresponding period last year. The results are in line with expectations that were foreshadowed in an announcement released to the Australian Stock Exchange on 20 December 2002.

The \$17.8 million improvement in its first half result demonstrates that the Company is benefiting from the initiatives taken to improve operating performance as well as the resolution of several long-standing issues. These initiatives are intended to put the Company in a better position financially and establish long-term sustainability.

The Company has been restructured and resized to ensure the conservation of cash whilst still providing customers with the necessary level of support to enable growth in revenue.

The organisation is now focused on day-to-day sales activity and at December 31 was 30% ahead of last year in the area of fee for service engineering activity.

One significant development during the period as announced on 10 January 2003, was the restructure and refinancing of Synerject, Orbital's joint venture with Siemens VDO Automotive. Siemens VDO's continued commitment to Synerject removes the uncertainty that had existed over their future involvement in the venture, as well as addressing the market's concern over on-going finance.

As a result of the restructure, which involves the addition of Orbital's marine and recreational systems business and the Siemens VDO non-automotive systems business, Synerject will enjoy improved sales revenue and enhanced growth prospects. Synerject has already provided a positive profit contribution to Orbital in the first half and the expanded operations should enhance this contribution in the second half. As a consequence of this restructure, Orbital will no longer consolidate the marine and recreational system sales, however engineering fees, royalties and licence income from this business segment will be retained by Orbital and there will be minimal impact on the bottom line.

Synerject is uniquely positioned as a non-automotive, engine management supply company, with franchises from both Orbital and Siemens VDO for fuel injection and engine management systems.

Synerject's business is now well established in the motorcycle, marine and recreational sectors and with this wider customer and product base further broadens the revenue base from which Orbital benefits as co-owner. In the motorcycle sector, for example, Synerject is able to offer either Orbital direct fuel injection technology for two and four stroke applications as well as Siemens VDO's port fuel injection systems for four stroke applications.

Orbital recently announced arrangements with the Indian parts and systems manufacturer UCAL, further demonstrating its unique position in motorcycle emission control technology. The UCAL arrangements provide a springboard to enter the large Indian motor scooter market.

Automotive

Orbital has a number of active funded programs from automotive OEMs, exploring the use of Orbital's technology in future products. Programs are ongoing both within Orbital facilities and those of customers. In addition to these current programs, several manufacturers have carried out extensive evaluations of the Orbital technology applied to their development engines. These evaluations place the technology in a position for use in future serial production.

The improvement in fuel consumption available by the use of Orbital's air assisted direct fuel injection system continues to be a key reason for manufacturer interest. Orbital automotive customers, including DaimlerChrysler and General Motors, continue to acknowledge the merits of the technology. The European manufacturers accord to reduce vehicle fuel consumption to 140g/km of CO₂ by 2008, should prove to be a major driver of technology improvements.

In addition to work specifically directed to the application of Orbital technology, Orbital is securing significant engineering contracts in the automotive arena. One such contract is for a clean sheet design for a new cylinder head and manifold for use on an existing cylinder block, creating an almost new four stroke automotive engine. Another involves the evaluation of the impact of petrol containing 20% ethanol on the performance and reliability of cars for Environment Australia. These activities broaden Orbital's revenue base and improve the absorption of overheads, whilst allowing the use of key expertise in fee earning activity.

Motorcycle

During the next European summer, up to eight different models of motor scooters should be on sale using Orbital's direct fuel injection system. Activity on further new models for introduction continues within Aprilia, Peugeot and Piaggio. After initial product launches of direct injected scooters, Peugeot Motorcycles unveiled their new "JetForce" scooters at the International Motorcycle Exhibition held in Milan in September 2002. These scooters introduce innovative chassis design and styling and are on schedule for release during the 2003 European summer. The first available models within this range will feature the new liquid cooled direct injected 50 cc Peugeot Motorcycle engine.

There is growing interest in Asia for direct injection for two stroke engines due to pending emission standards in these growth markets. For example, the emission levels proposed for India in 2005 will be difficult to achieve for two stroke engines, without the use of direct injection systems. Orbital is currently involved with two of the major Indian motorcycle manufacturers as well as ongoing activity with Taiwanese producers.

The recently announced arrangement with UCAL will provide the ability to localise supply of much of the direct injection system and should provide

local costs, service and support to the Indian motorcycle manufacturers. In addition to the 2-wheeler market in India and Asia, there are also fuel economy and emission benefits for 3-wheeler vehicles. Retrofit programs are being considered by some Indian manufacturers of 3-wheelers as, given their high use, they are a major contributor to poor air quality in some cities.

While most of the activity in the motorcycle sector is being directed to two stroke engines, Orbital's direct injection technology provides a number of benefits on four stroke motorcycles. Orbital is engaged in customer-funded activity on four stroke engines and is actively promoting the benefits to the wider industry.

Marine and Recreation

During the December 2002 half-year, the number of marine and recreation products utilising Orbital's direct injection technology continued to grow. In September, Bombardier unveiled their Sea-Doo® XP™ DI personal watercraft (PWC) for model year 2003 release. This sports model will bring Bombardier's OCP DI line-up to eight models, comprising four PWC and four Mercury Marine OptiMax® powered sport boats.

Polaris, a US\$1.5 billion manufacturer of ATVs, snowmobiles, personal watercraft and motorcycles also recently announced their entry into the jet-powered sport boat market and will begin selling their EX2100 sport boat in the North American spring of 2003. The EX2100 will offer two engine choices from Mercury Marine, including a 250 horsepower OptiMax®.

Mercury Marine's OptiMax® range continues to grow with seven models now in the range, including two models from Mercury Racing (consumer performance outboards). Tohatsu (Japan) continues with its OCP DI range of four 3-cylinder TLDI™ models ranging from 40hp to 90hp.

Calendar year 2002 was a difficult year for the marine and recreation market as it struggled with a slow US economy and general consumer concerns. Industry associations have reported the year ending "better than expected" with the overall decline in sales less than originally anticipated. Looking forward to 2003, it is too early in the season to accurately predict whether the expected recovery will occur. Weak consumer confidence continues in the US, however dealer inventories are low and manufacturers appear lean, well prepared and with an innovative model line up, should confidence return.

Synerject

Synerject contributed a profit to the Orbital result for the first time. As previously reported, Synerject has introduced a range of operational and structural changes over the last 18 months, including price increases and overhead cost reductions. There has been significant revenue growth, particularly in the motorcycle sector, with a number of direct injection and port injection products launched in Europe and Taiwan. This growth, together with improved margins and cost containment has resulted in a significant improvement in Synerject's financial results.

The expansion of Synerject's activities and the associated refinancing of its loan arrangements announced on 10 January 2003 now provide a solid base from which to grow its business. The improving volumes and expanded product range should considerably improve the operational efficiencies and profitability of Synerject.

Financial Results

Orbital's loss after tax of \$2.9 million for the half-year ended 31 December 2002 compares to a loss of \$20.7 million in the corresponding period last year.

The key points to note with respect to this result are as follows: -

- Revenue increased by 29% to \$29.9 million.
- Overhead expenses decreased by 28% to \$10.3 million.
- Depreciation and amortisation, including amortisation of marketing expenses decreased by 36% to \$1.6 million.
- Orbital's joint venture, Synerject, contributed a profit of \$0.7 million compared with a loss of \$2.7 million in the previous year.

STATEMENT OF FINANCIAL PERFORMANCE FOR THE HALF-YEAR ENDED 31 DECEMBER 2002

| | Dec 2002 A\$000's | Dec 2001 A\$000's | Change |
|--|-----------------------|------------------------|-------------|
| Revenue | | | |
| System sales | 23,236 | 16,919 | +37% |
| Engineering | 4,856 | 3,736 | +30% |
| Royalties | 1,529 | 1,213 | +26% |
| Licence income | 91 | 1,155 | |
| | <u>29,712</u> | <u>23,023</u> | |
| Other Income | | | |
| Proceeds on sale of fixed assets | 80 | 82 | |
| Other | 65 | 60 | |
| | <u>145</u> | <u>142</u> | |
| Total Revenue (excluding interest) | 29,857 | 23,165 | +29% |
| System purchases | <u>(21,696)</u> | <u>(15,919)</u> | |
| Gross Contribution | 8,161 | 7,246 | |
| Overhead expenses | (10,346) | (14,375) | (-28%) |
| Restructuring expenses | (199) | (1,884) | |
| Foreign exchange gain/(loss) | 249 | (388) | |
| Share of Synerject net profit/(loss) | 664 | (2,694) | |
| Provision Texmaco investment | - | (6,446) | |
| Earnings before Interest, Tax, Depreciation, and Amortisation | (1,471) | (18,541) | |
| Depreciation and amortisation | (1,158) | (1,398) | |
| Amortisation of prepaid marketing | (484) | (1,159) | |
| Net interest income | 147 | 391 | |
| Operating Loss before Tax | (2,966) | (20,707) | |
| Income tax (expense) credit | 67 | (30) | |
| Operating Loss after Tax | <u>(2,899)</u> | <u>(20,737)</u> | |

Orbital's three recurring revenue streams, i.e. system sales, engineering services and royalty income, all achieved growth. The improvement in system sales (+37%) reflects increased product range and improvements in the marine sector as this market recovers from recent lows. Engineering services revenue has increased by 30% as Orbital has introduced more rigorous sales and marketing processes, and expands outside its OCP focus to increase the scope of its business. This trend should continue in the second half. Increase in royalty income (+26%) results from the introduction of a number of additional products in the motorcycle market. Piaggio and Peugeot Motorcycles each launched two products into the European market during the last nine months. We anticipate increased volumes of these models during the next European summer.

Overhead expenses (excluding restructuring costs) have decreased by \$4.0 million compared to the previous corresponding period, primarily due to staff reductions in January 2002 and in June 2002. In the half-year ended 31 December 2001, Orbital incurred redundancy costs of \$1.4 million and other one-off restructuring costs of \$0.4 million. This half-year, total restructuring costs were contained to \$0.2 million. Orbital also achieved savings across a range of other cost centres.

Depreciation and amortisation expense decreased primarily due to the completion of the amortisation of prepaid marketing, which has been expensed over the last three years at \$2.3 million per annum.

Net cash outflow during the half-year was \$7.1 million compared to \$10.6 million in the half-year ending 31 December 2001. There were several non-recurring cash costs during the half-year, which made up a significant proportion of net cash outflows:

- The staff reductions, announced in June 2002, were implemented after the year end, resulting in payments in respect of redundancies, annual and long service leave of \$2.3 million in this half-year.
- Orbital provided Synerject with engineering and other services during the half-year to the value of \$0.8 million, which has been capitalised as part of the Synerject restructure.
- \$2.0 million working capital increase due to prior year (early) receipt of trade receivables.

The above items are one-off in nature and we anticipate that future periods will not be affected by such items. At 31 December 2002, Orbital had cash on hand of \$6.7 million.



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