GUD Holdings Limited

Managing Director's Review of Operations

51st Annual General Meeting

Thursday 23rd October 2008

RACV Club

501 Bourke Street

Melbourne

Thank you Clive and good morning ladies and gentlemen.

From an operational standpoint there were a number of significant developments affecting the structure of the GUD group during the 2007/08 financial year and these have implications for management decision making both in the current year and beyond.

The first of these was the sale of the Victa business in June this year. Victa became part of GUD following the acquisition of Sunbeam Victa Corporation in 1996. Victa is a true, home-grown Australian brand with great products, leading technology and a dominant market share.

Despite the efforts we applied to fundamentally altering the economics of this business to generate more consistent returns, the facts were that Victa's earnings record was volatile and we could not see any certainty in the pattern of future earnings.

USA-based Briggs and Stratton purchased Victa in June, 2008. Briggs and Stratton is a major supplier of engines to Victa, and a sizeable player in the mower market in its own right through recent acquisitions in its home market. Briggs is much better placed, due to its breadth of involvement in powered equipment, to maximise value from Victa.

The second major structural change we effected in 2007/08 was the transformation of the Oates cleaning products business to a fully sourced operation. We closed the two factories we inherited when we acquired Oates in 2005 – one in Melbourne and one in Perth – and have completed an intensive program of identifying and qualifying offshore and local suppliers for the complete range of products that Oates takes to market.

The factory closure program was completed in March this year and this business now operates from a purpose built distribution centre and office complex it relocated to in the previous financial year.

Suppliers to Oates are located in China, Thailand, Sri Lanka and Australia. The business has successfully migrated over a short period of time, to a sourcing and supply chain configuration.

The result of these activities, coupled with the decision to exit the Bissell floor care machinery distributorship, is a marked improvement in Oates' financial performance.

At this gathering last year I spoke at length about the performance and outlook of Davey Water Products. Following three years of rapid growth in sales and profits, stemming from both acquisitions and new products, Davey experienced a reversal in financial fortunes in 2007/08.

There were a number of noteworthy factors affecting profit performance in Davey over the last year. Principal amongst these was a decline in export sales and margins to the largest single customer in the swimming pool segment of the business, due to the weakening of the US dollar.

Domestically the pool business underperformed as pools starts declined 17% in the face of continuing water restrictions. We were also severely impacted by the state of the labour market in Western Australia, where the pool part of the business has its centre of operation following the acquisition of Monarch Pool Systems in 2006. Staff turnover and labour shortages in the face of increasing demand for people from the mining industry, in particular, affected our ability to manage the business effectively and efficiently.

Through the 2007/08 year these concerns were recognised and improvement actions were implemented. These actions included the closure of Western Australian manufacturing and the consolidation of operations from three sites to one. The majority of the product range made in Perth has been outsourced and only a small, dedicated team of product assemblers remains.

Additionally, all product development across the water products business is being centralised in Melbourne, bringing together a disparate structure that was inherited with the three acquisitions we made in this industry sector from 2004.

The management structure has recently been streamlined with one, functionally-based management team now responsible for operations across the three main market sectors we compete in – water, pool and spa.

As part of this structure the pool and spa sales and service functions have been merged and this should lead to improved customer service and better efficiencies.

We continue to hold the view that water products is an attractive growth sector over the medium to long term. We have clearly suffered from acquisition disruption, after having completed three business purchases in the space of just over three years, but we believe that the actions taken, as I have just described, position this business well to benefit from the attractive industry outlook.

The transformation of Oates and the further restructure in Davey leave the GUD group with only two significant manufacturing facilities – the main Davey site at Scoresby in Melbourne and Lock Focus in nearby Keysborough.

The other businesses – Sunbeam, Oates and our automotive businesses Ryco and Wesfil – source their complete product range from predominantly offshore suppliers. Indeed over 80% by value of the product that the group's businesses sell comes from offshore suppliers. The substantial majority of this product is sourced in China, with supplementary sources in Thailand, Korea, Sri Lanka, South Africa, Taiwan, Indonesia, Israel, Italy and the USA.

The transformation of the GUD group to a design, develop, source, market and sell business structure has implications for the nature of the management challenges and the skill sets required, now and in the future.

One of the most important issues we now face is an ever-increasing reliance on China and how we reduce the risk inherent in that reliance. There is no doubt that we are concerned that we are too dependent upon China and have commenced a program to actively seek suppliers in emerging economies who have the potential to supplement Chinese supply over the next three to five years.

This is a task not without its challenges. China has emerged as a cost-competitive and generally, good quality supplier of the products we seek. However, pressures in China will lead to the costs from there increasing rapidly in coming years – indeed this process has already commenced. As China costs increase the relative attractiveness of other sources will improve.

The factors that will negatively affect China's competitiveness over the next three to five years, and which are evident now, include labour cost increases. As the competition for labour intensifies, due to the number of people of working age peaking in 2010, the cost of labour is increasing. In southern China, where we source many appliance products, manufacturing wages have been growing at over double digit rates for the last four years.

In addition the Chinese government has withdrawn many of the export subsidies it provided manufacturers as an incentive to grow export income, and this is leading to higher product prices.

Prices will also grow in Australian currency terms as the Chinese Yuan appreciates, reflecting the huge trade surplus the country is generating, producing unprecedented levels of foreign exchange reserves.

We commenced a program in 2006 of identifying alternatives to Chinese suppliers for Sunbeam, Oates, Davey and, at the time, Victa. To date we have commenced supply projects with two Indian companies for cleaning products and have identified potential suppliers for pumps and appliances in both India and Thailand.

Simultaneously, the challenges of managing product quality and more recently, delivery reliability out of China have emerged as significant management issues. In response to these challenges we have taken a multi-faceted approach.

For one of our businesses we have partnered with another Australian company by using their China-based resources to undertake factory-level product quality inspection and assurance functions. This arrangement is in its first year of operation and is working well.

For Sunbeam, we established a Hong Kong-based office to manage product quality at our suppliers' factories in mainland China and to take responsibility for delivery reliability at the source.

Sub-standard product quality has the potential to damage the reputation of the brand with consumers and this has significant detrimental implications for business performance in the long term.

Poor delivery performance doesn't just translate to product being late into our distribution centre. If we fail to meet retailer catalogue commitments or fail to have product available for the key selling periods of Mothers Day, Fathers Day and Christmas the implications are costly and impact in lost sales opportunities and declining business reputation with our retail customers.

With the transformation of GUD to a collection of businesses that source a substantial proportion of product sold, we have had to adapt and embrace different skills from those we held when the group comprised intensive manufacturing businesses.

We have to critically examine every aspect of the supply chain – as we are now essentially product developers, supply chain managers and brand marketers. These three functions are the most critical for the future of our businesses and we are actively addressing each of them as Clive and I have described today.

This Review of Operations would not be complete without mentioning in more detail the performances of Sunbeam and the Automotive Products business.

Sunbeam continues to grow its market share in both Australia and New Zealand and generated double digit earnings growth in 2007/08. This growth is underpinned by the new product program and the incessant enhancement of existing product ranges.

The appliance business has been under increasing cost pressures from suppliers, as described earlier, but these were partly offset in the last financial year by the appreciating Australian dollar. We expect cost pressures to be sustained during the current year and have implemented actions to improve our cost base.

We believe that Sunbeam will be operating in a more constricted environment this year. We expect demand conditions to slow, due to uncertainty brought about by the recent financial turmoil and the impact on consumer confidence.

Activity behind new products and technologies to drive both sales and margin growth continues unabated. We recently implemented a management change at the senior level in Sunbeam and we expect that this change, coupled with the on-going implementation of the brand management program and a renewed focus on internal cost control will position Sunbeam well in the context of these extensive, external headwinds.

Our automotive businesses, Ryco, Wesfil and Goss, delivered an exceptional financial result in 2007/08, reporting record earnings and profit margins. These were generated by an improvement in New Zealand following the prior year's shift to an outsourcing structure.

Further structural change in automotive aftermarket distribution channels with the closure of National Parts, led to improved performance in Ryco and Wesfil in Australia. The Ryco business had anticipated this event and had taken pre-emptive steps by establishing alternative routes to market.

Wesfil, through its broader product range and geographical spread, was able to partially fill the void left by National Parts at the local reseller and workshop level.

Operationally, the management of foreign exchange has become a major factor in determining the GUD group's fortunes on an annual basis. The volatility of the Australian dollar against the US dollar provides a range of unique management challenges. As a net importer of product, the majority of which is denominated in US dollars, we benefit when the Australia currency appreciates – as it did in going to near parity a few months ago.

The subsequent rapid decline in value to well below 75 cents was not flagged by any reputable commentator. The timing and the speed of the reversal necessitated a different approach to currency management, compared with our approach when the dollar was appreciating. There is no doubt that this aspect of the management task now requires more intensive on-going concentration and an ability to rapidly change tack if circumstances warrant.

I would like to conclude by addressing the subject of growth. This is the biggest single challenge facing our businesses. Apart from water, the sectors we operate in are mature, in that demand is increasing at population or GDP growth rates. We have opportunities to increase market share across all businesses and actively action strategies each year to drive growth in this area.

But, in the context of the extremely competitive sectors in which we compete, this usually generates incremental, rather than quantum, change.

The latter will come from further acquisitions, both in the form of bolt-ons to existing businesses and in new lines of activity, as evidenced by the Oates acquisition of 2005. We have been active in seeking further acquisitions over the past five years; indeed we have reviewed well over 150 opportunities.

We are cognisant of the fact that the strength of our balance sheet enables us to make further acquisitions beyond those we have completed since 2004 – Spa-Quip, Contamination Control, Oates and Monarch Pool Systems.

But we are also disciplined and conservative in our approach as we will only seriously consider those opportunities that provide the required economic return and deliver earnings per share growth. Many of the opportunities considered previously were over-valued, in our view, and the recent change in market sentiment should provide openings for us to seriously consider suitable targets that have been re-priced.

Operationally, we remain focused on new product development, active supply chain management, superior band management, tight cost control and strong working capital management. With these fundamentals in place GUD should continue to deliver superior returns and allow renewed focus on value creating growth through further acquisitions.

Thank you

Ian A Campbell
Managing Director

23 October, 2008