Company: Brambles Ltd
Title: Brambles 2021 Half-Year Result Briefing
Date: 16 February 2021
Time: 18:00 to 19:08

Start of Transcript

Operator: Thank you for standing by and welcome to the Brambles Limited 2021 Half Year Result Briefing Conference Call. 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 Graham Chipchase, CEO. Please go ahead.

Graham Chipchase: Hello, everyone, and thank you for joining us today for our 2021 half year results announcement. Before I address the key financial messages, I'd like to acknowledge the efforts of our people who when faced with a global pandemic have risen to the challenge of delivering our essential services, enabling regional and global supply chains to remain open and ensuring the continued flow of life's essentials to communities around the world.

Now turning to slide 3 and the key messages of our half year performance. In the half, we delivered strong sales revenue growth of 6% in line with our objective for mid-single digit growth. This performance reflected strong volume growth and price realisation in the global pallet businesses and the roll out of a large Australian RPC contract which offset COVID-19 related declines in Automotive and Kegstar.

Our underlying profit increased 5% including a US$8 million one-off compensation benefit for service centre relocation in Australia. Excluding this one-off benefit, underlying profit increased 3% despite COVID-19 related impacts and input cost pressures. We also recorded a significant improvement in cash flow reflecting higher earnings, a disciplined approach to capital expenditure and effective management of working capital as well as some timing benefits.

Our return on capital invested increased 0.8 points to 19% at constant FX driven by the strong performance and underlying profit growth and asset efficiency improvements across the Group. During the half, we reinforced our sustainability leadership by launching our 2025 targets. I'll discuss in some more detail on the next slide. More recently, we announced the consolidation of our Kegstar business with US market leader MicroStar. The combination of these businesses will create the global leader in beer keg management and is expected to expand global growth opportunities significantly.

Moving to slide 4, our world-leading sustainability program defines not only what we do but who we are. In September we updated our sustainability ambition outlining a vision to pioneer truly regenerative supply chains leveraging the power of our share-and-reuse business model to create more positive impacts beyond our business for the benefit of future generations.

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Brambles commitments is to be nature positive, restore forests, go beyond zero waste and drawdown more carbon and create a regenerative supply chain to our customers. This regenerative concept means restoring, replenishing, then creating more value or capital for society and the environment than the business takes out. We believe this vision is ambitious and right now we don't have all the answers. However, through the commitment of our people & Partners, we'll collaborate to find the solutions. This vision forms the basis for our 2025 sustainability targets which include our forest positive commitment to plant two trees for every one we use.

In the half, our sustainability credentials continue to be recognised by leading industry groups and publications with *Corporate Knights,* the world's largest circulation magazine focused on sustainable business, ranking us at number 18 as the most sustainable Australian company in their global 100 list with only one other Australian company in the top 50.

I'd now like to take a moment to address the impact that COVID-19 has had on our business on slide 5. As you know, consumer staples account for 80% of Brambles' revenue and underpin the resilience and defensive qualities of the business. Despite the ongoing challenges of COVID-19, this again proved true in the first half. During the half, we experienced elevated pallet volumes as retailers responded to increased levels of at-home consumption and the need to provide greater contingency against changes in consumer demands by raising levels of inventories.

While revenue increased, with the elevated volumes we also experienced higher costs including transport, handling and repair costs while managing changes in demand patterns across the network. In addition, lumber, transport and wage inflation rose sharply in key markets particularly in North America. In our automotive business the recovery of production levels has been stronger than anticipated. However, customer demand remained below prior year levels and we maintain a cautious outlook for the business in the second half of the year.

Now turning to Brexit on slide 6. After many years of negotiation, as of 1 January 2021 the UK is no longer part of the EU. However, although a UK EU trade agreement is in place certain - supply uncertainties remain including around the implementation of border checks and transport availability. These uncertainties have been accentuated by disruptions related to COVID-19. In response, UK manufacturers and retailers have lifted their levels of inventories increasing their demand for pallets in the first half. This is likely to be a temporary swing in demand and may reverse in the second half. After a substantial period of preparation, we are well positioned to meet the ongoing logistical challenges presented by Brexit.

Moving to slide 7 for an update on the plastic pallet trials. During the year we continued our trials of plastic pallets within Costco's US supply chain. Though the trials have been delayed due to COVID-19, we still have three active trials underway and we expect to start a pilot of significant scale with a large customer later this year.

The purpose of these pilots is to test various products and business model parameters within Costco's end-to-end supply chain such as pallet durability in different operating environments, dwell times and efficacy of asset control mechanisms, our technology enabled business model which is a combination of RFID and smart assets and customer value pricing and operational complexity from multiple platforms. The decision to move beyond

trials to implementation is not expected to occur in fiscal '21. As we have always maintained any decision on implementation will be subject to strict financial and return criteria.

Now turning to our dividends and capital management program on slide 8. In line with our dividend payout ratio policy, we have declared an interim dividend of US$0.10 which will be converted and paid as AUS$0.1308. This represents a payout ratio of 50%. This ratio is consistent with the prior year and within our targeted payout ratio range of 45% to 60%. During the period, we also continued with our share buyback program. To date, we have repurchased 128 million shares at a cost of AUS$1.4 billion representing 61% of the share buyback program. Our expectation is that the buyback program will continue into fiscal '22.

Now turning to slide 9 and our full year 2021 outlook. While the COVID-19 pandemic and Brexit has introduced significant operational and macroeconomic challenges and uncertainty, the strong first half result has allowed us to upgrade our fiscal '21 sales revenue and earnings guidance. We now expect sales revenue growth to be between 4% and 6% at constant FX rates with improved underlying profit margins including and increasing US margins of just about 1 percentage point.

Underlying profit growth is to be between 5% and 7% at constant FX rates and in addition, we expect free cash flow to fund dividends and core business Capex to support growth, the impact of lumber inflation on pallet prices and investments to further develop digital and efficiency objectives. The dividend payout ratio to be within the 45% to 60% range in line with Brambles' dividend payout policy and the share buyback program to continue subject to the ongoing assessment of the Group's funding and liquidity requirements in the context of increased economic uncertainty. I'll now hand over to Nessa to take you through the financials.

Nessa O'Sullivan: Great. Thank you very much, Graham, and good evening, everyone. Starting on slide 11 with an overview of our first half results. Sales revenue increased 6% with price growth of 2% and strong volume growth of 4% which was reflecting increases in pallet demand in part due to COVID-19 and Brexit related demand and the first-time contribution from a large Australian RPC contract, won in the second half of the prior year. Underlying profit increased 5% including a 2-percentage point which were due to a [side] compensation relating to a service centre in Australia.

The balance of the earnings growth was driven by the sales contribution to profit, supply chain efficiencies and indirect cost control which offset cost increases due to COVID-19, inflationary cost pressures and higher repair and asset relocation costs to support customer demand, asset productivity and cash generation in the first half. Profit after tax increased 4% with operating profit growth of 5% partly offset by higher net finance costs reflecting deposits utilised to fund share buybacks and lower interest on Australian dollar deposits. The effective tax rate of just over 30% is broadly in line with the prior year. Basic EPS of US$0.198 increased 10% reflecting the higher earnings and includes a US$0.01 benefit from the share buyback program.

Turning to slide 12. Group revenue growth of 6% was driven by strong pallet demand in all regions and the onboarding of a large RPC contract in Australia. Revenue in our Automotive and Kegstar businesses, which account for less than 5% of Group sales, declined. Automotive revenues decreased 6% and Kegstar revenues decreased 56% as both businesses cycled pre-pandemic demand in the prior year.

Looking at the composition of sales revenue growth on the right-hand side of the chart, pricing growth of 2% was driven by pricing in the Americas region and indexation in the EMEA region noting that the surcharges in

the US are recognised as an offset in the related costs lines rather than in the revenue line. Like-for-like volume growth was exceptionally strong in the half driven by increased levels of at home consumption and retailer stockpiling due to COVID-19 lockdown restrictions in key markets and European volume growth also benefited from stockpiling in preparation for Brexit.

Net new business growth of 1% reflects ongoing momentum winning new customers in the Central and Eastern Europe pallets business and the contribution from the new Australian RPC contract. The strong net new business growth in the prior year first half of 3% included rollover sales revenue from a large US pallet contract that was won as well as a new Automotive contract.

Moving to slide 13 and the Group profit performance. As you can see from the chart, the sales revenue contribution to profit of US$92 million, more than offset direct cost increases and ongoing investments in productivity initiatives across the Group to deliver earnings growth. Looking at each cost in turn. The US$12 million increase in depreciation expense was in line with the growth in the asset pool and the investments we have been making in supply chain productivity initiatives over the last 12 months, including US service centre Automation which remains on track to deliver strong financial returns and operational benefits.

Net plant costs increased US$14 million driven by additional repair and handling costs, duty changes in network dynamics and unpredictable demand patterns which drove a need for higher plant handling and repair costs as well as increased transport miles to relocate pallets to enable us to deliver on the dual objective of supporting our customers and driving asset productivity while limiting incremental pallet purchases.

Wage inflation added further cost to plant operations. With overall cost increases partly offset by supply chain and procurement benefits which included automation benefits and lower damage rates across the major regions. Consistent with the increase in plant costs, the US$26 million increase in transport costs reflected more pallet relocations in servicing customer demand spikes and notably higher cost in Latin America which drove material improvements in asset productivity and very strong cash flow generation due to the success of the asset management program.

IPEP expense increased US$14 million despite lower loss rates in the half with the increase weighted to the first half largely due to year-on-year step up in pallet FIFO values. We would expect the full year charge to increase broadly in line with the full year revenue growth. Finally, other costs increased US$12 million reflecting investments in new sales tools, IT infrastructure & Productivity projects including digital asset trials as well as US$6 million declining gains on compensated and scrapped assets largely due to higher pallet unit costs.

Turning to slide 14 taking each segment in turn and starting with CHEP Americas. Pallets revenue growth was exceptionally strong at 8% driven by COVID-19 related demand retailer stocking in North America and ongoing price realisation in the US and Latin America businesses. Higher pallet revenues more than offset revenue declines in the North American IBC business. While there is still uncertainty about customer demand patterns over the balance of the year, we expect year-on-year revenue growth to moderate in the second half as the business cycles record volumes in the prior year following the initial COVID-19 outbreak in our major markets.

Underlying profit in the Americas segment increased 3% as the strong sales contribution to profit and supply chain efficiencies more than offset the impact of the higher cost environment and increased activities

associated with relocating and repairing pallets to service demand and improve productivity of the asset pool. While wage increases, higher US lumber prices and capacity constraints in US transport all put addition pressure on plant and transport costs, we successfully offset these inflationary cost increases through a combination of pricing, surcharges and benefits from investments in supply chain productivity and procurement initiatives.

Segment margins decreased 0.6 points in the half as the business cycled the prior year pre-pandemic trading in the region while also cycling lower FIFO pallet values. Margins in the first half were also impacted by higher costs supporting the asset productivity program in Latin America.

I'll now turn to slide 15 and address CHEP Americas margin performance and outlook in more detail. This slide outlines the contributions each business made through the CHEP Americas margin performance in the first half. As you can see, Latin America was the key driver of the 0.6-point reduction in segment margins in the first half. The decline was largely due to higher pallet collection repair costs in the first half of this year associated with the enhanced asset management program which delivered a 7-point improvement in pooling Capex to sales and also resulted in a year-on-year cash flow improvement of approximately US$25 million over and above the strong cash flow benefits in the prior year.

Margins also reflected the impact of higher pallet unit costs in line with the increased pallets. This increase is weighted to the first half of the fiscal year. The US and Canadian businesses delivered very strong revenue growth while maintaining margins in line with prior year despite material cost headwinds in each business.

In the US, disciplined cost control, supply chain efficiencies and ongoing product realisation including surcharge contributions offset higher costs due to COVID-19 inflationary pressures and higher unit FIFO pallet costs. We expect CHEP Americas margin to improve in the second half and on a full year basis largely driven by the guided increase in full year US margins of approximately 1 point over the prior year.

Higher second half margins in the US are expected to reflect supply chain efficiencies including benefits from the US automation program and ongoing cost recovery to pricing and surcharges. Margins in Canada and Latin America are also expected to improve in the second half as both businesses cycle higher cost in the second half of the prior year.

Moving to slide 16 and a more detailed look at the US pallets revenue growth in the half. US pallets revenue increased 7% which includes 2 points of pricing growth and 5 points from exceptionally strong like-for-like volume growth which compares to the historic norm of 1 to 2 points of growth of organic like-for-like volumes per annum. This increase reflected COVID-19 related demand from customers in the consumer staple sector and retailer inventory stocking in response to higher levels of at home consumption.

Net new wins in the first half were flat on the prior year with the prior year comparative period including higher than normal net new win volume growth of 3% due to the rollover benefit of a large new contract win in the prior year. For the full year we expect a moderation in both price and volume growth as we come to the end of our repricing program and the business cycles record demand in the second half 2020 following the outbreak of COVID-19.

Turning to slide 17 and an update on the US automation program, the program remains on track to deliver strong financial returns and material operational benefits. We are making good progress with the implementation of service centre automation across the US network. To date, we have automated 39 sites which are performing in line with the investment case and have collectively increased sortation capacity by 30% and repair capacity by 20% across existing facilities. We have identified 24 sites for automation in the second half of this year and are on track to achieve the full run rate of efficiencies in FY22.

Moving to slide 18, CHEP EMEA. CHEP EMEA delivered strong top line growth and margin expansion despite a challenging operating and cost environment in the half. Pallet revenues increased 6% driven by strong demand from existing customers in response to COVID-19 and Brexit-related stock piling. Growth in pallets offset the year-on-year decline in automotive revenue, notwithstanding a faster than expected recovery in automotive production levels since the outbreak of COVID-19.

Underlying profit increased 7% in the first half with the sales contribution to profit and effective cost control particularly in automotive more than offsetting additional transport and handling fees to support asset productivity improvements and strong pallet demand in Europe which included Brexit stockpiling.

ROCI increased 1.6 points reflecting asset productivity improvements and margin expansion driven by indirect cost control, higher compensations and lower scrapped assets in the first half. For the full year, we expect sales and underlying profit growth to moderate from first half levels given the strong second half comparative period which benefited from initial COVID-19 panic buying and the anticipated reversal or Brexit related demand in half 2 of this fiscal year. Full-year margins are expected to be broadly in line with the prior year.

Turning to slide 19, CHEP EMEA revenue growth of 4% in the first half reflected volume growth of 2% and pricing growth of 2%. The revenue growth was driven by strong growth with new customers in Central and Eastern Europe, price indexation and includes demand in the second quarter relating to Brexit stockpiling. Like-for-like volumes remained in line with the prior year despite higher pallet demand in response to COVID-19 lockdowns with underlying demand for pallets reflecting weak economic conditions in the region.

This COVID-19 and Brexit related volume demand increases were partly offset by lower volumes in automotive which accounts for 9% of the region's revenue as the business cycle pre-pandemic levels of customer demand in the first half of '20. For the full year, we expect pallets, revenue growth to moderate as the business cycles record levels of pallet demand in the second half of the prior year following the initial outbreak of COVID-19. First-half Brexit-related demand is expected to reverse in the second half and underlying pallet demand is expected to remain subdued in line with economic conditions.

In the automotive business we expect year-on-year revenue growth to improve in the second half as the business cycles lower revenues in the second half of the prior year following the COVID-19 outbreak. Notwithstanding the second half improvement, FY21 growth is expected to remain subdued in the automotive sector and subject to production levels as well as component availability in the global automotive industry.

Moving to slide 20, CHEP Asia-Pacific which includes Kegstar, delivered a solid first half performance. Pallets delivered strong revenue growth of 6% reflecting COVID-19 related demand and price realisation in Australia and ongoing growth in the China timber pallet business. Kegstar revenue declines offset strong growth in the

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RPC business which benefited from a large Australian RPC contract win and ongoing growth in the New Zealand business.

Underlying profit increased 4% with the strong sales contribution to profit from the pallets business and the US$8 million one-off compensation benefit in Australia more than offsetting lower Kegstar earnings and additional costs associated with the onboarding of a large Australian RPC contract and COVID-19 related costs.

ROCI increased 0.9 points driven by profit growth. ACI had remained broadly in line with the prior year as lower Capex in Kegstar and pallets was offset by increased RPC investments. The Australian RPC contract, which commenced in October 2020, is progressing well and performing in line with the investment case.

For the full year, we expect revenues from this contract to progressively ramp up while pallet growth should moderate as the business cycle strong COVID-19 related demand in the second half of the prior year. Costs control and supply chain efficiencies are expected to continue supporting underlying profit growth, notwithstanding RPC contract start-up costs in the second half.

Turning now to slide 21 and the Group cash flow. Free cash flow after dividends increased US$332.2 million as we cycled the US$183.2 million special dividend payment in the prior year. Free cash flow after ordinary dividends increased US$149 million which included US$80 million of first half timing benefits largely related to Capex payments which are expected to reverse in the second half.

Operating cash flow increased US$101.8 million driven by higher earnings and a US$41.5 million reduction in cash Capex largely reflecting the timing of capital payments. We continue to improve working capital management which was reflected during the half with better cash collections, noting that we were cycling exceptionally strong VAT refund inflows in the prior year following a concerted effort to accelerate refunds working directly with several European tax authorities.

Financing costs and tax payments reduced US$20.8 million primarily due to the prior year financing costs relating to the early termination of the US$500 million 144A bond. On a full-year basis, despite increased lumber cost driving higher per unit pallet costs and non-pooling Capex which is weighted to second half, we expect to fully fund both Capex and dividends from operating cash flows.

Moving to slide 22 and looking at capital expenditure. Capital expenditure in the first half reflected disciplined management of capital spend and asset efficiency improvements despite strong volume growth and customer demand variability. On an accruals basis, pooling Capex only increased US$5 million despite strong volume growth in the global pallets businesses. The pooling Capex to sales ratio improved 1 percentage point decreasing to 18.6% despite both lumber inflation and high volume demand.

Asset productivity improvements delivered a year-on-year first half Capex savings of US$21 million. Volume growth and price mix impacts on Capex were US$36 million in the first half. Automotive and Kegstar investment spend fell by US$28 million as we cycled prior year spend to support new contract wins partly offsetting growth investment in pallets and RPC businesses. Non-pooling Capex increased US$15 million in line with investments in facilities to support the Australian RPC contract and the ongoing investments in US service centre automation to support growth and deliver productivity benefits.

In terms of the full year Capex outlook, we expect the FY21 pooling Capex to sales ratio to increase by approximately 0.5 points from FY20 levels largely due to lumber inflation while non-pooling Capex is expected to be weighted to the second half of the year in line with our implementation plans in the US automation program. Notwithstanding these anticipated increase in Capex, we expect free cash flow to fully fund both Capex and dividends in FY21.

Turning now to slide 23, our balance sheet remains strong with over US$2 billion of cash deposits and undrawn committed facilities. We're well positioned to fund the remainder of our share buyback program and have no major debt refinancing due in the next 12 months. Our key financial ratios remain well within our financial policies and we remain committed to maintaining our current investment grade ratings of BBB+ from Standard and Poor's and Baa1 from Moody's.

Turning to slide 24, in closing our first half performance was strong. During the first half, we successfully met our customer's needs and offset the cost impact of COVID-19 and Brexit across our businesses through disciplined cost control and the delivery of supply chain efficiencies including benefits from strategic investments in automation and procurement initiatives. Our disciplined approach to capital spend and our focus on asset productivity delivered capital efficiency improvements across the Group despite the need to service strong demand growth and the change in both network dynamics and demand patterns which added to asset productivity challenges in the half.

Free cash flow generation was strong, fully funding dividends and Capex and we remain on track to fully fund Capex and dividends on a full year basis. We are also now upgrading ourselves in earnings guidance and reconfirming our commitment to delivering around 1 point of full year margin improvement in our US business. Our strong balance sheet positions us well to continue with our share buyback program. Thank you. I'll now hand over to the operator for Q&A.

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 Anthony Moulder with Jefferies. Please go ahead.

Anthony Moulder: (Jefferies, Analyst) Good morning or good evening, all. If I can start, Graham, perhaps with that plastic slide. You've talked to your strict financial and return criteria. Can you just remind us as to how you're thinking about both of those and what that criteria is still please?

Graham Chipchase: Well, so what we'd always do is ensure that there is - if we're going to make a large capital investment, we're going to get a return on that investment which is above our weighted average cost to capital as you would expect plus obviously a premium for risk relating either to which country it's in or if it's a new line of business. So we don't publish the hurdle rates as you would expect us not to if it's commercially sensitive but what we're saying...

Anthony Moulder: (Jefferies, Analyst) Sure.

Graham Chipchase: ...is we're not going to do this at any price. The key area still to test out is the scaled up operational benefits which we think there are from having smarter pallets and with Costco's investment in RFID

throughout their system to try and plug the gaps in terms of leakage. But the other piece of that is also the premium that our customers, the manufacturers will have to bear because obviously a plastic pallet is three times more expensive than the wooden one.

So there's an element of premium which we have to test in the market and there's also the operational benefits which we think are there and have come out through the smaller scale trials but we have not done them at scale across multiple customers, multiple geographies. That's the bit we've still got to get the data on and that's going to take some time.

Anthony Moulder: (Jefferies, Analyst) There's a point [there so] your return on invested capital is off the wooden pallet and you'd expect to drive a higher return on invested capital from more expensive equipment than these plastic pallets. That's the point though, right?

Graham Chipchase: No, we're not saying that. So what we're saying is that if we're going to invest new capital then depending on what the alternatives are - so again, this depends on what your baseline is. If you're saying that you want to replicate in the short-term margins or returns you're getting with wooden pallets, I think that's going to be extremely difficult to do. However, if your option is that you lose all that wooden business then clearly you might have a different - well, we have got a different baseline.

What we're saying is that even in that situation we're not going to do this sort of marginal improvement over WAAC. We'll do it with - to ensure that we're getting a decent return on the new capital spend. We've always said that. Then one has to take a view it's about what you think the alternatives are and we're not prepared to go through what we think they are. But obviously [they're for] a limited number and everyone's debating what those are throughout the industry.

Anthony Moulder: (Jefferies, Analyst) Sure and the timing it seems understandably pushed into next year. How does that overlap with the remainder of the buyback? Is the buyback locked in or could some of those proceeds be used as a [push] into plastic pallets?

Graham Chipchase: We've always said that when we started the buyback program on the sale of IFCO, we said that we would look out several years at whether they were large capital or uses of capital which would make us question whether the buyback should go ahead in its entirety and we just - we determined at that time that there wasn't and we would still be of that view, i.e. that we're still committed to the buyback.

Now clearly the thing that might change that and I'm not saying that it does, but we have to give the caveat is if general economic conditions change significantly and liquidity tightened up a lot then clearly, we'd have to look at the Group's balance sheet and make sure we were still comfortable but right now we're saying no we continuing to go ahead with the buyback program.

Anthony Moulder: (Jefferies, Analyst) Yes understood. The [large] last question on this, [promise] the - today, the large customer that is about to start trials with plastic. Is that driven by Costco or how does that large customer go into this trial?

Graham Chipchase: So it's a sort of joint conversation, tripartite conversation between us, Costco and the customer. But fundamentally it has to be between us and the customer and what we were trying to find is a

large enough customer that would give us really good data across multiple geographies, multiple lanes going into various parts of the Costco system. So it has to be a meaty customer to do that and it just took a little while to make sure we could get the right one on board in the right circumstances now I think we've got.

Anthony Moulder: (Jefferies, Analyst) Perfect. Switching into lumber pricing, we've seen lumber pricing escalate fairly significantly in the US market. It looks like that hasn't really come through in this first half '21 results but obviously it's a consideration for next half or the current half. What kind of escalation lumber pricing could you guys expect in that second half please?

Nessa O'Sullivan: So maybe I'll take that. So, Anthony, we did have lumber cost impacts in the first half. The fact that we managed the asset productivity well meant that we didn't spend as much on pallets as you might expect for the volume. So we got a benefit from that. We also year-on-year as we've been re-pricing all the contracts in the US where most of the lumber has been, we now have lumber surcharging in a - in the vast majority of our contracts in the US. So we have - the surcharging helps to recover costs in relation to that.

We are expecting some further increases in lumber in the second half which is why we've guided to say expect that we think full year Capex to sales ratio will be higher than prior year while we get underlying productivity. We do think these abnormally high lumber costs that we're seeing at the moment we're expecting that to continue into the second half. But I think if you looked at where we were three years ago on contracts, we didn't have coverage for surcharging. We do now.

Anthony Moulder: (Jefferies, Analyst) Just to be clear, that surcharge is for the OpEx into repair right? It's not - you're obviously - if you're building more pallets then…

Nessa O'Sullivan: That's right but…

Anthony Moulder: (Jefferies, Analyst) …that's a higher capital cost.

Nessa O'Sullivan: Yes. So for us in the first half, part of how we managed lumber costs, I talked about asset productivity. We also managed different mix of pallets, some from Latin America, some from the US. We also, if you remember have invested in sawmills. Jointly invested bringing new technology where we get better yields on lumber so we have some benefits from that. We also have some procurement arrangements that are in place as a result of some of those agreements, which means that while we suffer increases, we do have a scale advantage and we do have some benefits from those investments that we put in place. That's really the extent that we would really comment on it. But it is built into our outlook considerations.

Anthony Moulder: (Jefferies, Analyst) Lastly, if I could, you've talked to very good indirect cost control in this half. Is there scope to repeat that in the second half?

Nessa O'Sullivan: So we would - so as we go into - as we finished the first half, there are a number of initiatives we put in place that we would expect to continue into the second half.

Anthony Moulder: (Jefferies, Analyst) Very good, all right, thank you very much.

Operator: Your next question comes from Matt Ryan with UBS. Please go ahead.

Matt Ryan: (UBS, Analyst) Hi Graham, hi Nessa. I'm just wondering if you could comment on your confidence levels around getting higher Group margins under the current strategy of prioritising Capex ahead of OpEx?

Graham Chipchase: Perhaps I'll start and Nessa can add.

Nessa O'Sullivan: Yes.

Graham Chipchase: We are confident and I think part of that is because if you remember we had a lot of inefficiencies in the system in the latter half of fiscal '20 because of the volatility of demands from our customers because of the COVID lockdown and people stockpiling and panic buying. So we feel that there's a cycling in the second half on the costs front which we can - which will give us a benefit. In addition to that, some of the programs like automation and you've seen this in previous year or two are much more back end weighted the second half. So I think on just even those two items we think we're really confident that we'll be able to get to where we're committing to.

Nessa O'Sullivan: Yes and we want to be able to live with the margin improvements in a way that represents the right outcome for shareholder value. So, our drive to make sure that we don't overinvest just to service temporary peaks and demand, to make sure that we don't push for - if the lever is open to continue to spend on Capex, that's an easier solution to get a better P&L outcome in the shorter term but it doesn't give the right longer term economic outcome.

So there is always looking at do we have that balance right and I think the market should get some confidence that at a time when we had spikes in demand and lots of pressure, that we didn't give in to the temptation to solve the problem by just throwing a lot of Capex at it. So, we're going to keep pretty disciplined. We've been talking about this for the last few years. I think the - as you're seeing in the results now, that we are getting the balance right. We are being careful about how we allocate capital but we'll continue to look at what's the right mix because there'll always be an amount of new pallets you put in to maintain the health of the pool. But I think you should draw some confidence from the results and the actions that have led to them.

Matt Ryan: (UBS, Analyst) Thank you, and there's still a lot of comments around cost inflation, in particular in the Americas. Are we to sort of think that the surcharges are actually working in these markets at the moment?

Nessa O'Sullivan: So if you have a look at the US and you have a look at what's happening in relation to lumber costs, you think about some of the P&Ls from a repair standpoint, labour costs and transport costs, the mechanisms that we have in place, they never cover you 100%. It won't be in every single contract. The other thing that you have to bear in mind is that the surcharge mechanisms are never fully aligned with the exact costs that you get because they'll be linked to a calculation and an index that may or may not directly reflect the costs that you're facing at any given time.

So, I would say if you looked at where we were three years ago in the US with surcharging when we really didn't have effective clauses in place and look at where we are now, we're seeing that 75% to 80% coverage is really enabling us to still deliver the earnings growth despite all the challenges that we've got. So it's never going to be perfect. We have the surcharge mechanisms. They are working but I think it's a fair conclusion to

say that it has been a good contribution to offsetting costs in the Americas. You've got to remember the surcharges are netted off against the cost lines.

Matt Ryan: (UBS, Analyst) Thank you, and just a quick one to finish. The acquisition of forestry asset that went through the cash flow, can you just explain what that is and is this sort of something you think we're going to see more of?

Nessa O'Sullivan: Yes. Look this is particular to - in our South African business where we have had challenges in the region accessing the level of sustainable wood supplies. So this is a further add on to we already own forestry assets and we also own a milling operation. We vertically integrated, bought forestry assets, had them certified and they're continuing to that annual certification process. It's all part of our commitment to making sure that we've 100% of our lumber supplies are from sustainable sources. So a relatively small acquisition in total but that's all part of our global lumber supply initiative to ensure that we've accessed to sustainable lumber.

Matt Ryan: (UBS, Analyst) Thank you.

Nessa O'Sullivan: And the amount involved was US$60 million, yes.

Operator: Your next question comes from Anthony Longo with CLSA. Please go ahead.

Anthony Longo: (CLSA, Analyst) Good morning, Graham. Good morning, Nessa. Just a quick question I had to clarify the guidance. So I just wanted to get a bit more comfort around - I mean the second half volumes for Brexit expecting them to unwind and also the brought forward - COVID-19 brought forward demand. Can you perhaps talk as to how we should think about that second half number, just in the context of some of those thematics playing out?

Graham Chipchase: So I don’t think we want to give you the second half numbers ourselves but if you were to take the midpoint of the guidance which is not an unreasonable thing to do on the top line and the bottom line, I think you're clearly where we are anticipating a moderation of revenue growth in the second half compared to the first half and that's not wholly surprising when you think about the high levels of demand we saw in the fourth quarter last year as people were panic buying and stocking up as we've talked about a bit earlier on.

So we think we're obviously going to be cycling a much higher prior year number and as we get towards the back end of this year and therefore you'd expect year-on-year - half on half to slow down revenue. And as you pointed out yourself, the unwinding possibly of some Brexit stocking from H1 going - coming back out in H2. So we think the revenue line is likely to moderate but still show some growth but moderate. I think that's mathematically you can see that if you just do what I've suggested for full year guidance versus first half actual performance.

I think the trickier one to sort of get your head around is the margin/ULP piece and what we're saying again is, is we would expect the margin effectively to increase even though if you did a half-on-half profit number, that would possibly not increase just to make the numbers all work. And of course that makes - also makes sense because again our margins are as we pointed out in the US should be increasing. And also Americas generally

increasing based on being able to cycle the higher cost of experience at the end of last year and the fact that some of the efficiency programs are back-end weighted towards the second half.

There's a bit of phasing of costs as well but other than that, if you put all that together then I think we're pretty comfortable that revenue moderates but we can still improve margins in the second half. Nessa, is there anything I've missed out there?

Nessa O'Sullivan: Yes, so that's obviously from a Group, from a Europe perspective as we guided to on the slide, expect margins although they did increase in the first half to be broadly in line with prior year. We also called out that underlying demand in Europe was weak so if you sort of strip out - so we said Central and Eastern Europe net new wins was good but the underlying was weaker.

So if you strip out the COVID and the Brexit you should expect a fairly material moderation in Europe in the second half in terms of the revenue line. The comments Graham was making on the margins was from a Group perspective driven largely by that US improvement. So I just make that point from a full year perspective.

Anthony Longo: (CLSA, Analyst) No, that's great and look, thanks, I certainly wasn't asking you to give us your number. So I just wanted to get your confidence around that please. Second one, you did call out in the presentation that there were a lower level of conversions this time in the Americas. Any particular reason for that? Was that competition inertia or anything like that?

Graham Chipchase: I mean effectively…

Nessa O'Sullivan: Well, the [unclear] - yes, the - sorry, go ahead, Graham.

Graham Chipchase: I was just saying that the main reason is that we've been absolutely flat out servicing our existing customers, making sure that they don't run out as much as a lack of competitiveness compared to previous years. So I think there's another trend which is if you look at what's been happening with consumers in the US as they've been going into large supermarkets to stock up and maybe an element of panic buying, they've tended to go for the respected and renowned brands, the bigger brands. As a result, we've had our existing large manufacturers, large customers have done incredibly well.

That's what's driving most of the growth and as a result of that, we haven't really got the capacity in the short term to start going out and trying to convert current white wood - current white wood users into pool. I think that's just of a temporary thing but that's certainly been the case over the last six to nine months. We know for a fact that we are doing probably better than some of our competitors in keeping people supplied. So I suspect we'll see this is an industry wide trend that no one's really converting new customers at the moment because everyone is really trying to keep the existing customers fully supplied at the moment. That's particularly true in the US I would say.

Anthony Longo: (CLSA, Analyst) Okay great. I'll leave it there for now. Thank you.

Graham Chipchase: Thanks.

Operator: Your next question comes from Cameron McDonald with E&P. Please go ahead.

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Cameron McDonald: (E&P, Analyst) Good evening and good morning. Just a question aimed at Graham on your comment around the pallet - plastic pallet trials. You sort of intimated that you would have to look at the alternatives [and then], the worst-case scenario is losing the wooden trade. Is there a secondary or second order impact here where the implementation of plastic pallets essentially also drives down the wooden pallet returns as a defensive measure because people say, I want a cheaper price to stay on wood or otherwise I will go to plastic?

Graham Chipchase: So we don't think that's going to be the case and if we just - let's just step back a little bit from that level of granularity. This is something that is very specifically being requested by Costco and not necessarily for - driven for financial reasons. It's driven by their view on health and safety in their particular network because if you go into a Costco store you have pallets fully loaded stored in high bay racking which you don't see anywhere else and therefore, they are looking at the integrity and the appearance of the pallet. And as a result we feel that - and because plastic pallets are so much more expensive than wooden ones, we feel that if this is a solution for Costco, we don't think it's likely to spread across the whole system quickly because of the price premium that's concerned. So on that basis we don't see that it's going to drive down wooden pallet prices because we don't think the demand is going to be widespread for plastic across the whole system.

Now we are looking at obviously what would the impact be if we didn't have the current wooden pallets in the system. For Costco, they're being replaced by plastic pallets because it obviously has an impact on our network and the efficiency of the network. But we're factoring all of these things into the decision-making process to try and make sure that we are - we're not taking the wrong step. As I say we are a long way from making that decision. There are still a lot of assumptions and scenarios to look at before we actually make a decision.

I think all you should take from us is we're not going to do this in a way it's going to destroy value over the medium to long term for our shareholders. We just wouldn't do that. So, but at the same time we've got to put our best foot forward on this because we wouldn't want a competitor to come in and show that they can do it where we can't because we are the biggest plastic pallet operator in the world around the rest of the globe. So we should be in a good position to make this work, if anyone can make it work.

I think if I leave it at that because as I say there is a lot more data we have to collect. We are a significant period of time away from making a decision and I think people shouldn't over worry about it. I know people seem to be but our view is that this is something we have to explore but at the same time we haven't made a decision yet.

Cameron McDonald: (E&P, Analyst) Thank you, and, Nessa, can I ask just on, and in particular CHEP Americas, you've indicated that you are de-emphasising the Capex spend and more spending on Opex to make sure the pool is balanced and I guess that - and the underlying impact that has on margin. Why haven't we - well, we've seen a degradation return on capital invested as well. So why have we got both those measures going backwards?

Nessa O'Sullivan: So from an overall business perspective, you've seen the productivity across the total pool. But in the Americas region while the Latin America piece showed a major improvement in the productivity, we didn't see the same productivity improvement yet in the US and that's primarily because they took the brunt of

that massive increase in COVID-related demand. So if you look at the outlook that's why we're saying on slide 15 where we outlined this is what we expect to play out in the second half. And giving more granular insights as to why the first half is more challenging versus the second half to get to the full year result which we would expect to see margin expansion in.

Cameron McDonald: (E&P, Analyst) [But as]...

Nessa O'Sullivan: But if you had seen this volume increase in any other period going back a number of years, the Capex spend would have been materially higher. By the way we're measuring the Capex to sales efficiency gain that we set out on the Capex slide on slide 22. That's been done on an accruals basis because as you know we had a timing benefit from the pooling cash. So overall Latin America, the big generator of the unleashing of the cash for them has been definitely a big improvement in asset productivity.

Cameron McDonald: (E&P, Analyst) Okay, thank you and then just on - to follow up on the earlier question around the guidance, at your first quarter trading update which you re-modelled the full year number for, you did indicate that the second half would be stronger than the first half. Are we to view that [unclear]...

Nessa O'Sullivan: In terms of growth.

Cameron McDonald: (E&P, Analyst) Yes, so that's my question, so in terms of growth not in absolute dollars?

Nessa O'Sullivan: Yes correct.

Cameron McDonald: (E&P, Analyst) Yes okay thank you.

Operator: Your next question comes from Owen Birrell with Goldman Sachs. Please go ahead.

Owen Birrell: (Goldman Sachs, Analyst) Hi, guys, just a couple of I guess peripheral questions now that everyone has asked all the juicy ones. Just looking at the autos business in Europe, you mentioned some cost reductions in that business over the recent quarter. I was just wondering is that business now profitable again and at what level of pre-COVID production levels is it maybe - does it break even?

Graham Chipchase: Shall I do the cost reductions...

Nessa O'Sullivan: So, maybe I'll just make a couple of comments...

Graham Chipchase: Okay, no Nessa go that's fine.

Nessa O'Sullivan: Yes okay. Owen, I was going to say, yes, it is a profitable business, one of the changes that we've done is really over the last 12 plus months is that we've turned our automotive business into much more of a global business and we're seeing benefits of - we also last year if you remember we invested in automotive assets after a big contract win and we're seeing the scale benefits of those.

The timing issue for us of COVID was quite catastrophic because there was a - just a full stop in terms of demand which was in the last quarter of last year. We're seeing volumes up to indexing as high as 80% on

prior year, not sure what's going to happen with the shortage and semi-conductors as we go forward. But the business responded exceptionally well to that full stop, reorganised their activities and took our costs to make the business more efficient.

So I think that places us in a good position with the team that we're setting up a business and global reach. They've now optimised the cost base and I think are very much looking at what are the new opportunities on the horizon. And we definitely see that business as being something that can be a stronger contributor, already a positive contributor over time. Graham, I don't know if there's anything else you want to add?

Graham Chipchase: No, I think all I would add is echoing Nessa's comments about the business has been incredibly proactive right from last June in managing the costs and being ready for the next 12 months. But I think the other really great attribute is they've been winning new business in the last six to nine months which is not entirely what one would have expected in the automotive sector. So I think the business is set up to do very well going forwards.

Owen Birrell: (Goldman Sachs, Analyst) Are you able to say a sense of what the earnings contribution is likely to be going forward?

Nessa O'Sullivan: No. It's less than 5% of Group earnings at the moment and it makes a good return on capital.

Owen Birrell: (Goldman Sachs, Analyst) Okay. Just turning to the Asia-Pac business, just wanted to just confirm that if you remove that $8 million one-off benefit that you got in that business, that that business earnings actually went backwards during the period?

Nessa O'Sullivan: Yes, that's correct. So, if you remember in the prior year, we'd lost an RPC contract and then we won an RPC contract. So the timing of it is such that we've had the earnings roll off from the contract we lost. We then won a bigger contract but that's only coming onboarding. So as we said that started in October. So that'll progressively ramp up and we expect in the first year, we'll have start-up costs and then as we progress through the contract that's where it starts to contribute more to the overall earnings. But we're very pleased with where it's tracking in relation to its investment case which justified the investment but also gives us opportunity for growth. So there's a timing [unclear] coming off one RPC and winning another one.

Owen Birrell: (Goldman Sachs, Analyst) I was going to say just to try and help us work out what the underlying cost base of the Asia-Pac business has been doing, are you able to give us a sense of what those start up costs have been for that new...

Nessa O'Sullivan: No, what you have to just assume is that it's not - it's contributing to revenue this - broadly really high level, assume it'll make a contribution to revenue but won't make a contribution to earnings until next year, is the way you should think about it.

Owen Birrell: (Goldman Sachs, Analyst) Then just I guess trying to split out Kegstar within that - obviously, that was quite loss making during the period as well. Can you give us a sense of what that loss was given that that will effectively evaporate going forward?

Nessa O'Sullivan: Well, it won't evaporate going forward because we are part now of a bigger - we will have an investment that'll be accounted for where we will be bringing to account our share of the after-tax earnings every period. So, I think you should assume on a full year basis we're sort of assuming given that Kegstar revenue less than 1% of the Group revenue. Putting that in context, you should assume a material impact in terms of year-on-year growth from the change because we will still be booking to account our share of earnings or loss. And you have to assume if you're in a keg pooling business in the middle of a global pandemic when there is minimal on-premise consumption that the business is going to be challenged at least in the short term.

Owen Birrell: (Goldman Sachs, Analyst) So you're going to lose the 1% of revenues and your earnings is - the losses in the earnings line is going to be broadly consistent taking that equity accounted loss into [inaudible] in the Asia-Pac business?

Nessa O'Sullivan: I can't - so it won't - in the first half it's in continuing which is in Asia-Pac but as we go forward it'll be - for the full year it'll be in discontinued and it'll be shown as - you'll have an investment and we'll take into account as our share of the after tax earnings and we're not...

[Over speaking 64:23]

Owen Birrell: (Goldman Sachs, Analyst) Is that going to be allocated to [unclear 64:23] division?

Nessa O'Sullivan: Sorry?

Owen Birrell: (Goldman Sachs, Analyst) Will that be allocated in the future to Asia-Pac?

Nessa O'Sullivan: No.

Owen Birrell: (Goldman Sachs, Analyst) Okay. Excellent, that's the only questions that I had, thanks.

Nessa O'Sullivan: Great thank you.

Graham Chipchase: Thanks Owen.

Operator: Once again, if you wish to ask a question please press star one on your telephone and wait for your name to be announced. Your next question comes from Jakob Cakarnis with Jarden Australia. Please go ahead.

Jakob Cakarnis: (Jarden, Analyst) Hi, guys, just a question on the outlook for the CHEP Americas margins. Can you describe to us the dynamics that are happening there with some of the IPEP charges just noting that those were higher in the second half of 2020? Are they some of the higher costs that you're calling out in the FY21 margin expectations?

Nessa O'Sullivan: So included in our total outlook we've factored in - so there's first of all - let me take you in the helicopter first. So IPEP overall the increase year-on-year charge which is largely FIFO driven is weighted to the first half. So when you think about full year IPEP you should think about it increasing broadly in line with

revenue growth. I can't tell you exactly what it's going to be but if you're looking for a directional guide to across each of the businesses, we continue to book IPEP. It's factored into the outlook.

The major driver of what's giving an improvement, we've highlighted that we think that the increase as we look at Latin America and Canada that's weighted towards the first half in terms of the charge. But what's driving then margin improvements as we go forward, there is that phasing, but it's really more to do with as we start in the US getting some automation benefits and as we are as a Group cycling higher COVID costs across all three parts of the business. So the bigger driver is we get some more efficiency benefits and we cycle COVID from prior year.

Jakob Cakarnis: (Jarden, Analyst) Okay thanks, Nessa, appreciate the colour there. Just finally, you've had some other costs for investing for growth in the past, it seems as though the corporate costs are a little bit lower. I assume some of that's related to travel. Can you just talk to how we think about that for the balance of the year and what's happening with the investing for growth initiative please?

Nessa O'Sullivan: So as you look at the first half, you're right, we've put in some - you'll see we've stood out there is some standards. We look at our digital initiatives and we've got a number of digital trials underway. We would expect to see some increase in that in the second half but we would also expect to still see good cost control across the business. So all of that again factored into the outlook comments that we've put together.

Jakob Cakarnis: (Jarden, Analyst) Thanks, guys.

Operator: There are no further questions at this time. That does conclude our conference for today. Thank you for participating. You may now disconnect.

End of Transcript