Event Transcript

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Start of Transcript

Raluca Chiriacescu: Morning everyone. This is Raluca Chiriacescu from Brambles Investor Relations Team. Thank you for joining us for the presentation of our 2018 Half-Year Results. In a moment, our CEO, Graham Chipchase and CFO, Nessa O'Sullivan will present our first half results. There will be a Q&A at the end of the presentation and I'd just like to remind everyone that all currency amounts are in US dollars and that we refer to the growth rates in constant currency, unless we state otherwise. I will now handover to Graham.

Graham Chipchase: Good morning everyone and thank you for joining us today for our 2018 Half-Year Results announcement. I'd like to start with a few key messages about the results. We delivered sales revenue growth of 5% in line with our guidance for mid-single digit growth. This performance reflected volume growth in our North American, European and Latin American pallet businesses and continue robust growth in our IFCO RPC business. Our return to underlying profit growth was driven by strong contributions from our EMEA, Asia-Pacific and IFCO businesses, which more than offsets the drag from increased cross pressures in North America and previously announced items relating to our HFG joint venture and Australian RPC and automotive businesses.

A highlight of the results and in line with one of our key financial objectives we set out last year, was the material improvement in our cash flow generation with free cash flow after dividends increasing by US$89 million and as you'd be aware from our announcement last week, we completed the sale of CHEP Recycled on the 14th of this month. Later in the presentation I will provide an update on the progress we have made against our strategic priorities. I'll now hand over to Nessa.

Nessa O'Sullivan: Thank you Graham and good morning. I'll start on slide 5 reviewing our P&L in more detail. Sales review of 5% reflected strong growth across our portfolio. Operating profit increased 42% reflecting 1% growth in underlying profit and US$133.8 million year on year reduction in significant item expense. The reduction in significant items reflects US$120 million of non-recurring impairment expense in the first half of the prior year, which related to the Group's investment in the HFG joint venture. We saw small increase in net finance costs of US$2.6 million in the half reflecting higher interest rates in North American and emerging markets as well as some increased expenses relating to the pre-funding of maturing debt. These increases were largely offset by increased interest income of US$5.5 million relating to the HFG shareholder loan and deferred consideration.

We recorded a tax benefit rather than a tax expense in the period. The benefit of US$13.6 million is largely driven by the recognition of a one off non-cash benefit to income tax expense of US$130.1 million due to changes in the US tax rate. Specifically, this benefit resulted from the decrease in the Group's deferred tax liabilities following the lowering of the US federal tax rate from 35% to 21% effective from the 1 January 2018. The Group's overall effective tax rate reduced by 2.5 percentage points to 26.8% in anticipation of the lower US tax rate and due to a change in the geographic mix of earnings. Profit after tax and EPS both increased by 198% reflecting the one-off income tax credit and the cycling of the prior year non-recurring impairment charge. Turning to sales revenue growth. The constant currency sales revenue growth of 5% was driven by strong volume growth across CHEP Americas, CHEP EMEA and IFCO.

Taking each segment in turn. CHEP America accounts for 39% of Group revenues and delivered revenue growth of 5% in the half. Growth was due to improve volume momentum and a return to historic levels of 4% volume growth in the

US pallets business with share gains despite competitive intensity in the market. Pleasingly, Latin American continues to perform strongly and deliver double digit revenue growth in the half.

CHEP EMEA also continued to grow strongly, increasing its sales revenue by 7%. The growth reflects volume expansion in all EMEA regions. Price increases were realised in the Africa, India and the Middle East businesses. However, overall pricing in the region was broadly flat to prior year as price increases were offset by pricing initiatives to support growth and share gains across the region.

Revenues in CHEP Asian-Pacific decreased 5% in the half largely due to the previously announced loss of a large OPC contract and the wind down of the automotive industry in Australia. Excluding the impact of these items, revenue growth was 2% at constant currency. Finally, our IFCO segment increased by 9% accounting for over 30% of the Group's total half one revenue growth. The growth reflected ongoing expansion with new and existing retailers in all regions as well as price and product mix benefits in North America.

Turning to slide 7. Looking at the key components of the Group's underlying profit results. As advised to the market at the full year results presentation in August last year, the first half underlying profit growth in FY18 has been impacted by the full six-month inclusion of HFG joint venture losses and was also impacted by the loss of OPC and automotive contracts in CHEP Australia. These items collectively reduced the first half Group underlying profit by US$15 million or 3 percentage points. Price, volume and mix impacts combined contributed to US$62 million to the underlying profit growth. Largely driven by volume across the Group, pricing was broadly flat to prior year reflecting competitive market conditions and strategic pricing initiative to support our growth and network density objectives. This growth has helped us to further strengthen our competitive and market positions in the first half.

Depreciation increases reflected the increased investment and pooling equipment to support the strong volume growth across the Group. In terms of direct cost, pricing and productivity gains in the half did not fully offset the US$24 million increase in net transport costs and the US$17 million increase in net plan costs. Higher than expected transport costs in major markets as well as structural cost pressures in the US pallets business, were the main drivers of these increased costs. I will address both these points in more detail shortly. Finally, the US$19 million difference between actual and constant currency underlying profit in the waterfall chart represents the depreciation of the US dollar relative to other operating currencies in the first half in particular the euro.

Turning to slide 8 and looking at transport and lumber and cost inflation. We saw higher than expected inflation in both transport and lumber costs, particularly in the US and Europe markets. Third priority freight rates increased 5% in the US and 4% in Europe during the first half with improved economic activity, labour shortages an increased regulation constraining market capacity and resulting in increased transport costs. Fuel price increases further contributed to the overall transport inflation in the first half. Looking at the financial impact of this inflation in the first half we incurred an additional US$12 million in transport cost due to higher third-party freight costs.

Lumber prices also increased by 2% in the US and 7% in Europe, reflecting improved economic activity in Europe and a combination of import tariffs and a resurgent housing market in the US. This lumber inflation resulted in a US$6 million increase in our first half capital spend due to the higher unit cost of pallets, particularly in Europe driven by higher lumber costs.

Finally, as you can see at the bottom of the slide, inflation rates for both transport and lumber have increased further in December and January and as a result we are anticipating increased transport and lumber costs in the second half. We have a range of productivity, cost out and other initiatives planned to help offset these costs. I'll cover these in more detail further on in the presentation. Moving from our review of Group results and looking at each segment in detail, I'll start with CHEP Americas.

In the first half, we saw improved momentum in the US pallets business and volume growth of 4% with particularly strong growth in the beverage and gross receptors. The volume growth was evenly split between new business wins and growth with the existing customers. Our pallets business in Latin America delivered another strong period of double digit growth reflecting expansion with new and existing customers as well as price growth. The 2.4%-point decline in Americas margin is largely due to the performance of the US pallets business, which faced a number of costs pressures. ROCI for the segment declined 3.2 percentage points reflecting the lower underlying profit in the US pallets business and a higher average capital invested balance largely driven by investments to support growth.

Turning to slide 10. Within the Americas region it's worth looking more closely at the first half sales of the US pallets business. Many of you will remember this chart from the full year FY17 presentation and our comments then, that we expected volume growth to revert back to historic levels of around 4% with minimal pricing expected given the competitive landscape. In the first half, the US business has delivered volume growth of 4% in line with these expectations. Net new business wins, which reflects market share gains contributed 2 percentage points to the growth. The balance of the growth was driven by increased demand from existing customers, particularly in the beverage and gross receptors. We expect the US business to maintain volume momentum for the remainder of FY18.

Also, in line with what we communicated at the full year results pricing in the half was broadly flat to prior year reflecting both customer mix and competitive market pressures. Looking at CHEP Americas underlying profit performance in more detail. The solid sales contribution to profit did not fully offset cost increases primarily in the US pallets business. Specifically, US plant cost increases included higher pallet repair and handling costs as well as other plant inefficiencies associated with capacity constraints. The increase in net transport costs reflected both third party freight inflation and higher transport miles in our network. Cost inflation accounted for US$8 million of the net transport cost increase. The higher transport miles was due to a combination of US plant capacity constraints requiring more pallet moves as well as changes in commercial arrangements with customers and retailers. To offset these cost pressures the business is pursuing a range of efficiency, productivity and cost saving initiatives as well as pricing actions.

Firstly, we are pursuing collaboration opportunities with both retailer and manufacturing customers to reduce costs across the supply chain. Secondly, we're focussing on increasing productivity and taking out costs in our own operations. There is a material opportunity to automate US service centres, which have limited automation. This is in contrast to our European service centres, which have a higher level of automation. Our experience in Europe is that automation initiatives have good paybacks generating higher returns, while also adding capacity and capability to our network. The initial phase of this increased automation investment in the US is currently underway and is highlighted on the capital investments slide. Thirdly, we're looking at opportunities within our own business to achieve other overhead savings. Finally, there are plan pricing actions to recover increases in cost serve.

Turning to slide 12 our CHEP EMEA segment delivered an impressive first half results with a revenue growth of 7%. Volume growth was strong across all businesses and margins were maintained despite increasing cost and competitive pressures. In the European pallets business revenue growth was 6%, with 5% volume from new customers and 2% growth from existing customers. Growth was particularly strong in central and eastern Europe. Overall pricing was slightly below prior year reflecting mixed changes, competitive pricing to support growth and to strengthen the network density in the region. Underlying profit growth of 7% at constant currency was in line with sales and revenue growth despite transport and other cost inflation as well as competitive pressures. Margins were in line with the prior year. Sales growth, supply chain efficiency and price indexation on Europe pallet contracts offset cost inflation. The increase in depreciation cost was in line with investment to support growth in the region. ROCI continued to be strong at 24.4% with investments in the region continuing to attract returns well above the cost of capital.

Our CHEP Asia-Pacific business delivered profit growth and increased returns despite the loss of a large Australian OPC contract and the cessation of a number of automotive contracts due to the wind down of the automotive industry in Australia. These factors drove the 5% revenue decline and also reduced underlying profit by US$10 million in the first half. Excluding the impact of these items, sales revenue increased 2%. Underlying profit growth of 3% and the 1.8%-

point improvement in the margins were driven by overhead cost savings and an increase in the collection of asset compensations in the first half. Due to the phasing of asset collections being weighted to the first half underlying profit growth in the second half is expected to be below the first half.

Turning to IFCO. Our IFCO OPC segment continued to make a significant contribution to the Group's overall revenue growth. Sales revenue increased by 9% reflecting volume growth with retailers in Europe, price and product mix benefit in North America and volume expansion in Asia and South America. Underlying profit growth of 6% was driven by the strong sales contribution to profit and efficiency gains which largely offset both higher depreciation costs in line with investment to support growth and transport inflation in Europe and North America. ROCI improved by 0.3 percentage points driven by capital efficiencies.

Turning now to the Corporate segment, which includes Corporate overhead, BXB Digital expenses and the equity accounted losses of the HFG joint venture. Corporate costs decreased by US$6.7 million reflecting lower indirect costs, which included a reduction in share base payments. The increase in HFG joint venture losses reflects the full six months' inclusion of equity accounted losses in the first half of this year compared to only three months in the prior corresponding period. BXB Digital expenses in the first half are broadly in line with the prior corresponding period. We continue to expect full year BXB Digital investment to be in the region of US$15 to 17 million.

Turning to Significant Items. In the first half, we have recognised a US$127.2 million post tax significant item benefit largely due to the recognition of the US$130.1 million credit to income tax expense reflecting the reduction in the US federal income tax rates from 35% to 21%. Pre-tax significant items reduced considerably in the first half, largely due to the cycling of the non-recurring US$120 million impairment of the HFG joint venture recognised in the prior period. In addition to this other significant item expense reduced by US$13.8 million reflecting savings following a strategic review of the significant item progress and the completion of other multiyear programs. Significant item expense of US$4.7 million in the first half is in line with our previously announced expectation for significant items of between US$10 to 15 million in FY18 to complete legacy projects.

Turning to cash flow. We delivered a material improvement in cash flow generation across the Group. Cash flow from operations increased by US$98.1 million over the prior corresponding period. Reflecting increased profitability, improved cash flow management and disciplined capital allocation. Looking at the key movements in the period. Capital expenditure on a cash basis increased US$13.2 million due to the timing of capex payments. On an accrual basis capital expenditure increased US$65 million at actual FX rates and US$45 million at constant currency. With the appreciation of the euro being the main driver of the US$20 million difference between actual and constant FX. We also saw a US$20 million increase in proceeds from the sale of property, plant and equipment, which reflects the increased collections of asset compensations in the first half. Debtor collection and working capital management also improved across the Group contributing US$28.8 million to increase cash flow in the half.

Finally, other cash flow movements resulted in an improvement in cash flow of US$17.1 million, which included the benefit of lower employee related payments and reflects the cycling of an acquisition-related earn-out payment in the prior year. Looking at capital expenditure in more detail, the chart on the left-hand side breaks down our capex on property, plant and equipment by segment and between pooling and non-pooling capex. Capex on property, plant and equipment increased US$65 million are 12% at actual FX rates. However, US$20 million of this increase was due to FX translation, largely due to the stronger euro relative to our US dollar reporting currency. On a constant currency basis capex on property, plant and equipment increased US$45 million are 9% over the prior year. Pooling capex increased 6% in the half reflecting investments to support volume growth in existing businesses as well as higher pallet costs due to lumber inflation in Europe and investments to facilitate expansion in new markets.

Asset efficiency delivered US$7 million of capex savings in the half primarily due to efficiencies in IFCO and cycle time improvements in both the US and Europe. In line with our focus of increasing the level of automation in our global service network centre, non-pooling capex increased US$14 million as we allocated more capital to supply chain technology and service centre automation. Before moving onto the balance sheet, I wanted to provide an update on our current assessment of the US tax reform package and the implications for our business.

As noted early in the presentation the lowering of the US federal tax rate resulted in the recognition of US$130.1 million benefit to tax expense in the half. In line with Accounting Standard requirements the first half's effective tax rate of 26.8% includes the anticipated impact of the lower US tax rate on US earnings for the second half. The US tax reform package is complex and we are reviewing the implications of all the proposed changes. Based on our current assessment, the impact of the US tax reform on the Group is not expected to be significant. We expect our annual effective tax rate from FY19 onwards to be between 27% and 29%.

Turning to slide 20. Our balance sheet remains strong. Net debt was US$2.7 billion as at the 31 December 2017. Representing an increase of US$134.7 million over the 30 June 2017 balance with US$84 million of this increase due to the impact on translation of non-US dollar denominated debt. During the first half, we further strengthened our funding profile with the €$500 million European medium term note issue, which was completed in October 2017 with the coupon rate of 1.5%. These proceeds will fund the April 2018 maturing EMTN, which has a coupon rate of over 4.5%. The issue also supported the increase in the average term of facilities from 3.7 years to 4.7 years and increase the headroom in undrawn committed facilities to US1.8 billion. Our net debt EBITDA ratio 1.74x and EBITDA to net finance cost cover off 14.7x both remains strong and, of course, given our strong profitability and conservative balance sheet we maintain our investment grade credit ratings of BBB+ from Standard and Poor's and BAA1 from Moody's.

I'll now hand over to Graham.

Graham Chipchase: Thank you Nessa. I would now like to provide you an overview of our progress against our five strategic priorities. By growing our market share in our key regions, we've added scale and density and strengthened our network advantage. At the same time our increased investment in pallet quality and enhanced market offerings, such as our first and last mile solutions provide customers with additional reasons to partner with us. As an organisation, we remain focussed on delivering operational and organisation efficiencies. Over the last 12 months we've optimised our network, increased our investments in automation, delivered overhead cost reductions and implemented procurement initiatives aimed at mitigating the inflationary pressures we face in lumber and transport. At the start of this presentation and during Nessa's section we noted the material improvement in cash generation. Through our focus on asset efficiency, working capital management and disciplined capital allocation we've moved significantly closer to our objective of funding dividends from free cash flow.

Now turning to slide 23. We continue to invest in innovation to create new value for shareholders and customers. Most recently this has been in the form of a number field trials conducted using technology developed by BXB Digital. These trials have been focussed around opportunities to improve our assets efficiency and to provide our customers with valuable insights in how their products move through their supply chains. As an organisation, we continue to prioritise the safety of our employees and our commitment to our zero-harm policy has seen our safety metrics continue to improve. We've also refreshed and strengthened the leadership team and continue to provide development programs to build the pipeline of future leaders.

Now turning to our outlook. By delivering on its strategic objectives, Brambles expects to deliver sustainable growth and returns well in excess of the Company's cost of capital. Sales review growth is expected in the mid-single digits, primarily driven by growth with existing customers, the ongoing conversion of new customers to pooled solutions and expansion across geographies. Through the progressive delivery of operational, organisational and capital efficiencies, Brambles expects to deliver underlying profit growth in excess of sales revenue growth through the cycle. A return on capital invested in the mid-teens and sufficient cash generation to fund the growth, innovation and shareholder returns.

As previously articulated at the fiscal '17 results announcement in August 2017, fiscal '18 underlying profit growth will be impacted by the following items. US$23 million of fiscal '17 underlying profit, which will not reoccur in fiscal '18 due to the loss of a large Australian RPC contract and the impact of automotive plant closures on a number of Australian automotive contracts. US$5 to 7 million increases in BXB Digital investment, which is expected to be approximately US$15 - 17 million in fiscal '18 and the full 12-month inclusion of losses incurred in the HFG joint venture.

Before opening up for questions, I'd like to outline how we are tracking against our key financial objectives, which we committed to last August. As indicated by the green light we delivered sales revenue growth in line with our objective. The light next to our underlying profit objective is amber to indicate that's - although we haven't yet achieved underlying profit leverage, we did achieve a return to underlying profit growth despite considerable cost and competitive pressures in our key markets. We, of course, remain committed to delivering underlying profit leverage through the cycle and have clear initiatives in place to do this. During the half, we materially improved our cash flow generation and moved significantly closer to our stated objective of fully funding dividends from free cash flow. However, as free cash flow does not yet fully cover dividends we have given ourselves an amber light. Return on capital invested remains strong at 16.2% and is in line with our objective.

Thank you for your time today. We'll now take questions from people on the phone and webcast.

Operator: Ladies and gentlemen, we will now begin the question and answer session. If you wish to ask a question today, please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request at any time, please press the pound or hash key. Your first question today comes from the line of Simon Mitchell from UBS. Please go ahead?

Simon Mitchell: (UBS, Analyst) Good morning. I just wanted to dig into the US cost pressures in a bit more detail. You've mentioned potential pricing initiatives to help offset. Can you just go into the levers you have available there, so are you talking more about surcharges, which obviously, the business has used in the past for fuel or are we talking about having to wait until contracts expire and then reprice on renewal?

Graham Chipchase: I think it's a combination of both those things, so clearly there is a mechanism around surcharges, which we'll absolutely employ and I think again notwithstanding the fact that there are competitive pressures in the US. I think the nature and the scale of these inflationary pressures is such that I would be very surprised if, as the industry leader, we didn't take some action to share some of that cost and pressure through the supply chain. Doesn't mean we don't think we should be taking some of it ourselves and mitigating it through our own efficiencies, but I think it's a combination of all those actions.

Simon Mitchell: (UBS, Analyst) That gets to my second question, in given your pooling competitor is arguably under more pressure, because of lack of network scale and also the lack of automation ability and also given the whitewood industry would seem to be experiencing similar pressures, wouldn't it be possible for you to pass on pricing?

Graham Chipchase: That's what I just said we would be looking at, so yes.

Simon Mitchell: (UBS, Analyst) Secondly, just on the European cost pressures, can you talk to the similar issues there, passing that on?

Graham Chipchase: Yeah. I mean, I think as we've said previous calls, so the European business is somewhat better structured to cope with inflationary cost pressures for two reasons. One is the contractual nature of the surcharge is such that they're priced in and they're more regularly able to pass on inflationary cost pressures, but also we've got a much higher level of automation in our European business, so our ability to offset inflationary cost pressures with our own efficiencies is greater and that's the challenge we have now in the US, which is to ensure that we start investing in that business, so that the level of automation in the US businesses it becomes more equal to that in the European business and therefore, we've got more opportunity to create our own efficiencies.

Simon Mitchell: (UBS, Analyst) Where are you at with automation in the US?

Graham Chipchase: So I mean we really are - if you roughly take the level of penetration of automation in the two businesses you versus US we're probably a quarter of the level we've got in Europe in the US, so there's quite a long way to go in the US, which is what we're now looking at in terms of prioritising which plants we do first and how much capital we're going to put into the business, but there's a - there's certainly a lot to go for.

Simon Mitchell: (UBS, Analyst) Okay. Just one last question for me on corporate costs. A big drop off from US$17 million to US$11 million [unclear] for the pure corporate part of the cost base, you touch on the sustainability of that obviously, I suppose it comes down to share based payments, but that aside what sustainability is?

Graham Chipchase: So we think the corporate cost would be a bit higher in the second half, because we won't get that benefit from the share based payments, but the flip side is we won't have the year on year hit of HFG compared to what we had this year, so it will go up a bit, but not a huge amount, so yes, it's not sustainable, its current level, but it will go up a bit.

Simon Mitchell: (UBS, Analyst) Okay. That's it for me. Thank you.

Graham Chipchase: Thanks.

Operator: Your next question comes from the line of Anthony Mulder from CLSA. Please go ahead?

Anthony Mulder: (CLSA, Analyst) Good morning all. Can I start in the US? Can you talk to the TPM changes the retailers are looking at, is it likely that some retailers will end TPM arrangements for you in the US market?

Graham Chipchase: So I think we're seeing both actually, because I think some are ending arrangements and actually with some other retailers, who are able to persuade them to revert back to TPM, so I don't think net net it's a big issue. I think this is just a continuation of what we talked about at the full year results in terms of some of the retailers in trying to pass costs onto the supply chain and to us and obviously, our competitors, where before they weren't doing that. Our response to that has been a combination of negotiating with them, but also trying to be innovative in how we offset that cost pressure. So that's the reason we didn't sell all of recycled or one of the reasons we didn't sell all of recycled, because we're retaining people and assets to recover more of our pallets from the retailers as well as being more innovative in terms of logistics and trying to get people, who are leaving the retailer empty to come and take our pallets back to our service centres. So those are all - it's just a continuation of the things we talked about at the full year.

Anthony Mulder: (CLSA, Analyst) Part of that also was a negotiation with one of the retailers around their asset terms. Can you give us - because that's a key focus of view, of course, can you give us any updates as to where those discussions have gone to?

Graham Chipchase: Well the discussions have gone well I think, but as you can imagine we're talking about turning a super tank around, so it takes a while to see the impact through the numbers, but the actual actions that we've agreed seem to be going as planned.

Anthony Mulder: (CLSA, Analyst) What are those actions you've agreed?

Graham Chipchase: That's not the level of detail I want to go into, because that's something, obviously, it's very confidential between us and that retailer.

Anthony Mulder: (CLSA, Analyst) Okay. Into the [unclear] rate of US lumber 9% through the US, are you starting to see some indications from the sales team that the conversion rate is increasing from white to [unclear]?

Graham Chipchase: Well I think that's probably explaining why our top line performance in the US has been as good as it is with the net new wins being at the 2% level and the organic being it too, I think that supports the fact that we are - we're seeing some conversion from whitewood. As you know my view is that that's, that correlation between lumber prices and conversion to pooling is not a straight forward one, so I don't put so much store in that, but clearly there's got to be some things driving the improved and the restoration to historic levels of the net new business rate.

Anthony Mulder: (CLSA, Analyst) Lastly, on BXB Digital, obviously when we've caught up a year ago the investment looked like it was going to be closer to US$20 million for BXB Digital, it's now potentially as low as US$15 to 17. Still confident in what BXB Digital gives the wider Group?

Graham Chipchase: Yes. I mean, if anything more confident now than I was 12 months ago. I think the phasing and timing of the cost are partly to do with just when we set about doing trials, I wouldn't set anything into the fact that the numbers a little lower than we thought it was going to be and we'll obviously give a lot more detail about the trials and what we're seeing out of the pilots when we do the investor day in March, but I would say I'm more confident now than I was 12 months ago.

Anthony Mulder: (CLSA, Analyst) Perfect. Thank you.

Operator: Your next question comes from the line of Owen Birrell from Goldman Sachs. Please go ahead?

Owen Birrell: (Goldman Sachs, Analyst) Hi Graham. Hi Nessa. I'm just following up on some of the previous question are asked around the efficiencies that you expect to see it offset some of these costs to suddenly come through the cost base. In terms of the transport efficiencies, the discussions you're having with those retailers and third parties increased automation and a pricing action, how long do you think it will be before we see those benefits come through to offset the impact you've seen in this half? That was my first question.

Graham Chipchase: So I think if we were to assume that inflation, in terms of transport and lumber was not going to increase in the second half, which of course, we're not saying that, because it probably will go up, but if you were to assume it stayed flat, then because of the initiatives we are taking and about to take, then probably, I don't know, three quarters of that cost inflation would be recovered within the next six to nine months' period. There's going to be a lag and we won't necessarily get all of it back, but I would say that a material amount of it will get back, now the trouble is, if inflation keeps on going up and the rate of inflation keeps on going up, we'll always be in a bit of catch up there, but I don't think one should get overly concerned about the impact that you've seen in the first half numbers, because we will get some of it back and I'd say our view is a material amount of it back.

Owen Birrell: (Goldman Sachs, Analyst) I guess a bit of follow up and it's in the same line, but the increased automation that you're putting into the business, I think it was US$14 million of additional PP&E investment in the first half, what's the rough pay back that we should consider, is it a payback time on that investment?

Graham Chipchase: So what we're looking at probably around three years, I mean it might go up a little bit more than that once we start looking at - as you go down this from the low hanging fruit to the something more difficult plants then the pay back might go up to four years something like that, but the one's if it - from our - based on our experience in Europe the plants where's there a lot of opportunity we can certainly get two to three years and then it goes up after that.

Owen Birrell: (Goldman Sachs, Analyst) That's great. Just finally on HFG, I'm just wondering what driving the increase and the losses in that business and is it one off in nature. I mean, we've got oil prices improving, we are expecting probably to see some synergies come through from the merger. Just wondering what's happening under the hood there?

Graham Chipchase: Well again as far as I'm aware and I'm not an oil and gas expert although whilst the price is coming up part of the problem in the bit of the industry where we are is that there is a lot of overcapacity and that part of the business has not yet picked up, because it's obviously much more downstream than the exploration parts. So whilst the industry's still quite fragmented and there's a lot of overcapacity it's very difficult for the business to get prices up to start getting a decent return. Now the only good sign is that we are seeing a gradual improvement, but it's not enough to turn the P&L around.

Owen Birrell: (Goldman Sachs, Analyst) So how should we consider that loss rate going forward?

Graham Chipchase: Well I think we're assuming in our planning - it's H2 will look a bit like H1 and that's what we're assuming.

Owen Birrell: (Goldman Sachs, Analyst) Okay. Thanks, guys.

Graham Chipchase: Thanks.

Operator: Your next question comes from the line of Paul Butler from Credit Suisse. Please go ahead?

Paul Butler: (Credit Suisse, Analyst) Good morning. Just a question back on the US, so you're sighting an additional US$10 million of cost for increased transport moves related to changed arrangement with retail customers. Can you just explain what are these changes of arrangements with the retail customers?

Nessa O'Sullivan: Yeah. Paul. It's Nessa here. A couple of things, first of all under some of the contracts, some of our customers have options for us to do - to take on transport legs at an agreed price relative to them doing them. As we've seen more transport inflation, more customers have opted to pass those costs to us. That is then going to be part of our cost review to say are we pricing appropriately for that level of transport legs coming back to us. Also, in some competitive cases we've had cases we're tendering for a new contract where competitors have offered that as an option to customers, where we have also competitively agreed to do that where it makes sense.

The other piece that's happened is really due to capacity in the plants, because as we've gone back to more historic levels of volume growth, we're actually having some capacity constraints in our plants, which have meant that we've handled more relocations than we would have if we had a higher levels of automation, so some of that is going to be ongoing as we take on more of the transport legs and other of them we will have opportunities to take out directly as we automate, so we'll either end up in a situation as costs go up to look at passing through pricing or to look at ways through automation to take out some of those extra, extra legs in transport.

Paul Butler: (Credit Suisse, Analyst) Okay. I mean, given that I think you're sighting increased transport cost inflation pressures in the second half, then surely customers are going to be increasingly taking up this option to get you to handle transport services for them, is that?

Nessa O'Sullivan: Yeah. Hence, where - hence my comment about key for us is we continue to look at what's the cost to serve and how do we price for that, so as we look at what the cost is that will be a key part of what we look at. Remember about a third of our contracts come up for renewal every year and within others there is opportunity to change the pricing as costs move up and down, so it'll be a combination of both.

Paul Butler: (Credit Suisse, Analyst) I mean, given - we're - globally we're moving back into a higher inflationary environment, what's your ability to - because on these contracts which you have, which are typically three-year contracts, what's your ability to factor in some pricing for future inflationary expectations or is it a case that you're always going to be playing catch up?

Graham Chipchase: Well I think, I mean there's - a lot of our contracts have indexed ability to increase prices, so that bit's always - you've always got an element to that and that's always going to be a lag, because you obviously you have to wait to see what the index does before you increase the pricing, but in terms of actually reflecting a change in the structural nature of inflation within a three period, we have to wait till the contract comes up for renewal and then you'll see us looking to take a view on inflation over that next three year period and price accordingly and one would hope that the market will have done the same and therefore it won't be a uncompetitive thing to be doing.

Paul Butler: (Credit Suisse, Analyst) Okay. I mean, I think in the US you outsource roughly 80% of plant operations. I'm just wondering what you're seeing happening with pricing for plant operation services from your subcontractors, particularly with labour market getting tight, I mean is there - has that had an impact in the past half or are you expecting that to become more of an issue going forward?

Graham Chipchase: I don't think we've seen it come through the numbers in the first half particularly, and I think you've got to think about the labour part of our operations is actually not that big, so the labour cost inflation in our operations is not such a big driver, but clearly I mean, I think if you start thinking about the US economy as a whole and if wage inflation starts going up significantly, then we clearly will see some of those pressures, but we have some pretty good contracts and we will obviously be as robust with our own suppliers as our customers would be with us, so I think that's - you could expect us to be taking a pretty tough view on that of inflationary pressure.

Paul Butler: (Credit Suisse, Analyst) Okay. Cool that's it from me. Thank you very much.

Operator: Your next question comes from the line of Guy Bunce from JP Morgan. Please go ahead?

Guy Bunce: (JP Morgan, Analyst) Thank you. Good morning everyone.

Graham Chipchase: Morning.

Guy Bunce: (JP Morgan, Analyst) Just back onto to CHEP USA. In December and January, we did see the whitewood pallet manufacturers increase their selling prices significantly on the back of higher input costs, so I assume that you've already started having these discussions with your own customers about raising rental rates based on those initial discussions. Can you give us a feeling for confidence about rates going up in second half?

Graham Chipchase: Well that's the thing I said earlier on, we'll deploy a number of different things to recover what we think are the cost pressures we're facing, so increasing our prices is one of them, but recognising that we have got long terms contracts, so we can't do those until the contract expires. We're relying on contracts which are coming up for renewal and we're relying on the surcharges we can apply for things like transportation and we then have to rely on ourselves to become more efficient and get more efficiencies to offset the cost. So I don't think you should see the opportunity of a massive price increase in the future for our business, but yeah, we'll do what we can do and we have to I think, because these prices of transport inflation and the lumber inflation is significant, so I don't think it's a big concern, but it's something we have to get on and action in the next six months.

Nessa O'Sullivan: Yeah. Look probably worth noting if you look at slide 8 where the market inflation rates were double what our inflation rate was, because we effectively managed those costs to ensure that we don't take the full impact of the market inflation rates.

Guy Bunce: (JP Morgan, Analyst) That's a good point, Nessa, and it actually segues nicely into my second question, which in terms of your transport cost inflation, looking at the spot freight rates, they seem to have risen considerably more than what your reporting, so spot rate's up 20 to 25% year on year and obviously you're saying that in the first half in terms of transport inflation in the US was only up about 5%, I imagined some of that's to do with your dedicated service contracts you have with the trucking operators. How long can those contracts protect you for?

Nessa O'Sullivan: Well part of what we do is so we're about - we've have historically when transport inflation is more benign, we tend to have about 50% dedicated and 50% at spot rate, remembering that our customers hold pretty low levels of safety stocks, so we always have quite a bit of volatility, so we need to have a fair chunk of spot rates. Also, relocation of pallets means those longer transport lanes that it is much more efficient to do that at spot even with the rising inflation levels. So when we look at the inflation we benchmark against similar lanes to what we use. You would - might expect to see us go up to higher levels of dedicated contracts with higher inflation, but we would still at the optimal level, still have only about 60% dedicated and still need to have 40% playing in that spot market.

Guy Bunce: (JP Morgan, Analyst) Okay. Thanks very much.

Operator: Your next question comes from the line of Scott [Rile] from [Remor] Equity. Please go ahead?

Unidentified Participant: Thank you. I have a couple of questions. Nessa, you [unclear] the first and last mile solutions in talking about the EMEA business, can you just clarify - I think I know what you mean, but I just want to make sure that I've got it please?

Nessa O'Sullivan: Sorry, can you just repeat that in relation to EMEA, the question?

Unidentified Participant: Yeah. You referred to first and last mile solutions on page 12, I think it was and the fact that you'd…

Graham Chipchase: So the first mile solutions are what we probably would think of as our container business, so it's the things that are taking product from producers into their factories, so it's their bulk ingredients and the last mile solution is the step that goes either to a convenience store or to the consumer, so the reason we focus on these is that they're an area where we're adding more value into both the retailer and the FMCG producer and therefore whilst a small percentage of the business actually the returns we get from our investment they're very good and it's growing faster, so it is an area of focus for us.

Unidentified Participant: Okay. Secondly, there's been a little bit of a theme clearly on the call, but could you just talk to the plant and transport cost increases that you think are unique to Brambles, you've obviously talked of plant costs a fair bit and some of the inefficiencies that you've seen as you're getting capacity constraints. What - would you say that's a 50% of the cost process is unique or less more?

Nessa O'Sullivan: Yeah. If you have a look at the net transport cost and the bridge that we have on slide 7, so we call out that we had US$12 million increase from rate inflation and the other 12 was to do with increased miles. Overall that, that equates to about a 2% increase in inflation and we see market inflation at 4%. So from a relative sense we would say the competitive set we would assume would be having a higher level of inflation than we're experiencing, however, we do have some inefficiencies and further opportunities, so overall our increases around that 4% level in terms of transport costs.

Unidentified Participant: Okay. But what you're saying is the increased transport miles is something that you believe is unique to Brambles or is it unique to the CHEP operation as opposed to market driven?

Nessa O'Sullivan: Well I think there are structural changes, because part of the reason why we're taking on more transport legs is because competitively that they have been options that have also been offered by competitors as well.

Unidentified Participant: Okay.

Graham Chipchase: I think it links back to the other comment we made around this need to automate more in the US. So part of the inefficiencies - because we haven't got the capacity where we'd like it and therefore we're moving pallets around more, so this is why the automation project for the US is absolutely critical going forwards, because it clearly is a much more efficient way of getting capacity and then building more and more supply - service centres around the US.

Unidentified Participant: Okay. Understood and that brings me onto my last question. How do you control the level of equipment that goes into a plant that you don't operate?

Graham Chipchase: So we have a lot of oversight about how those outsource operations actually run and there are a lot of metrics around heads and costs that we then control in - if you like a service level agreement, with the outsource provider, so that's how we control it, they're not given a free hand as to how they actually run the service centre.

Unidentified Participant: Okay.

Nessa O'Sullivan: In the significant number we also own equipment, which is part of the contractual terms taking into account the cost of the capital investment in that site.

Unidentified Participant: Right. Okay. That's all I had. Thank you.

Graham Chipchase: Thanks.

Operator: Just a reminder ladies and gentlemen, if you do wish to ask a question today, please press star one on the telephone. Thank you. Your next question comes from the line of Paul Butler from Credit Suisse. Please go ahead?

Paul Butler: (Credit Suisse, Analyst) Just a follow up on the Asia-Pacific business. Did you - because it's obviously a strong result in the business - did you make up any of the lost RPC volumes with new contracts to replace the large contract that you lost?

Graham Chipchase: Not particularly, we had some - we've had a little bit of growth in the RPC business, but there's quite a lot of effort going into replacing that lost business and I think you'll see us have some success there in the next 12 to18 months, so that's the time frame we're looking to replace it at, but there's been a bit of growth, but not - it's been a bit driven by the growth of the pallet business in Asia-Pac.

Paul Butler: (Credit Suisse, Analyst) Is there any prospects for significant growth in that RPC business or have you - what have you done with the assets that you had previously to service the large contract?

Graham Chipchase: Well the assets have gone with the contract, so that's - we don't have an issue about under-utilised assets, but the plan is we'd like to replace that lost volume with new business that's not necessarily served by RPCs today and there are plenty of opportunities to go after that and that's what our business is trying to do.

Paul Butler: (Credit Suisse, Analyst) Okay. Thank you.

Graham Chipchase: Thanks.

Operator: Just another reminder ladies and gentlemen, if you do wish to ask a question today, please press star one? Thank you. There are no further questions at this time, I would like to hand the conference back to today's presenters, please continue?

Graham Chipchase: Great. Well thanks very much for your time and we'll speak to you all in the next few days I hope. Thanks a lot.

End of Transcript