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Event Transcript

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Start of Transcript

Operator: Thank you for standing by and welcome to the Brambles Limited 2020 half-year results conference call. I would now like to hand the conference over to Mr Graham Chipchase, CEO, please go ahead.

Graham Chipchase: Good morning, everyone. Thank you for joining us today for our 2020 half-year results announcement. I would like to start with a few key messages about the first-half performance. We delivered strong sales revenue growth of 7%, in line with our objective for mid-single-digit growth. This performance reflected volume growth with new and existing customers across all CHEP pallet businesses, improved price realisation in our US business, and illustrated the resilience of our European business despite significant geopolitical, economic and cost headwinds. Our underlying profit was up 5%, including the impact of AASB 16, which is in line with the guidance we provided at our full-year 2019 announcement.

Underpinning this performance was the strong growth in sales revenue, improved supply chain efficiencies, and a moderation in transport and lumber inflation, which were partially offset by higher operating costs and increased asset charges across the Group. Previously, we outlined a number of initiatives to restore margins in our US pallets business. These initiatives included the accelerated automation program, the lumber procurement program, and a number of productivity and pricing initiatives. I am pleased to report that these initiatives delivered a 1% margin improvement in the period, which is in line with our commitment to lift US business margins by 2 to 3 percentage points by fiscal '22.

In December, our Asia-Pacific business won a 10-year RPC contract with a major Australian retailer, commencing in July 2020. The contract win reaffirms our commitment to the RPC business in Australia. During the half, we recorded a significant improvement in cashflow, driven by increased earnings, lower capital expenditure and improved cash collections across the Group. Our return on capital invested of 18% remains strong and well above our cost of capital.

Now turning to our dividends and capital management program. In line with our new dividend payout ratio policy, we have declared an interim dividend of US$0.09, which will be converted and paid at AU$0.1338. This represents a payout ratio of 50%. This ratio is consistent with prior year, and within our targeted payout ratio range of 45% to 60%. During the period, we also conducted significant capital actions. In June 2019, we commenced our US$1.65 billion on-market share buyback. To date, we have repurchased $51.4 million shares at a cost of US$415 million. We expect to complete the buyback in late fiscal '21. In October, we returned US$312 million to shareholders, comprising $183 million of special dividends and a pro-rata capital return of US$129 million.

I would like to take this opportunity to remind everyone of our global leadership position in sustainability. Firstly, though, it's worth noting that when we first set the target in 2015 the goals were considered very ambitious and, in many cases, we did not have fully defined pathways to achieve the objectives. As such, it is extremely pleasing to report that we are on track to achieve many of our key targets by the 30 June 2020 deadline.

Without mentioning all the achievements, I would like to highlight some. We expect, by June 2020, we will be able to report that 100% of our wood comes from certifiable sustainable sources. We will have reduced our carbon dioxide emissions by 25% since 2015. We helped removed 1.3 million tonnes of waste from customers' supply chains. We have eliminated 70 million kilometres of trucking haulage through transport collaboration with our customers. As a Group, we remain committed to our sustainability leadership position. It is our intention to launch our 2025 sustainability goals at

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our May 2020 investment day in Orlando. They will again be ambitious and designed to maintain Brambles as one of the world's most sustainable companies.

I would now like to take a moment to address what Brambles is doing to support bushfire-affected communities in Australia. All of us at Brambles have been shocked and upset by the devastating bushfires we've seen across Australia in recent months. These fires have significantly affected whole regions and communities, and many of our own employees have been impacted.

Our Australian team has provided emergency relief, including significant in-kind support for our charitable partner, Foodbank, which continues to provide food to affected communities. We've also allowed for paid leave for up to four weeks for Rural Fire Service and emergency services volunteers. Additionally, we have donated AU$500,000 to be shared equally between Foodbank Australia, the Australian Red Cross Disaster Relief and Recovery, Landcare Australia and the Australian Rural Fire Services. Brambles is also matching any donations made by our employees globally. Providing this support, both financial and in-kind, recognises that sustainability is in our DNA as a business, and this includes contributing positively to the communities in which we operate.

We know from previous discussions that many of you are interested in our ongoing trials with a US retailer to test the operational functionality, asset management and economics of plastic pallets, in line with the retailer's stated strategy to convert all their inbound platform flows to plastic.

While commercial and customer sensitivity prevents me from going into greater detail, I will make the following points. Total flows from this retailer represent less than 3.5% of Brambles's global pallet flows. All our major US competitors are participating in these trials. The trials involve extensive testing of new plastic pallet designs and asset management technology. The trials will extend into the second half of 2020. In addition, I would add that Brambles already maintains the world's largest pool of plastic pallets and operates substantive wood and plastic parallel pallet pools in Europe.

Now looking forward to our expected operating landscape and our full-year 2020 outlook. Volatile global trading conditions and political instability, including Brexit, have led to a slowdown in organic growth in core European markets such as the UK, France and Germany. These conditions are expected to continue in the second half of fiscal '20. Similarly, the Coronavirus may lead to a slowdown in Asia, though our businesses there remain small and not material from an earnings perspective.

Transport and lumber inflation in the US business is moderating, though other sources of inflation, such as labour and property lease inflation, continue to rise. While sales revenue growth in the Americas segment is expected to remain strong, benefits from timing of customer contracts of 1% to 2% are not expected to repeat in the second half of fiscal '20. Within this context, at constant FX, and including the impact of AASB 16, Brambles's outlook for full year 2020 is for mid-single-digit sales revenue growth and underlying profit growth to be in line with sales revenue growth.

I'll now hand over to Nessa.

Nessa O'Sullivan: Thank you, Graham. Good morning, everyone. I'll start with an overview of the first-half fiscal '20 result. We delivered sales and earnings growth across each of our regions in the first half. Sales revenue growth of 7% was at the top end of the Group objective to deliver growth in the mid-single digits. Underlying profit growth was 5%, including a 3 point increase from the implementation of AASB 16. We have had no significant items in this period or in the prior year first half. Hence, the underlying profit growth of 5% is in line with operating profit growth.

Earnings growth was driven by sales, efficiency gains and lower lumber and transport inflation, which more than offset higher operating costs and asset charges across the Group. The first-half increase in asset costs partly reflects the weighting of annual asset charges in Latin America to the second half of FY19 which are now phased across the full year. Profit after tax, which includes discontinued operations, decreased 9% due to the prior-year period including

earnings of $51.4 million from the IFCO business which was sold in the second half of FY19. Underlying EPS of US$0.178 increased US$0.01 per share, reflecting higher earnings and a $0.003 benefit from share buybacks.

The new leasing standard, AASB 16, came into effect for Brambles on 1 July 2019. The key points to note are as follows. AASB 16 contributed 3 percentage points to the Group underlying profit growth. Whilst the standard has a net nil impact on the total statutory consolidated cashflow, there is a $56 million net increase in reported free cashflow, with $56 million of lease payments now classified as debt repayments and recognised in the payment of principal component of lease liabilities line in the consolidated cashflow statement within the statutory accounts. In terms of the impact on the Group ROCI, AASB 16 resulted in a 1.8 percentage point reduction in the Group reported return on capital invested. For those seeking more information, Appendix 3a and 3b provide more details, including a breakdown by segment.

Turning to the Group sales revenue on slide 12. Group sales growth of 7% was driven by a good balance of volume growth and price realisation across our businesses. Price growth of 3% includes price realisation across all markets, with a notable increase in the Americas region reflecting inflationary trends and cost-to-serve increases. Group like-for-like volume growth was 1%, driven by growth in the Americas and Asia-Pacific regions. Like-for-like volumes in the EMEA region were in line with the prior year.

It should be noted, however, that all regions contributed to the 3% growth in net new business winds in the half, including the EMEA business which delivered net new business growth of 3% despite economic challenges in the region. In terms of the second half, our expectation is to see Group revenue growth moderate by 1 to 2 points, reflecting ongoing economic challenges, the roll-off of a contract loss from the second half of FY19 and the cycling of prior year customer wins.

Turning to slide 13 and the Group profit analysis. Sales revenue made a strong contribution to the profit of $94 million, which was partly offset by direct and indirect cost increases across the Group. Depreciation expense increased $14 million, reflecting growth in the asset pool to support increased issue volumes net of improved asset efficiencies. The increase in depreciation also reflects the ongoing investment in the US supply chain automation and lumber projects, with $115 million spent to date which has been funded by $250 million of proceeds from FY18 asset actions exiting underperforming assets.

Net transport costs increased $7 million, largely driven by higher collections in Latin America following the launch of the enhanced asset management program in the second half of FY19. This cost increase also drove increased pricing in the region, which is recognised in the price volume mix bucket on the slide. In the transport cost bucket, this increase was partly offset by a $2 million decrease in US transport cost reflecting lower third-party freight rates in the period.

Plant cost increases of $25 million related to three key factors. Firstly, labour and property inflation, with particularly notable increases in North America. In Europe, we incurred additional handling and inspection costs largely due to an increased focus on asset efficiency across our service centre network. Finally, we experienced some anticipated inefficiencies in the US pallets business during the rollout of the automation program in the region.

IPEP expense increased $25 million in the half, reflecting higher asset charges partly due to an increase in pallet written-down values across the Group. $5 million of the increase related to the rephasing of higher asset charges in the first half of FY20 in Latin America, which followed the recognition of a higher cost-to-serve in the second half of the prior year.

Other costs increased $13 million, largely due to investment in additional overheads across the Group to support supply chain efficiency and asset management programs, particularly in the Americas region, to support the delivery of improved commercial outcomes across those regions. Finally, AASB 16 contributed $12 million benefit to the underlying profit growth in the period.

Now looking at our segment performance and starting with CHEP Americas on slide 14. Sales revenue growth in the Americas was very strong at 9%. This included improved price realisation across the US and Latin America to recover input cost inflation and cost-to-serve increases. Despite these pricing initiatives, volume growth was robust and reflected contributions from the current and prior year contract wins in Canada, Latin America and the US.

AASB 16 contributed 0.6 points to CHEP Americas' margin, which improved by 0.2 points in the half. Excluding the benefit of AASB 16, the Americas region margin declined 0.4 points, notwithstanding a 1 point increase in US margins in line with our stated objective. The decline in segment margins was driven by anticipated first-half margin pressure in Canada and Latin America. Which includes the impact of half-one, half-two phasing of costs in Latin America related to assets and the asset management program, which were recognised in the second half of the prior year.

Slide 15 details the components of the CHEP Americas margin increase in the first half, and provides commentary on our expectations for the full year, with improvement expected in the second half. Starting with the US, the 1 point margin improvement in the first half translated to a 0.6 point benefit to the overall Americas segment margins. This 1 point of US margin improvement reflected improved cost recovery through price, a moderation in lumber and transport inflation, and efficiency benefits from our lumber procurement initiative. These benefits offset labour and property inflation, as well as anticipated inefficiencies during the rollout of the US automation program. As we look to FY20, we expect US margins to increase by 1 point on FY19 levels.

As anticipated, Canada margins declined in the first half, decreasing the overall Americas margin by 0.5 points. This decrease was driven by higher asset repair costs associated with the stringer-to-block pallet transition and increased IPEP due to higher unit pallet costs. As a result of these additional costs, we expect the year-on-year trend in half-two and full-year Canada margins to be consistent with the trend noted in the first half.

Latin America margins declined in the first half, reflecting higher asset charges recognised in the current period, with the prior-year charges weighted to the second half of FY19. First-half FY20 overhead costs also reflected investment in the additional headcount associated with initiatives and actions implemented in the second half of FY19 to deliver higher asset collections and improve cost recovery through pricing in the region.

The pricing and asset management initiatives in Latin America have already started to deliver results, with improved price realisation and $24 million of additional cashflow from asset efficiency benefits in the region. We expect margin improvement in both the second half and for the full year, reflecting improved cost recovery through price and the benefit of the year-on-year phasing of half-two asset charges. In summary, excluding the benefit of AASB 16, Americas FY20 region margins are expected to increase on FY19 levels, largely driven by the anticipated margin improvements in the US and Latin America businesses.

Turning to slide 16, and US sales revenue which reflected improved price and volume growth in the first half. Pricing initiatives to recover costs contributed 4 points to revenue growth. Although effective price, which includes surcharges, was 1 point lower at 3%, reflecting a reduction in surcharge contributions in line with the moderation in lumber and transport inflation over the past six months. Like-for-like volume growth of 1% was in line with historic levels. Net new business wins increased to 3% and included the rollover contribution from a major contract win in the prior period.

Looking to the second half of the year, we expect volume growth to moderate by 1 to 2 points, driven by a roll-off of a prior year contract loss and the cycling of prior year second-half wins. In addition, surcharge contributions are expected to decrease in line with current trends in third-party freight rates.

Turning to slide 17, we have made good progress with our US margin improvement initiatives during the first half. As you can see from the shaded circles in the chart, our pricing and procurement initiatives have largely been implemented and we expect full-year contributions from both initiatives in FY21. Our automation program is on track, with the 25 sites automated to date delivering in line with our initial investment case expectations. Collectively, we continue to expect that

these initiatives will deliver 2 to 3 points of margin improvement on the first-half '18 levels, and for the phasing of this improvement to reflect an annual increase in margins of around 1 point per annum across FY20, FY21 and FY22.

Turning to the CHEP EMEA segment, where the margins and returns remain strong despite challenging economic conditions and cost headwinds. Revenue growth of 4% was driven by solid volume growth and price realisation in most parts of the business. Excluding the impact of AASB 16, underlying profit was flat on the prior year as the sales contribution to profit was offset by direct and indirect cost increases.

Direct cost increases reflected higher transport costs in the automotive business, and additional inspection and handling costs in Europe pallets business as the business sought to optimise pallet balances across the network. Indirect costs increases were driven by higher pallet unit costs in the IPEP calculation, and investment in overhead to support new business growth and improved commercial outcomes across the region. The 1.7 point reduction in region ROCI reflected lower profit margins and higher ACI, which included the impact of prior year automotive asset purchases and CapEx to support Brexit-related increased retailer stocking.

On slide 19, looking at the EMEA sales revenue in more detail. Despite challenging macroeconomic conditions which impacted like-for-like volumes which were flat on the prior year, CHEP EMEA delivered growth of 4%, which included a 1 percentage point contribution from price realisation in line with cost inflation in the region. The net new business wins of 3% was below the prior year FY19 level. However, FY19 included a 2 point contribution from a large automotive contract win. Looking to the second half of FY20, we expect like-for-like volumes in the European pallet and automotive businesses to continue to be impacted by broader economic uncertainty.

Turning to CHEP Asia-Pacific which delivered margin uplift and strong returns in the first half. Solid revenue growth in the pallets business, and cost control and efficiencies across the region, more than offset the impact of a large RPC contract loss in the prior year. We won a large RPC contract with a major Australian retailer in the first half. The contract, which has a term of 10 years, will commence in July 2020. Revenue contributions from this contract will commence in FY21 and we expect earnings benefits to flow through from FY22 onwards. In terms of capital and return considerations, upfront capital investment will be made in FY21, with returns expected to be well in excess of the cost of capital over the 10-year life of the contract.

Looking at our cashflow performance in the first half of '20, on slide 21. Excluding the impact of the $183.2 million special dividend which was funded by IFCO sales proceeds, free cashflow increased $108.1 million on the prior year first half. This outcome was driven by a significant increase in operating cashflow which reflected higher earnings, a $33 million reduction in cash capital spend despite volume growth, and increased cash collections which drove working capital improvements in the period.

Reported free cashflow also included a $56 million increase due to the implementation of AASB 16. Which, together with stronger operating cashflow, was more than offset by the $119 million adverse year-on-year impact relating to the divestment of IFCO. The $119 million year-on-year IFCO related reduction in cashflow is made up of the $97 million IFCO cash contribution to the prior year comparative period recognised in discontinued operations, as well as $22 million of current year ordinary dividend outflows which related to prior year IFCO earnings. Importantly, ordinary dividends were fully funded by underlying free cashflow after adjusting for IFCO-related dividends and the investments in automation which are funded through proceeds from FY18 asset actions.

Moving to slide 22. On an accrual basis, total capital expenditure decreased $26 million at constant currency in the first half, reflecting asset efficiency benefits and timing of non-pooling CapEx. Our key asset efficiency metric, the pooling CapEx to sales ratio, improved materially in the first half, with a 1.8 percentage point reduction to 19.6%. This improvement was delivered despite ongoing investment to support volume growth, and reflects asset efficiency across the Group, with a notable contribution from our Latin America pallet business.

Prior year pooling CapEx included two items which did not repeat in the current year. Firstly, $11 million of additional pallets to support Brexit-related retailer stocking which is yet to unwind. Secondly, $12 million of CapEx invested in automotive assets relating to a large contract win in the prior year. Non-pooling CapEx decreased $15 million over the prior year, largely due to the timing of investment in the US automation program, with commissioning of sites weighted to the second half of FY20.

Turning to the balance sheet on slide 23. Net debt increased $1.4 billion on FY19 levels, reflecting $718 million of lease liabilities brought on balance sheet under AASB 16, and $674 million of capital management transactions which included share buybacks, as well as a capital return and a special dividend payment in the first half. We have significant headroom on our balance sheet, with $2.4 billion of cash and undrawn credit facilities which is more than sufficient to fund the balance of our share buyback program.

As we look to the full year and considering the impact of AASB 16, we expect FY20 net interest expense to be between $85 million and $90 million for FY20. During the half, we revised our financial policy to include the impact of AASB 16, with the revised policy targeting net debt to EBITDA below two times, which is aligned with our commitment of maintaining our investment-grade BBB+ credit rating. In addition, we have also revised our EBITDA definition to recognise IPEP as a depreciation line expense, which is in line with the methodology applied by the credit rating agencies.

In summary, revenue growth in the first half was resilient in the face of macroeconomic uncertainty. The initiatives we've implemented in the Americas region are on track to deliver both operational and financial improvements over the medium term. We delivered a material improvement in underlying cashflow, reflecting asset efficiency across the Group and disciplined working capital management. Finally, we have a conservative and flexible balance sheet which continues to be underpinned by an investment-grade credit rating. Thank you. We will now go to 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 speakerphone, please pick up the handset to ask your question. Your first question today comes from Anthony Moulder with Jefferies, please go ahead.

Anthony Moulder: (Jefferies, Analyst) Good morning, all. If I can start with the guidance level you've talked to, 1 to 2 percentage points, revenue impact in the second half, do I take that that's evenly split across the Americas and EMEA?

Graham Chipchase: No, it's in the US, basically. There'll be a little bit in EMEA, but the majority of it's in the Americas.

Anthony Moulder: (Jefferies, Analyst) That's the volume impact from the contracts rolling?

Graham Chipchase: Yes.

Anthony Moulder: (Jefferies, Analyst) So economic uncertainty in EMEA, no real impact?

Graham Chipchase: So I think what we're highlighting there is it's very similar to what we said in August, or our thoughts are similar to August and probably the year before that as well. Which is this is not just a Brexit impact. We're seeing economies slowing down in places like France and Germany as well. But do we see the impact being worse in the second half than we've already seen in the first half? I would say probably not. Which is we've seen flat underlying like-for-like growth in Europe. So we think it's going to be like that rather than going negative. But you've just got to keep a close eye on it.

Because, again, what could the impact be of global trade wars getting worse or Coronavirus spreading outside of Asia? We don't know at this point. But our view at the moment is, the second half in Europe, it will be similar to the trends we've seen in the first half.

Anthony Moulder: (Jefferies, Analyst) You're no longer providing the geographic regions of Europe. Can you talk to whether or not one of those has been more impacted by that slowdown?

Graham Chipchase: Well, yes, I mean I think what we're saying is it's the - I'll call them established, rather than developed, markets in Europe, so you're talking mainland Europe. We're still seeing good growth on the fringes and in some of the Middle East, India type parts of that reporting segment. So, again, that does lead a little bit to why we're calling out, in terms of the margin growth, that whilst we're seeing growth in some of these other markets, they're not necessarily going to be as high profitability as the France, Germany, UK part of Europe. So I think that's the picture you should be thinking about.

Anthony Moulder: (Jefferies, Analyst) Or western and northern.

Graham Chipchase: Yes.

Anthony Moulder: (Jefferies, Analyst) You commented on the automation program's running to expectations. Given customers, over the last 12 months, have agreed to the pricing increases from higher inflation in the system, are you expecting customers to ask to share the benefits of the automation program when they start to step up?

Graham Chipchase: No, that's not our assumption. I don't think we've had any indication, from the negotiations we've had so far, that that will be the case. So we're very confident that that margin guidance we've given over the next three years is something we can deliver.

Nessa O'Sullivan: I think, Anthony, it's also worth nothing, as we talk about effective pricing, we've highlighted that effective pricing is lower than the actual price realised on the top line. That reflects that we're getting lower surcharges. So the mechanism is, largely, as the lumber costs come down and transport come down so too do our surcharges. But particularly in the US region, the Americas region, that is not reflected on the top-line revenue. It's an offset to the cost line. So that's where the flip comes in. As costs come down, our surcharges come down also.

Anthony Moulder: (Jefferies, Analyst) Remind us as to how long that takes to normalise down, please?

Nessa O'Sullivan: Two to three months, depending on the exact wording in each of the contracts. But roughly it's around that time lag.

Anthony Moulder: (Jefferies, Analyst) So not a six-month impact I guess is the benefit. Lastly, while I'm still in the US, has there been any change to retailers' behaviour in that market positively or negatively?

Graham Chipchase: I'm going to say no material change either way.

Anthony Moulder: (Jefferies, Analyst) All right, that's it from me, thank you.

Graham Chipchase: Thanks.

Operator: Thank you. Your next question comes from Matt Ryan with UBS Investment Bank, please go ahead.

Matt Ryan: (UBS Investment Bank, Analyst) Hi, Graham. Hi, Nessa. Just a question on EMEA margins. I think you've called out a number of direct and indirect cost pressures on slide 18. Just curious on which of these costs do you think are temporary or one-off? Looking out maybe to FY21, your thoughts on this increased cost pressure?

Nessa O'Sullivan: Look, a couple of comments, Matt. One would be, if you look at the make-up of the growth, given that we do have high growth in you'd say more emerging or developing markets where we don't have the same level of scale, we're getting great returns and strong margins from them but they're not at the same level of the total region. So I think, pleasingly, what this is showing, that although we're seeing a slowdown in Europe, that the business has been able to get good momentum and a pipeline for growth in new areas of development.

We should expect that kind of shape as we go into the second half. If economic conditions change materially, then we can probably expect to get more organic growth, which may give us a little bit of a benefit through on margins. But, overall, for the region, we're still at very, very strong margins and strong returns, and I wouldn't be building into any of the models a tick back up in margins. We'd rather continue to see good strong growth at high returns for the business be added in.

Matt Ryan: (UBS Investment Bank, Analyst) Okay, that's clear. Then on slide 13 there's an other line, which looks like you've incurred about $13 million of extra overheads.

Nessa O'Sullivan: Yes.

Matt Ryan: (UBS Investment Bank, Analyst) Can you just describe what that is exactly and should we just double that for a full-year impact?

Nessa O'Sullivan: So the answer is yes, in terms of a full-year impact. But the nature of the costs, first of all it includes the Latin America piece, if you remember. So for the second half of last year we started implementing the new asset management program. So we added more resources, commercial resources and market resources, asset recollection, et cetera, into that market. We also, across the Group, have added more resources to improve our commercial pricing of contracts. Also, as we're looking to use more digital capabilities across the Group, including we've rolled out a new sales tool for our salesforce. So they're the key contributors to that added cost.

Matt Ryan: (UBS Investment Bank, Analyst) I guess I mean circa $25 million, that's close to 3% of EBIT. Is that a bit higher than what you were thinking that number might be?

Nessa O'Sullivan: No, that was in line - as you can see, the results we've delivered have been in line with what we had indicated. Really, the biggest flip, in terms of first half, second half, is really the timing of asset charges first half versus second half, rather than this as an overhead cost. Look, a key piece - and that's what we called out. Look, a key piece of as we got price realisation was recognising higher cost-to-serve, particularly in that Latin America business.

Matt Ryan: (UBS Investment Bank, Analyst) Okay. Then the US transport and lumber costs, can you tell us whether you're a net beneficiary at that cost line after taking into account the surcharge reversals? So did you benefit from…

Nessa O'Sullivan: Yes, so, look, we still have - we're still a net-net beneficiary. So we called out that we had a $2 million benefit net in the US from transport. We generally saw the lumber really net-net out with the surcharges. The challenge for us though in the US, which we've seen come on, is increased labour inflation and also increased property costs, which are the two new components that we have in our total cost base.

Matt Ryan: (UBS Investment Bank, Analyst) Okay, that's all for me, thank you.

Graham Chipchase: Thanks, Matt.

Operator: Thank you. Your next question comes from Owen Birrell with Goldman Sachs, please go ahead.

Owen Birrell: (Goldman Sachs, Analyst) Hi, guys, just a few questions from me. Just, firstly, on the guidance. I know you've changed your guidance from the lower end of mid-singles up to the middle of mid-single-digits growth. But it sounds like you're talking down the growth profile across all the markets. I'm just trying to reconcile that into what's actually changed since August to give you a little bit more confidence in the growth outlook?

Graham Chipchase: So I think let's just talk about guidance language generally. I think - and we'll take the blame for this - we are talking on a pinhead here, between going from mid-single digits up slightly above, and we're talking about the ULP being in line with, or slightly above to in line with. Just to step back from the words, we are still sticking by our view on ULP for the year.

What we're just trying to reflect a little bit, in terms of the language, is we did better on the top line in the first half than I think we expected. But that was partly, as Nessa talked about in terms of this US business that's coming off, we held onto it for a bit longer than we thought. We've done a little bit better in other regions, in terms of sales growth, than we did in Europe. There's obviously a margin mix impact there just because Europe's such a profitable market. So, in reality, I don't think we're saying much has changed at all. We're just reflecting what's actually happened in the first half on the top line. Our views on the bottom line stay pretty much the same.

In terms of the market outlook, the only area where I think we continue to be cautious is around Europe, just because we are seeing a slowdown in the underlying economies. But again the business did pretty well in the first half, notwithstanding the macroeconomic implications. Then the only other thing I think I have to say is we don't know what the impact of Coronavirus will be on our business in Asia and China. It's very small, our business. Therefore, from an earnings perspective for the Group, it's not material. But it's hard to call right now what will happen if there's a pandemic which is global. I certainly don't know. I don't think many other people know at this stage. So I think we're just trying to stay balanced about outlook in terms of the macroeconomics.

But I think the important things to come back to are, yes, we've had a lot of economic uncertainty in the first half. Our business is very resilient and is still able to produce really good top-line growth and bottom-line growth numbers even in those conditions. More importantly I think for Brambles, two of the key things which we were trying to deliver in the first half were really good cashflow, which we've done, and convince everybody and show everybody that our plans for US margin improvement were going to happen and we've nailed that on the head in the first half as well. So I think if you put all that together, us being slightly - still remaining cautious about global outlook growth is a minor point compared to the positives on the other ones.

Owen Birrell: (Goldman Sachs, Analyst) All right, understood. Just on that US pallets revenue, you talked to a 1 to 2 percentage points roll-off in the second half. Just to confirm, so what you're saying is the US market, 8% growth in the first half, it should be around about 6% to 7% growth in the second half year-on-year, and the deviation is essentially in that net new business wins?

Graham Chipchase: Me being me, I would go 5%, 6% or 7% possibly, rather than any higher than that. So you could take the 8% minus 2% for sure. Then you've got take a view a little bit on some of the pricing rollover and all the rest of it. But, yes, I think your view and analysis is good enough.

Owen Birrell: (Goldman Sachs, Analyst) Okay. Just in the Australian market, you talked about the new RPC contract that you've won. I mean we can all guess at who that is. I'm just wanting to get a sense of what the nature of that contract is. Is it actually a pool management contract, or is just a pool servicing contract as per what it used to be?

Graham Chipchase: No, so we are effectively taking on the management of the pool and washing of the crates from their own inhouse operations. We're taking on the full operations of it.

Owen Birrell: (Goldman Sachs, Analyst) Okay. Can you give us a sense of what level of investment is actually required into that? Because we understand that the old facilities they had were quite old as per your facilities. Can you give us a sense of the scale and the magnitude of investment that's likely to go in - what is it - FY20 I think it was?

Graham Chipchase: We can't because it's sensitive, but it's not life changing. It's an amount of capital, but I think the most important thing is that the return on that capital investment is above the cost of capital across the period of the contract. I think more importantly for me is that strategically we're back in business in RPCs in Australia. Whereas if we had not won that contract, I think we'd have to significantly rethink what we were doing. But from an economic perspective, it is a good project to have won. It's just there's a bit of timing, as you've already alluded to, between the investment going in next year and us getting the ULP flowing out in the year after. But it's a good program.

Owen Birrell: (Goldman Sachs, Analyst) In terms of the return profile there, I mean the WACC, I would imagine, for the project over that period is quite low. I know your internal hurdles are quite high. Can you confirm whether you're actually going to be exceeding your internal hurdles on that project?

Graham Chipchase: Yes, because our internal hurdles are our internal hurdles and that's how we judge projects. So whether they're the right internal hurdles or not, whether they're too high reflecting the lower cost of capital across the globe, we can have a debate about that. But we kept them up as high as they were before and we will beat those hurdles with this project.

Owen Birrell: (Goldman Sachs, Analyst) Okay. Look, just a final question for me on BXB Digital. Nothing mentioned in this results on BXB Digital. What's happening there? Are there any updates or any new projects or initiatives that have come out of there?

Graham Chipchase: So they're still very much focused on supporting the business, in terms of understanding better where the leakage is occurring and how we can run our business more effectively. I think we'll talk a little bit more about what's going on when we get to May, so the investor day. But I think you can see the impact of BXBD, or the insights we're getting from that, flowing through in the better asset productivity and the CapEx per sales numbers. Because that's all linked to are we understanding where the assets are going missing and can we change contractual terms to get better pricing to reflect the higher cost-to-serve. So it's supporting all of that activity. But there's no new major initiatives which we need to talk about until we get to May.

Owen Birrell: (Goldman Sachs, Analyst) That's great. Thanks, guys.

Graham Chipchase: Thanks.

Operator: Thank you. Your next question comes from Anthony Longo with CLSA, please go ahead.

Anthony Longo: (CLSA, Analyst) Good morning, everyone. Look, just a couple of questions from me. So earlier you mentioned comments on CapEx, and particularly Brexit. Are you able to give a bit more colour as to what we should…

Operator: We're now reconnected, please go ahead.

Anthony Longo: (CLSA, Analyst) Yes, hi, I'll try again. So my question was around about the UK and the impact of Brexit. Are you able to give a bit more colour as to what we should expect from that market now, just given the commentary that you did give on the CapEx number?

Nessa O'Sullivan: Well, maybe I guess, look, from a total CapEx, we spent extra CapEx last year. We haven't seen it come back out. We would expect, at some point in the future, the incremental CapEx that we outlined for half-one, half-two last year, we would expect that, over time, to reverse back. It's fair to say we all saw that Brexit got delayed. We see stocking levels still continuing to remain relatively high.

That's been part of the driver with increased handling costs. Because as we got any of those types of pallets back, we repatriated them so that we can reissue them, because a lot of the flows come from mainland Europe back to the UK on that particular pallet. So the impact for Brexit is more impacting us in terms of the cost line at the moment. The CapEx has been spent, but we're keeping a placeholder and we'd expect that to reverse over time. Not sure what the timeframe is yet.

Anthony Longo: (CLSA, Analyst) Yes, not a problem. That's great. So the second question from me was just looking at the input costs. I do appreciate your comments around net plant and also transport that you're seeing. Are you able to give a bit more colour on what you're seeing on labour inflation, and also the property costs which feels like you've highlighted this time around?

Nessa O'Sullivan: Yes, look, I think the US economy has really performed very strongly. Demand for particularly blue-collar labour has been particularly high; it's gone to construction and other parts of the economy. Plus there's also been quite a bit of activity with the likes of Amazon and those bigger big box retailers who are the e-commerce end, which has just bid up the cost of labour. So while it's impacting us now, I think this also reinforces why we need to continue to automate and look for efficiencies as we go forward. Because there are challenges with getting access to that labour, particularly when the economy is doing well.

The other thing we have seen is, again, property inflation. We had quite a lot of leases that we started renewing in the second half of last year, all of which had quite significant increases. We did quite a lot of work looking at property benchmarking. Again, us looking to automate the existing plants and get 20% to 25% more productivity out of the sites that we're automating is obviously a good move in light of those increased costs.

Anthony Longo: (CLSA, Analyst) Yes, sure. Just in terms of a bit more colour, in terms of those lease increases, are you able to give an order of magnitude as to what you've seen that inflation running at?

Nessa O'Sullivan: No, because it varies so widely geographically depending on where we are.

Anthony Longo: (CLSA, Analyst) Yes, not a problem. Look, last one from me. Just looking at the Asia-Pacific business, we've seen lower revenues year-on-year, but we've seen a bit of margin expansion come through there. Can you perhaps talk through what some of the dynamics were in seeing that expansion?

Nessa O'Sullivan: Well, look, a couple of things. Is that the Asia-Pacific team has been particularly good at delivering year-on-year efficiencies in terms of their overhead costs. We also commissioned a new service centre. The nature of our business being quite a developed business, in the Australian market in particular, is that we have service centres that were aging. So we've been embarking on a program of upgrading those. So the first one of those in Victoria has come online and that contributed to some of the efficiencies that you're seeing in there.

Anthony Longo: (CLSA, Analyst) That's great. Thanks so much, appreciate the time.

Graham Chipchase: Thanks

Operator: Thank you. Your next question comes from Jakob Cakarnis with Citi, please go ahead.

Jakob Cakarnis: (Citigroup, Analyst) Morning, guys. You've called out a 1% margin improvement in the US, but you've also mentioned in the commentary that there's still some inefficiencies from network disruptions due to automation implementation. Can you let us know how those inefficiencies will sequence into the second half and what some of the remedies are there, please?

Nessa O'Sullivan: Yes, so, look, we were always clear that, as we started automating, the challenge for us is that you have to take capacity out to upgrade the plants. As a result of that - particularly if you're already capacity constrained, which we were at the start of this - you end up having extra handling and other costs as a result of it. So, hence, why we're saying the best way to think of it, we've packaged it all together in terms of the efficiencies we get from the ones that are up, plus the inefficiencies from the commissioning. To say that's why, over each of the next three years, we're saying approximately 1 point of margin improvement. That wraps up in the lumber automation, we're doing the pricing, all those components together.

Jakob Cakarnis: (Citigroup, Analyst) Okay, thanks for that. Just on the EMEA business, can you let us know how indexation is impacting margin recovery there, and whether or not these inspection and handling costs and the other costs that you're calling out are actually captured under the cost indexation that you do have in the EMEA contract?

Nessa O'Sullivan: Yes, so not all of the cost increases we have are covered by indexation. So that's a key point to note. Some of the cost increases aren't necessarily just inflation driven. So for us, we had increased costs in our automotive business which we called out. Some of that is due to as we look at how we're operating with new contracts there. So we're looking at ways to get more efficiencies in there.

So, look, generally the way the indexation works in the EMEA contracts is that there is an increase generally in the first half of the year, that's indexed at the beginning of the year, reflecting what's happened to the key inputs which is largely lumber, labour, transport. That if there is a major change during the year, there may be some moderation in the surcharge, but generally you should think about it as an annual change.

Jakob Cakarnis: (Citigroup, Analyst) Okay, thanks. One final one for me. You've called out a reduction in the pooling CapEx intensity. Can you let us know what initiatives are driving that, and whether or not you guys are considering changes to the replacement rate and the rate of new issues to service customer volumes, please?

Nessa O'Sullivan: Yes. So, look, as you know, our big focus has been how do we sustainably improve cashflow. A key component as to how we do this is managing the asset pool. So you saw us talk about putting in a new asset program in Latin America, which was a big outlier, and we're starting to see big improvements there. That's involved market mapping, new arrangements with customers which makes them more accountable for losses, higher pricing reflecting their loss rates on a more granular level, plus arrangements with retailers to improve the efficiency of our collections that we're doing in conjunction with them.

In the other markets we're also doing similar things, working with customers and retailers to improve collections. We'll talk more on investor day about some of the key initiatives that we're putting in place using data analytics, and also using AI and ML to help us get better with how we collect and how we run our pool better. So there's more to come in that space. I would say we're making progress, but we'd like to make faster change and we think there's more opportunity. We'll talk about that at the investor day.

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

Graham Chipchase: Thanks.

Operator: Thank you. Your next comes from Cameron McDonald with Evans and Partners, please go ahead. Cameron McDonald, your line is now live.

Cameron McDonald: (Evans and Partners, Analyst) Sorry. Good morning. Just a question on the other cost line item, on the $13 million. Nessa, you said that the $13 million was somewhat related to Latin America. Why was that not put into the Latin America and, hence, the Americas division as a cost item and held at the Group level?

Nessa O'Sullivan: No, so in terms of total overhead, we have overheads. So there are direct costs that relate that go into the segment and then there's some overhead costs. If you look at some of the corporate costs, we do have some centralised costs that have been about helping to drive global improvements in efficiency. We had global costs that relate to the deployment of the new asset tool. So there is some switch with us putting some central resources that are helping with the overall problem solving around the region. As we look at the statutory reporting, the corporate costs get allocated to the region based on activity.

Cameron McDonald: (Evans and Partners, Analyst) Okay. Then on the cashflow, you've got a big positive working capital movement given the change to AASB. Can we just get an update on what you expect that benefit in the second - or for the full year to be? Or should we just be doubling that $56 million benefit? Then thinking into the following year, does that then unwind?

Nessa O'Sullivan: So the first thing that you should note about the big improvement in working capital, it's actually because we spent a lot of time working through dispute resolutions with customers and improving our whole collection process. So there's been a big improvement in the processes and the efficiency of cash collection. That's what's driving the working capital benefit.

In terms of the actual reported numbers, you can that the benefit from AASB 16 that's in free cashflow, noting that the leasing standard doesn't give us any free kick in terms of total statutory, but in terms of reported free cashflow, the $56 million benefit that we got is dwarfed by the impact when you take out the impact of IFCO which was $119 million year-on-year. So you can look at the cashflow, the year-on-year improvement, and know that actually the underlying cashflow has actually improved by more than that number there. When you look at working capital, to know that it's about how we're managing collections has been the major driver of that.

Cameron McDonald: (Evans and Partners, Analyst) Okay. So presumably we'll get a full year benefit from the AASB 16?

Nessa O'Sullivan: Yes, and we will call that out so you can separate it out. But in the same way we also had IFCO, remember, in the second half of the year, so there'll be a contribution from IFCO that will come out too. I think the key big picture needs to be material improvement in cashflow generation which we said was a key objective, we showed improvement last year, we've gone even further this year. Obviously, a contributor to that has been the increased earnings, including that 1 point margin improvement in the US business.

Cameron McDonald: (Evans and Partners, Analyst) Okay. Then just a final question on the plastic pallet trials with one of our major retailers that you've called out, involving new pallet designs and asset management technology, how are the discussions going around who's going to pay for this and what are the economics looking like? Is the customer getting the benefits that they think they're getting or think they're wanting to get?

Graham Chipchase: Well, I think if you look at the slide, [we said] because of the commercial sensitivity I'm not really prepared to go into great detail about this. But the trials are ongoing. We are testing out exactly those issues you have raised around the level of pricing, around the level of leakage and loss and damage rate. But I can't really say anything more than that, because the trials are still ongoing and we won't really know for some time what the results of the trial are.

But, again, I would just reiterate that it's a small percentage of the business. All of the competitors in the US are going through this. This is not just a Brambles's initiated thing. I know there was a lot of concern around having to build up separate service centres to run a plastic pool alongside a wooden pool. We do exactly that in Europe already without there being a significant fixed cost increase issue. So I don't think this is something to be alarmed about. I think we'll keep people up to date as we learn more, but it's something that is just a trial.

Cameron McDonald: (Evans and Partners, Analyst) Okay, thank you.

Operator: Thank you. 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 Paul Butler with Credit Suisse, please go ahead.

Paul Butler: (Credit Suisse, Analyst) Good morning. I just wanted to ask a question about the increase in the IPEP charge. I think you've highlighted there that a portion of that relates to Latin America and I think also Canada. How much of that, roughly, relates to Latin America and Canada versus other parts of the business?

Nessa O'Sullivan: So we called out that $5 million phasing is due to phasing which comes back into - it was the first half versus second half last year. But if you actually look at the total increase of the $25 million, 80% of the increase is due to the higher cost per pallet which was partly reflected in the second half last year, increased FIFO cost, and then the Latin America $5 million [chained]. So of the $25 million, you can go $15 million is higher IPEP unit costs, $5 million is due to the phasing. The balance, you'd expect to see some growth given the volume growth that we've had is largely how you should think about it. Noting that, from an underlying perspective, we're getting efficiencies in the asset pool.

Paul Butler: (Credit Suisse, Analyst) So are you saying $15 million is because of the higher cost of pallets? Is that what you mean when you…

Nessa O'Sullivan: Yes, the higher unit cost of any of the pallets that we're providing for, yes. Some of that came up last year and this is now flowing through into the first half of this year. If you're looking at why we're not giving specific IPEP guidance, you can take it that you shouldn't see this level of step-up in IPEP costs. As you get into the second half, you'll be cycling the Latin America piece. Plus we had some of that increased unit cost in the second half.

Paul Butler: (Credit Suisse, Analyst) Okay. Now, if you were to think about the cashflow in terms of a cashflow conversion metric, what would be your preferred way of thinking about that?

Nessa O'Sullivan: Well, we've always said our objective that we work on is to make sure that we want to be in a position to be fully funding the capital in the business and the dividends. So that's how we look at it. Rather than saying big picture what should the flowthrough be, we look at all the components of it. I think that goes to the quality of the earnings, seeing this increase in cashflow consistently that we've had now year-on-year.

Paul Butler: (Credit Suisse, Analyst) Okay. I just wanted to ask about the competition you're seeing. I mean I think in the presentation you've said competition levels in the US are strong but rational. Have you seen any changes in competitive behaviour over the last six, nine months?

Graham Chipchase: No, I think they remain competitive and rational. I think there are absolutely no changes at all.

Paul Butler: (Credit Suisse, Analyst) Okay. Then just another one related to Brexit. I think there was a significant inventory build over the last 12, 18 months. Are you expecting to see that unwind?

Nessa O'Sullivan: Yes, and we've called it out there as a bit of a flag. We're just saying, because everything got delayed with Brexit we haven't yet seen those inventories unwind. But we would expect to see, at some point, those incremental pallets that we put in to support the increased stocking come out, given that we know everybody will be driving for

efficiencies through their supply chains. But at the moment, given uncertainties about how everything's going to operate, we're still seeing that everybody is holding that incremental stock and we haven't yet seen it unwind.

Paul Butler: (Credit Suisse, Analyst) Okay. Then just on the trial with the plastic pallets, when are you expecting that trial to conclude? Is the view from the customer that their intention is that predominantly all of their flows would be on plastic pallets, or would it be just some smaller group of stock items?

Graham Chipchase: Well, we're not expecting to see results from the trials until the second half of calendar '20. You'll have to ask the customer what their real views are. But we can only back on what they have stated publicly, which is that they would like to convert all of the wooden flows to plastic. Now, clearly, that will depend on the economics for them and for us, as poolers, and for their suppliers who are our customers, but that's what their stated ambition is.

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

Graham Chipchase: Thanks.

Nessa O'Sullivan: Thanks.

Operator: Thank you. Your next question comes from Niraj Shah with Morgan Stanley, please go ahead.

Niraj Shah: (Morgan Stanley, Analyst) Morning, Graham and Nessa. Just to round out the discussion on competition, you mentioned it was stable and rational in the US. I'm just curious about the competitive environment in Europe, both in the core as well as the fringes.

Graham Chipchase: Yes, so, again, I mean it's not the same sort of picture. Because it's much more fragmented across the whole of Europe, which makes, therefore, the impact of any changes less material than it would be perhaps in the US. But I think it's fair to say that it's still very rational, but maybe a little bit more competitive. You can see that, in terms of as the economic conditions get a bit tougher I think people will start trying to win volume. But our view is that no one's doing it stupidly and neither are we. So I think it's still very rational, but it probably is a little bit more competitive than it was 12 months, 18 months ago.

Niraj Shah: (Morgan Stanley, Analyst) Got it, thank you.

Graham Chipchase: Thanks.

Operator: Thank you. There are no further questions at this time. I'll now hand back to Mr Chipchase for closing remarks.

Graham Chipchase: Well, thanks, everyone, for dialling in. I know we'll be seeing a few of you over the next few days, so I look forward to that, but thank you very much.

End of Transcript