Company: Brambles Limited
Title: Brambles formation of Oil & Gas Container Joint Venture

Start of Transcript

Raluca Chiriacescu: Good morning everyone. This is Raluca Chiriacescu from Brambles Investor Relations speaking. Thank you for joining us at short notice for this call. With me in Sydney is our CEO Tom Gorman and our CFO Zlatko Todorcevski. Joining us on the line from the US is Jason Rabbino, Group President of Containers and Head of Group Strategy. Hopefully you've all had time to review the announcement lodged with ASX this morning. Tom and Zlatko will take us through a few slides covering the highlights of the announcement and we will then open for questions. Over to you Tom.

Tom Gorman: Well thank you very much Raluca and welcome to everyone on the line. As Raluca mentioned Zlatko and I will walk you through the presentation and Jason will be available for questions and answers to follow. Today we have announced our intention to combine our Oil & Gas containers business unit with Hoover Container Solutions. Hoover is a leading provider of container rental solutions and associated services to the Oil & Gas and Chemical sector. The combination of these businesses will form Hoover Ferguson Group or as we'll refer to it going forward HFG. Our Oil & Gas business unit comprises the Ferguson Group which is the offshore Oil & Gas containers logistics business which we acquired in September of 2014. It also includes our CHEP Catalyst & Chemical Containers business which serves the refining sector.

HFG will be an independent joint venture owned equally by Brambles and Hoover shareholders. Hoover is majority owned by First Reserve Corporation, a leading global private equity and infrastructure investment firm which specialises in the energy sector and has raised approximately US$31 billion of capital over the past 30 years. This transaction has compelling industrial logic. We are creating the second largest player in the Oil & Gas and Chemical container logistics space. The new business will open up substantial synergy opportunities from rationalisation of operating costs, improved asset utilisation, cross selling benefits and of course global scale. HFG will go after these opportunities aggressively and immediately creating a strong platform for growth and value creation at a time of industry uncertainty. We have signed a shareholder agreement that governs key aspects of the joint venture including exit provisions.

Now we see four key benefits of this transaction for Brambles. Firstly, it enables us to continue to pursue our aim of lending our unique expertise to improving supply chains in this sector and to enhance our position in the industry without additional capital outlay. Secondly, we see substantial synergy opportunities. HFG is targeting annual cost and CapEx synergies of US$5 million to US$10 million within three years. Then we'll also seek to maximise the substantial revenue opportunities related to cross selling services and products globally. The transaction is expected to be neutral to underlying EPS in FY17 and accretive as synergies are realised going forward.

Thirdly, this creates considerable optionality in relation to the scale of and the capital allocation to this sector including our future ownership and potential exit. Lastly, the transaction creates an independent self-funding platform for growth allowing us to manage our exposure while providing access to greater potential upside. Now I would like to provide a quick overview of HFG. We will have a strong footprint in key global regions of the Oil and Gas sector notably North America, the North Sea region, Latin America, the Middle East, Australia and South-East Asia.

We will have 78 dedicated facilities worldwide, more than 110,000 high quality rental units and approximately 500 employees. Pro forma sales revenue in the 12 months ended 31 December, 2015 was US$217 million with EBITDA of US$86 million. Now since December oil and gas conditions have continued to be challenging and both businesses have implemented various cost reduction measures to date. This transaction will bring with it additional cost savings and revenue opportunities not currently available to either business on a standalone basis. From a management and governance perspective, HFG will have an eight member board of directors with equal representation from Brambles and Hoover's existing shareholders. HFG will be led by the current Hoover CEO, Donny Young.

Now this slide provides a visual representation of the highly complementary geographic footprint of the three businesses and the truly global nature of HFG's combined operations. The key point to know here is the strong Americas presence particularly in the Gulf of Mexico which Hoover adds to the Ferguson and CCC footprint. This is a key strategic expansion opportunity that we highlighted following the acquisition of Ferguson in September 2014. It is also worth noting that customers have been increasingly demanding third party service providers that are capable of servicing their needs on a global scale. The merger of these businesses will create a comprehensive global platform with the capability to service the industry's largest customers in every major oil and gas region in the world.

Now before I hand over to Zlatko to take you through the financing and accounting implications of this transaction, I want to take the opportunity to review the creation of the new Oil & Gas joint venture and put it in the context of the bubble chart that we use to explain our approach to capital allocation across our portfolio. Now many of you are familiar with this chart and would have seen it in previous presentations. The chart here is based on FY15 data. It plots each of our business units' return on capital invested relative to growth in average capital invested. Now the size of the bubble reflects the size of the business or in this case the total average capital invested.

Now this chart provides a view of how we see value creation from the perspective of both investing in more mature businesses that have high returns today and also investing in those businesses that are less well established where the return timeframe is a bit longer. As we stated at our FY15 results, we have been keenly assessing the allocation of capital to all of our business units across our entire portfolio.

Our focus has been on business units that we feel may not be able to achieve the desired level of returns or the appropriate scale within a timeframe that is both acceptable to us and to our shareholders. LeanLogistics at the bottom left-hand corner stood out. Lean as you will recall is a software as a service business which was less suited to the type of return on capital metrics appropriate for the vast majority of our portfolio and from which we believe we had extracted all the available value. We completed a divestment of this business in early June of this year.

Now the Oil & Gas business unit has a different profile. Like our IFCO Europe and our intermediate bulk containers operation, it carries considerable goodwill as a result of acquisitions specifically in this case the acquisition of Ferguson. This business generates very attractive incremental returns on capital. However, as a result of the severe decline in the industry conditions over the past 18 months, the time horizon over which we can drive higher returns to improved utilisation and investing in growth at those very high incremental returns has in fact lengthened.

Now the formation of a self funding independent joint venture structure with a very strong partner meets many of our strategic needs in this sector. It allows us to manage our investment in this sector while creating optionality over future ownership. It enables us to achieve greater scale and synergies and it positions the new entity HFG uniquely to take advantage of further opportunities with no further capital requirements from Brambles. Now we believe this is the solution that enables us to pursue the upside from our initial strategic investment in this sector while mitigating downside risk created by the changed industry conditions that we're presently facing.

We will continue to be disciplined in our assessment of the allocation of capital to all of our business units with a particular emphasis on ensuring that both the level of returns and the amount of investment are adequate. This ongoing rebalancing of our portfolio will also present opportunities for broader organisational efficiencies. I'm now going to hand over to Zlatko to talk through the financing terms and the accounting impacts of this transaction in a bit more detail - Zlatko.

Zlatko Todorcevski: Thanks Tom and good morning everyone. This first slide sets out the key financing terms in more detail. Through the transaction Brambles will receive approximately US$75 million as consideration from First Reserve to equalise ownership of HFG. US$40 million of this payment we will receive immediately on closure of the transaction and the balance on a deferred basis. Brambles will contribute Ferguson and CCC with US$164 million of debt. Our debt contribution includes a US$150 million subordinated shareholder loan with a cash interest rate of 10% per annum.

We are providing this loan because capital markets are not currently conducive to refinancing the joint venture at appropriate terms. When that situation changes, HFG will target an entirely self funding capital structure which will enable the full repayment of the shareholder loan of Brambles releasing more cash to Brambles as shareholders. Existing Hoover debt will be rolled over into HFG and HFG will seek to maintain a leverage profile consistent with the long asset lives in the sector.

On this next slide we'll look at the specific accounting impacts of the transaction. Ferguson and CCC will continue to be accounted for and continue operations for the FY16 year. We anticipate to incur US$7 million of transaction costs which will be recognised as significant items over the FY16 and FY17 periods. Looking forward upon completion of the transaction Ferguson and CCC will be deconsolidated and Brambles' stake in the new joint venture will be equity accounted. In the income statement this means a number of changes. Firstly, results previously attributed to Oil & Gas will no longer be fully consolidated in Brambles' accounts. Our 50% share of HFG profits will be recognised as a single line item on a post tax basis within the share of results of joint ventures and associates.

Finally, interest income from both the shareholder loan and deferred component of the equalisation payment will be recognised as finance revenue and form part of our FY17 interest expense guidance. In the balance sheet, our equity stake in HFG will be recognised within investments and the shareholder loan and the deferred equity equalisation payment will be recognised within non-current operating assets. The body of the ASX Release we lodged this morning and the appendix of this presentation provide you with a more detailed overview of these impacts including a pro forma balance sheet as at 31 December, 2015.

Before handing back to Tom I'd like to cover the US$38 million impairment charge which will be recognised against the value of our oil and gas assets as at 30 June, 2016. This impairment charge reflects the impact of current market conditions in the oil and gas sector. From an accounting standpoint, this charge is non-cash in nature and will be recognised as a significant item in the FY16 financial statements. While this impairment is disappointing, we are confident the creation of HFG will strengthen the position of our oil and gas business in the current market conditions. Notwithstanding this impairment charge in this transaction, our FY16 guidance remains unchanged. We continue to expect constant currency growth in sales revenue and underlying profit of between 8% and 10%. I'll now hand you back to Tom.

Tom Gorman: Well thanks very much Zlatko. So that brings to an end our prepared remarks. Let me close however by recapping a few key points. The transaction announced today has compelling industrial logic. The strategy here is very sound. Firstly, it enables us to apply our unique pooling expertise to the combined HFG business which strengthens our position without additional capital outlay. Secondly, we see a number of cost CapEx and revenue synergy opportunities. The transaction is expected to be neutral to underlying EPS in FY17 and accretive as synergies are realised going forward. Thirdly, this transaction demonstrates discipline capital allocation mitigating risk but providing access to upside. Lastly, it creates optionality over future ownership including potential exit options. We will now take any questions. Thank you very much.

Raluca Chiriacescu: Thank you Tom. The first question is from Anthony Moulder at Citi. Please go ahead Anthony.

Anthony Moulder: (Citigroup, Analyst) Good morning all. Just let's start more on the strategy side of it, how many other businesses the auto and I guess aero space would also benefit from a similar kind of joint venture with other parties to give more scale et cetera, more global reach. Is that what you could be thinking of for those other parts of the container business also?

Tom Gorman: No well I think - well thank you Anthony for joining us and thank you first for the question also. Look I wouldn't just start with this with a focus only on containers. I think that we've been very open that we look at our business as a portfolio business. So what we have been trying to do and I think doing it relatively successfully over the number of years is really focusing on each one of our businesses, seeing where they are in terms of our ability to [rate] this concept that we talk about of quality and quantity. The quality of the business, ie. what's the return profile of the business and the quantity which is how quickly we can grow and add capital to each one of those businesses.

I think what you're seeing here with this action is that we're demonstrating flexibility that given the certain circumstances and given the certain opportunities I think as a company we remain open and flexible. As we sit here today we don't have any plans to create any other ventures like this in any other parts of our portfolio. I think we do want to remain flexible as we think about how businesses develop, how our businesses develop going forward. If you look at our IBC business we've made a number of acquisitions, we've really built that business through acquisitions but we can't really talk specifically yet about the performance of the year because we'll be coming to our earnings release in two weeks' time.

You will see that that business continues to grow nicely and it's growing nicely organically. In the same pace with the automotive business, if there were opportunities we would look at those opportunities but the strategy there is really fully organic growth as well. So the simple answer is when there are opportunities presented we would consider those but there's nothing planned for any other parts of our portfolio at the moment.

Anthony Moulder: (Citigroup, Analyst) Right okay. Can I ask as to how this came about? You mentioned customers were increasingly asking for this grab a third party service providers outside of the global reach that you've had through Ferguson. I would have thought that you would have known that going into the acquisition of Ferguson or has something changed as far as the market dynamics that make that more...

Tom Gorman: Well Anthony I think it's just the opposition actually. When we made the acquisition we talked about the foot print of Ferguson and we clearly recognised that particularly with the Americas that that was an area that we would look to grow the business. If you look at the complementary nature of this combination of businesses, the big thing that Hoover brings from a geographic perspective is their position in the Americas. So we identified that early on. As you would imagine over the last couple of years since we've owned the business, we've had multiple conversations. It's an industry that obviously is confronting some economic and market headwinds and so I think you see a lot of players talking to many different people in this space. You are seeing some other consolidation. You saw what OEG has done in this space.

So I think there was a fair bit of activity. Early on we found that we were very like minded with Hoover. All of the work we have done with them thus far the cultures mash extremely well. We're very impressed with Donny Young as a leader and I think with the First Reserve team we have a financial backer of that business that understands the O&G space very well. They've been around for 30 years, they've weathered ups and downs in the space. We think the combination of the management team that we'll now be joining the Ferguson team plus the ownership of First Reserve, we really have the best solution for us going forward as we focus on building this business.

Anthony Moulder: (Citigroup, Analyst) Very good. Lastly if I could there's a third component of the US$75 million you get US$40 million in the door - how long before the other US$35 million could be paid in its entirety?

Zlatko Todorcevski: Anthony there are a number of triggers of when we might get that US$35 million back but I think the short answer there is essentially First Reserve can't really monetise their interests in this joint venture before we get our money paid out. So that includes being paid dividends or for example selling down their interest. So we're comfortable with that situation.

Anthony Moulder: (Citigroup, Analyst) Okay, alright. Thank you.

Raluca Chiriacescu: Thanks Anthony. The next question is from Simon Mitchell at UBS. Please go ahead Simon.

Simon Mitchell: (UBS, Analyst) Good morning. Perhaps a question for Zlatko if we could have some more colour on the capital structure of the joint venture? Obviously there's the US$150 million of debt in shareholder loans but if you could touch on any our debt and then if we applied that to the US$86 million of EBITDA for calendar year 2015 what would the profit of the joint venture look like?

Zlatko Todorcevski: Yeah Simon unfortunately we're not in a position where we can give you colour on what Hoover's existing debt is. That existing debt will be rolled into the joint venture, that's obviously not public at the moment. What I can say is that the joint venture's financials are able to carry the amount of debt it's got. The overall level of debt that will be within HFG is akin to what you'd normally see with the private equity backed venture of this kind. We've not over geared it and there's plenty of capacity there for that business to run and do what it needs to do. It's obviously going to be quite cash generative as you'll recall with Ferguson particularly in the current situation where we're not investing a lot of CapEx but businesses do generate quite a deal of cash. So unfortunately we can't give you the details but I'd say it's a moderate level of gearing with some capacity to give us some comfort.

Simon Mitchell: (UBS, Analyst) Okay so we're going to have to make some estimates on net profit on that business.

Zlatko Todorcevski: Yeah unfortunately. What I will say Simon though is we've said within the Release that this will be reported within the share of results of joint ventures and associates, from FY17 this will be the only joint venture within that line item so you'll get some visibility will be net profit line.

Simon Mitchell: (UBS, Analyst) Okay and the US$460 million thereabouts of book value for the combined Ferguson and Catalyst & Chemical Containers, how much of that roughly is ascribed to Catalyst & Chemicals? I presume the book value of that business was almost close to zero.

Zlatko Todorcevski: It would be quite small. Obviously we've got pooling equipment and the like there but it's relatively small.

Simon Mitchell: (UBS, Analyst) Yep, okay. Alright, thank you.

Raluca Chiriacescu: Thanks Simon. The next question is from Cameron McDonald at Deutsche Bank. Please go ahead Cameron.

Cameron McDonald: (Deutsche Bank, Analyst) Good morning all. Two questions if I can. You've said that it is EPS - well it will be earnings neutral - is that inclusive of the 10% shareholder loan return or is that excluding that?

Zlatko Todorcevski: No it includes the interest component on the shareholder loan count.

Cameron McDonald: (Deutsche Bank, Analyst) Okay so once that is repaid that potentially creates an earnings hit?

Zlatko Todorcevski: No we would expect obviously that then it would be driving both cost synergies and the revenue synergies. So once we realise that it should be positive to EPS after the loan is repaid.

Cameron McDonald: (Deutsche Bank, Analyst) Right, okay. Then just with the exit mechanisms that you've highlighted, what sort of exit mechanisms are you potentially contemplating and specifically does Hoover or First Reserve have a put back to Brambles at any stage for the business?

Tom Gorman: Yeah well I think we've probably addressed this but first Cam thanks for joining us. I think that fundamentally I think what we have here is we have found a great partner to increase the growth potential, mitigate risk but give us the opportunity for the upside. I think at a point in time down the road we will then decide whether this is a business that really belongs in the Brambles portfolio and then we would buy back the business. So if we're comfortable with that business, this is still some time to go we would evaluate that business, we would look at the performance and then we could make a decision does it come back into the portfolio?

Do we exit the portfolio? Or do we remain as a partner with a potential other player? So none of those things have been decided. None of those things have been committed to at all but by saying it creates optionality that's what that means. It gives us optionality on the future path, none of which has been decided today but with a strong partner and an ability to grow this business over time with no additional capital outlay from Brambles it does give us the potential to really have a multiple number of choices a number of years down the road.

Cameron McDonald: (Deutsche Bank, Analyst) Yeah so I just wanted to be clear though that you maintain that flexibility and that you are not forced to buy back into the business if you do not want to?

Zlatko Todorcevski: No we're not Cam so just to be clear, with both ourselves and the Hoover shareholders particularly First Reserve, recognise that we need to spend the next two years in particular focused on running this business, driving the synergies, releasing the costs opportunities out of it. So that will be the focus but we were very conscious as we defined all the shareholder agreements and the like that we wanted to maintain flexibility. There is no put from First Reserve to us but we have got flexibility around options whether that's an IPO or a trade sale. I will say that's probably how we're thinking about it.

Cameron McDonald: (Deutsche Bank, Analyst) Yep okay that's great. Thanks guys.

Raluca Chiriacescu: We have a question now from Sam Dobson at Macquarie. It is - what is the expectation for further capital calls to support growth as Latin America still looks like in terms of exposure?

Tom Gorman: Well Sam there's no expectation here. This is meant to be a venture in HFG that is self-funding that can not only meet its current requirements as Zlatko has touched on but also has the cash to fund future growth. That is really the key component here is that this is a self-funding vehicle. So as we've said in the prepared comments it creates optionality with no requirement for us to contribute additional capital.

Raluca Chiriacescu: The next question comes from Scott Ryall from CLSA. Please go ahead Scott.

Scott Ryall: (CLSA, Analyst) Thank you. I just want to confirm the cash movements and a couple of things around the debt first of all. You've got US$75 million coming in with some of that deferred and US$150 million going out in terms of debt which you're expecting to be reasonably short term as you've said when the debt market stabilises. I know you've said you won't talk about the overall capital structure but is First Reserve providing debt of a similar nature as well?

Zlatko Todorcevski: In terms of the shareholder loan are you asking Scott?

Scott Ryall: (CLSA, Analyst) Yeah correct.

Zlatko Todorcevski: No so essentially what's happening is there's an existing facility within Hoover that's been rolled over. That's external third party debt and then there's a revolving facility that's been put in place with a number of lenders.

Scott Ryall: (CLSA, Analyst) Yep okay so all the other debt is external third party?

Zlatko Todorcevski: Yeah.

Scott Ryall: (CLSA, Analyst) Okay and so what was the necessity to put this debt in? Is it to provide that extra flexibility so the company in terms of being self funding?

Zlatko Todorcevski: Yep essentially right.

Scott Ryall: (CLSA, Analyst) Yep.

Zlatko Todorcevski: As we said had the markets been more conducive we would have obviously put in place third party debt but unfortunately as you guys know debt capital markets are not supportive for oil and gas at the moment. So we'll look to replace this shareholder loan with a standalone facility as soon as we can.

Scott Ryall: (CLSA, Analyst) Okay is it...

Tom Gorman: Definitely I think we think the industrial logic of the combination of the two businesses is really fantastic. We're in a market condition that's presenting some challenges. Our ability to lend into the vehicle has created the opportunity to bring these two businesses together and now as we've said in our prepared comments we can access the synergies that neither one of us would have been able to access on our own. So the upside here we think is fairly significant and once markets stabilise we would move quickly to refinance the debt.

Scott Ryall: (CLSA, Analyst) Yep okay and I wouldn't dispute your industrial logic at all based on our look at the businesses historically. I was more just trying to get to the bottom of some of the capital flows. Tom just while I've got you though in terms of your comments, your prepared comments around slide 6, could you just talk to Brambles' view about the ongoing diversification of your pooling portfolio and your current views around that please?

Tom Gorman: Yeah look our strategy remains really unchanged from the last couple of years where we've talked about both platform diversification and geographic diversification. So on the geographic side if you look at the new markets that we have entered in the past year and we've strengthened our position in a number of markets, obviously we bought out our partner with IFCO when we strengthened our position and our footprint in Japan. We made a number of smaller acquisitions in Latin America which really give us a very strong market position with our RPC business there.

We're doing a number of exploratory work on an organic side in the pallets business also focused in Latin America. We've been open in terms of our Central and Eastern European moves and our office now is open in Russia. So we continue to look at geographic expansion. We have moved from the southern cone in Africa to a number of smaller markets - Zambia and Namibia, Mozambique and we are - we have on the drawing board thoughts around West Africa. So I would say the geographic approach is very much well and truly embedded in the organisation and growth will continue to come in that way.

When we look at platform diversification our focus really has turned much more to last mile and first mile solutions. So these are opportunities that in a way are based in and around the pallet business unit but when you think about first mile it is very much about IBC growth. So the relationship between pallets and IBCs is becoming closer as we think about first mile into the manufacturer. As we think about last mile many of those solutions really touch on the RPC business. So I think we're seeing a number of synergies across all three of our business units. So for the near to medium term I would say that the platform diversification has much more to do with last mile and first mile and things that you probably would traditionally say are closer to our core. That's how we view it when we look through the next couple of years of growth as we work towards our FY19 objectives.

Scott Ryall: (CLSA, Analyst) Ultimately closer to the broader FMCG market as opposed to new sectors of interest, is that fair?

Tom Gorman: I think LMS and FMS so they fundamentally equate to that. So I think in broad terms I would agree with you but we are looking at a number of opportunities in both LMS and FMS and not all of them are just specifically related to fast moving consumer goods. The bulk of the growth is going to come in that space. If you just look at the size of our business today in a way it's just a law of large numbers here. The bulk of the growth is still going to come from that space going forward.

Scott Ryall: (CLSA, Analyst) Okay and then just one question maybe it's Zlatko's question in terms of the guidance that will be provided for fiscal 2017 you always look at like-for-like and constant currency guidance so you've mentioned that the Oil and Gas business will stay within continuing operations for fiscal 2016 but will that be excluded for the purpose of providing your 2017 guidance?

Zlatko Todorcevski: Yeah it will Scott, yep.

Scott Ryall: (CLSA, Analyst) It will. Okay, great. That's all I had, thank you.

Raluca Chiriacescu: Great. There are no further questions at this time. So with that we'll wrap up. Tom, were there any final comments you'd like to make?

Tom Gorman: No. Thank you all for joining us. Just to repeat we're very excited about this opportunity. We think that fundamentally it gives us great optionality for the future of the Oil & Gas business. It mitigates risk in the near term and it's a very, very exciting opportunity for us and we look forward now to getting to work and building this combined HFG and focusing on delivering synergies in the near term. Thanks again for your participation today.

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