Company: Brambles Ltd

Title: 2017 Half year results

Start of Transcript

Raluca Chiriacescu: Good morning everyone. This is Raluca Chiriacescu from Brambles Investor Relations Team. Thank you for joining us for the presentation of our 2017 half year results. On today's call Tom Gorman will provide an overview of our 1H17 results, Nessa O'Sullivan will go through our financial results in more detail and Graham Chipchase will comment on our FY17 guidance. Following these prepared remarks, we will open the lines for Q&A. I remind you that all forward-looking statements are subject to the disclaimer on slide 46 of the presentation lodged with the ASX this morning and that unless otherwise stated all currency announced are in US dollars and gross rents are in constant currency. I will now hand over to Tom.

Tom Gorman: Thank you Raluca and good morning everyone. I would like to start with a few key messages about our result for the half year which ended December 31, 2016. In the half we delivered constant currency sales revenue growth of 5% with growth in every operating segment despite challenges in our North American Pallets business, which I will discuss in more detail shortly.

Outside the North American Pallets business we were particularly pleased to see strong growth across our RPCs, Containers and the emerging market pallet businesses, as well as a return to higher levels of volume growth in Pallets Europe. Sales revenue growth translated into constant currency underlying profit growth of 3% which was disappointing. The lower rate of underlying profit growth is largely reflective of direct cost pressures in Pallets North America and some margin pressure from specific pricing actions taken by our Pallets Europe business to defend and expand our market share. On the positive side, our RPCs and Container businesses delivered impressive profit leverage in the half.

As flagged at the first half 2017 trading update, which we delivered on January 23 of this year, we have undertaken a review of our investment in the HFG joint venture. In light of the ongoing market headwinds facing this business the review has been completed and today we have announced that a $120 million non-cash impairment charge will be taken against the carrying value of this investment on our balance sheet. Despite this non-cash impairment I would like to emphasize that the HFG joint venture has only been in operation for four months now and the new management team is in the process of implementing programs to deliver revenue, cost and capital synergies across the business.

During the half we also completed the divestment of the Aerospace business in December of 2016. We recognize a gain on disposal which has been included in discontinued operations.

Turning now to our statutory reporting metrics you will note the impact of the HFG impairment charge which has been classified as a significant item. Operating profit, which includes significant items, declined 26% and profit after tax declined 42%. The higher rate of decline in profit after tax relative to operating profit reflects the fact that the HFG impairment was non-deductible for tax purposes.

Excluding the impact of the HFG impairment operating profit increased 1% which is below underlying profit growth of 3% due to the impact of other of the significant items. And this primarily relates to the One Better cost out program.

The board maintained the interim dividend at $0.145 per share and this is in line with both the 2016 interim and 2016 final dividends. The DRP remains in place with a zero discount and we will continue to neutralize any diluted impact of the DRP via on-market purchases.

Now turning to our return metrics, return on capital invested declined 1.3% and this is due to the higher rate of growth in average capital invested relative to the growth in our underlying profit. The increase in average capital invested reflects continued investments to support growth, and this was particularly in RPCs and our Pallets business in Europe and in the Americas, while underlying profit growth was impacted by the factors I have mentioned on the previous slide.

Cashflow from operations declined $26 million primarily reflecting the timing of capital expenditure payments and higher investments in RPCS, Pallets Europe and Pallets Latin America. These increases were partly offset by a $28 million

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decrease in capital being invested in our North American Pallet business and this is in response to lower volume growth in the period.

Now this slide here provides an overview of the first half performance in the various businesses in our portfolio. Nessa will provide a detailed overview of the financial performance in each segment so I will not spend much time on this slide, but I would like to make just a few key points.

Firstly, with the exception of Pallets North America all of our other businesses delivered first half 2017 results in line with our expectations and continue to deliver against their respective strategic objectives. In Pallets EMEA we saw a return to higher levels of volume growth in Europe which more than offset the impact of a more challenging pricing environment in the region.

Some of the volume growth came at the expense of lower margins as the team implemented targeted pricing actions to defend and expand our market share. This however is in line with comments we have made for some time now that in Europe we would not hesitate to trade some margin for additional growth.

While not specifically shown on this slide our emerging market Pallets business which represents 11% of revenues continue to grow strongly with new and existing customers, particularly strong in Latin America in the half. RPC has continued to deliver sales revenue growth in excess of 10% including a return to higher levels of growth in North America following challenges in FY16. The business also delivered strong improvements in profitability with network efficiencies in most markets and pricing growth in North America.

Although now a smaller part of our portfolio the Containers segment, which includes the global IBCs and automotive businesses also delivered strong topline growth and exceptional profit leverage in the half.

Now to address the key business challenges. I will spend the rest of my presentation discussing the issues we have faced in Pallets North America. At our first half trading update on January 23 we flagged a number of challenges in North America which were based on a very initial analysis of the result. These included revenues and cost pressures associated with customer destocking, lower rates of new customer conversions to pooling and pricing pressure in the recycled pallets business.

Following a more detailed analysis of the result since that trading update I would like to now provide more clarity on the key factors which impacted our first half performance. The first of these factors relates to competitive pressure. As noted in our trading update since the FY16 results, we have called out a slower rate of net new business conversions due to extended and more competitively negotiated tender processes. This trend has been driven by a decline in recycled white wood pallet prices over the last 12 months. Also driven by an increase in price based competition from other poolers and we have also seen an increase in the level of analytical rigor being applied by our customers to new pallet supply contracts. This includes the use of third party procurement advisors.

These competitive pressures during the half resulted in lower pricing growth and lower net new business wins in the US Pooled Pallet business and also resulted in a revenue decline in the US Recycled Pallets business.

The second factor relates to changes in our network cost profile. We have noted an overall increase in our costs resulting from additional transportation, handling and asset recovery costs. These additional costs have been partly driven by our expansion into NPD channels. Lastly, we have seen some destocking during the second quarter which was exacerbated in the months of November and December.

To illustrate the collective impact of these three factors on our business during the second quarter we have prepared the chart on the right hand side of this slide. This chart illustrates our net pallet flows during the second quarter which is calculated quite simply as pallet returns less pallet issues. The chart shows the three months of the second quarter, that is October, November and December of 2016 and it compares it to the three year average for the same months in FY14, FY15 and FY16.

As you will note, and you would likely expect, October and November are typically months where we have net pallet outflows in support of the Christmas season. With December generally recording net pallet inflows following that Christmas period.

Now due to the combination of lower than expected net new wins, lower like-for-like volume and destocking, we saw a divergence with historic trends commencing in November. As you will note from the chart net pallet issues in November were significantly below historic levels and net pallet inflows in December were more than double the average over the past three years.

Consequently the business recorded higher than expected pallet inventories at the end of the second quarter. Now Nessa will take you through the financial implication of these trends and expectations for the second half and she will do that shortly.

Although we are facing some challenges in North America at the moment I believe that all of our businesses are in good shape and we have planted numerous seeds for future growth including technological innovation, new market entries and strategic initiatives specifically in first and last mile solutions. Brambles is blessed with outstanding employees who are all dedicated to the company and dedicated to their customers. They will be a strong support for the new management team.

In closing I would just like to add that this marks my fifteenth and final earnings conference call. It has been both a privilege and an honor for me to lead Brambles for the past seven and a half years. Thank you all for your support and willingness to challenge over the years. I will now hand over to Nessa who will take you through the detailed financial performance for the half. Nessa.

Nessa O'Sullivan: Thank you Tom and good morning everyone. I'd like to begin with an overview of the first half sales revenue. We delivered revenue growth across all of our operating segments with particularly pleasing growth in Pallets EMEA, RPCs and Containers businesses. Highlights included RPCs growth across all regions. Growth of over 20% in Pallets Latin America, as well as sales growth of 15% in the Central and European Pallets businesses.

Looking at each segment individually. Pallets America grew by 3% which included a very strong result from Latin America. Growth in the US Pooled business was also 3% despite competitive challenges in that market which resulted in lower than anticipated volume and pricing. We also saw revenue declines in the Recycled Pallets business. Our Pallets EMEA business delivered strong revenue growth of 4% driven by both increased net new wins and organic growth with some price investment to support sales growth in the region.

Sales growth in the Pallets Asia-Pacific increased 1% as growth in Australia and New Zealand was partly offset by lower revenues in Asia. The RPC segment revenues increased 12% and accounted for over 40% of group sales revenue growth in the first half. Our Containers businesses had solid revenue growth across both the Automotive and Intermediate Bulk Containers businesses.

Turning to the group's profit analysis and the key drivers of underlying profit growth of 3% at constant currency. Price, volume and mix contributed $77 million to the underlying profit growth. Depreciation increased by $25 million during the period, reflecting increased investment in our core Pallets and RPC businesses during FY16 and the first half of FY17. We delivered plant and transport efficiencies across our operations. However these savings only partly offset the cost pressures, especially evident in our North America Pallets business.

Other costs increased by $16 million in the period which included equity accounted loss of $3 million relating to our share in the HFG joint venture, as well as costs associated with our investment in innovation, particularly the creation of the BXB Digital.

Turning now to a more detailed review of the US Pooled business. This slide sets out further details about the sales and cost trends we've seen in our US pool of pallet business and their implications for the balance of the year. The chart on the left hand side sets out sales revenue growth for the first and second half of 2016. This highlights the slowdown in growth in the first quarter of 2017 and a further step down in the revenue growth in the second quarter to around 2%.

We reported exceptional sales growth of 10% in the second half of 2016 so we had strong momentum going into the first quarter of 2017. The rate of sales revenue growth slowed in the first quarter of 2017 with pool competition and lower white wood pricing putting added pressure on the net new business conversions. There was an expectation of higher growth in the second quarter, however second quarter net new wins were three points below expectation. Lower than expected pallet issues to new customers resulted in 2 million addition of pallets in plant stock, which led to higher transport, handling, storage and repair costs during the half.

Pallet returns from retailer destocking in November and December added to these incremental costs. The cost-to-serve also increased during the half in part due to a change in the mix of customers and retailers participating in the network. This included an increased number of flows to NPD Channels for which we charge higher fees. Efficiency savings only partly offset these increased costs.

Moving to the right hand side of the slide. We've broken down the first half margin decline into three causal factors. Competitive pressure, higher network costs and customer destocking. In terms of implications for the second half we expect the following. Competition is expected to remain robust. Costs associated with the additional pallet stock are expected to continue into the second half until pallet stock levels normalize. CapEx in the US Pooled business will be reduced, however, we will balance any reductions with ensuring sufficient pallets are on hand to service the increasing new business expected in the second half.

Whilst the increased network costs are expected to continue, the business will also continue to focus on delivering supply chain efficiencies to help offset these costs. The durability program is driving some repair cost savings, however, it should be noted that major savings originally expected were dependent on lower damage rates. Damage rates are not expected to materially change in the second half. The increase in the level of repaired stock at December 31 is however expected to provide a cost benefit in the second half of around $2 million.

Turning to an overview of each operating segment and starting with Pallets America. Despite challenges in North America, the America's region delivered sales revenue growth of 3% with the US Pooled business also growing at 3%. The Recycled business sales declined with a lower white wood pricing. Latin America was a highlight with revenue growth of 21% in the first half. The decline in earnings of 8% was driven by the US Pooled business, which I've already covered in detail.

Turning to Pallets EMEA. We achieved strong volume growth across Europe, particularly in Central and Eastern Europe where growth was 15%. The 1 percentage point margin decline in the first half reflected specific price investment to support our growth in the region as well as depreciation increases which were in line with growth in the pallet pool. From a direct cost perspective transport and plant cost increases were largely offset by supply chain efficiencies.

Turning to Pallets Asia Pacific. Sales revenue increased 1% on a constant currency basis, primarily reflecting modest pricing gains and organic volume growth in Australia and New Zealand. The ongoing reduction of plastic pallet volumes in China and some competitive pressures resulted in lower revenues in Asia. Underlying Profit increased 3% largely due to direct cost efficiencies.

The RPC businesses delivered strong revenue growth of 12%, cycling 15% revenue growth in the first half of last year. The European business delivered sales revenue growth of 13%, which included the benefits of major customer wins during the prior year.

The North America business delivered both pricing and volume growth, which included a higher mix of wood grain crates. The US business was also cycling the loss of advocacy of a major retailer which impacted both volumes and network costs in the prior year. Underlying profit growth of 31% reflected the strong revenue growth as well as network and transport efficiencies in Europe. The improved performance in North America reflected increased pricing, volume growth and improved direct cost efficiencies.

Finally Containers. The strong underlying profit margin and return on capital performance in the Containers segment reflected scale efficiencies as well as both customer and product mix benefits. These benefits more than offset the impact of the $3 million equity accounted loss associated with our investment in the HFG joint venture.

Turning to the profit reconciliation of underlying profit to a statutory operating profit. Significant items of $139 million in the period included $120 million non-cash impairment of our investment in the HFG joint venture. We saw a modest reduction in net finance expenses largely due to the interest income on the loan to the HFG joint venture.

Finally, the effective tax rate of 42.1% was impacted by the impairment on the HFG joint venture which is non-deductible for tax purposes. Excluding this impact the effective tax rate on the statutory operating profit is 29.5%.

Turning now to capital expenditure. Capital expenditure on property, plant and equipment of $528 million was broadly flat to prior year and included a $28 million reduction in North America pallet CapEx. The first half capital expenditure reflected investment to support strong volume growth in RPCs, Pallets Latin America and Pallets EMEA.

Turning to the cashflow. The key comments in relation to the first half cashflow are as follows. EBITDA increased by $19 million. Whilst capital expenditure was broadly in line with prior year the cash outflow related to capital expenditure was $24 million higher than the prior year, driven by the year-on-year timing of payments. The other line includes provision movements, primarily reflecting the earnout payment relating to an acquisition as well as employee related payments.

The decrease in cashflow relating to significant items and discontinued operations primarily relates to the oil and gas and Aerospace business outflows of $17 million in the first half. Financing costs include $3 million of interest received from the HFG shareholder loan. The increase in tax paid relates largely to increased profit and the timing of tax payments.

Dividends paid increased by $90 million reflecting the decision to neutralize the impact of the DRP by on-market purchases in the first half of 2017. In the prior corresponding period the cash outflow for the dividend payment was materially lower due to the high level of participation in the DRP which was not neutralized.

Turning now to the balance sheet. Net debt of $2.5 billion declined by $146 million since June 2016. This was driven by the receipt of around $160 million in proceeds from the creation of the HFG joint venture and the divestment of the Aerospace business. Consistent with the reduction in net debt the ratio of net debt to EBITDA improved during the period relative to the first half 2016 from 1.78 times to 1.68 times. Our net debt to EBITDA is well within our policy target of no more than 1.75 times.

Finally, before closing I would like to walk you through the change we've made to the way we calculate and report our return on capital metric. Previously the capital employed base used for the ROCI calculations included the add-back of historic cumulative significant items.

Going forward we will no longer be adjusting the capital employed base for significant items. This will allow for a less complex and more transparent calculation of ROCI that can be calculated from reported data. This is consistent with market practice. For this result we've provided ROCI on both the old and new methodologies in the background information pack that's provided as part of our ASX release.

I now hand over to Graham.

Graham Chipchase: Thank you Nessa and good morning everyone. I'd like to begin my part of the presentation by sharing some of my initial impressions of Brambles. Firstly, it's clear in the short time I've been at the company that the strength of Brambles lies with its people and culture. Throughout the business there is clear evidence of a high performance culture which is centred around the customer. And as you'd expect from the company that invented pooling, there is industry leading expertise and operational excellence across the organization.

Turning to the next slide. I'd like to reiterate the primary considerations behind the management changes that were announced on February 7. These considerations included some delayering of the organizational structure and streamlining at reporting lines to enable me to be closer to the businesses and to achieve greater consistency of approach across the group.

The new structure also highlights the importance of BXB Digital to our future plans and facilitates the continuation of Brambles supply chain solution strategy. I feel it is also important to add here that while there may be some small cost saving as a result of this realignment the motivation was not cost driven, but rather to ensure a more cohesive organization going forward.

Turning to our fiscal 2017 guidance. We expect constant currency sales revenue growth to be in line with first half 2017 of about 5% reflecting continued growth across all segments and a modest improvement in net new business wins the North American Pooled Pallets, particularly in the fourth quarter. We expect underlying profit to be flat compared to fiscal 2016 reflecting more challenging comparatives in the second half of second 2017 versus the first half of the fiscal year, and the full six month impact of the continued challenges faced by the HFG joint venture.

The guidance for both net interest costs and effective tax rate remain unchanged. Finally, as you would expect, growth capital expenditure will decrease given the high level of existing inventory in the North American Pooled Pallet business. Of course all of our guidance is subject to there being no substantive change to the key economies in which we operate.

Going forward the basis of Brambles supply chain solution strategy is unchanged. We will remain focused on the allocation of capital, the value accretive growth and innovation opportunities. We will continue to drive operational and asset efficiency while leveraging our network advantage and global scale. Finally, the business will, as it always has, have to evolve and adapt to changing, operating and competitive environments.

Turning to our financial focus going forward. I would like to emphasize that everyone on the Brambles leadership team remains absolutely focused on delivering superior levels of shareholder returns that are well in excess of our cost of capital.

Based on my experience, for a business like Brambles, return on capital invested at or around current levels is attractive and strikes the appropriate balance between financial returns and growth opportunities. With this in mind, we believe that the previously articulated fiscal 2019 return on capital invested target is no longer appropriate, nor do we intend to set any new medium-term targets.

In summary, before we open up for questions, I'd like to reiterate my strong belief that Brambles is an outstanding business, underpinned by strong fundamentals with market-leading positioning and continuing opportunities for sustainable growth.

Thank you and we'll now open for Q&A.

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. Just a question around the US pallets business, the conversation around what's happening in that business appears to have shifted very much from focused on customer destocking to competitive pressures. Can you just elaborate on that and are we talking about a pricing issue or a product differentiation issue and are we talking about an issue versus pools competitors or your one pool competitor or white wood? Thank you.

Tom Gorman: Yes, Simon, you'll probably hear a couple of voices on the response to this. So first I'll just start by saying that, as we said in our prepared comments, back when we gave the market guidance in third week of January, we identified a number of drivers affecting the business.

On initial view, we did see a significant increase in our stocking levels and we've referred to that and the chart that I showed you showed shifting dynamic that occurred for us in November and December. Clearly we have seen a higher return of pallets from our customers, notably one large retailer where we saw really an aberration in the fourth quarter of the calendar year. So destocking is still a component of it.

I think what we then went on to further describe and I'll hand to Nessa in a moment here, we also did touch on the lower level of net new business wins. We had anticipated in delivering some of those wins; if you remember our earlier update, we really focused on the second half of the year, but those wins were below expectation in the second quarter and we also saw a decline in organic growth in the second quarter as well.

So it's a combination of a number of issues on the pooled side and you know as well as any of us that our primary pooled competitor in the US is PECO, so when we talked about a pooled competitor, the pooling competitor really is PECO.

But in broad terms, competition also comes from white wood, as you know, so that's why we wanted to highlight this point of white wood prices being lower and that has an impact on the revenue base that I think we've called out very clearly in the slide, as it impacts the recycle business. But it also impacts on our ability to convert customers from white wood, one-way disposable solution to a pooled solution. But I'll hand to Nessa and she can give you more insight.

Nessa O'Sullivan: Look, I think it's absolutely true that we did see destocking, particularly coming through at the end of November and into December. However, when we analysed all the results, it was apparent that the net new business

wins were really a major driver of us not issuing as many pallets as had been anticipated across that November/December period in particular.

We also, as we analysed the results, thought it was important to set out where we saw some changes in the cost structure or the cost to serve in our network, particularly we saw that we were incurring higher transport and handling costs, as well as asset recovery costs. You'll remember from last year that we reported increased revenue from having increased number of NPD flows in our mix and we continued to see that in the first half which also added to cost.

We did obviously see that destocking piece that Tom talked about, but we tried to put it in context so everybody could understand the basis for the outlook statement.

Simon Mitchell: (UBS, Analyst) So do we take it that the conversation with potential customers has moved more towards price rather than the other attributes of value proposition that we've talked about in the past, being consistency of product quality and also consistency of supply to the customer of pallets?

Tom Gorman: Well Simon, I wouldn't necessarily jump to that conclusion. I think the value offering for us is very much the same and it goes well beyond consistency of quality and availability of supply. I mean the whole idea of our go to market strategy, not just in the US but globally, is that we provide a lot more than that to our customers. We are underway with a number of joint business plan projects with our customers where we bring our logistics expertise. I think you know this very well that we share transportation lanes with customers. We work on a series of ways that we think that we delivery value.

What has happened, clearly and I think most of the market understands this as well, in a position of rising white wood prices, that is always better for us in term of the gap created between the cost of a pooled solution versus a one-way disposable solution. When you get a reduction in that gap and we've seen now a reduction in white wood prices, what that does is with the marginal customer that we are trying to convert, it takes longer to work through that process and as we also pointed out, a number of our potential customers are now engaging with third party procurement advisers.

That doesn't change our story at all. It doesn't change in any way our value proposition, but what it does do is it does take longer time to work through a set of analyses for the customer. There's no telling how this will turn out, we believe that our pipeline is strong and there are a number of customers that we're in active conversation with, but it has taken longer than we would have liked, than we would have expected and that we indicated when we set out at the beginning of the year.

As Nessa point out I think very clearly, the overall growth in net new wins in the half was well below what we achieved last year. We came into this year with a good deal of momentum, we felt we could build on that momentum and from a revenue perspective, we've been unable to do that in the US.

Simon Mitchell: (UBS, Analyst) So sorry to harp on the issue further, but I guess the question is, then, do you view this as a dislocation in terms of timing or do you consider that there are permanent steps required in terms of your pricing and/or product offering to become more competitive?

Tom Gorman: I think probably it's inappropriate for me to comment going forward. But what I can tell you is that for the first half, the team has continued to work on a number of initiatives, as we've always said, to drive our cost down, from an operating cost perspective, we wanted to drive our cost down so that we could continue to be competitive while expanding margin.

Maybe I'll pass over to Nessa to respond a bit on the forward-looking basis, but as I said, we have a funnel, that funnel has a number of active customers in it, we're involved in active conversation, but where we sit today, in terms of what we delivered in the first half, we simply did not deliver against our expectations.

Graham Chipchase: So Simon, it's Graham here. Perhaps whilst I've not been here very long, I can give you some of my thoughts a little bit to try and answer that question of yours. If you look at our North American pooled business, clearly it's got a very strong market share within the North American pooled business; as Tom said, there's just the one other competitor. I think what we're pointing out here is that there are some short term dislocations around cost and around the way that we've been having to manage the network.

Over time, particularly as the net new business wins come in, that should dissipate and over time, we have to become more efficient in the way we're managing our assets in North America. So the big point around competitive pressure on pricing, I would say, the main reason we want to draw this to people's attention was to substantiate our view about the fiscal 2019 view which the market, I think, believes that the margins in the North American pooled business would get to the same level as Europe.

I think this, for us, we're trying to highlight why that is not the case because of course we've got a completely different market structure in Europe versus North America and we are seeing more competitive pressure. So for me, that's the longer term takeaway, this is still a strong business, it's still developing strong margins, but it may not get to that place that Europe is today and that was, I think, a message that the market had and we thought it was important to correct.

Simon Mitchell: (UBS, Analyst) Okay and just one further question if I could and it goes to your comments you just made on differences between the Americas and EMEA. Your comments around return on capital for the group which are currently sitting around 16%, you've obviously got some very broad dispersion within the different divisions on return on capital, so Europe at 27% and Americas at 17%, what is your view on that dispersion? Do you see a normalization? You've already spoken about Americas potentially not moving up to that same level as EMEA, but I guess I'm more interested in the EMEA level being potentially too high.

Graham Chipchase: I think there are structural reasons for the difference and not all of those structural reasons will dissipate. So there's no reason to assume that everything will go down to the lowest common denominator over time because I think there are different barriers to entry in the different markets. I think one of the jobs that Tom and the team have already started and I think Nessa and I have got to continue, is investing in things like innovation and technology to maintain those barriers to entry and ensure that we don't go down a downward path to the lowest common denominator.

Simon Mitchell: (UBS, Analyst) Okay, I'll leave it there, thank you.

Operator: Your next question comes from the line of Matt Spence from Merrill Lynch. Please go ahead.

Matthew Spence: (Bank of America Merrill Lynch, Analyst) Hi guys. Tom, just given this will be the last chance a lot of us get to ask you a question, structural versus cyclical, I think confidence in the stock's probably at a low point for at least the last couple of years and there are a lot of concerns around structural issues, whether it's B2C/Amazon market share versus white wood. Can you give us a few comments on the former and just the B2C issue and whether you're seeing a structural impact from B2C?

Tom Gorman: You're talking about omni channel, is that what you're referring to?

Matthew Spence: (Bank of America Merrill Lynch, Analyst) Yes.

Tom Gorman: Well, look Matt, I think again, forward-looking comments from me, Graham's taking over from today, I think it's better to hear from him in terms of his view on forward-looking, but I'm happy to reiterate everything that we've talked about over the years. For us, it isn't just about e-commerce, for us it has been an omni channel story and omni channel for us has to do with small store format, it has to do with click and collect and it has to with direct to home.

I think as you know, Matt, as well as anyone, there are a number of initiatives that we have underway. I think Graham and his team have identified clearly last-mile and first-mile solutions as a growth area. I think the restructuring of the business is a focus on that area as well.

So I think the opportunity for us to continue to deliver solutions in a changing retail environment, to me, I think it's very strong. The combination of our focus on last and first-mile, with the technological innovation that we've already kicked off is going to help us provide more value to our consumers - to our customers and ultimately that flows to the retailer as well.

In terms of the e-commerce side, I think we've shared this historically. We have relationships with the major e-commerce players, specifically with Amazon in Europe and in the US. Our volume directly into Amazon is relatively small today, but we have had and we are still having conversations with them to provide solutions to other parts of their logistics challenges. It's probably best for me to stop there because that's pretty much everything that we told you and that activity, my guess, will accelerate going forward.

Graham Chipchase: Again, I would just completely reiterate what Tom said in terms of where we've been, what the challenges are and our commitment to investing in these sorts of channels and the ways we go to market. So I mean I've got nothing to add to that, because I think Tom summed it up absolutely perfectly.

Matthew Spence: (Bank of America Merrill Lynch, Analyst) Okay, this one's to anyone. You've identified net new business wins slower in the US in the half, to what extent do you think they're slower because of the considerable management change and the uncertainty and whether there was the same pressure on the sales team?

Tom Gorman: Zero.

Matthew Spence: (Bank of America Merrill Lynch, Analyst) Zero?

Tom Gorman: Zero. The people that drive this business are as focused as they've ever been on delivering for the customer and delivering to their commitment. They are very focused and look, it's a time for us to rally around and support those teams. We've been doing this for a long time here and the engine doesn't always fire on all cylinders and when it hasn't, the team has been able to rally and come back from that and I assume under the new leadership the focus will be where it needs to be and the challenges at the moment are in North America.

But if you guys think back to our history, we've had challenges in Europe at times, we've had challenges in the RPC business at times, we've had challenges in containers at times. It's a portfolio of businesses, we operate in 60 countries around the world, we have literally thousands of customers that we satisfy and it's my view that our people are as focused as they've ever been on satisfying the customer. There's a transition underway here, but we announced this transition back in August. I don't think any of our employees are surprised.

Matthew Spence: (Bank of America Merrill Lynch, Analyst) Okay, just one last one, when did Graham's option stock for LTI purposes price from?

Graham Chipchase: Well that is yet to be decided, I think. I would expect to be treated the same as everybody else.

Tom Gorman: There are no options at all in our LTI or STI programs.

Matthew Spence: (Bank of America Merrill Lynch, Analyst) I guess what is the start base for the share price from which Graham's performance will be assessed off, for LTI purposes? Was it January 1?

Tom Gorman: I'm not privy to that, nor aware of it. I think that's a separate conversation, maybe you can take it off line.

Matthew Spence: (Bank of America Merrill Lynch, Analyst) Okay. I'd point out there's a big difference whether it's January 1 or some future date, that's all. Thanks.

Tom Gorman: Good observation.

Operator: Your next question comes from the line of Anthony Moulder from Citigroup. Please go ahead.

Anthony Moulder: (Citigroup, Analyst) Good morning all. Let's start with this comparison to white pallets if we can, we've seen the pricing of white being relatively volatile over the last 10 years, can you talk to what is the differential that you're seeing today and how is that compared to the history of that differential?

Tom Gorman: I think Anthony, just in the half, we probably won't share all of the specifics in terms of white wood price movement. But white wood has come down and I think we're comfortable to say in the range of 5% to 10% we have seen it. I think as you know and I think most of the analyst community knows, that first of all there is no national price for white wood, so white wood prices are really driven by supply and demand, by market.

I think everybody knows there's also multiple grades of white wood, the highest grade, which is grade A, we still have, if you look at - if I were to step back and look on a national account basis and compare that national account on a grade A to a national pool, so a large FMCG player in the United States, there's still significant room between where we price that service to our customers and on the grade A price. But as it comes down, Anthony, what we believe it causes the customer to do is just to take a step back and think through that decision a little more carefully.

I must also point out and I think you know this, that actually timber prices in the US are actually going up, so you can imagine that when our team meets, we talk not just about the near-term issues, but some of the longer term trends and although timber prices are going up, that does not convert immediately or linearly with what's happening with white wood. That has more to do with supply and demand and those prices have come down.

Anthony Moulder: (Citigroup, Analyst) So that's a timing issue, effectively?

Tom Gorman: Look, for me to predict what's going to happen in white wood, it's first of all not my place, nor would I want to do it. But you're correct to point out that it's volatile, that it does go up and down and you also know that when a customer makes a decision to go to pool, they are relatively sticky in a pooled environment. So you rarely see people going back. It does happen, it surely does happen and sometimes if it doesn't work for us economically or the customer, you will see a move back to white wood.

But these are big decisions for the customer because they're in essence giving up their capability to manage their pool and so it's just taking a little bit longer to make those decisions. I think Graham and Nessa responded to that question accurately, that the team is still committed to growing our business and there's plenty of upside, but it has not delivered to our expectations in the half.

Anthony Moulder: (Citigroup, Analyst) Can I reference that into the ROIC targets of FY19, obviously disappointed to see them removed given the board's commitment to them last August, what does that tell us about the focus as to how the business would have got to those FY19 targets? Is that growth in the US pallets and RPCs business just too hard to predict over the next two-and-a-half years?

Tom Gorman: Well let me just say, again I don't think it's appropriate for me to comment on the future, but what I can say is in the half and look I think that there are a couple of things that you have to notice in the half in the US business. It's not just top-line driven and it's not just costs associated with that top-line failure.

One of the things that we committed to do this year, which we have not been able to do and I've been very clear about this and the comments made that we wanted the US business, the US pool business, to look more like Europe, was really driven by our durability program. That program is paying some dividends. Clearly the durability program is working but it is clearly not working to the level that we expected it to in the first half. That, to me, is a much bigger building block if you're going to improve the return on capital in the US. That really is the primary building block.

Look, sales revenue growth will move up and down over time. We came into the year with very bold expectations for the US team. But the bigger issue, to me, is the cost performance and we are lagging what we thought we would be able to do. I believe that within the outlook for the rest of this year, it really is not assuming that we're going to deliver on those commitments and that is material to me and that's a big draw on the ability to get to where we wanted to get to.

Anthony Moulder: (Citigroup, Analyst) Lastly, if I could, you mentioned the-

Nessa O'Sullivan: Sorry, I think it's also important just to reiterate that there will continue to be a very strong focus on making sure that returns continue to be well above cost of capital, but there's no doubt as competition has increased that our focus has to be in making sure that we keep our market-leading positions, we keep our competitive advantage with network density and that we're able to invest in growth where we see appropriate to ensure the long term health of the overall business.

So I think that's really one of the key parts of the rationale for the change. It's not a change in strategy, it's not a change in focus in terms of returns well in excess of cost of capital.

Anthony Moulder: (Citigroup, Analyst) No, no. I get that, I get that. I wanted to understand this NPD channel, obviously some growth or some expansion into these NPDs, what particular channels were they? Was that the food service with the JVS contract? Because obviously you would know the cost to serve into some of those food service customers, given that you have a large proportion of food service customers, so just trying to understand what was the surprise around that NPD service channel.

Tom Gorman: I don't think it was a surprise and I think Nessa covered this, Anthony. I think that it was no surprise. I think what we're seeing here is that when we started growing in the NPD channel, which in the long run, if managed well, is a very good thing for us. I've said this many times over the years and I would just reiterate it, that complexity in

logistics is actually a good thing for us, because as we get network density, we can manage that complexity better than any of our competitors and that includes the focus on the NPD channel.

What we have to make sure of is that we understand the cost to serve in that channel and that as we add customers who have flows into NPDs or in fact if retailers convert from participating distributors to non-participating distributors, that we accurately reflect the cost to serve. We believe that we are capable of doing that. I think what you're seeing here is that we talked about it at our last release, we were growing in the NPD channel and what you're seeing in this period is some of the costs of that, that cost to serve coming through.

I think it's important for the team, this is a forward-looking comment, but that the team stays on top of our cost to serve and understands not just from a collections standpoint, but from a holistic standpoint how we're delivering in those channels and what our real cost structure looks like. So a bit more cost in the half reflecting that.

When you combine that with a slowdown in both organic and net new wins and the destocking that we have referred to and that destocking, so in total drives period cost and Nessa already referred to some of those costs coming out in the second half, but the period costs are not insignificant. There's both logistics as you're getting more pallets back and therefore trying to get them in the right location, there's storage costs with them as we're holding more pallets and plant stock than we anticipated at the end of the year.

Obviously there's repair costs in the period because, I think as everybody understands, when the assets come back, we repair them, but they're immediately placed in usable stock. So when you put all that together, you saw that cost in the half and I think the forward-looking statements are now that we don't see as robust revenue as we originally planned in the year in the second half, so those costs will take some time to work their way through the system.

Anthony Moulder: (Citigroup, Analyst) Great, thank you.

Operator: Your next question comes from the line of Sam Dobson from Macquarie. Please go ahead.

Sam Dobson: (Macquarie Securities, Analyst) Good morning. If I can start with a question to Graham, just in terms of the FY19 targets, obviously you've removed that, we've talked about that, you've made a statement that the current ROIC or ROIC at or around current level is attractive and strikes the appropriate balance between returns and growth. In that context, how shall we be thinking about what the ROIC looks like over time and also the previous guidance of $600 million Capex in FY2018 and FY2019, obviously you've cut 2017, how does the previous Capex guidance fit?

Graham Chipchase: I think the first thing is you need to understand that this business is one which is clearly quite capital intensive if there's growth. So I think one of the reasons that we made the comment we did around where the ROIC currently sits, seems attractive, but we need to then calibrate it with growth opportunities. If we are in a period of high growth opportunity, particularly in the pooled pallets business, then you would expect to see the Capex at those higher levels. But if we are in a period where sustainably we're in a lower growth environment, then you would expect the CapEx to come down, with a consequential impact on the ROIC.

I think this is more about, in terms of our view about the ROIC going forwards, I think we're calling out that we are in a very strong positon, we've got very good margins and we need to ensure that we keep those sustainably. That will require us to invest in new geographies for future growth, which will clearly be slightly diluted in the short term, but from a ROIC perspective, it will require us to invest in new technology, which again, within the short term will be dilutive. But over time, will help us maintain the current barriers and margins.

So I think that's what we're trying to get across, rather that specifically saying we think the ROIC is heading in this direction, that direction. I think once you just recognize that it is significantly ahead of cost of capital, therefore it is generating shareholder value today and what our job is to do, is to ensure that carries on but still get a decent level of top line growth as well.

Sam Dobson: (Macquarie Securities, Analyst) Yes, okay, understood. I guess then the implication of the FY17 cut to CapEx means there is some downward pressure then on 2018 and 2019 given the current growth outlook. Is that fair?

Graham Chipchase: Well I think we're not saying what the current growth outlook is in particular. I think someone has commented on that high single digit revenue growth which went along with the 2019 ROIC targets as disappearing as

well. I think when you look at how that was comprised, it was split between a number of different factors and the range really was somewhere between the mid-single digits to the high-single digits.

I think you can assume that clearly from what we're seeing today, we're moving towards the lower end of that range in terms of our initial thoughts on growth, but it's still too far away to tell; things are changing positively and negatively quite quickly. So I wouldn't make any definite statements about 2018 and 2019 growth.

Sam Dobson: (Macquarie Securities, Analyst) Okay, alright, understood. I guess a question for Nessa, so on the US pooled slide, you made a comment that supply chain efficiencies will help offset the increased cost. Can you just give us a sense of what actions - Nessa and Graham, what actions you will be taking with respect to those supply chain efficiencies?

Nessa O'Sullivan: Well, there are a range of efficiency programs already in place that will continue to be rolled out and developed. There's a number of things that have been put in place with improved optimization in the plant flows as well as in the flows to customers.

There's also a range of transport efficiencies being put in place and that involves efficiencies with how we run our own transport line, but also in collaboration in with customers using - where they have excess miles where we can actually use some of their capacity as well.

There's also a range of efficiencies related to - while the durability program isn't delivering to the same level that had been expected, there were also savings in relation to lower component cost in terms of repairs that will continue to be included in the supply chain efficiencies.

And obviously as we go forward, we're going to continue to look at that and you would expect a good business to continue to look for further efficiencies, which will be a key priority for us.

Sam Dobson: (Macquarie Securities, Analyst) Right, okay. And look, just finally on RPC, so clearly stronger on a PCP basis and really a continuation of the second half result. But the first half margin of 14.2% actually declined by 10 basis points I think on the 2H 2016 margin. Can you just talk us through that and whether there was anything specific that contributed to that margin outcome?

Nessa O'Sullivan: Just - that's due to seasonality.

Sam Dobson: (Macquarie Securities, Analyst) That's all it is.

Nessa O'Sullivan: Yes.

Sam Dobson: (Macquarie Securities, Analyst) Okay, thank you.

Operator: Your next question comes from the line of Cameron McDonald from Deutsche Bank. Please go ahead.

Cameron McDonald: (Deutsche Bank, Analyst) Good morning. A few questions if I can.

Just firstly on the operational result and you've talked about the increase in pallet returns relative to issues on slide 6 and then allocated some continued destocking from customers on slide 9 - sorry slide 11.

Firstly, on the cost front associated with those increased pallet returns, did you actually have the capability and capacity within the business to absorb all of the associated costs that would have come with those pallet returns so late in the year? Or should we be expecting further cost increases as you work through those - that increased pallet stock early in the first - in the second half of FY17?

Tom Gorman: Cam, it's a flow business, so when the assets return that's really where you generate - you know when the asset is distributed. So an issue as we refer to it - I think you know our terminology well - that's really where the revenue flows. When the asset comes back, you really get the cost.

So in this case, those costs came in really right at the end of the half, in the last two months of the half and that was the intent of my chart to show you that relative to three years of history, we frankly were surprised by the level of returns of assets. And I did point out to you that a large retailer has returned a number of assets to us.

Our first view of that is we refer to that as destocking. That's the terminology that we use. When we look at the underlying data whether it's US Census Bureau or Nielsen, ACI Nielsen data, what is apparent is that we got more pallets back from our major retailers and that was a bit of a surprise to us.

What that drove then is period costs and I think we've identified those period costs. So they're logistics because the pallets don't always come back where you need them, so now you have to move those. That's the first thing.

We have added storage costs because we can store X number of pallets and we're a bit over that level so you have storage costs in the period. And then we do repair the assets when they come back, so - and again our strategy is to have them as assets that we can send to customers on short notice. This goes to the availability issue which we're in good shape on.

So those were in the period. As I think Nessa said very well, those will work their way through in due course. What the key thing now is to see what demand develops like over the coming months, how we balance that with our CapEx because even though you'd like to turn CapEx off all the time, you need to be careful here because when you win a new customer you need to be in a position to support that customer's transition as quickly as possible.

So look our pallet balances are a little bit above where we would like them to be and we're absorbing that cost in the period. The only comment that we made very specifically is that the added $2 million of cost for repair, we will not repair again. They are sitting in stock that's good to go and that will work its way out for sure in the second half. The rest of the costs will really be dependent on demand flows and the pallet balances over the coming four months.

Nessa O'Sullivan: Yes. So you should expect until we get our pallet balance back to a more normalized level, we'll continue to incur additional storage costs and there will be some inefficiencies associated with where pallets are, where they're moved and related costs.

There will also be ongoing repair costs associated with those returns, because not all of them were repaired. However as Tom said and I referenced on my slide when I went through it there is a $2 million benefit that comes into the second half.

So if you're thinking about in terms of first half/second half, I would assume a fairly similar cost profile second half relative to the first half relating to us winding back down those additional pallets and reissuing them out.

Cameron McDonald: (Deutsche Bank, Analyst) Okay. And just reverting back to the slide 7, can you give us a sense of what you've seen in January, relative to the average over the last three years like that slide. So have we seen a continuation of that trend or is it reversed.

Tom Gorman: No, January is typically a month of inflows so we've only - we've shown the three months at the end of the quarter. But January, as you'd imagine is typically a month of inflows and we have received our pallets back broadly in line with our latest expectations.

Cameron McDonald: (Deutsche Bank, Analyst) Okay. And Nessa, there's no or little comment really - I think you've made some comment around some optimization efficiency, but there's been no real commentary around the $100 million cost-out program that was initially put in place as part of the FY19 targets. Do we take it that the removal of the FY19 target also eliminates that cost-out program?

Nessa O'Sullivan: Look, a couple of comments. At FY16 we announced that we'd delivered $34 million of cumulative savings against that and there's an incremental $6 million of savings in the first half related to that program.

In terms of where we are with that program there are a number of projects that are still ongoing that will continue to deliver savings. Our view would probably be that the savings related to that would probably be closer to $70 million as opposed to the original $100 million. But that's based on a different profile of investments in some of the efficiencies and I guess an update is due as to where we're tracking.

It's fair to say that when we looked at the savings coming through, we're really seeing them offsetting other cost increases rather than seeing them as an additional flow through in terms of the underlying profit.

Cameron McDonald: (Deutsche Bank, Analyst) Okay. And just finally a question for Graham if I can. Graham you've mentioned that the current ROCI levels are appropriate and I understand that as you grow and specifically in the new geographies et cetera that it could be dilutive. But previously we've heard quite a lot about how the incremental organic growth opportunities and deployment of CapEx in the existing businesses is very accretive to those ROCI returns.

So are you actually saying as part of this you're willing to trade away that organic ROCI improvement for further and faster growth from a - not necessarily from a capital perspective but just from a volume perspective?

Graham Chipchase: I wouldn't say trade away. What I would say is I think that if we're looking sustainably into the future, for the long-term growth of the company, we have to ensure that we're doing enough of these emerging market, new market investments which just by the very nature of the business take quite a while to become high ROCI operations.

So it's a bit like cooking. You need some salt and pepper and some of these things are a bit salty. They do take a little longer than you'd like, but you still have to have them. It's about getting the balance right. So we absolutely will continue to invest in our more established businesses where the returns are very good.

It's about - all I'm saying is I'm just trying to get the balance right, so implying that we will - and we will invest in things like BXB Digital because again that's a longer term play when it comes to ROCI.

I think the other thing is I'm just calling out that we are saying that we over - certainly over the medium term we will need to invest a little bit in pricing to offset some of the competitive pressures because it's absolutely essential that we keep the volumes and the flows going through the great network advantage we've got and we can really leverage our operational and asset efficiencies. I think that's trying to get that balance right between those various pieces.

Tom Gorman: And if I could just make one correction in the comment that you've made. I think over the years, I think we've been very clear on the difference in new market entries. So - and we've called out for example, both India and China where we are very early in the stage of developing modern resistance in those markets. And I did point out to you that those markets take a long time and I think we've been responsible in how we deploy capital both in India and China. And you're absolutely correct that we do not cover our cost of capital.

Where there are other new markets, I've referred to them in the past there's continuous market entry. So take Turkey or the Baltics or the Balkans. In those markets, what I've talked to you about previously is that you can get to an incremental profitability position quite quickly because you're actually putting very few incremental overheads into those markets and you're building off the base of talent that you have. In the case of the Baltics and the Balkans you're really doing that from our strength in Western Europe.

So I would just caution you going forward that I wouldn't paint every emerging market with the same brush because it really depends on the pace at which modern distribution is going to grow and the deployment of capital as we're building a presence there. That's the only correction.

Cameron McDonald: (Deutsche Bank, Analyst) Okay, thanks Tom. Just sorry - just a quick follow up to Nessa if I can. There's been some commentary about the NPD channels and the increased cost to serve this. I don't seem to be able to find the updated loss ratios in the pack or the data, unless I've missed it. Can you just give us a comment on what the current loss ratios are given that effectively moving into NPD channels is a bet on pallet recoveries?

Nessa O'Sullivan: Yes, look we don't publish that. I've actually just checked with a couple of other people who've been around a bit longer than me here. But look, obviously as Tom talked about, one of the key things that we're going to have to do is continue to be very aware about what the cost to serve is. And that'll mean as we've got new business and increased mix into this channel, obviously as you would expect us to do, we'll continue to trace what the total cost to serve is in that and look at our price in modelling in accordance with that.

Cameron McDonald: (Deutsche Bank, Analyst) Okay. Thank you.

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

Paul Butler: (Credit Suisse, Analyst) Hi. Thanks very much. You've cited weak pricing levels in the white wood market as being a key issue. Can you just give us some insight into why we are now seeing weaker prices in white wood and what your view is on how long that's going to persist?

Tom Gorman: Yes, again I'll just comment maybe a little bit. But thanks Paul for the question first.

Look I think as, I think everybody knows and I'll just reiterate that the white wood market, first of all it's a regional market in the United States number one. And number two, it's really driven by a simple supply and demand requirement in the short term. And you might also know that we alluded to, a number of times in our formal presentation, that we did see a slowdown in organic demand in our business in the second quarter over the first and that will drive the need and the demand for white wood.

And so what happens here in this system is the way white wood works is we go out along with the other recyclers in the United States and then we buy from distributors and retailers, the white wood at the back of their docks - very simply, we do some minor repair as required and then we resell that asset. So it really is driven by supply and demand.

It's difficult for me now to - I think for any of us really to forecast how that market will change because fundamentally you're then asking us to forecast organic uplift in the US which at the moment is a very difficult thing to do.

So I would hold off on providing any forecast of my own. But clearly it's driven by supply and demand and it makes sense to us in terms of what's happened in the broader FMCG space.

Paul Butler: (Credit Suisse, Analyst) Well, just a bit further on that, I mean you've cited the competitive issue being 40% to 45% of what's happening in the US. How much of that is PECO and how much is white wood? I've interpreted from what you've said that the majority of it was white wood.

Nessa O'Sullivan: I think our comment on that would be that it's a combination of both. It's very hard to be able to identify exactly what would be driven by PECO and what would be driven by white wood. We do know that when white wood prices are higher that we're more successful at getting net new wins. We also know that if you have a competitor who's less aggressive it's easier to convert.

So I think the - if the perception is it's white wood, I think you should think about it more in the context of having a number of factors impacting us. But we see competitors as being a major factor, we see white wood as also being a factor, but I would say the competitive factor on a weighting we would see as bigger.

And look, and over time we would expect white wood prices to go up and down as supply and demand does. And so there'll be different years when we'll have the benefit of that and of the years like this year where it makes it harder for us to grow the top line.

Paul Butler: (Credit Suisse, Analyst) Okay. And on the destocking, you've cited one large retailer returning an unusual number of pallets. Is that the sole driver of this destocking or are you seeing higher returns from other retailers as well but perhaps not at quite the same level?

Tom Gorman: I think that's a great question, Paul. I think look, one of the challenges for us is that the data are really mixed. As I mentioned, we have access to some ACI Nielsen data, we obviously look at US census data on an ongoing basis and then we know what actually comes in the door. We know what comes in the door, we know broadly who it comes from, we know what region it's in.

And over the last month now, we've been in a position to be able to complete all of that analysis. I alluded to - not by name, but I alluded to one larger retailer. Oftentimes, look our customers don't like us sharing all this information by name. But clearly in this instance, it was a surprise to us in terms of the number of pallets that came back.

The only challenge with the word destocking here is that as I think you know in the US, our retailers do hold our pallets and there is some down-streaming of pallets in the United States. So the return of our pallets doesn't actually mean anything other than we got our pallets back.

Whether that's a sign of lower demand going forward, whether that's a sign of them driving inventories down, those issues are extrapolated from the fact and the fact is that we got more back. And we referred to that back in January as destocking.

There have been some comments from one of our largest customers in the US around their views on inventory levels and most recently, we had this conversation around the board table.

So look I think that the situation in the US today, we often get this question and I'm sure Nessa and Graham will get it going forward, what's happening in the US economy with all the noise that's going on politically. And I would just say at the moment things are a bit uncertain in the United States and I think retailers are probably being cautious to some degree.

But there's no question that we got more pallets back than expected and that's why we tried to show those data to you graphically. We did not share specific numbers because we don't disclose that. It's the relative position of those bars that are critically important in explaining what happened at the end of the half.

Paul Butler: (Credit Suisse, Analyst) Look I presume when you get one customer returning and particularly a large customer returning a large number of pallets that you go and talk to them and find out what's going on. What did they say?

Tom Gorman: So we've had multiple conversations as you would expect - and thank you for pointing out that we do that - both with our retailers and with our manufacturing customers. None of the customers want this attributed to them, so they're all holding positions that are strategically important to themselves.

So oftentimes even when we get a win with a customer, they do not want us to disclose their name and they clearly do not want us to disclose volumes with them because that's tipping off the hand to their competitors. But what we are seeing again was a mixed bag of results. There are some customers that clearly had lower volume in the second quarter. There are others that reported Christmas was more - the Christmas season was more or less in line with expectations. But the fact is that we got more pallets back.

Paul Butler: (Credit Suisse, Analyst) Okay, thanks. Just if I could ask about the durability program. Nessa you made the comment that you don't expect an improvement in the damage rate in the second half. Can you give a sense of what the damage rate is running at?

Nessa O'Sullivan: No, we don't - we don't actually disclose what the damage rates are running at. But I can tell you that when we originally did speak to the market about the durability program, it was clear that while we expected to get material savings, that was based on a reduction in the damage rate.

What we're seeing is that the durability program is delivering benefits, in terms of the repairs that we're using less components for repairs and making some savings in that area. However, that's a relatively minor part.

So whilst we still are supportive of the durability program, we haven't yet seen a reduction in the damage rate which would drive the higher levels of savings that had been anticipated. So that was the rationale for that comment.

Tom Gorman: And Paul, just to reiterate - Nessa's correct here. I'll maybe explain this a slightly different way in terms of severity and frequency. So the severity of the damage, so our cost to repair is actually coming down. That's a positive and that's the positive effect of the durability program. But the frequency of the damage is not coming down. So that's how we would - that's how we refer to damage ratio.

So even though the actual cost is coming down, the frequency of it is not coming down as planned and therefore we're not delivering the cost saving that we had committed to for this year.

And as I mentioned to you earlier in my comments about more forward-looking statements, there are some issues that we fundamentally had to get our hands around in the United States and that is this issue of the very high damage rate. And the durability program was one step in approaching that.

There are other strategies that we're working on as you would imagine. They're more specific with individual customers and individual situations. We've not talked about those as frequently, but I think you can rest assured that the team is

committed to this issue because it is fundamental to the improvement of the US. Whether you choose to redeploy that in pricing strategies as Graham has indicated, no matter what you want to do, you've got to get it first. So you've got to continue to stay focused on this and I think the team will do that.

Paul Butler: (Credit Suisse, Analyst) Okay. If I could have one last question. Graham, you've made the comment that you want to put a message out that the margin potential in the US pallet business probably isn't the same as what the European business is achieving. But I was just wondering if you can comment on your view, on whether the current level of margins in Europe is sustainable, because - despite having come down slightly in the half, it is running very much above where it's tended to average.

Graham Chipchase: I don't think there's any real data that suggests that it's not sustainable. So our view is for the moment it looks reasonably sustainable. And clearly there are lots of moving pieces and we are seeing competitive pressure there, but we've got ways of mitigating that in terms of our operational efficiencies. So for the moment, I'd say we're reasonably comfortable.

Paul Butler: (Credit Suisse, Analyst) Thanks very much.

Operator: Your next question comes from the line of Scott Ryall from CLSA. Please go ahead.

Scott Ryall: (CLSA, Analyst) Thank you very much. Graham in your prepared comments referring to slide 25, you cited more challenging conditions in the second half than the first half. Could you please elaborate on that a little bit, where you're seeing pressures in the second half that perhaps we haven't seen in the first half.

Graham Chipchase: I think I was mainly alluding to the fact that we're getting a full year impact of what's going on in HFG which we only saw part of it in the first half. And it's talking a little bit about the fact that as you saw the first quarter, we had quite - a better performance in North American pallets than we had in the second quarter and we're calling out that we're seeing that momentum going through into the second half. And those are the main reasons. Nessa's going to (inaudible) answer that.

Nessa O'Sullivan: Yes, and look the comparators in the second half are more challenging than they were in the first half. So if you look at the actual earnings that are being flagged by that, the actual earnings are still being forecast to increase from - in the second half relative to the first half.

Scott Ryall: (CLSA, Analyst) Okay. And then the second question with respect to - Graham, you've been asked a couple of times on your balance between ROCI and growth. Could you maybe - a lot of focus obviously on the Pallets Americas business, but maybe in the context of the Pallets EMEA business where you haven't called out as many market specific issues. Could you just discuss that a little bit, how you saw that result?

I get that the return on capital is well above the cost of capital, but if I do some quick calculations with a 10% increase in average capital invested and a 1% increase in underlying profit, all in constant currency, it looks like your incremental return on capital has been pretty poor.

So how are you thinking about the investments in that business, albeit that wasn't while you were in charge. But is this - if we see this happening in the short term, should we be thinking that you're making this in order to make sure that you've got scale and you'll get the return increases at some time over the medium term? Or is there some other way of thinking about it please?

Graham Chipchase: Again, I'd defer to those who have been around a bit longer than me. But my understanding is what we're seeing a little bit is we're investing in new adjacent markets in Europe and therefore there's a lot of - we're investing ahead of volume growth and therefore you would expect to see the short-term decline in ROCI.

But there's nothing else more worrying than that within the European business. I think it's a really good space and I don't think I would be extrapolating to say that we expect to see a continuing decline in ROCI just because we're investing more assets in the business. They are good markets to be investing in.

Scott Ryall: (CLSA, Analyst) Okay. No, that's fine, understood. Sorry, just to come back on the HFG joint venture. I haven't got into the nuts and bolts yet, Nessa so I apologize for this. But could you tell me what was the interest income you booked from the loan and did you receive that in cash please?

Nessa O'Sullivan: Yes, we did receive it in cash and it was $3 million from that loan to the HFG joint venture.

Scott Ryall: (CLSA, Analyst) $3 million okay. And in terms of the write-off of $120 million, what was that against? Is that against the receivable from the - from HFG or is it more to do with the carrying value of the equity please?

Nessa O'Sullivan: The carrying value of the equity of the investment.

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

Operator: Your next question comes from the line of Damon Kitney from The Australian. Please go ahead.

Damon Kitney: (The Australian, Journalist) Hi folks.

Can I ask, first of all, at what point did you get any sense that you were going to step away from those 2019 targets.

And secondly, for Tom, given you had such a great record of delivering on promises, how disappointing is that for your legacy for the company to step away from those targets?

Graham Chipchase: Let me answer the first one. I think it's very much based on what we're seeing obviously at the very, very end of the calendar year last year and going into the beginning of this year around the North American business. And if you look at what some of the key assumptions to get to the fiscal 2019 targets, where it was all around the North American business. And I think that's what really substantiated the decision to say no, we want to step away from those targets.

Tom Gorman: As it relates to me, I think I've been pretty clear as I said in my statements, I'm pretty proud of where we've taken the business over the last seven and a half years. I think what I really wanted to do was to hand the business off in a stronger position than when I came on board back at the end of 2009 and I'm incredibly proud of where the company is today.

Damon Kitney: (The Australian, Journalist) So Tom, also you've been criticized for selling shares after last year's annual result and then we've seen some changes in forecasts going forward as we've seen today. Do you have any comment on that? Can I ask your comment on that criticism?

Tom Gorman: Yes, you can ask.

Damon Kitney: (The Australian, Journalist) You don't want to respond.

Tom Gorman: No, I don't have any comments, no.

Damon Kitney: (The Australian, Journalist) Okay. Thank you.

Operator: Your next question comes from the line of Greg Ward from Trafalgar Capital Management. Please go ahead.

Greg Ward: (Trafalgar Capital Management, Analyst) Hi. Good morning everyone. Gentlemen, apologies for not having the detail, I've only covered the company for a while. But just from what I've heard today and talking to a few people in recent weeks, my understanding is you lost a couple of contracts with PECO. Has that affected your network effects in terms of the volume?

Tom Gorman: So look I can comment. Our net new wins in the period are positive, so we win customers and we lose customers in the US. We wouldn't comment specifically on a customer. It would have to be a very large customer, to be blunt, to have a massive impact on our network efficiencies.

But look, losing customers is not a good thing and I think Graham nailed it when he commented on that earlier that in a network business as ours, we want to continue to stay focused on growth. But look we win customers and we lose customers all the time. That's why we refer to the net new wins in our outlook. So no specific comment around that.

Greg Ward: (Trafalgar Capital Management, Analyst) Okay. All right. Is it fair to say that it's a far more competitive - submittable competitive you've had for many years and hence it's finding it more difficult to actually win new FMCG contracts.

So my question essentially is if you're being pushed into secondary markets such as food service where obviously the asset returns are probably equivalent to FMCG but the distribution channel is far more fragmented hence the rise in NPDs. And hence what you've basically said is you need to price that accordingly.

So my question, follow-up question is as a result of that are you actually seeing you're price in that cost hitting this inflexion point with white wood and hence you're finding it actually difficult to sign new clients because they're actually more hesitant to move away from white wood which is clearly cheaper than what this new costing would be.

Tom Gorman: Well, to be clear again you've asked sort of a very involved question here really around the value proposition that we offer. So to be clear, white wood prices today, even today, where we sit today for Grade A are above the average issue fee to our national accounts. So I think your first inference is actually not correct.

But clearly as we've stated now I think for the last 45 minutes, that white wood prices do have an impact on customer decisions, particularly those customers that are looking to convert. But our value proposition really remains the same. And it isn't simply on availability and quality standards but it's really bringing the full strength of our network to bear.

And I believe that our ability to work down different verticals and different challenges, given the density of our network puts us in the best position to be able to compete going forward.

I think also just to your comment and I think all three voices have said this today, the competitive environment in the US has intensified. I think we've said that but I don't think anybody here is walking away from our ability to compete. So I think we have a very competitive team in the US, we have a very competitive value proposition and we have competitors.

For those of you that have been around watching us for a long time, you'll remember some competitors that we had back in the sort of 2007 to 2010 period. And they forced us to get better and forced us to compete more aggressively and we came through that period very strong. And I anticipate that given the quality of the team that's now leading Brambles as well as the quality of the team in the US that they'll continue to focus and compete very aggressively.

Greg Ward: (Trafalgar Capital Management, Analyst) All right. Okay. Thanks for that. So you mentioned your pricing on the national account is a discount to Type A wood pallets, white pallets. Can we get into the detail because it's important because it's ultimately a structural decision or a question as to whether the economics of CHEP work in the secondary slow returning fragmented NPD channels of whether the economics work. So specifically in those slow returning channels what is your price that you charge your customers versus A, B or C white pallets?

Tom Gorman: Look, I appreciate he question and I appreciate your strong interest in the business, but that's just something that's really proprietary to us. And disclosing our pricing - broadly our pricing strategies or specific - our pricing action either with a company or a specific vertical is something that we haven't done and I would recommend that we shouldn't do. It's part of our strategies in building our businesses.

What I can say and I think Graham understands this very well is that the density of the network is really what drives ultimately the competitive advantage. And when you get that denser network, if anyone can deliver to a different vertical, you are going to win that competition. And that's why I think growing a pooled business is so important and continuing to build the density of your network.

And I don't think anybody here disagrees with that. I think the team understands that very well. It may be that we have to sort of raise our level of competitiveness in the US from time to time, but we've been here before. We've done this before, as those of you that are watching us for a long time know, competition is a good thing for us. It forces us to focus a bit more.

We have done a great job looking after our customers, but if we're going to grow, I'm sure there are some things that we're going to do differently in the US to accelerate the rate of growth.

I will point out that the US pool business is still growing and we came into the year with a very high expectation. You've seen the charts. We came off a heck of a great year last year, and we simply haven't been able to deliver to what we thought we could in the half.

Greg Ward: (Trafalgar Capital Management, Analyst) Thank you very much. That's a fair answer. Just on the other point that did come up earlier in terms of a structural shift to e-commerce and affectively companies like Amazon taking significant share from physical outlets. Not as evident in Australia given Amazon's - earlier this year, but the number of white vans delivering small parcels in cities all around the world has been obviously increasing.

Maybe you can talk the economics and how that's actually going to evolve from a pallet point of view. Obviously, it won't affect SMCG as much, albeit we've got [Ricardo] over here but in the case of merchandise and other channels. How do you see the economics and how will CHEP given their experience in pool and in particular RPCs, how do you think that's going to unfold?

Tom Gorman: Greg, look I'll just make a comment then, and I'll pass to Graham. But in terms of what we've done up until this point in time I'll just maybe reiterate a little of what I said earlier.

For us it's really a broader discussion around what we refer to as omni channel retail. Clearly e-commerce gets the most visibility and the most general media coverage, but the face of retail is changing is many different ways. It's not just e-commerce. Although e-commerce is very big and you might see some of the moves that Walmart has made recently in the US through acquisition. We really see it on three fundamental phases.

One is the footprints. So, small store formats which are growing. Very popular already in Europe, but continuing to grow in the United States. We think we can offer quite a few solutions into store level. That's what we refer to as last mile solutions. There are a number of initiatives that we've talked about previously that are underway there.

In terms of click and collect, we're actually piloting with some things of our own here to have a look at what role we could play in click and collect, and what role we might be able to play as a new initiative in direct to home. It's a long way off still, but we are spending money on that, and we're making investments, and we're looking at that.

Last, but not least, is your comment around e-commerce which is direct to home from a large distribution centre, or as Amazon refers to them as a fulfilment centre. In this case, if they were to grow their FMCG flows, we would continue to see a larger growth and more pallets going into those fulfilment centres.

We would then be able to collect our pallets more quickly, so that helps from a velocity standpoint. That also would reduce damage to some degree. So, on that front on a cost perspective it would probably be good for us in the long run. But clearly, with that the complexity of the distribution network comes down. As I said before we bring value with complexity.

The other thing that I alluded to in a very high level is that we are in conversations with Amazon, and we are talking to them about how we can bring our expertise within their network. I think that's a potential for us still going forward. But the conversations are underway.

They are a participating distributor for us in the United States, but as I said the actual volume penetration of our customers on our pallets into Amazon is very small. So, it remains an opportunity, and as we continue to develop our own technology I think that we're in a position to help the online distributors.

Greg Ward: (Trafalgar Capital Management, Analyst) Okay, thanks Tom.

Operator: Your next question comes from the line of Sondal Bensan from BT. Please go ahead.

Sondal Bensan: (BT Investment Management, Analyst) Hi, look I just wanted to explore a bit more the comments you made today about this differential margin and return on capital in EMEA verse the US. If I go back in time, I think when you started Tom, the margins in the US were a lot higher. The comment made was that there's structural differences between the US market and the markets in Europe that meant that the European margins should never be expected to rise to that high level of the US margin.

Now, if we roll forward we're saying that there are structural issues in the US market, or issues in the US market that mean that the margins in that market will not go up to the high levels of the EMEA margin which are now higher than, or almost at the similar level as what the US margin was pre the IFCO acquisition from years ago.

I mean my understanding is that obviously it has something to do with changing competition from what you've been saying today in the US. Can you maybe elaborate that? Where you have multinational customers, who are probably going to be seeing this result and seeing that you feel that you can generate higher returns on capital in the EMEA, but less in the US because there's more competition in the US. What do you think your multinational customers are going to say or respond to that kind of comment by the company?

Tom Gorman: Well, I won't comment on what our customers might or might think, but clearly, we understand that our customers review our results as we review theirs. I think that's just a given.

I think in terms of the margin and the return movements over the last couple of years between the two markets, we've actually talked about this for a number of years actually. So, if you got back a few years ago, we have been able to deliver in both markets. Now, this is in broad terms. In broad terms, we've been able to deliver the same gross amount of supply chain efficiency in our European pool business, and in our US pool business.

What happened in the US, is that we've seen far more inflation pressure in the United States. Actually, the cost pressure in the US, and it's been on many different fronts, there was a period of time where we saw a big increase, and I think you'd be familiar with this, or remember this, a couple of years ago, where we saw 9% increase in rates in the United States. That both impacted the pool business, as well as it impacted the RPC business at the time.

We also saw increase in timber costs in the United States, and a number of our other cost inputs. At the same time, we saw a reduction in fuel prices in the United States. Because we have a different structure in the business in the US that actually worked slightly against us.

So, if you would normalize and you go back a couple of years, you would see that the divergence in margins was really as much driven by inflationary costs in the United States that we were not able to offset with efficiencies. Whereas, and I've said this on many occasions, whereas in Europe, because of the benign level of inflation we weren't getting much price relief in Europe, but what we were getting is that performance improvement was leading to margin expansion and ultimately expansion and return on capital.

The second adjustment that I think you would have to make, and I think you know this because you alluded to it, is that when looking at the US business we have a very large recycle business in the United States. That business because of the goodwill assigned to it, is a significant drag on return on capital in the US. Because of the margin structure it's a significant drag on margins.

We have in the past backed that out and explained to the market what the difference is. So, that's how we get to where we are today, Sondal. I think that we've been very open about our European margin structure, that most of that benefit was coming from a benign inflation environment, really essentially no pricing, but this ability to deliver efficiencies across the supply chain.

Those same efficiencies in the US unfortunately have not offset the cost pressures. That really brings us up to where we are today. The competitive environment, it's competitive in both places for sure it is. But we have seen a strengthening competitive profile in the US, and I think Nessa and Graham have focused on that and they've brought that to your attention.

Nessa O'Sullivan: Yes, and I think there's probably another point that Tom referenced earlier which is complexity is good for our business and our pricing. If you look at the European market, there are 10 times the number of distribution points relative to that in the US which makes European market a lot more complex.

When you have complex supply chains to manage, you charge for that because you're adding significantly more value to your customer. So, that's another key reason why it would be reasonable to expect that you would have higher margins in the European context than you should expect in the US business.

Sondal Bensan: (BT Investment Management, Analyst) Right, but I mean given the market structure and the strength of CHEP's franchise in the US in terms of its market share and your ability to win new customers, I mean I know there has

been a lot of unexpected cost inflation in the business over time, but why isn't any of that able to be passed through over time given, I mean it's a duopoly structure in the marketplace basically.

Tom Gorman: I think that over the years I've tried to be very clear here, and I think a number of analysts have said that we should be more aggressive on price. What we have tried to do in the United States is get the right balance as we've tried to do in our European business. To get the right balance between margin expansion and value delivery and growth. Our focus has been in growing in the United States.

If you go back to the 2010 and 2011 period, if you look at the growth that we delivered in the United States, it's been very strong. I would argue that that growth has come on the back, not only of an improving product and service quality offering, but it's also come on the back of a really good value equation.

So, the growth that we've had in the US, and you remember as well as anyone when we won back our customers from IGPS back in the - I guess it was FY10 and FY11 period, we were able to continue to build our business and we really held fire on taking aggressive pricing. I would still say that that was the right strategy to deliver growth for us. The cost inflation and our inability to offset all of that with efficiencies has really led to a fair bid of that margin divergence between Europe and the US.

The businesses are very different. The US is still fundamentally a 1SKU business. Europe has six different pallet types, plus a number of initiatives now in last mile and first mile. The US is scratching the surface on a number of those initiatives. But the businesses are different.

But I believe that the US has grown its business very well, and it can continue to improve, but it needs to get its hands around the cost issues. That's why I was very open, and I think we've all been open, on the importance of the durability program and the importance of getting our hands around the damage rate in the US.

Nessa O'Sullivan: Yes, because the damage rate in the US is materially higher than the damage rate in Europe.

Sondal Bensan: (BT Investment Management, Analyst) Thanks. Just one last question for Graham. I mean at a very high level, I mean if you look at the earnings delivery of Brambles, the guidance has been met every year, and full credit to the management team for delivering those outcomes. Particularly in light of some of the challenges that you've had in the US on costs and margins.

I mean if you look at it at a high level, Graham, I mean there would be some people that are sceptical about such a positive outcome on earnings delivery given the major divergence in the operating performance of the two divisions. Really the outcomes in EMEA have been well above anyone's expectations for years now. The US obviously have been below people's expectations and the company expectations over that same time period.

I mean in that context, how convinced are you that EMEA - the changes in EMEA are sustainable and there aren't any unexpected surprises or issues that face that business as has been faced by the US which has led to it seeing a year-over-year decline margins for some time now. I mean what specifically is it about EMEA that you think that the current high margins and the terms will be sustained at these levels.

Graham Chipchase: I think the first point to make is I'm not saying that I don't think there's anything unexpected coming along because I can't say whether there is or there isn't. That's by the very nature of its tag. I think when you look at the European business as we see it today, then everything that Tom and Nessa have just said about the European business is something that gives you confidence that if there are some changes at the margin, the business will be able to respond because there is complexity. There are lots of programs in place to optimize both costs and efficiency.

So, one would expect that if there was, again, at the margins if you've got increasing pressure in certain geography, or with a certain customer, you should be able to respond to it and mitigate that impact. It's not so straight forward in the US because there are fewer customers, and the market structure is completely different. That's why I say what I say.

Now, does that statement mean I'm happy and confident forever? No, of course it doesn't, because stuff happens. We are talking about in the near term, near to medium term, and I think that's very consistent with what you'd expect us to say. We have reasonable visibility of what's going on in the business and we've got good programs in place to keep the costs under control and to monitor what's going on in the market.

Sondal Bensan: (BT Investment Management, Analyst) Okay, thanks for that.

Operator: Your next question comes from the line of Simon Evans from Financial Review. Please go ahead.

Simon Evans: This is a really simple question. How many pallets have you got in the United States?

Nessa O'Sullivan: 98 million pallets.

Simon Evans: Just triple checking. At the end of December, you had 2 million more pallets in your pool coming back to you than you had originally anticipated a few months earlier.

Nessa O'Sullivan: Yes, that's right.

Simon Evans: Okay. Thank you.

Operator: There are no further questions at this time. I would like to hand the conference back to today's presenters. Please continue.

Nessa O'Sullivan: Thank you all for your time today.

Operator: Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may now disconnect.

End of Transcript