

SE portfolio
 HD **Ramping up Brambles**
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 WC 1,743 words
 PD 17 January 2014
 SN Financial Review Smart Investor
 SC FRSINV
 ED First
 PG 44
 LA English
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 CEO Q&A

Chief executive Tom Gorman talks to Patrick Commins about the logistics **company's** growth opportunities after selling its documents business.

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What was the strategic rationale behind the decision to spin off your document management business, Recall?

It was pretty straightforward. Recall was only 15 per cent by revenue of the organisation and we think we can get fundamentally higher returns on capital – and that there are more growth opportunities – in the pooling business [pallets and containers].

So what ultimately would have happened is we would have put less and less capital into Recall, making it less and less competitive in the long run – and that's not the right thing to do. Recall is a very good business. With a focused management team and ownership structure they will make their investments in line with returning a strong return on capital for their shareholders. I know that they are highly motivated and excited about being independent. I think the future is bright.

How is Brambles different now from when you first joined in late 2009?

When I came on board there were two fundamental issues.

One was we had a business in the US that was broken and we needed to turn that around. We were able to reinvest heavily in the US business and fundamentally shift the product and service quality of the organisation and capture some lost market share. That's reflected in our share price.

A big bit of our value decline prior to my arrival had a lot to do with the US business struggling. We had an upstart competitor there at the time called IGPS. They have subsequently filed for bankruptcy, maybe six to eight months ago, and we've been able to win back the vast majority of those customers.

The other component over the past four years was getting a growth strategy and then starting to execute against that strategy, which, simply, is to continue to grow geographically and to diversify the assets we pool.

The biggest transformation for that was acquiring IFCO, which is in the reusable plastic crates [RPC] business. It services the fresh and produce supply chain. The concept is "from farm to fork". It's one touch through the supply chain to the other end where the consumer actually picks the fresh produce out of one of our crates in their local grocery store.

The IFCO **acquisition** took us from something like 3 per cent of total revenue coming from RPCs to something like 17 per cent, so it was a fundamental shift.

Where else have you expanded your pooling businesses?

We've made a number of other acquisitions in key areas. We're building an aerospace pooling business, which is the unit load devices (ULDs) that go inside an airplane, so think of those big containers that carry packages and luggage and things of that nature. We have a business that we both pool and repair those ULDs at airports around the world.

Our most recent **acquisition** was Pallecon at the beginning of this year. [The **company** is] in the intermediate bulk container space. So the idea here is to capture the inbound raw material to the manufacturers that we work with, where we ship finished goods on our pallets.

Where do you operate internationally?

We operate in over 50 countries around the world but there are some big pockets of activity for us. The US is by far the biggest market; over a third of revenue comes from there. All of Europe is about 40 per cent, but on a country basis the US is by far the biggest. We are aligned by supply chain, so we have a global head of pallets, of containers, and of reusable plastic crates. The top five countries for us would be the US, UK, Spain, Australia and Canada.

We have a very strong business in South Africa, and emerging businesses in the Middle East run out of Dubai. We're moving eastwards in Europe; our eastern Europe headquarters is in Istanbul. We are looking even further east and whether we should be in Russia or not. We have identified a country manager to **lead** our Russian effort, but that's still in the very, very early stages.

We are in Brazil. We are doing some RPC projects in India and, particularly, **China**.

Do you have a focus on developing economies?

The first thing you look at is the potential size of the prize. So you look at **China** – it's massive. But in India and **China** they are still hand-loading trucks. That will change as labour rates go up and they look to automate – labour supply is an issue in **China** – but these are very long gestation periods. We break even in **China** today, but in terms of really delivering returns on capital it'll definitely be five to 10 years.

In the US it took us something like 11 or 13 years before we were cash-flow positive, but that business went from zero to \$1.1 **billion** [in sales] over that decade.

What gives Brambles a competitive advantage?

There are a number of things, but it starts with the network coverage. The pooling business is a network business – you ship from point A to point **B** and it's very expensive to get that asset back to point A.

So what you try to do is to find a customer at point **B**. The first thing is that our network and market coverage gives us a very good competitive advantage to be a low-cost producer and a low-cost mover of those assets.

Another advantage we have is over the depth of our relationship with our customers on both the retail and manufacturing side. Think of names like Tesco, Walmart, Costco, and Coles and Woolworths here.

You get strong relationships with the retailers and you combine that with strong relationships with the manufacturers, such as Nestlé, Unilever, Procter & Gamble, Coke and Pepsi.

When you're trusted on both sides you can continue to strengthen your business.

Are you gaining share in your major markets?

We've been gaining share everywhere around the world. Last year we made significant share gain in the US as we won back a number of big accounts that we had lost previously to IGPS.

What's your share in the US?

Broadly, we would say 45 to 48 per cent share, but it's not that studied.

With the role you play in the transport and logistics industry, are your earnings tied to the economic cycle?

Actually, I think most people when they look at Brambles see a defensive play, because the underlying demand for our customers' products is resilient.

Most of what we sell are consumer staples: food, beverage, personal care products, pet food. Even in difficult times people eat, drink and bathe, and that's what we are moving for our customers. So we see relatively low volatility of the underlying demand.

Typically, what you'd see in a normal growth period is organic growth somewhat less than CPI.

Would you normally see a rebound in earnings early on in an economic recovery?

We see what's going to be sold 30 to 90 days in advance, because the supply chain has to be stuffed with products before you sell it. So we know when demand is going up. There's a little bit in the US – nothing to write home about – but in Europe the problems are more structural. We think Spain has bottomed, but it's going to be a long time [before you see a sustained recovery].

We still see organic growth in demand for our products globally of 1 to 2 per cent, so slightly below global GDP growth.

What's your dividend policy?

We frank to 30 per cent and we have what's called a "progressive" dividend, which means it will grow as our earnings grow. We don't target a payout ratio. One of the challenges we have is we pay in Australian cents, but we actually record our earnings in US dollars, so you get some volatility based on exchange rates.

So if you look at where the Aussie is today, the payout ratio will come down. But if you look at where it has been – at \$US1.05 – it gives you a very high payout ratio as a percentage of earnings. So we don't target 50 or 55 per cent, we just say we want it to be progressive.

We are also a growth business and we are funding \$300 million to \$400 million in growth investment every year, and we need the capital to continue that.

Will acquisitions be part of your growth strategy?

I think they will. I don't know that there's a big transformational deal – à la IFCO – out there, but particularly in the container space if there's someone who has some expertise in that space you could see us do something there. There's not a lot for us to buy in the pallets business, so if it's going to happen it's largely going to be containers.

So the growth in your pallets business will be by improving performance and expanding into new markets?

Exactly.

There's nothing so major you'll need to raise capital or a big slab of debt?

No, if you look at our balance sheet today ex-Recall we have quite a bit of debt capacity, quite a bit of firepower.

How will Brambles be different in five years?

This is one business called "pooling" in many different spaces and we to continue to drive that. Hopefully what you'll see five years from now is a bigger percentage of RPCs as a percentage of revenue, with more penetration. In the US we grew the top line at 19 per cent last year and we want to accelerate that. You should continue to see that diversification, so five or 10 years from now you'll see a more highly diverse business.

Tom Gorman

CEO, Brambles

Tenure

4 years, 1 month

One-year share price return

28.6%

Brambles

JUNE 2011: Brambles announces acquisition of reusable plastic crates business IFCO.

JUNE/JULY 2012: The **company** cancels a planned demerger of Recall and raises fresh capital.

DEC 12: Acquires Pallecon, a bulk container business.

DEC 13: Recall demerger finally completed.

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IN i8396 : Diversified Holding Companies | ibcs : Business/Consumer Services

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AN Document FRSINV0020140116ea1h0001d