

# Chairman's Review

## Restoring value

The past year has been a difficult one for shareholders who have seen a substantial decline in the value of their holdings in Brambles. The key concerns of many shareholders are whether the fall in the share price is indicative of ongoing issues within Brambles, and the efforts by the Board and management to restore value.

Despite the problems identified within CHEP, which were detailed at the 2002 Annual General Meeting, all our core operations showed solid revenue growth and remained soundly profitable throughout the entire year. The strength of our key businesses provides a platform to deliver sustainable profit growth and the return of market confidence.

Last year, we highlighted the imperatives behind the creation of the dual listed companies structure (DLC) and the need for the transformation of Brambles. As the repositioning of CHEP progressed, it quickly emerged that the previous high rates of growth were unsustainable. The level of capital required to fund this growth was placing undue strain on margins and the balance sheet. In addition, one of the key disciplines in managing a pallet pool – that is, control of the assets – had not been sufficiently rigorous. The correlation between the growth of the pallet pool and the commensurate growth in revenue had become increasingly disproportionate.

Over the past year, there has been an enormous effort to improve the asset productivity of the pallet pool. CHEP Europe has relocated 2.4 million pallets across the network to enhance utilisation rates. Physical audits led to another 1.1 million pallets being added back to our customers' holdings, with associated revenue improvements, and customer deficits resulted in compensations being charged for another one million pallets. Provisions were made in relation to a further four million pallets that were written off as a result of this process. The asset productivity improvement program is continuing in the current year. There is still considerable work to be done to improve customer satisfaction and overcome the operational issues that have been identified. All of this work is expected to be completed within the timeframe set out in November 2002.

Apart from reconfiguring our CHEP operations in Europe and improving the returns in America, the other challenge for CHEP is to leverage its position in the supply chain to provide greater value-added to our customers: in essence, to improve the relationship between profitability and capital employed.

Following the formation of the DLC, the company focused on implementing the correct drivers of long-term shareholder value. The adoption of a value-added approach, which involves charging businesses for the use of capital employed, has contributed to a significant change in performance measures and, in turn, in Brambles' culture. This initiative, among others, is critical to long-term accretion in value.

The management initiatives are starting to deliver tangible benefits. The improvement in cash flow in the six months to 30 June 2003 and the decline in net debt are encouraging, and provide a foundation to deliver continued growth. In the second half of the year, for the first time since the formation of the DLC, Brambles generated operating free cash flow after meeting its obligations of interest, tax and dividend.

The valuations ascribed to Brambles by the stock market prior to the formation of the DLC appeared to have relied on the extrapolation of high earnings growth rates for many years into the future, which were not related to the generation of free cash flow. The importance of free cash flow reflects the increased emphasis on discounted cash flow analysis within Brambles. The readjustment of growth expectations that has taken place, to more realistic and sustainable levels, may have accounted for the major part of the decline in Brambles' share price.

Within the framework of our continuous disclosure policies, Brambles is committed to ensuring that the external expectations of sustainable growth rates do not materially diverge from the internal view. The improvement in our financial disclosure should substantially reduce the capacity for such divergent opinions to emerge. Stock markets, however, remain more volatile and difficult to correlate with the underlying value of the businesses. It is our challenge to improve the market's understanding of Brambles' businesses.

The second major influence on our share price has been uncertainty, since the initial identification of the problems within CHEP. The confidence of the market has been shaken by recent events and it will take some time to remove this sense of uncertainty. In reorganising CHEP Europe, the market is concerned about execution risk – the ability to deliver all restructuring initiatives on time and within the estimated costs. This higher perception of risk may have been another factor in the share price decline. Delivering several consecutive financial results in line with market expectations will be key to restoring Brambles' credibility with shareholders and the broader investment community alike.

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**“Brambles is fortunate to have strong market positions in each of its core businesses. This year highlighted the benefit of the group’s core businesses as strong growth from Recall, stable earnings from Cleanaway and robust cash generation from Brambles Industrial Services provided a buffer against the difficulties in CHEP.”**

The third area of volatility has arisen from currency movements. The strength in the Australian dollar in the final quarter of 2003 adversely impacted on the reporting of Brambles Industries Limited's earnings in that currency. The results of Brambles Industries plc were marginally affected by movements in pounds sterling against other currencies. Brambles now operates in almost 50 countries and currency fluctuations will be an ongoing feature of our trading results. However, the diversity of Brambles' business portfolio and the relevant mix of underlying currencies generally mitigate the trading profit impact. Short-term currency movements do not influence the inherent value of our businesses in these various countries. Consequently, Brambles' diverse global platform should be considered a strength.

The overriding principle in managing the business is the creation of sustainable shareholder value. Fundamental to the creation of value is the selection of businesses and their inherent industry growth prospects. Brambles is fortunate to have strong market positions in each of its core businesses. This year highlighted the benefit of Brambles' core businesses as strong growth from Recall, stable earnings from Cleanaway and robust cash generation from Brambles Industrial Services provided a buffer against the difficulties in CHEP.

As CHEP restructures in both Europe and America, it is easy to overlook the inherent strength of this business. In the past year, CHEP achieved sales growth of 10% in constant currency terms and an overall EBITA margin of 15%.

## Corporate governance

Following the publication of our Corporate Governance Policy and Remuneration Policy in the 2002 Annual Report, we have again submitted these reports to our shareholders with a view to more closely aligning management objectives and those of the Company with the expectations of shareholders. As was the case in 2002, we will again be submitting the Remuneration Report to shareholders for approval this year.

The Board recognises that the globalisation of investment flows continues at pace with the availability of capital from international markets increasingly moving to those economies and companies that demonstrate sound corporate governance standards and an overall commitment to sustainability.

Our policy is to comply with the various rules and regulations of those jurisdictions where we operate and adopt the better of the prevailing standards.

The Board also recognises that we cannot afford to strive for anything less than continued strong performance. There is no room for complacency given the volatile nature of international markets and the possibility of unforeseen external events.

## Board review

An independent review of the Board was undertaken during the year. The review focused on areas such as the role of the Board, performance evaluation, procedures and practices, and behaviours and cohesion. Action programs that evolve from this review will be developed to assist the Board to be more effective, both collectively and individually, going forward.

Sir John Parker has decided to retire from the Board at the conclusion of the Brambles Industries plc AGM in October, given his other workload commitments. Sir John has made a significant contribution to Brambles, and I am sure shareholders join me in thanking Sir John for his contribution.

As part of the ongoing process of renewal of Board membership, Mr Ron Milne – who will stand for re-election this year – has indicated a desire to retire at the conclusion of the AGMs in 2004, having regard to his length of service.

We have engaged an international search firm to provide a list of candidates with the appropriate skills and attributes to replace Sir John, and will continue the ongoing review and appraisal process, aimed at ensuring an appropriate mix of skills and experience on the Board.

I would like to pay tribute to the Board who also shouldered the burden of restructuring the Brambles balance sheet, and I thank them for their resolve in tackling the difficult issues that confronted us.

## People

The past 12 months have been immensely challenging for all Brambles employees. The economic backdrop across most of our businesses has not been easy and the need to effect major changes, particularly within CHEP, has placed strains on our people. The professionalism and diligence they have demonstrated over the past year in tackling these problems and, in particular, in improving the CHEP business model has been superb. On behalf of the Board, I would like to thank them for their efforts and recognise their role in building shareholder value.

## Outlook

Looking forward to the next twelve months, economic recovery remains tentative in the USA and Europe.

In CHEP, we continue to see revenue growth opportunities in all of our markets. Within the Americas segment, initiatives in the USA to optimise the operation of the new service centre network will increase costs in the short term and this will result in weaker performance in the first half compared to the prior year but with a stronger cash flow. Trading in the second half should be better than the comparable period last year. In Europe, trading should improve as the year progresses as benefits are realised from the restructuring program. Overall, CHEP is expected to make good progress for the year as a whole.

Cleanaway's margin will be affected by the one-off event of DSD re-tendering. However, Cleanaway is strategically well positioned to meet this challenge and to resume growth momentum thereafter.

Growth is anticipated from Recall, and Brambles Industrial Services should continue perform steadily.

In summary, although trading for the first half in constant currency will be weaker than last year we expect a better performance in the second half, leading to improved cash flow and good progress for the year as a whole.

I encourage all our shareholders to keep abreast of the latest developments within Brambles by regularly logging onto our website at [www.brambles.com](http://www.brambles.com).

**Don Argus, AO**  
Chairman