Figure 12: **Filling the Pipelines of the top US retailers**

Avg. value / pallet (food)	$1,300
Avg value / pallet (merchandise)	$1,300
Avg. manufacturer cycle time (food)	32 days
Avg. manufacturer cycle time (Merch)	38 days
CHEP costs	
Issue/Delivery Fee	$1.70
Daily Hire Fee	$0.035
Transfer Fee	$1.07

Food Companies	Food Type	FY00 sales (US$m)	Proportion Palletised [1]	No. pallet trips pa (m)	Inventory Turns pa (x)	Pallets in DC/Store @ once @ X turns (m)	CHEP pentration		CHEP Pallets in system at one time (m)			Retailer's number in US:		CHEPs	Margins	Add new Depn.	Adj. EBIT
							Inbound	DC / Store	Total =	Manuf. Cycle	+ DC / Store	DC's	Stores	EBITDA	EBIT		
Kroger	*Food*	$49,000	85%	32.0	12.2	2.6	50%	50%	2.7	1.4	1.3	41	3,660	36.8%	25.4%	$0	25.4%
Albertson's	*Food*	$36,762	85%	24.0	10.7	2.2	50%	50%	2.2	1.1	1.1	19	2,533	36.6%	24.6%	$0	24.6%
Safeway	*Food*	$31,977	85%	20.9	13.0	1.6	50%	50%	1.7	0.9	0.8	16	1,688	36.8%	25.7%	$0	25.7%
Walgreen	*Convenience*	$21,207	50%	8.2	8.0	1.0	15%	15%	0.3	0.1	0.2	9	3,165	36.2%	22.7%	$0	22.7%
CVS	*Convenience*	$20,088	50%	7.7	5.7	1.4	15%	15%	0.3	0.1	0.2	10	4,133	35.6%	19.5%	$0	19.5%
Total Food		**$159,034**	**na**	**92.9**	**na**	**8.9**	**na**	**na**	**7.2**	**3.6**	**3.6**			**na**	**na**	**0.00**	**na**
Average Food		**$31,807**	**76%**	**18.6**	**9.9**	**1.8**	**36%**	**36%**	**1.4**	**0.7**	**0.7**			**36.4%**	**23.6%**	**0.00**	**23.6%**
Broadline retailers	**Retail Type**																
Costco	*Warehouse*	$32,164	95%	23.5	13.7	1.7	40%	40%	1.7	1.0	0.7		335	39.8%	28.6%	$0	28.6%
Wal*Mart	*Discount*	$148,687	70%	80.1	9.3	8.6	**30%**	**80%**	9.4	2.5	6.9	55	3,118	39.4%	**26.5%**	**$8.63**	**18.0%**
Kmart	*Discount*	$37,028	70%	19.9	4.3	4.6	20%	20%	1.3	0.4	0.9	18	2,150	37.9%	19.2%	$0	19.2%
Target	*Discount*	$36,362	70%	19.6	9.2	2.1	40%	40%	1.7	0.8	0.9	19	1,307	39.3%	26.5%	$0	26.5%
Sears	*Department*	$40,937	25%	7.9	7.8	1.0	5%	5%	0.1	0.0	0.1	108	2,960	39.1%	25.4%	$0	25.4%
JCPenney	*Department*	$32,649	25%	6.3	5.7	1.1	5%	5%	0.1	0.0	0.1	8	3,725	38.6%	22.5%	$0	22.5%
Federated	*Department*	$18,407	25%	3.5	4.5	0.8	5%	5%	0.1	0.0	0.0		404	38.0%	19.7%	$0	19.7%
Total		**$391,972**	**na**	**182**	**na**	**23.0**	**na**	**na**	**14.6**	**4.9**	**9.7**	**227**	**15,333**	**na**	**na**	**8.63**	**na**
Average Broadline Retail		**48,997**	**60%**	**22.7**	**7.7**	**2.9**	**19%**	**25%**	**1.8**	**0.6**	**1.2**	**38**	**1,917**	**38.9%**	**24.1%**	**1.08**	**23.0%**

1. Proportion of retail sales that can be palletised.

Source: CSFB estimates.

Figure 13: **CHEP USA—Revenue/cost/margin scenarios by channel**

		Total Channel per Annum Based on Asset Turns of Individual Customer										
		Dry Grocery					FMCG Channel					
							Warehouse	Discount		Department		
Trading Revenue	**Base-Case One Cycle E.g.**	**Kroger $m**	**Albertso $m**	**Safeway $m**	**Walgreen $m**	**CVS $m**	**Costco $m**	**Wal*Mart $m**	**Target $m**	**Sears $m**	**JCPenney $m**	**Federated $m**
- Issue and delivery fee (@ $1.70)	$1.70	$27.23	$20.43	$17.77	$2.08	$1.97	$15.98	$40.83	$13.31	$0.67	$0.53	$0.30
- Daily rental fee (@ $0.035)	1.23	17.94	13.46	11.71	1.37	1.30	12.50	31.94	10.42	0.52	0.42	0.24
- Transfer fee (@ $1.07)	1.07	17.14	12.86	11.19	1.31	1.24	10.06	25.70	8.38	0.42	0.34	0.19
- Lumber Surcharge (@ $0.10)	0.10	1.60	1.20	1.05	0.12	0.12	0.94	2.40	0.78	0.04	0.03	0.02
Total Revenue	**$4.10**	**$ 63.92**	**$47.95**	**$41.71**	**$4.88**	**$4.62**	**$39.49**	**$100.88**	**$32.89**	**$1.65**	**$1.32**	**$ 0.74**
Assumptions for cycle times (days)												
Manufacturing cycle	35	32	32	32	32	32	38	38	38	38	38	38
Distributor cycle	32	30	34	28	46	64	27	39	40	47	64	81
Repair cycle	3	3	3	3	3	3	3	3	3	3	3	3
Storage / Depot cycle	17	17	17	17	17	17	17	17	17	17	17	17
Transport cycle	1	1	1	1	1	1	1	1	1	1	1	1
Total Cycle	88	83	87	81	99	117	86	98	99	106	123	140
Asset turns / annum	4.1 x - 1 x in this eg.	*4.4*	*4.2*	*4.5*	*3.7*	*3.1*	*4.3*	*3.7*	*3.7*	*3.5*	*3.0*	*2.6*
Expenses												
- *Direct costs*												
Transport	$1.00	$16.02	$12.02	$10.45	$1.22	$1.16	$9.40	$24.02	$7.83	$0.39	$0.31	$ 0.18
Storage / Depot Fee's	0.17	2.72	2.04	1.78	0.21	0.20	1.60	4.08	1.33	0.07	0.05	0.03
Repairs and Maintenance	0.70	11.21	8.41	7.32	0.86	0.81	6.58	16.81	5.48	0.28	0.22	0.12
Depreciation	0.48	7.28	5.74	4.64	0.66	0.74	4.41	12.94	4.24	0.23	0.21	0.14
Other	0.10	1.60	1.20	1.05	0.12	0.12	0.94	2.40	0.78	0.04	0.03	0.02
- Total direct costs	$2.85	$45.24	$34.22	$29.42	$3.56	$3.49	$26.70	$69.87	$22.80	$ 1.16	$0.96	$0.56
- *Gross Margin*	*30.3%*	*29.2%*	*28.6%*	*29.5%*	*27.1%*	*24.5%*	*32.4%*	*30.7%*	*30.7%*	*29.8%*	*27.5%*	*25.3%*
Selling and Marketing	0.10	0.36	0.29	0.23	0.03	0.04	0.22	0.65	0.21	0.01	0.01	0.01
HO Overheads	0.40	1.46	1.15	0.93	0.13	0.15	0.88	2.59	0.85	0.05	0.04	0.03
Provision for doubtful debts	0.04	0.64	0.48	0.42	0.05	0.05	0.39	1.01	0.33	0.02	0.01	0.01
- *Indirect costs*	$0.54	$2.46	$1.91	$1.58	$0.21	$0.23	$1.50	$4.24	$1.39	$0.07	$ 0.07	$0.04
Total Expenses	**$3.39**	**$47.70**	**$36.13**	**$31.00**	**$3.77**	**$3.72**	**$28.19**	**$74.11**	**$24.19**	**$1.23**	**$1.02**	**$0.60**
Assumptions for direct costs												
Average transport cost / pallet	$1.00											
Storage rate / pallet / day	$0.01											
Retrieval-Handling-Inspection / pallet	$0.40											
Repairs and Maintenance												
- Damage Rate	20%											
- Repair cost / pallet	$3.50											
Depreciation / pallet / annum	$2.00											
Other / pallet	$0.10											
EBITDA	**$1.18**	**$23.49**	**$17.56**	**$15.36**	**$1.77**	**$1.65**	**$15.71**	**$39.71**	**$12.94**	**$0.65**	**$0.51**	**$0.28**
Margin %	28.9%	36.8%	36.6%	36.8%	36.2%	35.6%	39.8%	39.4%	39.3%	39.1%	38.6%	38.0%
EBIT	**$0.70**	**$16.21**	**$11.82**	**$10.71**	**$1.11**	**$0.90**	**$11.29**	**$26.77**	**$8.70**	**$0.42**	**$0.30**	**$0.15**
Margin %	17.1%	25.4%	24.6%	25.7%	22.7%	19.5%	28.6%	26.5%	26.5%	25.4%	22.5%	19.7%

Efficiency Calculations:											
Customer Total Trips	32	24	21	8	8	24	80	20	8	6	4
CHEP's % of Inbound	50%	50%	50%	15%	15%	40%	30%	40%	5%	5%	5%
CHEP's Trips	16	12	10	1	1	9	24	8	0	0	0
Required pallets by CHEP	3.6	2.9	2.3	0.3	0.4	2.2	6.5	2.1	0.1	0.1	0.1
Number of pallets in Manufacturing circuit	1.4	1.1	0.9	0.1	0.1	1.0	2.5	0.8	0.0	0.0	0.0
Number of pallets in DC / Store	1.3	1.1	0.8	0.2	0.2	0.7	6.9	0.9	0.1	0.1	0.0
Total CHEP pallets in circuits	2.7	2.2	1.7	0.3	0.3	1.7	9.4	1.7	0.1	0.1	0.1
CHEPs actual asset turn	**4.4**	**4.2**	**4.5**	**3.7**	**3.1**	**4.3**	**2.2**	**3.7**	**3.5**	**3.0**	**2.6**
Utilisation efficiency	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**60%**	**100%**	**100%**	**100%**	**100%**
Additional Depreciation Charge @ $2.00	$0	$0	$0	$0	$0	$0	$8.63	$0	$0	$0	$0
Adjusted EBIT	$16.21	$11.82	$10.71	$1.11	$ 0.90	$11.29	$18.14	$8.70	$0.42	$0.30	$0.15
Adjusted EBIT Margin	25.4%	24.6%	25.7%	22.7%	19.5%	28.6%	18.0%	26.5%	25.4%	22.5%	19.7%
Assets	$73	$57	$46	$7	$ 7	$44	$216	$42	$2	$ 2	$1
ROA Adjusted	22.3%	20.6%	23.1%	16.7%	12.1%	25.6%	12.4%	20.5%	18.4%	14.0%	10.8%

Source: CSFB estimates.

Figure 14 estimates the CHEP margin sensitivity to the various key variables for the Wal-Mart pallet pool. Our base case assumptions appear in the first column with a respective EBITDA and EBIT margin for the CHEP/ Wal-Mart pool of 39.4% and 26.5%. The margin sensitivities are absolute changes from the base case. Thus, a 25% increase in the Issue/ Delivery Fee (from $US1.70/ pallet to $US2.13) translates to a 5.6%pt and 6.8%pt EBITDA and EBIT margin increase, respectively. In contrast a 25% increase in the Transport cost (from $US1.00/ pallet to US$1.25/ pallet) generates a 6.0%pt margin contraction for both EBITDA and EBIT.

Revenue – Adjustment to Revenue items (i.e. Issue/ Delivery fee) falls through to the EBIT line without any affect to Depreciation (fixed). Thus, applying a 25% increase in the Issue/ Delivery Fee the EBIT margin movement is 1.2%pt greater than the EBITDA margin movement.

Depreciation – Depreciation costs are fixed based on a $2 depreciation charge per annum. That said, the depreciation cost becomes variable when the $2 charge is apportioned over the number of asset turns. In an efficient pool, this works well, and margin expansion can occur. In an inefficient pool (Wal-Mart is estimated to be 60% efficient), the number of pallets required to service the circuit increases to counter the 'lost' or "idle DC/Store" pallets. Thus additional assets means an additional fixed depreciation charge. We believe this was the major reason for the fall in margins as a result of retailers "de-stocking".

Cycle times - Cycle times are a key determinant in asset turns and therefore profitability.

Expenses- Movement in Expenses (excl. Depreciation) impairs EBITDA and EBIT margins equally.

Please note this sensitivity table does not include the Adjusted EBIT margin (i.e. no depreciation charge for the unbalanced inbound/ outbound inefficiency).

Figure 14: **Margin Sensitivity to Variables (absolute change - %)**

Issue/Delivery Fee (R)	**$ 1.70**	**+ / - 5%**	**+ / - 10%**	**+ / - 15%**	**+ / - 20%**	**+ / - 25%**
EBITDA margin	39.4%	1.2%	2.4%	3.5%	4.5%	**5.6%**
EBIT margin	26.5%	1.5%	2.9%	4.2%	5.5%	**6.8%**
Daily rental (R)	**$ 0.35**	**+ / - 5%**	**+ / - 10%**	**+ / - 15%**	**+ / - 20%**	**+ / - 25%**
EBITDA margin	39.4%	0.9%	1.9%	2.7%	3.6%	4.4%
EBIT margin	26.5%	1.1%	2.3%	3.3%	4.4%	5.4%
Transfer fee (R)	**$ 1.07**	**+ / - 5%**	**+ / - 10%**	**+ / - 15%**	**+ / - 20%**	**+ / - 25%**
EBITDA margin	39.4%	0.8%	1.5%	2.2%	2.9%	3.6%
EBIT margin	26.5%	0.9%	1.8%	2.7%	3.6%	4.4%
Manufact. cycle (C)	**38 days**	**+ / - 5%**	**+ / - 10%**	**+ / - 15%**	**+ / - 20%**	**+ / - 25%**
EBITDA margin	39.4%	0.8%	1.7%	2.5%	3.3%	4.1%
EBIT margin	26.5%	0.9%	1.7%	2.4%	3.2%	3.9%
Distributor cycle (C)	**39 days**	**+ / - 5%**	**+ / - 10%**	**+ / - 15%**	**+ / - 20%**	**+ / - 25%**
EBITDA margin	39.4%	-0.1%	-0.2%	-0.2%	-0.3%	-0.4%
EBIT margin	26.5%	-0.3%	-0.6%	-0.9%	-1.2%	-1.6%
Storage cycle (C)	**17 days**	**+ / - 5%**	**+ / - 10%**	**+ / - 15%**	**+ / - 20%**	**+ / - 25%**
EBITDA margin	39.4%	-0.3%	-0.5%	-0.7%	-1.0%	-1.2%
EBIT margin	26.5%	-0.3%	-0.6%	-1.0%	-1.3%	-1.7%
Transport (E)	**$ 1.00**	**+ / - 5%**	**+ / - 10%**	**+ / - 15%**	**+ / - 20%**	**+ / - 25%**
EBITDA margin	39.4%	-1.2%	-2.4%	-3.6%	-4.8%	**-6.0%**
EBIT margin	26.5%	-1.2%	-2.4%	-3.6%	-4.8%	**-6.0%**
Damage Rate (E)	**20%**	**25%**	**30%**	**35%**	**40%**	**45%**
EBITDA margin	39.4%	-4.2%	**-8.3%**	-12.5%	-16.7%	-20.8%
EBIT margin	26.5%	-4.2%	**-8.3%**	-12.5%	-16.7%	-20.8%
Repair cost / pallet (E)	**$ 3.50**	**+ / - 5%**	**+ / - 10%**	**+ / - 15%**	**+ / - 20%**	**+ / - 25%**
EBITDA margin	39.4%	-0.8%	-1.7%	-2.5%	-3.3%	-4.2%
EBIT margin	26.5%	-0.8%	-1.7%	-2.5%	-3.3%	-4.2%
Depreciation (E)	**$ 2.00**	**+ / - 5%**	**+ / - 10%**	**+ / - 15%**	**+ / - 20%**	**+ / - 50%**
EBITDA margin	39.4%	0%	0%	0%	0%	0%
EBIT margin	26.5%	-0.6%	-1.3%	-1.9%	-2.6%	-6.4%

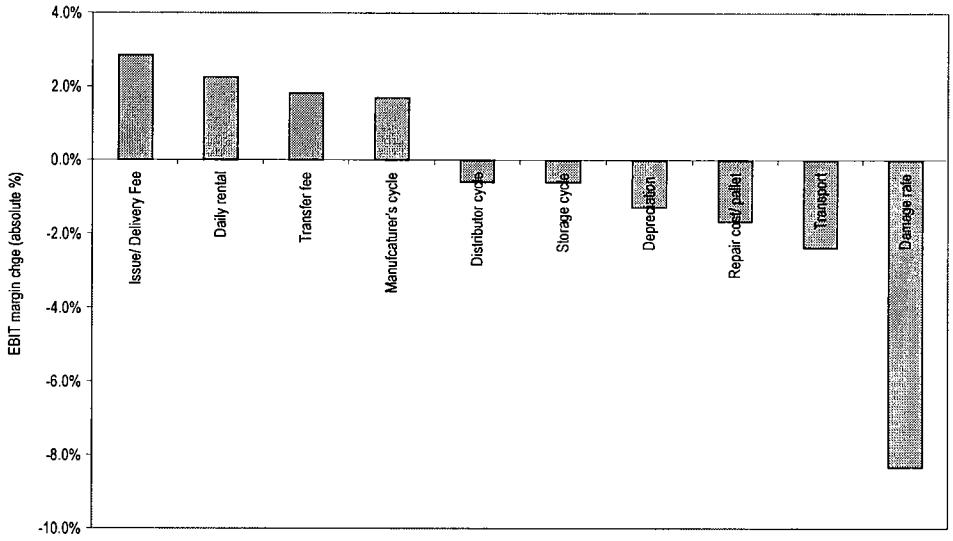
Key: R=Revenue; C=Cycle Times; E=Expense / Costs

Source: CSFB estimates.

Figure 15 estimates the sensitivity of CHEP's EBIT to an independent 10% movement in the key pallet pool variables for the Wal-Mart contract. A 10% increase in the Issue/ Delivery fee delivers an estimated 2.9%pt EBIT margin improvement to CHEP while a 10% increase in Transport costs erodes CHEP's EBIT margin by 2.4%pt. A 10%pt increase to the pallet Damage rate (from 20% to 30%) reduces CHEP's EBIT margin by 8.3%pts.

This sensitivity has been calculated on an unadjusted EBIT basis. Consequently, it excludes the impact of the depreciation charge attributed to the pallets required to sit idle in the DCs.

Figure 15: **CHEP EBIT sensitivity to 10% change in variables—(using the Wal-Mart circuit)**



NB. We have increased Damage rate by 10%pts from 20% to 30%

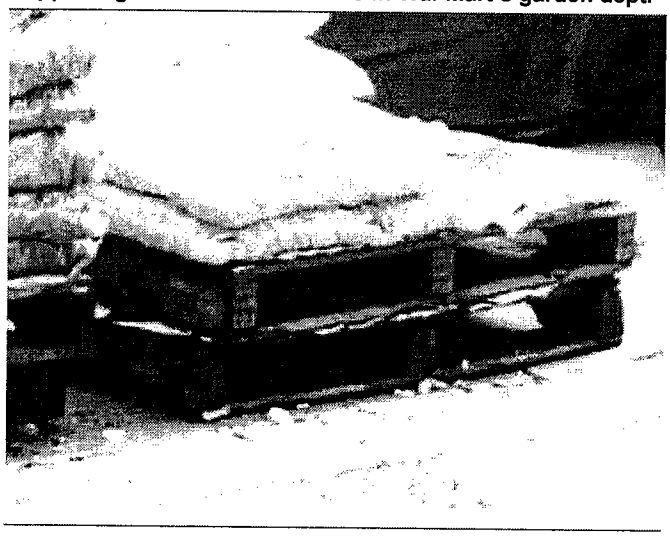
Source: CSFB estimates.

CHEP pallets entering Wal-Mart's secondary circuit

CHEP pallets entering the secondary circuit increasing dwell times, impairing asset turns and resulting in greater pallet deterioration

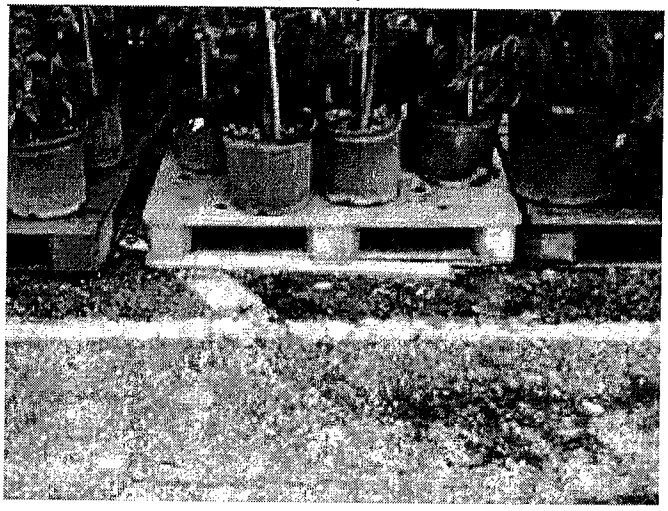
As highlighted previously, in the UK, the Retailer/Distributor should return CHEP pallets to CHEP approximately 30-45 days after receiving it, with ample time to process the product and order pick onto either white pallets or roll cages before shipping to the retail stores. In the case of the US, Wal-Mart is transporting product from the DC to the retail stores on CHEP pallets. Furthermore, once the pallet is at the store level, Wal-Mart is using CHEP pallets as display platforms for a wide range of products, including garden pot plants and fertiliser.

Figure 16: **Despite in the Dry Food Channel, this pallet is supporting chemicals / fertilisers in Wal-Mart's garden dept.**



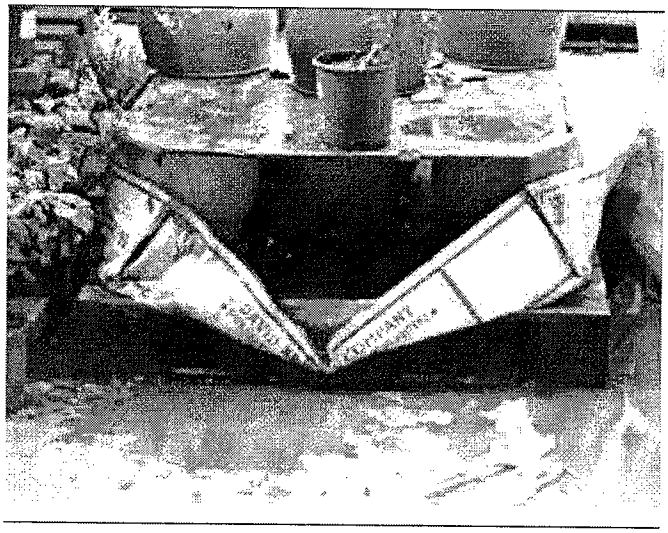
Source: CSFB.

Figure 17: **US$60 plastic pallet not generating revenue. The right hand corner of this plastic pallet has been broken**



Source: CSFB.

Figure 18: **High damage rates in the Home Depot secondary circuit**



Source: CSFB.

Figure 19: **The number of CHEP pallets in the Wal-Mart garden departments triple leading into Spring**

Source: CSFB.

The impact of large retailers / distributors' inappropriate use of the pallet pool (filling DCs and sending pallets to the stores) is as follows:

Short term impact:

- Reduced asset turns— we estimate CHEP currently has approx. US$180m worth of pallets (9m pallets @ US$20/ pallet) in the Wal-Mart circuit (DC and stores). Based on Wal-Mart's inventory turns and our assumptions, CHEP should be generating asset

turns of 3.7x per annum. However, due to the stockpiling of Wal-Mart's DC's and Stores, we now assume each pallet is currently only generating an estimated 2.2x pallet turns/ year. At US$4.20 revenue per trip, then CHEP could be generating US$100.88m in revenue from the Wal-Mart channel (Wal-Mart suppliers). In normal circumstances, CHEP would earn EBIT margins of approximately 26.5% or $26.77m, but as a consequence of CHEP supplying Wal-Mart with working capital, the "Adjusted" EBIT Margin falls to around 18.0% and ROA falls to 12.4%.

- Higher repair costs—We estimate the pallet damage rate is approximately 20% when transferring between Manufacturer and DC (Primary Circuit). This is relatively low and in part, reflects the Manufacturers self interest to look after the pallet and its load so as to minimise product damage, conveyor belt down time or "cubing out" on a truck before "weighing out". However, some industry experts estimate the damage rate increases from 20% to 60% when the pallet is sent from the DC, downstream to the retail store (Secondary Circuit). Based on a 20% damage rate, an estimated repair cost per pallet of $US3.50 per repair, and the average number of asset turns of 4.1x, the annual average repair bill for a pallet is $2.87. If the damage rate increased to 60%, this would increase the estimated cost to $US8.61 per annum per pallet.

The risk also in the short term is that Wal-Mart is only 80% penetrated. Given the scope for Wal-Mart's pallet pool to become a greater proportion of the US total pool, we see two discernible risks:

- The deterioration in the Wal-Mart pallet pool could become a larger issue as Wal-Mart continues to take market share from other retailers, such as K-Mart. Wal-Mart is expected to open another 7 DCs this year, but this generally averages between 8-9/annum. Similarly, Wal-Mart is likely to add an additional 1,500 stores over the next two years. This may have a proportionately larger impact to CHEP USA's asset turns and margins; and
- We estimate Wal-Mart will need another 2.3m pallets in its DCs before it has 100% CHEP penetration. Once Wal-Mart's DC racking is 100% filled with CHEP pallets, CHEP's asset turns should be at the low point and should then start to improve, as the proportional gap of inbound closes on the 100% proportion of filled DCs.

Long term impact:

Will other retailers want the same benefits as Wal-Mart?

We believe the threat to the value of the CHEP US business is that its difficulties with Wal-Mart's DC and stores confirms to other large retailers that the retail industry continues to hold the power in the supply chain. The Wal-Mart experience could set a precedent for other powerful retailers (such as Costco, Target, Sears etc) to seek similar terms. In our view there is evidence Home Depot is already adopting similar practices to Wal-Mart, and using pallets in the secondary circuit.

Inevitably, when the total US supply chain is well penetrated, the imbalances between inbound versus DC / store pallets should be less of an issue. Also, CHEP at that point should be able to exercise some pricing power to recover some of the lost earnings and returns following the initial funding of the retailers' working capital.

CHEP pallets sent to NPDs

Background—Brambles management delayed CHEP's entry into the US market by 6 months in 1990 so it could fine tune the Distributor Agreement allowing it to secure contracts with Participating Distributors (PDs). This was to ensure CHEP could control and manage the pallet pool effectively. In essence, every Distributor in the US was an NPD when CHEP launched. Through effective controls, strong systems and management, CHEP USA effectively "controlled" the roll out of the pool, managing the supply chain and minimising the leakage.

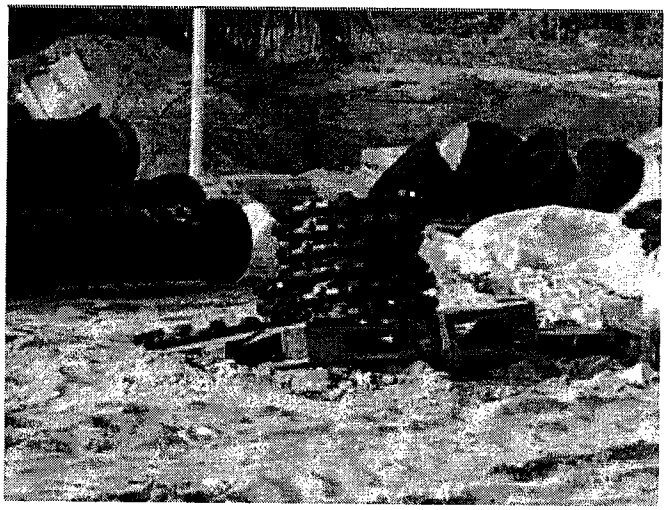
Pallets leaking to NPDs; NPDs are not legally liable for pallet loss, damage or return

However, since then pallet leakage to Distributors who are not authorised to handle CHEP pallets (NPDs) has increased. As NPDs do not have contracts with CHEP, NPDs are not legally liable for the loss or damage of the pallets.

Figure 20: **An NPD? —taken at the back of a food distributor, where he was receiving 90%+ white pallets + a few CHEP**

Source: CSFB.

Figure 21: **Lost and Broken—This pallet was probably leaked to an NPD, and then lost to the industrial channel**



Source: CSFB.

The launch of the AVP was the start of the material leakage to NPDs

In 1997, the new management team launched the "Accelerated Volume Program" or AVP, a program to increase market penetration by aggressively pushing large volumes of new pallets into the market. We expect this may have been a strategic decision. Brambles had recently held discussions with General Electric (GE) regarding a potential sell down of 20% of CHEP and was further threatened when GE entered the equipment pooling market (acquisition of the Loscam pallet pooling business in Australia).

Nevertheless, Brambles didn't have the resources to effectively ensure the pallets were being sent to PDs, or track the destination of the pallets ensuring the receiver was signed up with a Distributor agreement. As a result of the AVP, control of the pool was lost and the resultant leakage occurred.

Not long after the launch of the AVP, management made the decision to cease paying compensation to dock-sweepers, pallet Recyclers etc for the accumulation, segregation, storage, handling and load out of CHEP pallets (in essence sorting and returning CHEP

pallets). A growing number of CHEP pallets have been lost/stolen and a large number are being traded in the black market pool. In July 2001, CHEP reintroduced the compensation payment.

Management agrees with our estimate that 20% of CHEP's US pallets are with NPDs

Management has agreed to our estimate of 20% or approximately 12 million of CHEP's US pallets are currently with NPDs.

Some industry observers suggest NPDs are a vital ingredient to greater market penetration. The more players using CHEP pallets, the quicker CHEP pallets infiltrate the supply chain. Whilst we agree this should assist pallet and sales growth in the short term, we do not believe CHEP will extract financial benefit. In fact, we believe it is likely to be an expensive exercise. Reasons include:

Ramifications to CHEP's earnings and business template

1) A decline in asset turns / increase in dwell time for the pool—some CHEP pallets are lying dormant at the back of FMCG Distributors' docks with no one to collect them. However, declining asset turns would also be a result of pallets being leaked to channels outside of the initially targeted FMCG channel, such as the lower turning DIY / Homeware, or worse still, industrial channels. The pallet in Figure 21 is likely to be a lost pallet that has leaked or been lost to the industrial channel;

2) An increase in the damage rates of the pallets, and hence increased repair costs—based on the average asset turns of say 2.2 turns (estimated turns for Wal-Mart), every 10%pts increase over the standard 20% damage rate results in an estimated fall in EBIT margins from 26.5 to 18.2. Multiply this by 12m pallets with NPDs and it is an additional $4.2m cost per annum to the CHEP US pool;

3) Growing proportion of lost pallets—what proportion of the 20% or 12 million pallets (US$240m in assets) are expected be returned / collected from NPDs?

4) Greater collection and transport costs resulting from pallet "leakage"—While 20% of CHEP's pallets may be shipped to NPDs, this could represent 40-50% of locations where CHEP pallets exist. Thus, the geographic displacement of these NPDs should result in higher transport and collection costs for CHEP;

5) "Black Market" pallet pool proliferation—the establishment of the inevitable black market pool has come earlier than, and is bigger than, one would have anticipated given the US' relatively immature or low penetration of some 30%. This in part was due to a culmination of i) the launch of the Accelerated Volume Program (AVP) in 1997 and the resultant large leakage to NPDs; and ii) the abolition of the collection compensation fee paid to Recyclers. It is difficult to control "or put out" a black market, as evidenced in Australia;

6) Increasing litigation (see *First Edition*, 21 November 2001) with three class actions against CHEP. All three are (Edgar Lozano has been settled out of court) seeking damages for unpaid compensation (Recyclers fee for returning CHEP pallets), while the Buckeye Recycler case is also challenging the ownership of CHEP pallets sent out of its control (those sent to NPDs). We are not in a position to comment on the strengths and weaknesses of any of the cases, nor do we know whether the company has made any legal cost provisioning; and

7) The dilution of value incorporated in the Participating Distributor Agreement and the potential impact that will have on:

- The unwillingness of NPDs to sign the Participating Distributor Agreement now given they have been enjoying the benefits of the use of CHEP pallets without any liability nor obligation, and hence are likely to incur additional costs and liabilities by signing such; and
- Most PDs joined the CHEP pallet pool to reduce unit costs hoping to gain a competitive advantage through passing on those cost savings through lower prices. However, NPDs are also generating similar benefits by using CHEP pallets without incurring the liability of pallet accountability/ ownership.

The issues highlighted above have both short and long-term potential ramifications. In the short term they will likely continue to inhibit potential earnings growth and ROIC for the business. What is of greater concern to us is that the establishment of precedents may see these difficulties remain on a more permanent basis, in particular: i) the creation of the black market pool; ii) Litigation challenging the ownership structure and the potential costly controls that will need to be introduced should Brambles lose these legal cases; and iii) the dilution of value incorporated in the Participating Distributor Agreement.

Like the Wal-Mart issue, unless CHEP regains control of the pallet pool and converts NPDs to PDs, this could be an increasing issue as the US pallet pool continues to grow. The Company may need to slow CHEP USA's growth (not sign new customers) to ensure it regains control of these issues.

In Figure 22, we have split CHEP's US pool into four distinct channels in an attempt to assess the profitability of each channel and illustrate the issues noted in this report.

For the first two channels of Food and FMCG, we have simply used the average of the data provided by the US retailers (refer to Figure 12). These two channels appear profitable and efficient.

For the remaining two channels we have attempted to illustrate the potential earnings and margins impact regarding the CHEP problems.

The Wal-Mart Channel – Wal-Mart takes into account the imbalance of pallets in Wal-Mart's DCs, which results in CHEP being only 60% efficient, with asset turns falling from the expected 3.7x down to approximately 2.2x. We have also factored in an increased damage rate from use of pallets in the Wal-Mart stores. As a result, Wal-Mart's EBIT margin falls from 26.5% to an adjusted EBIT margin of (–7.0%).

NPDs – We have assumed that asset turns are significantly lower given NPDs have less incentive to return CHEP pallets quickly. To illustrate the point, we have given NPDs an inventory turn of 3.0x which means it is in the hands of the NPDs for 122 days (could in reality be longer or shorter), allowing CHEP a maximum of 2.1x asset turns (WM is 2.2x) per pallet/ per annum. We have also increased the average transport cost/ pallet and Retrieval/ Handling/ Inspection Fee by 50% to take into account the fragmented displacement of pallets (20% of the US pool (12m pallets) vs 50%+ of the locations) and the material transport cost of retrieving these. Finally, we have increased the damage rates of pallets to 50% (one in two are repaired). This results in an estimated EBIT margin for the NPD market of (-31.3%).

Figure 22: **CHEP USA—Revenue/cost/margin scenarios by channel**

		Total CHEP US Market				
	Base-Case	Food	FMCG	Wal-Mart	NPDs	Total USA
Trading Revenue	**One Cycle E.g.**	**$m**	**$m**	**$m**	**$m**	**$m**
- Issue and delivery fee (@ $1.70)	$1.70	$111.22	$76.89	$40.83	$48.38	$277.33
- Daily rental fee (@ $0.035)	1.23	73.28	60.15	31.94	34.87	$200.24
- Transfer fee (@ $1.07)	1.07	70.01	48.39	25.70	30.45	$174.55
- Lumber Surcharge (@ $0.10)	0.10	6.54	4.52	2.40	2.85	$16.31
Total Revenue	**$4.10**	**$261.05**	**$189.96**	**$100.88**	**$116.55**	**$668.44**
Assumptions for cycle times (days)						
Manufacturing cycle	35	32	38	38	35	36
Distributor cycle	32	37	47	39	122	61
Repair cycle	3	3	3	3	3	3
Storage / Depot cycle	17	17	17	17	17	17
Transport cycle	1	1	1	1	1	1
Total Cycle	**88**	**90**	**106**	**98**	**178**	**118**
Asset turns / annum	4.1x - 1x in this eg.	*4.1*	*3.4*	*3.7*	*2.1*	*3.1*
Expenses						
- Direct costs						
Transport	$1.00	$65.43	$45.23	$24.02	$42.69	$177.37
Storage / Depot Fee's	0.17	11.12	7.69	4.08	4.84	$ 27.73
Retrieval-Handling-Inspection Fees	0.40	26.17	18.09	9.61	17.08	$70.95
Repairs and Maintenance	0.70	45.80	31.66	42.03	49.81	$169.30
Depreciation	0.48	32.22	26.37	12.93	27.71	$99.23
Other	0.10	6.54	4.52	2.40	2.85	$16.31
- Total direct costs	**$2.85**	**$187.28**	**$133.56**	**$95.07**	**$144.97**	**$560.88**
- Gross Margin	*30.3%*	*28.3%*	*29.7%*	*5.8%*	*-24.4%*	*16.1%*
Selling and Marketing	0.10	1.61	1.32	0.65	1.39	4.96
HO Overheads	0.40	6.44	5.27	2.59	5.54	19.85
Provision for doubtful debts	0.04	2.61	1.90	1.01	1.17	6.68
- Indirect costs	$0.54	$10.66	$8.49	$4.24	$8.09	$31.49
Total Expenses	**$3.39**	**$197.94**	**$142.05**	**$99.32**	**$153.06**	**$592.37**
Assumptions for direct costs						
Average transport cost / pallet	$1.00				**$1.50**	
Storage rate / pallet / day	$0.01					
Retrieval-Handling-Inspection / pallet	$0.40				**$0.60**	
Repairs and Maintenance						
- Damage Rate	20%			**50%**	**50%**	
- Repair cost / pallet	$3.50					
Depreciation / pallet / annum	$2.00					
Other / pallet	$0.10					
EBITDA	**$1.18**	**$95.33**	**$74.28**	**$14.49**	**-$8.80**	**$175.29**
Margin %	28.9%	36.5%	39.1%	14.4%	-7.6%	26.2%
EBIT	**$0.70**	**$63.11**	**$47.91**	**$1.56**	**-$36.51**	**$76.06**
Margin %	17.1%	24.2%	25.2%	1.5%	-31.3%	11.4%
Efficiency Calculations:						
Customer Total Trips		182	226	80	28	516
CHEP's % of Inbound		36%	20%	30%	100%	32%
CHEP's Trips		65	45	24	28	163
Required pallets by CHEP		16.1	13.2	6.5	13.9	52.8
Number of pallets in Manufacturing circuit		5.7	4.7	2.5	2.7	15.7
Number of pallets in DC / Store		6.6	5.9	6.9	9.5	28.9
Total CHEP pallets in circuits		12.3	10.6	9.4	12.2	44.5
CHEPs actual asset turn		**4.1**	**3.4**	**2.2**	**2.1**	**3.0**
Utilisation efficiency		**100%**	**100%**	**60%**	**100%**	**na**
Additional Depreciation Charge @ $2.00		$0.00	$0.00	$8.61	$0.00	$8.61
Adjusted EBIT		$63.11	$47.91	-$7.05	-$36.51	$67.46
Adjusted EBIT Margin		24.2%	25.2%	-7.0%	-31.3%	10.1%
Assets		$322	$264	$215	$277	$1,078
ROA Adjusted		19.6%	18.2%	-3.3%	-13.2%	6.3%

Source: CSFB estimates.

Can these issues be resolved?

We think these issues can be resolved. However, it is difficult to ascertain how long it will take and at what cost.

Management has now acknowledged these issues are prevalent and impacting profitability. Encouragingly, the new Brambles Group management is pursuing several initiatives to remedy the situation. The initiatives include:

These difficulties can be solved...but it will take time and expense

1) Management: Changes—The appointment of Mr Keith Norder (ex – GE) as CFO of CHEP USA. Also Mr Andrew Patterson, one of the original group who transferred to the UK, has returned to the US in the last few months;

2) Wal-Mart: Renegotiations—Management stated it is trying to resolve the Wal-Mart issue by limiting Wal-Mart to a maximum number of pallets in the system at one time. CHEP's contract with Wal-Mart expired in September 2001. We are aware the two parties are involved in renegotiations to resolve this issue at the time of writing; and

3) Wal-Mart: Penalty for poor pallets—Some suggest Wal-Mart introducing a penalty charge of US$20 a pallet to Manufacturers / Suppliers for sending product on anything but GMA-1 or CHEP pallets will help arrest CHEP's dilemmas (GMA-1 pallets are the Grade 1 superior pallets which cost manufacturers US$7-US$8 to buy). We think the opposite. Such a charge could actually exacerbate the difficulties. First, we should highlight Wal-Mart has long had a policy of charging (deducting from invoices) manufacturers for sending poor quality pallets, including poor quality CHEP pallets. However, it has not been as well enforced as it is now. As for the impact of Wal-Mart reiterating the "incentive" of using CHEP, one of the major problems is the Wal-Mart circuit. To the extent that currently every pallet going to Wal-Mart is a problem for CHEP, the problem will now get worse. Unless the economics of the pallet trip are sensible, the problem grows with the increase in trips. Before increased volumes are shipped into Wal-Mart, we believe CHEP needs a solution to control damages, limit the cycle time and (by implication) get the pallets back.

4) Wal-Mart: We again highlight to investors that once Wal-Mart's DCs are full, increased volumes should close the imbalance between pallets in the DC versus inbound pallets. However, it is also important to note that accelerated volumes from Wal-Mart suppliers may also lead to greater volumes being sent to NPDs as new suppliers who convert to CHEP will also be sending pallets to other Distributors.

5) NPDs: Compensation Fee—CHEP has reintroduced its Recycler compensation payment of a minimum of US$0.75 / pallet, a fee paid when Recyclers return CHEP pallets from NPDs. This will be a new cost for CHEP for the next 12 months.

   We think this will assist CHEP significantly in retrieving its pallets. That said, CHEP may still encounter some obstacles given Recyclers can currently receive US$5 per CHEP pallet on the established Black Market, versus US$0.75 from CHEP.

6) NPDs: Sign up NPDs—The sales team is now actively following the pallets through the supply chain and converting NPDs to the CHEP scheme. We expect this will assist in arresting the problem, although some NPDs will likely be unwilling given they have to date been enjoying the benefits of the use of CHEP pallets without neither liability nor obligation, and hence are likely to incur additional costs and liabilities by signing the agreement.

7) NPDs: Channel Pricing—CHEP has introduced a charge for its customers (suppliers/manufacturers) of between $US2 and $US8.50 per pallet for pallets sent to NPDs. This represents something in the magnitude of a 50-200% increase in trip costs to the customer. A few points come to mind on the potential impact:

   i) We do not believe large customers such as Proctor & Gamble, which has been shipping to NPDs for many years, would be willing to pay such a charge. We expect it will be for new volumes only.

   ii) Those smaller customers (manufacturers/suppliers) who have also been shipping to NPDs may look to convert back to white pallets, or as a minimum, use white pallets for those consignments going to NPDs. This means there could be a net decrease in revenue for CHEP as a consequence of this policy, which in itself highlights the seriousness of NPDs and the potential losses to get to a point where such a remedy needs to be introduced.

   iii) How will the PDs react? PDs will see some of their suppliers willing to pay $8.50 to ship to an NPD (often the PDs competition), and hence could conclude their own participation in the CHEP scheme is saving the supplier around $7.43 per trip (i.e. $8.50 – $1.07 – the current de-hire fee). How much of that will be required by PDs and what is the new increased cost to the supplier ($8.50+$7.43 or return to white pallets?).

   We believe the NPD de-hire fee (channel pricing) makes sense and is justifiable when presented to a customer as a fee for choosing to ship to an NPD. However, customers could see it as too costly when introduced after the shipments have started.

8) NPDs: Channel Pricing—To assist in the implementation of Channel Pricing, CHEP has announced the implementation of Savi Technology, which will enable asset-tracking capabilities (see *First Edition*, 16 November 2001). The rollout of the technology is expected to take 18 months. We forecast the capital and implementation cost will be US$300m (IFCO is currently trialling Savi and estimates it will cost less than US$100m; CHEP is four times bigger than IFCO in revenues). To install RFID tags on pallets to allow asset tracking, CHEP will refurbish its pallets with lead boards, whereby the RFID will be mounted/attached. Refurbishing pallets with lead boards might cost $1 a pallet, $60m to the US pool or $160m for the global pool.

9) NPDs: Improving pallet transportation—CHEP recently extended a contract with JB Hunt (US logistics provider) to enable greater control of the transportation of CHEP pallets at 11 depots. JB Hunt has been transferring

CHEP pallets between CHEP depots in the US for many years. The new three-year agreement is a more dedicated/ permanent service for the delivery of pallets, not just between CHEP depots, but also from i) CHEP depot to customer; and ii) customer to CHEP depot. Previously an assortment of smaller carriers provided this service, which we believe, may have contributed to the current pallet leakage issue. That said, we believe there are material risks to CHEP's increasing trend of outsourcing, including offering of all of its transportation needs (potentially eroding the company's knowledge regarding customers, network configuration / density etc) to one supplier. Refer to area headed "Other Risks".

This new arrangement is anticipated to offer greater cost savings due to i) economies of scale; ii) truck-run density; iii) standardised trailers (unlike existing vehicles) resulting in guaranteed pallet load amounts etc; iv) management time and related efficiencies. That said, CHEP historically used its in-house "Electronic Load Tendering" (ELT) System, which used to have three trucking companies bid to carry the load. Given most of these trucking companies were likely to be looking for back-loads, we would have thought the bids would have been at a very low price (enough to cover the fuel).

This move should alleviate some of the pallet leakage problems as CHEP and JB Hunt share similar customers (i.e. Wal-Mart, Kroger, Proctor & Gamble, Kraft).

... not immediately, in our view

Timing to resolve the issues

Attribution of a turnaround date is difficult but we do not believe these issues will be resolved for at least 12 months. Thus, the implementation of measures to gain control will likely contribute to margin contraction, in our view.

When the control and quality of CHEP USA is once again intact, CHEP USA should be a sound business model demanding a substantial market premium.

Potential catalysts to gauge progress with these issues include:

- Asset turns for the US pool—Brambles does not disclose this information, and it is near impossible to calculate or estimate.
- Repair costs/ damage rates—almost impossible to estimate.
- Proportion of Blue to White pallets Inbound vs proportion in the DCs – As previously highlighted, to ensure maximisation of pool efficiency, these should have similar proportions; This may be estimated from talking to some of the major retailers, but again, will be difficult to ascertain given the potential number of distributors.

  WM DCs are almost full—given Wal-Mart represents 30% of the CHEP US pool, we believe the likely turning point where US asset turns reach the bottom is when Wal-Mart's DCs reach saturation (100% with CHEP pallets). Given that it took six years to achieve 80% DC penetration, we suspect that on natural flow it will take no more than 18 months. The likelihood is that the 80% penetration was achieved more recently, maybe over the past two years. To illustrate the point, Wal-Mart has annual inventory turns of approximately 9.3x, which means it turns its DCs over every 39 days. Hence to fill the remaining 20% of the DCs, Wal-Mart could theoretically fill it in 7.8 days.

However, that is to fill the DC, and hence find the low point in the asset turns / margins. From there, the difficulty we see for CHEP is to close the gap between inbound and DC proportion, meaning it has to sign on more manufacturers than the current 30% (volumes) coming inbound to Wal-Mart. This could take a number of years.

As highlighted earlier, we believe the catch 22 is that if CHEP aggressively signs up more manufacturers, there is some risk the issues associated with the NPDs will be exacerbated.

In the following Figure we estimate the sensitivity of the Wal-Mart pool to varying levels of inbound penetration to DC/Store penetration. We have assumed the Wal-Mart Channel is 30% penetrated by CHEP while CHEP pallets account for 80% of the pallets in Wal-Mart's DCs. This translates to an estimated 18.0% EBIT margin and a 2.2x asset turn.

In our view CHEP could, at best, achieve equilibrium between inbound and DC/ store penetration. At equilibrium, estimated EBIT margin increases to 26.5% while asset turns increase to 3.7x. These statistics apply at any penetration level, provided the pool operates at equilibrium. As can be seen, there is significant scope for CHEP to deliver returns closer to expectations, once it overcomes the existing issues.

In this sensitivity, we have used an Adjusted EBIT and Adjusted EBIT margin.

Figure 23: **Wal-Mart sensitivity - Inbound vs DC/Store penetration**

EBIT (after depreciation adjustment), USD millions

		Inbound penetration					
		30%	40%	50%	60%	70%	80%
	50%	$ 30.31	$ 44.16	$ 58.00	$ 71.84	$ 85.68	$ 99.53
	60%	$ 28.07	$ 41.91	$ 55.76	$ 69.60	$ 83.44	$ 97.28
DC/ store penetration	70%	$ 25.83	$ 39.67	$ 53.51	$ 67.36	$ 81.20	$ 95.04
	80%	**$ 23.58**	$ 37.43	$ 51.27	$ 65.11	$ 78.96	$ 92.80

EBIT margin		Inbound penetration					
		30%	40%	50%	60%	70%	80%
	50%	23.1%	25.3%	***26.5%***	27.4%	28.0%	28.5%
	60%	21.4%	24.0%	25.5%	***26.5%***	27.3%	27.8%
DC/ store penetration	70%	19.7%	22.7%	24.5%	25.7%	***26.5%***	27.2%
	80%	**18.0%**	21.4%	23.5%	24.8%	25.8%	***26.5%***

Asset turnover		Inbound penetration					
		30%	40%	50%	60%	70%	80%
	50%	2.9	3.4	***3.7***	4.0	4.2	4.4
	60%	2.7	3.1	3.4	***3.7***	3.9	4.1
DC/ store penetration	70%	2.4	2.9	3.2	3.5	***3.7***	3.9
	80%	**2.2**	2.7	3.0	3.3	3.5	***3.7***

Source: Company data, CSFB estimates.

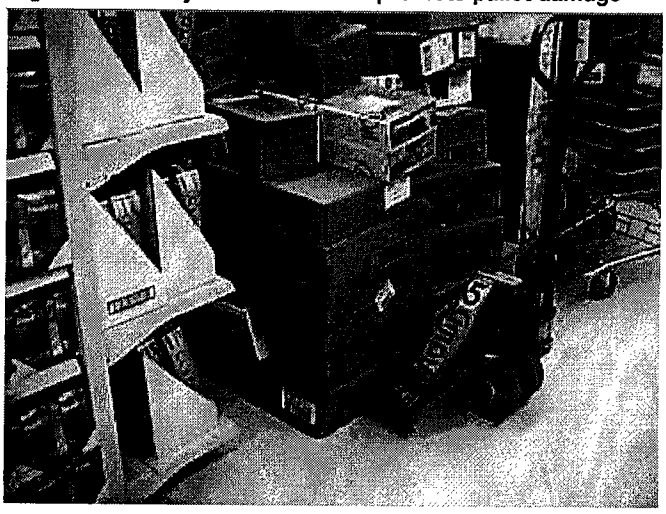
Our concerns now appear well understood by the market, but are almost impossible to monitor

Hence, investors could find it very difficult to monitor the improvement or further deterioration of the difficulties being experienced in the CHEP US pool. With limited visibility to possible solutions, and the difficulty we expect in addressing these issues, we would prefer investors to remain at market weight.

Figure 24: **Deteriorating pallet quality**

Source: CSFB.

Figure 25: **Hand jacks at the store promote pallet damage**



Source: CSFB.

Other Risks

We identify a number of other risks, both positive and negative, which we believe warrant separate discussion. These are;

Positive Risks

- Management changes the accounting policy for the depreciation of wooden pallets, where the assets are written off over 20 years instead of the current 10 years.

Negative Risks

- There is an increasing trend of CHEP outsourcing important functions to assist in its daily operation. While this may provide short term benefits, we are cautious on CHEP placing a number of intermediaries between itself and its customer, thus foregoing the valuable daily intelligence and transferring the relationship to the subcontractor. We believe the information and system of CHEP is more important than the wooden assets. However, the intelligence and operation of the system has now partly been transferred to external parties.
- According to LPR, the French Pallet Pooler is currently aggressively expanding its network into many of CHEP's dominated markets and taking market share from CHEP. LPR is now gearing up to expand into CHEP's flagship market, the UK, with the endorsement of the four major retailers (Tesco, Sainsbury, Safeway and Asda). Larger retailers typically operate a 'two-supplier' policy, and this extends to logistical requirements. As the power of the supply chain befalls the retailers, in our view, this is the largest risk to CHEP consolidating a global monopolistic position. We believe CHEP will need to increase customer switching costs and tighten its customer service/ relationships by impregnating their systems further – IT systems/ asset tracking etc.

These Risks are discussed in greater detail below.

Positive risk we see for CHEP is extending the pallets' useful life to 20 years – we think this is unlikely – 30% probability

Positive Risks

A change in the Depreciation policy?

There has been some suggestion that CHEP's wooden pallets should be deprecated over 20 years instead of the current 10 years. The basis of this argument is that the pallets are effectively depreciated twice on the P&L statement, once through the depreciation charge, and the other through the repairs charge. Used to support this argument, the average loss rate (pallets that are lost/stolen or those that become irreparable) of pallets is 5% in markets such as the UK, then a pool is effectively lost (or replaced) every 20 years.

We do not agree with this view, and list below why we believe Brambles management is likely to maintain the more conservative, but in our view appropriate accounting policy of writing its pallets off over 10 years.

1. There is clear evidence CHEP's pallet loss rates are increasing from the historic 5% to levels of 7% and upwards, due in part to:
   - Loss of control of the pallet pool in the US - The US market is significantly more difficult to operate given i) it is a one-way trip model; and ii) its geographic size and spread differs to the tightly controlled UK market; and
   - Growing black market pools.
2. Outside of the issues being experienced in the US, we suspect entry into new geographical markets such as Asia, Eastern Europe and South America present further risk to the intrinsic loss rate of the pallet pool. That is; i) fewer legacy systems/ participants to ensure control is administered; ii) in Developing countries, wood and / or pallets are a relatively more valuable resource, thus presenting the likelihood of pallets being stolen and used as firewood / mulch / sold on the black market.
3. Pallet configurations are being superseded – We believe the CHEP USA pool is made up of 60% "Block Pallets" and 40% "Stringer Pallets". Recent anecdotal evidence* suggests that CHEP is trying to phase Stringer pallets out, which could see an accelerated write down of these assets. (*Block pallets are being sent from East to West coast, but the growers on the West coast prefer to use Stringers for sending produce to the East, hence there is a double freight imbalance created).
4. Similarly, new plastic technologies are seeing a rapid fall in the cost to make plastic pallets (were over US$100, now closer to US$40). Given most manufacturers and suppliers would prefer the use of plastic over wooden, providing the economic case can be made for plastic, there is a good probability wooden pallets around the world will be phased out over the next ten years.
5. While it is true CHEP both depreciates and repairs the pallets, the repairs (or replacements) are only to the top and bottom deck boards, while the "core" is never repaired. The core is expected to have a life of 10 years;
6. Both LPR and GE Loscam depreciate their pallets over 10 years; and
7. Brambles has always depreciated its pallets over 10 years.

Points 1-4 above imply the asset life of CHEP's pallet pool is shortening not extending. We believe therefore that now, more than ever, Brambles is likely to maintain its existing accounting policy of depreciating the asset life over 10 years.

Conclusion

- We believe it is premature for Brambles to change it accounting policy for the reasons highlighted above.

Negative Risks

Outsourcing the Information and System Ownership

We identify an important strategic risk to CHEP's business template. We consider CHEP an information company, not a pallet pooling business. The strategy in recent years to outsource a number of functions previously managed internally could put at risk the business' competitive advantage and thus reduce the barriers to entry for CHEP. The following functions have been outsourced;

- Asset Tracking Capabilities - The selection of Savi Technology to provide asset tracking technology rather than buying/ establishing proprietary software may transfer useful insights into i) differing supply chain dynamics (asset turns/ utilisation); and ii) customer and product shipping behaviours. The "Rental Ledger" was CHEP's old internal system of tracking pallets through the system.
- Docksweeping Services - The appointment of Propak (Wal-Mart dock sweeping) enables Propak to understand i) which suppliers are using white pallets vs. blue pallets; ii) volume of product being shipped; and iii) cycle times of the product etc.
- Transport and Logistics - Similarly awarding JB Hunt the dedicated contract for the transport of pallets between depot and customer (and back) could allow the logistic operator to gain intimate knowledge of the logistics side of the US pallet industry ie network density, white pallet inbound vs. outbound, freight imbalances and ways to rectify. The contract had previously not been awarded to one sole provider; rather this was previously carried out by a number of trucking companies who made bids through CHEP's "Electronic Load Tendering" system.

In essence, CHEP has placed a number of intermediaries between itself and its customer, thus potentially foregoing the valuable daily intelligence and transferring the relationship to the subcontractor. We believe the information and system of CHEP is more important than the wooden assets. However, the intelligence and operation of the system has now partly been transferred to external parties.

LPR – a new competitive threat following the endorsement of UK retailers

A negative risk is Retailer endorsement for a CHEP alternative and hence the potential success of LPR

CHEP's major competitor in Europe is the French pallet pooling company, Le Pallet Rouge (LPR) – LPR is a 100% subsidiary of Algeco, which is 67% owned by the German diversified company Pressaug (market capitalisation €5.7b/A$9.7b). Preussag's gearing level (D/(D+E)) was approx. 70.6% (at Q3 result).

LPR—a potential threat to CHEP Europe / UK

Historically, the equity market (we included) has largely dismissed or at least underestimated the competitive threat that LPR posed. A discussion with LPR recently