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PaperlinX Limited reported net profit of \$64.8 million for the first half ended December 2001, up 24 percent from the previous first half. Broadly, what were the drivers of the first half profit growth?

**MD Ian Wightwick**

Earnings have been strongly influenced by the inclusion of the Spicers Paper and Coast Paper businesses, which were acquired in January 2001 and May 2001 respectively, net of the divestments we made in the half-year.

Specifically, earnings were supported by the strong growth in the communications paper manufacturing area, where we had some easing of prices internationally, but certainly not reflective of the low level of pulp costs. Our paper machines performed superbly at record production levels.

Against that, we had lower demand for communication papers as the economy slowed in Australia. We offset that with higher exports, albeit at a lower margin than Australian sales.

Also, our merchanting business was adversely affected by the slowdown in the US and Australia in particular, with less printing paper being consumed and therefore fierce competition for fewer tonnes and a squeeze on margins.

Packaging paper was the one area where earnings were down, with our largest customer Amcor having had a major industrial strike, and lower international prices for the product we exported.

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What is the outlook for earnings for the full year?

**MD Ian Wightwick**

Our first half is traditionally our stronger half but having said that, there are early signs of an increase in corporate activity in Australia and some very early signs of increased activity in the US. We expect to see moderate increases in paper prices and no dramatic move in pulp prices. So we'd expect a steady second half and therefore a reasonable full year.

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At the time of the Spicers acquisition, you projected cost savings due to the acquisition of \$15 million to \$18 million in the first full financial year. Following the restructure of your Australian merchanting business in October, are you tracking in line to achieve the forecast cost savings?

**MD Ian Wightwick**

Yes, we're on track. All the "hard yards" are behind us. We've now got all the people in place, the products in place, and the warehouses in place and in the current half-year, we're tracking at the rate of \$15 million to \$18 million per annum in synergy benefits. We're looking to getting a saving of around \$10 million this financial year and enjoying the full benefits in 2003.

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Following divestments in the first half that released funds of \$255 million, PaperlinX had gearing of 33.6 percent at the end of December 2001, compared with 58.6 percent in June 2001. You've recently issued senior unsecured notes in the North American market, raising the equivalent of US\$100 million. What was the purpose of the note issue and how has it affected your gearing levels?

**MD Ian Wightwick**

Gearing levels aren't affected because the notes replace the bank loans we had in North America for the operations of the Coast Paper and Spicers businesses. The notes give us a more balanced debt profile, with a component of longer-term debt, which we believe is the correct way to manage our finances going forward. Also, having debt in the local currencies acts as a natural hedge for our assets in the region.

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Your strategy is to pursue the expansion of your merchanting business internationally. Is the current slowdown in the global economy creating acquisition opportunities for PaperlinX?

**MD Ian Wightwick**

Yes. It's given us the opportunity to talk a reasonable price for the businesses we're looking at. One doesn't want to bid for businesses at a high point in economic activity and pricing and profits.

The slowdown certainly hasn't dissuaded us from our strategy. We've had a great deal of interest throughout the last half-year. And that continues. We'll continue to work through modeling up and checking out acquisition candidates, which are quite numerous.

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Paper merchanting generated EBIT of \$28.6 million in the first half, up from \$13.8 million previously, yet pre-tax operating margin fell to 2.6 percent from 3.4 percent previously. What's the outlook for merchanting margins for the full year and going forward?

**MD Ian Wightwick**

I can't give specific figures, but all the signs are that we're seeing an improvement in the current half coming from two drivers. First, now that the restructuring is completed in Australia, we're able to focus on our expenses to sales ratio. That's an internal driver we'll continue to work on.

Second, gradually improving demand should take the pressure off competitors chasing fewer tonnes. The industry here and in the US needs to see better returns on its investment. A pick up in demand should help paper merchants re-focus on improving their bottom line rather than increasing market share by continuing to drive down prices. We're starting to see that already in the Australian market.

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PaperlinX generated revenue of \$446.8 million in North America in the first half, up from \$44.1 million previously, reflecting the acquisition of Spicers and the Canadian paper merchant Coast Paper in May 2001. What are the drivers of the merchanting business in the North American market and what is the outlook for the full year?

**MD Ian Wightwick**

The drivers are not dissimilar to Australia, although in Australia we have a greater presence in office papers. In North America, the business is predominantly driven by the printing and publishing industries, and particularly the general printing industry. That has been affected by declining business confidence as a result of the "correction" throughout 2001 of previously high US growth and then the events of September 11.

While it's probably a bit early at this point, we'd expect to see an improvement in our North American business coming from a return of business confidence and a return to more normal levels of commercial activity in the general printing area. There's a lot of caution about the outlook, but one thing is sure – there are very low levels of inventory right through the supply chain. That means when confidence does return, merchanting will have a resurgence as the pipe line gets filled.

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What scope is there to improve margins in your North American merchanting operations?

**MD Ian Wightwick**

We've reorganised the back office areas of our Canadian and US operations and we've taken out some costs, but there aren't the same sort of synergies available as putting merchants together in the one market.

We'll see margin opportunities from demand recovery, which I believe will come during the current calendar year. And we're looking at some acquisition candidates in Canada

and the US, so we also have the potential to improve margins by getting larger and therefore a larger market share.

Importantly, our acquisition of Coast Paper, and the opportunities it gives us for further moderate growth in Canada, has been excellent. And we're confident of meeting or exceeding our profitability targets in North America. Specifically, of achieving return on funds employed of at least 15 percent within three years.

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Your communication papers manufacturing business booked EBIT of \$70.3 million in the first half, up 59 percent from the previous year, reflecting low imported pulp prices. You've commented that the linkage between paper and pulp prices has been broken. Do you believe that the de-linkage of paper and pulp prices is sustainable over the longer term?

**MD Ian Wightwick**

We've seen the pulp price down around US\$350 and US\$400 per tonne and it hasn't had a major impact on paper prices. And why should it? Only 10 to 15 percent of the world's pulp is traded, so there's no reason the price of that marginal tonnage should affect returns on every piece of paper that's produced.

I believe there's every chance the nexus between pulp and paper prices has been broken permanently, barring some major catastrophe. Firstly, going forward there's unlikely to be the sort of growth in capacity there was over the past 15 years, when South American and then Asian pulp and paper manufacturers brought on massive capacity. Secondly, following a series of industry mergers, there are fewer and larger players internationally. That merger and acquisition activity is likely to continue and will encourage the continued discipline of the major players, who have taken down huge amounts of capacity to ensure they're not flooding the world with paper while demand is down.

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What is the outlook for communication papers for the full year?

**MD Ian Wightwick**

Remembering the second half is not our strongest half, I think we'll probably have a reasonable current half in communication papers provided pulp prices remain stable. And with 700,000 tonnes per annum of pulp capacity coming on stream in Brazil, I'd expect a pretty sane pulp market. At the same time, we've seen a slight increase in paper prices from Southeast Asia from January and our wholly owned manufacturer, Australian Paper, will raise the price of most of its paper grades, excluding Reflex, by 4 percent from March.

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In the first half, your packaging papers business reported a 28 percent fall in EBIT to \$20.5 million, reflecting lower Australian sales and an unfavourable product mix. What is the outlook for packaging papers for the full year?

**MD Ian Wightwick**

I think we'll see a reasonable finish to the year in packaging as against the first half. Certainly, Amcor have indicated a return to a more normal product mix in the second

half, with some increases in the kraft component. That will be helped by the competition to place kraft linerboard in the corrugated box market from Visy, whose new capacity is now on line.

Also, the bag making machine that had equipment failure during the first half returns to full production at the end of this month, so we'll again be making our full range of packaging papers, which will help us in the last quarter.

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What growth opportunities are there for PaperlinX in the packaging papers market?

**MD Ian Wightwick**

The opportunities are predominantly in the non-Amcor component of the business. We make most of Australia and New Zealand's needs in paper for multi-wall sacks, which are used for cement and milk powder for export, etc. We've just approved capital expenditure for equipment to increase that paper's stretchability, so it has a greater ability to withstand handling in the supply chain. This suits the needs of the Australian market and importantly, there's high demand for this type of product in the Southeast Asian markets. Production should start around the last quarter of next year.

Given that Southeast Asian manufacturers cannot make sack kraft, it commands a higher margin than most other papers we export to the region. Certainly, a product of the quality of our stretchable sack kraft should bring us a good return.

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PaperlinX paid a dividend of 13 cents per share, fully franked, in the first half, unchanged from the previous first half. The payment was equivalent to a payout ratio of 65 percent. What is the outlook for dividends for the full year?

**MD Ian Wightwick**

I see no reason we wouldn't maintain the payout if our full year expectations are achieved. It has to be said of course that as our earnings move more offshore, our ability to fully frank the dividend will decrease. Our final payment this year might be less than fully franked, although certainly not far below.

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Thank you Ian.

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