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PaperlinX Limited is sensitive to paper prices. Have you seen any rises in European paper prices and what is the outlook for 2006? What macro factors have to be in place for price rises to gain traction in the markets in which you operate?

**MD & CEO Tom Park**

When discussing prices for paper in Europe, we need to look at the global supply and demand situation as well as regional and local issues. European prices have been held back by the level of the Euro against the weak US dollar. While demand has improved over the last year in North America and Europe, which has led to improved mill operating rates, the currency differential has meant that the coated paper selling price rises seen in the US market have not translated into the European market.

European paper manufacturers, who ultimately determine paper selling prices in Europe, are seeing stronger market conditions that will support price rises for coated fine paper. US prices are already higher for coated paper, and US demand appears to look fairly solid, which is encouraging.

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What is your sensitivity to the Australian dollar and what will happen to your earnings if the Australian dollar continues to rise into 2006? Is it possible to improve earnings if the Australian dollar stays at current levels?

**MD & CEO Tom Park**

The key impact on earnings of the high Australian dollar, or more correctly the low US dollar, is not in currency translation, but occurs because of the impact it has on the price of paper imported into Australia. Paper internationally is priced in US dollars. The bulk of paper sold in Australia is imported, so the price of imported paper largely dictates the prices that we can achieve for our Australian manufactured paper. Over the past eighteen months, we have seen the combination of lower international demand and a strong Australian dollar make Australia an increasingly attractive market for imported paper. As a result there have been falling paper prices and an increase in imports, driving us to export paper at lower margins which has depressed earnings for Australian Paper.

As we look forward, there are some positive factors beginning to emerge. Some of these are macro, while others are a direct result of our own actions.

On the macro side, demand is improving in the USA and in Europe. Assuming this continues, this will lead to tighter markets globally, putting upward pressure on international paper prices while at the same time reducing the amount of paper looking for a home.

From our own actions, we have leveraged our local supply advantages to win a 40,000 tonne contract with a key Australian buyer of copy paper. This is based on a range of benefits that we can provide this customer, while bringing paper back to the domestic market that we would otherwise export at lower margins. We have also invested in the key Reflex brand and seen a positive response to the improved quality of the product and the increased promotion.

In a few months the upgrade of our sack kraft paper machine will be completed, and this will improve quality and lead to higher profitability on these products.

However, while these type of actions will help the business, and we remain focussed on reducing our production costs and improving competitiveness, the current level of paper selling prices in Australia is continuing to significantly depress the earnings of Australian Paper.

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You've flagged a potential rise in capital expenditure over the next three to five years to levels higher than depreciation expense. Given the likelihood that impairment testing of Australian Paper's manufacturing assets under International Financial Reporting Standards will result in a loss against retained earnings, how can you justify a higher level of spending on these assets? What are your plans and timing?

**MD & CEO Tom Park**

There are a number of issues here, and an historical perspective is needed. While conditions are challenging for Australian Paper at present and earnings are significantly depressed from normal levels, this is a business with long term strategic advantages, and a history of above target returns. We would expect Australian Paper to be able to make a 12 percent return over the cycle, however, with current returns of 2.9 percent it is well under that target.

We have stepped back in our capital expenditure in Australian Paper over the past 18 months or so while we took a detailed look at our current and future customer needs, and the best long term product and equipment mix to meet these needs. This review has highlighted a number of potential high returning investment opportunities. While these opportunities will be tested against our internal investment criteria, and competing uses for the capital, we have flagged to the market the potential for a higher level of capital expenditure over coming years by way of keeping the market fully informed.

Not all of these opportunities will proceed, and any that do will need to fit in with the capital capability that we have as a Group. The first project that has been highlighted is the potential to look at upgrading our pulp manufacturing capacity. This project has yet to be finally approved, and this will not happen unless certain preconditions are met. Nonetheless, if it does proceed, the project offers returns ahead of our targets and will enhance product quality, environmental performance and reduce the cost of production. It is also important to understand that projects like this are multi year, with the largest elements of cost typically at the end of the project which could be 3 or 4 years out. Expenditure would be phased over a number of years to recognise our capabilities to undertake such investments.

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Net operating cash flow before interest and tax was \$8 million in the first half, down from \$104 million, partly reflecting a \$102 million increase in working capital over the six-month period. What gives you confidence you'll reduce working capital by the end of June? Wouldn't any recovery in demand require a larger investment in inventory?

**MD & CEO Tom Park**

As outlined at the interim results, we saw a rise in working capital at the end of the December period impacting cash flow. There were a number of coincident events that we would not expect to occur again.

PaperlinX is firmly committed to achieving a solid cash flow from operation for the year to June 2005, including reducing working capital through proactive management of each of the components of working capital. Substantial progress is being achieved.

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Net debt to net debt plus equity was 38 percent at the end of December, up from 36 percent six months earlier. First-half interest cover was 2.8 times. What are the implications of the relatively low interest cover for your current loan covenants and for borrowing costs going forward?

**MD & CEO Tom Park**

Our net debt to net debt plus equity ratio remains at the very low end of our target range, so we have ample room to move. Interest cover remains well above our loan covenants.

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PaperlinX announced an unfranked interim dividend of 13.5 cents per share, unchanged from the previous year's interim payment. Can you comment on the sustainability of payments at this level and give some guidance on the outlook for the dividend and franking in the current year?

**MD & CEO Tom Park**

The dividend payout ratio was 50 percent of reported earnings per share including the benefit of tax consolidation and 96 percent excluding the tax consolidation benefit. The final dividend for this year would not be impacted by any decisions we may make on capital expenditure currently under consideration. The Board takes account of the financial position of the company when making any decisions on dividends.

When determining the dividend payout we take into account that 60 percent of our shareholders are retail and a significant proportion of the institutional shareholders are investing for the yield. It is likely the dividend will remain unfranked at least this year.

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With the interim results announcement in February you forecast an improved second half. Does this guidance remain valid?

**MD & CEO Tom Park**

We have no updates to make to our interim results release in February.

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Thank you Tom.

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For more information about PaperlinX, visit [www.paperlinx.com](http://www.paperlinx.com) or call David Shirer (+61 3) 8540 2302

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