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DS Smith PLC

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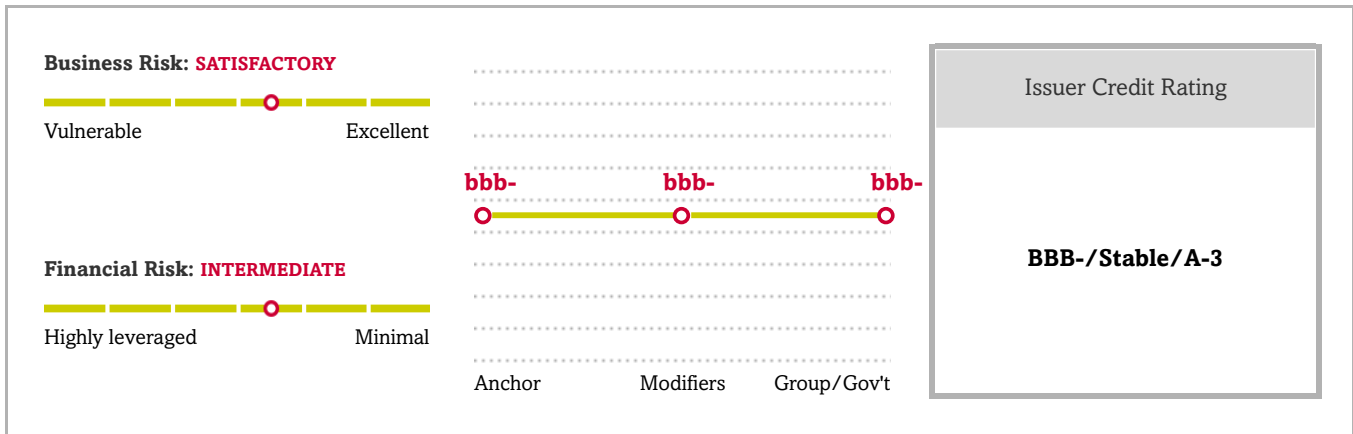
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DS Smith PLC



Credit Highlights

Overview

Key strengths	Key risks
Large scale and leading market position in Europe.	Commoditized product range.
Primary exposure to relatively stable end-markets.	Volatile containerboard and box prices.
Backward integration in recycling and paper production.	Exposure to volatile input prices, such as old, corrugated cardboard (OCC) prices.
Adequate geographic diversification.	

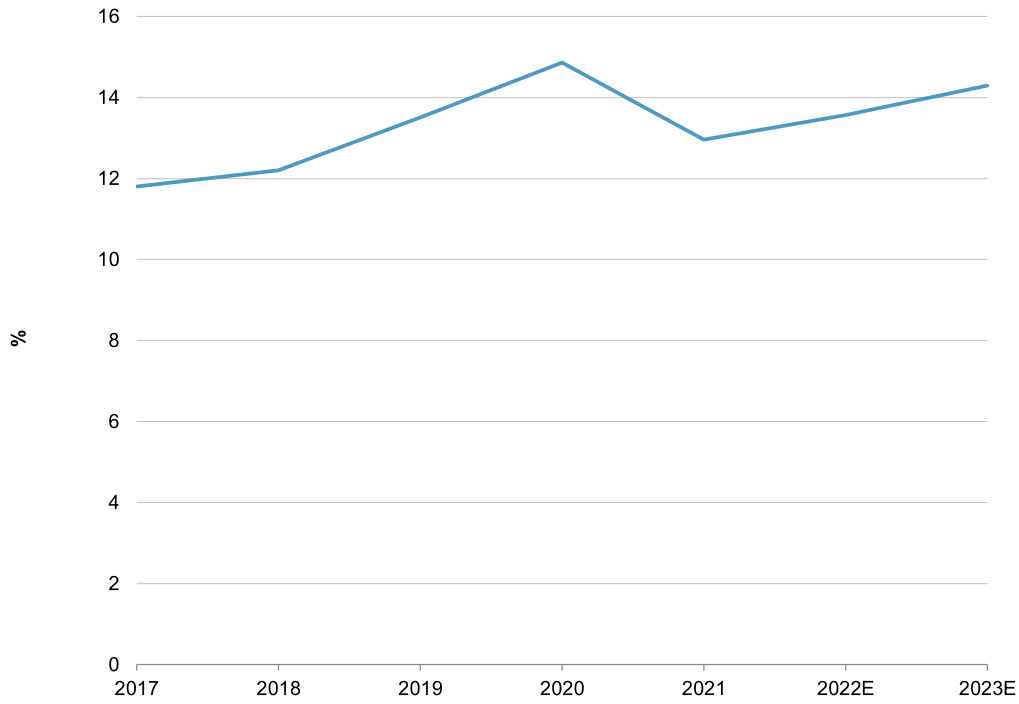
Despite our expectation of significantly higher selling prices and strong volumes for fiscal 2022 (ending April 30, 2022), S&P Global Ratings-adjusted EBITDA margins will likely remain constrained by cost headwinds. Although higher compared to fiscal 2021, we expect S&P Global Ratings-adjusted EBITDA margins to remain constrained at about 13.5% in fiscal 2022. Strong corrugated box volumes and selling price increases are largely mitigated by higher input cost inflation, primarily related to recovered paper and labor costs. Although we expect DS Smith to successfully pass on these cost increases, we expect margins to be affected given typical delays in the passthrough of selling prices.

For the six months ending October 2021, sales increased by 16% and the S&P Global Ratings-adjusted EBITDA margin stood at 12.6%. The company experienced volume growth of more than 9% for its corrugated boxes on the back of strong demand from its consumer end markets (about 80% of its sales), while its volumes in the industrial segment continue to recover. The increase in box selling prices was offset by significant input cost inflation.

We forecast credit measures to remain in line with our expectations for the 'BBB-' rating, but headroom remains tight. As of end fiscal 2021, S&P Global Ratings-adjusted leverage and funds from operations (FFO) to debt stood at 26.3% and 3.1x, respectively. We expect adjusted FFO to debt of 30%-35% over the next 12-24 months and leverage to remain below 3x. This is supported by adjusted EBITDA margins of about 13.5%-14.5% and expected strong free operating cash flow (FOCF) generation. DS Smith's credit metrics are sensitive to improvement in operating performance as well as to changes in its financial policy.

Chart 1

DS Smith - EBITDA Margin Trend

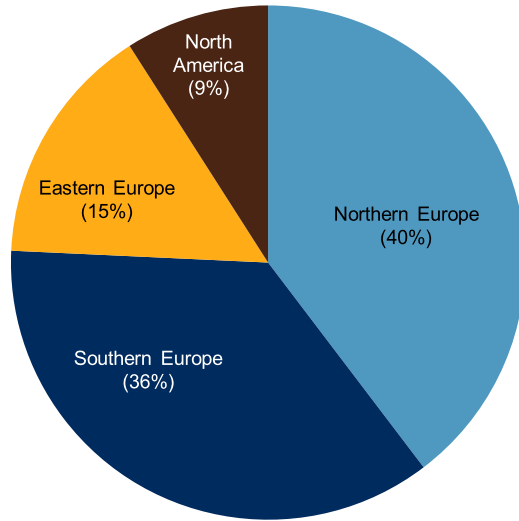


E--Estimate. Source: S&P Global Ratings.

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Chart 2

DS Smith--Revenue By Geography
As of fiscal year-end April 2021



Source: S&P Global Ratings.

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Outlook: Stable

The stable outlook reflects our view that the pandemic is likely to lead to a slight deterioration in DS Smith's credit metrics. Given the group's conservative financial policy, we expect FFO to debt to revert to about 30% and adjusted leverage to decline below 3x over the next 12 months. However, we believe that DS Smith is committed to maintaining an investment-grade rating, with cash flows supported by the deferral of the 2020 dividend and tight capex management.

Downside scenario

We could lower the ratings if the negative impact from the pandemic is more pronounced and protracted than we anticipate. We could also consider a downgrade if DS Smith pursues a more aggressive financial policy, including higher debt-funded investments, or if it does not complete the asset disposals in a timely manner. This would most likely translate into FFO to debt remaining below 30% and debt to EBITDA exceeding 3x over a prolonged period.

Upside scenario

We view an upgrade as unlikely as DS Smith has limited headroom under its current credit measures. However, we could consider raising the ratings if FFO to debt exceeded 40% and adjusted debt to EBITDA was around 2x on a sustained basis.

Our Base-Case Scenario

Assumptions

- Eurozone GDP growth of about 4.4% in 2022 and 2.4% in 2023. In the U.S., we expect growth in real GDP of 3.4% in 2022 and of 2.4% in 2023.
- Revenue growth of more than 10% in fiscal 2022 due to recovery in volumes and higher selling price increases. Thereafter, sales growth of about 5% in fiscal 2023.
- Improvement in the adjusted EBITDA margin to about 13.5% in fiscal 2022 from 13% in fiscal 2021, due to higher volumes and selling prices and an absence of COVID-19-related cost increases. This is offset by raw-materials inflation. Thereafter, we expect the EBITDA margin to recover to about 14.5% as DS Smith continues to implement price increases.
- Annual capex of about £430 million-£450 million in fiscals 2022 and 2023.
- Annual working capital outflows of about £15 million-£10 million.
- Disposal proceeds of about £50 million in fiscal 2022 from the sale of excess paper assets in central Europe (already received).

Key metrics

- Adjusted debt to EBITDA of 2.7x for fiscal 2022 and 2.4x for fiscal 2023.
- Adjusted FFO to debt of 30.5% for fiscal 2022 and about 34.5% for fiscal 2023.

Over the next 12-24 months, we expect DS Smith's credit metrics to improve to historical levels. We expect adjusted FFO to debt of 30%-35% over the next 12-24 months, compared with 26% in fiscal 2021. We also anticipate that adjusted leverage will revert below 3x, supported by improvements in profitability and a prudent financial policy.

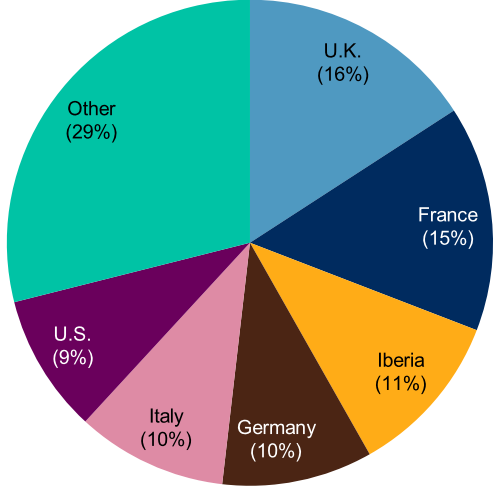
Company Description

U.K.-based DS Smith is the second-largest corrugated paper-packaging producer in a fragmented European market. It operates 14 paper mills (12 in Europe and two in the U.S.), 200 converting plants, and about 30 recycling depots. This includes two kraftliner (virgin paper) mills, one each in the U.S. and Europe, and the remainder are to produce testliner (recycled paper).

DS Smith relies on client proximity with its closed-loop operating model, whereby it collects and recycles cardboard boxes from retailers. In fiscal 2021, it generated sales of £6 billion and adjusted EBITDA of £774 million. Around 16% of sales relate to the U.K., and the remainder mostly to Europe, with the U.S. accounting for around 9% of sales (see charts 3 and 4).

Chart 3

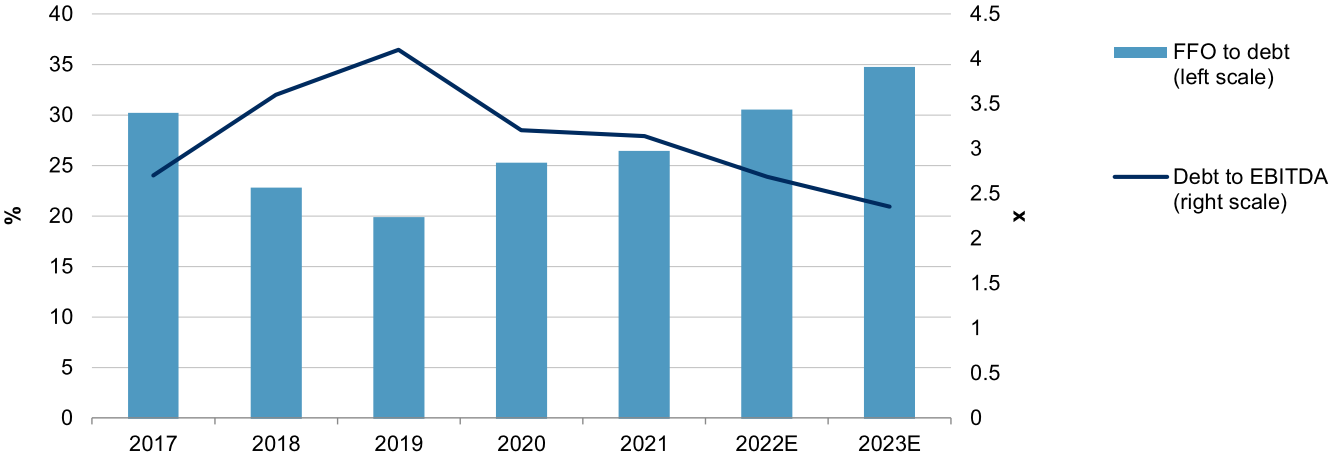
Revenue By Geography
As of fiscal year-end April 2021



Source: S&P Global Ratings.

Chart 4

DS Smith - Key Credit Metrics



E--Estimate. Source: S&P Global Ratings.
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Peer Comparison

Table 1

DS Smith Plc--Peer Comparison				
Industry sector: Packaging				
	DS Smith Plc	Mondi Plc	Smurfit Kappa Group PLC	International Paper Co.
Ratings as of March 31, 2022	BBB-/Stable/A-3	BBB+/Stable/--	BBB-/Stable/--	BBB/Stable/A-2
--Fiscal year ended--				
	April 30, 2021	Dec. 31, 2020	Dec. 31, 2020	Dec. 31, 2020
(Mil. £)				
Revenue	5,976.0	5,969.9	7,642.7	14,299.5
EBITDA	774.0	1,191.6	1,322.5	2,256.1
Funds from operations (FFO)	639.0	966.8	1,038.4	1,447.3
Interest expense	69.0	90.5	126.3	333.3
Cash interest paid	69.0	74.4	110.2	365.0
Cash flow from operations	782.0	1,110.1	1,111.4	1,585.4
Capital expenditure	331.0	618.2	459.6	396.6
Free operating cash flow (FOCF)	451.0	491.9	651.7	1,188.8
Discretionary cash flow (DCF)	451.0	270.6	404.4	(102.9)
Cash and short-term investments	810.0	342.3	798.3	1,137.3
Debt	2,428.0	1,750.0	2,961.7	3,507.1
Equity	3,535.0	3,926.2	3,389.5	6,707.0
Adjusted ratios				
EBITDA margin (%)	13.0	20.0	17.3	15.8
Return on capital (%)	5.3	13.3	12.2	11.8
EBITDA interest coverage (x)	11.2	13.2	10.5	6.8
FFO cash interest coverage (x)	10.3	14.0	10.4	5.0
Debt/EBITDA (x)	3.1	1.5	2.2	1.6
FFO/debt (%)	26.3	55.2	35.1	41.3
Cash flow from operations/debt (%)	32.2	63.4	37.5	45.2
FOCF/debt (%)	18.6	28.1	22.0	33.9
DCF/debt (%)	18.6	15.5	13.7	(2.9)

N.M.--Not meaningful

DS Smith has comprehensive pan-European coverage and a growing presence in the more consolidated and slightly more profitable U.S. market. However, the group lacks Smurfit Kappa Group PLC's or Mondi Plc's access to high-margin, low-cost, emerging markets. Instead, DS Smith focuses on higher-volume and lower-margin customers. In contrast to Smurfit Kappa, DS Smith is short in paper. This results in lower capex and EBITDA margins. That said, its return on capital is healthy. The group benefits from resilient end-markets, mainly FMCG.

Business Risk: Satisfactory

DS Smith is the second-largest corrugated paper-packaging producer in the fragmented European market. The stable FMCG segment represented 80% of the group's revenues in fiscal 2021. DS Smith has comprehensive pan-European coverage and a growing presence in the U.S. The U.S. containerboard and corrugated box market is more consolidated and therefore slightly more profitable than the European market.

DS Smith distinguishes itself from its peers with its focus on product innovation and value-added services. It also stands out with its vertical integration into recycling operations. This ensures the supply of recycled fiber to DS Smith's mills and box plants but generates low margins. This and DS Smith's short paper position explain why the group's adjusted EBITDA margins are below those of other paper-packaging peers.

DS Smith pursues a short paper strategy, that is, it is a net buyer of paper. Currently, about 80% of DS Smith's operations in Europe have backward integration into paper, and the group is seeking to reduce this to 60% over the medium term. The group plans to sell some paper mills in central Europe, with completion likely over the next 12-24 months. This strategy reduces the business' capital intensity but exposes DS Smith to unexpected shortages and price volatility in paper--mainly in testliner, and to a lesser extent in kraftliner.

Financial Risk: Intermediate

We expect DS Smith's credit measures to recover in fiscal 2022 compared to fiscal 2021 as the global economy recovers. Credit measures deteriorated in fiscal 2021 because of the pandemic.

Rating headroom remains tight and is sensitive to improvement in projected profitability.

We believe that the credit metrics will recover over the next 12-24 months to a level commensurate with the ratings, with FFO to debt of about 30%-35% and adjusted leverage of less than 3x. Support also comes from DS Smith's strong commitment to maintain an investment-grade rating. DS Smith continues to review its dividend policy based on market conditions.

Financial summary

Table 2

DS Smith Plc--Financial Summary					
Industry sector: Packaging					
	--Fiscal year ended Apr. 30--				
	2021	2020	2019	2018	2017
(Mil. £)					
Revenue	5,976.0	6,043.0	6,171.0	5,765.0	4,781.0
EBITDA	774.0	898.0	831.5	702.0	562.0
Funds from operations (FFO)	639.0	725.0	671.1	568.7	449.0
Interest expense	69.0	76.0	77.4	66.3	56.0
Cash interest paid	69.0	79.0	75.4	51.3	52.0

Table 2**DS Smith Plc--Financial Summary (cont.)**

	--Fiscal year ended Apr. 30--				
	2021	2020	2019	2018	2017
Cash flow from operations	782.0	762.0	612.1	46.7	537.0
Capital expenditure	331.0	376.0	303.0	347.0	244.0
Free operating cash flow (FOCF)	451.0	386.0	309.1	(300.3)	293.0
Discretionary cash flow (DCF)	451.0	164.0	122.1	(457.3)	172.0
Cash and short-term investments	810.0	592.0	379.0	294.0	139.0
Gross available cash	810.0	592.0	379.0	294.0	139.0
Debt	2,428.0	2,880.0	3,389.5	2,501.4	1,490.5
Equity	3,535.0	3,351.0	3,112.0	2,110.0	1,355.0
Adjusted ratios					
EBITDA margin (%)	13.0	14.9	13.5	12.2	11.8
Return on capital (%)	5.3	7.3	8.2	10.2	11.8
EBITDA interest coverage (x)	11.2	11.8	10.7	10.6	10.0
FFO cash interest coverage (x)	10.3	10.2	9.9	12.1	9.6
Debt/EBITDA (x)	3.1	3.2	4.1	3.6	2.7
FFO/debt (%)	26.3	25.2	19.8	22.7	30.1
Cash flow from operations/debt (%)	32.2	26.5	18.1	1.9	36.0
FOCF/debt (%)	18.6	13.4	9.1	(12.0)	19.7
DCF/debt (%)	18.6	5.7	3.6	(18.3)	11.5

N.M.--Not meaningful

Reconciliation**Table 3****DS Smith Plc--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. £)****--Fiscal year ended April 30, 2021--**

DS Smith Plc reported amounts							
	Debt	Shareholders' equity	EBITDA	Operating income	Interest expense	S&P Global Ratings' adjusted EBITDA	Cash flow from operations
Reported	2,395.0	3,533.0	757.0	311.0	67.0	774.0	761.0
S&P Global Ratings' adjustments							
Cash taxes paid	--	--	--	--	--	(66.0)	--
Cash interest paid	--	--	--	--	--	(69.0)	--
Trade receivables securitizations	407.0	--	--	--	--	--	21.0
Reported lease liabilities	230.0	--	--	--	--	--	--
Postretirement benefit obligations/deferred compensation	130.0	--	3.0	3.0	2.0	--	--
Accessible cash and liquid investments	(810.0)	--	--	--	--	--	--

Table 3

DS Smith Plc--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. £) (cont.)							
Share-based compensation expense	--	--	9.0	--	--	--	--
Nonoperating income (expense)	--	--	--	6.0	--	--	--
Noncontrolling interest/minority interest	--	2.0	--	--	--	--	--
Debt: Put options on minority stakes	76.0	--	--	--	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	5.0	5.0	--	--	--
Total adjustments	33.0	2.0	17.0	14.0	2.0	(135.0)	21.0
S&P Global Ratings' adjusted amounts							
	Debt	Equity	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations
Adjusted	2,428.0	3,535.0	774.0	325.0	69.0	639.0	782.0

Liquidity: Strong

The short-term rating on DS Smith is 'A-3'. We assess DS Smith's liquidity as strong. We expect the group's liquidity sources to exceed its uses by more than 1.5x over the next 24 months, supported by strong cash balances and significant availability under its committed revolving credit facilities (RCFs).

Principal liquidity sources	Principal liquidity uses
<ul style="list-style-type: none"> A cash balance of £614 million as of Oct. 31, 2021 (excluding £130 million of bank overdrafts); £1.5 billion of availability under the committed RCFs; and Our forecast of unadjusted FFO of £650 million-£700 million. 	<ul style="list-style-type: none"> Short-term debt maturities of about £674 million; Annual capex of about £450 million; Dividend payment of about £200 million; About £96 million toward the purchase of a stake in Interstate Resources; and Up to £15 million in working capital outflows (includes seasonal working capital needs).

Covenant Analysis

The RCFs' documentation includes a leverage covenant that caps net debt to EBITDA at 3.75x. We expect that DS Smith will have ample headroom under this covenant in the near term.

Environmental, Social, And Governance

ESG Credit Indicators

E-1	E-2	E-3	E-4	E-5	S-1	S-2	S-3	S-4	S-5	G-1	G-2	G-3	G-4	G-5
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ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumeric 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

ESG factors have no material influence on our credit rating analysis of DS Smith. As a producer of corrugated packaging, its environmental and social risks are comparable to those of the broader industry. Although not assumed in our forecast, we think the group could benefit from the switch away from plastic packaging in the medium to long term given the recyclable nature of its paper packaging products.

Issue Ratings - Subordination Risk Analysis

We have not identified any factors that could lead to the material subordination of the senior unsecured debtholders at DS Smith.

Capital structure

The £2.4 billion of debt primarily comprises bank loans, overdrafts, and bonds.

Analytical conclusions

We rate DS Smith's unsecured obligations 'BBB-', in line with the long-term issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating

BBB-/Stable/A-3

Business risk: Satisfactory

- **Country risk:** Low
- **Industry risk:** Intermediate
- **Competitive position:** Satisfactory

Financial risk: Intermediate

- **Cash flow/leverage:** Intermediate

Anchor: bbb-

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Containers And Packaging Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of March 31, 2022)*

DS Smith PLC

Issuer Credit Rating

BBB-/Stable/A-3

Senior Unsecured

BBB-

Ratings Detail (As Of March 31, 2022)*(cont.)**Issuer Credit Ratings History**

13-Jun-2019	BBB-/Stable/A-3
18-Jun-2018	BBB-/Negative/A-3
10-Mar-2015	BBB-/Stable/A-3

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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