

DS Smith H1 Trading Update Conference Call Transcript

Speaker key

OP	Operator
MR	Miles Roberts
AM	Adrian Marsh
BD	Barry Dixon
CO	Catriona O'Grady
JJ	Justin Jordan
FL	Fabio Lopes
DB	David O'Brien
JW	Jolyon Wellington

OP Good morning ladies and gentlemen, and welcome to the DS Smith Trading Update Conference Call. My name is Maddi and I will be your co-ordinator for today's conference. For the duration of the call you will be on listen-only, however at the end of the presentation you will have the opportunity to ask questions. If at any time you need assistance please press star zero on your telephone keypad and you will be connected to an operator. I will now hand you over to Mr Miles Roberts to begin today's conference. Thank you.

MR Good morning everybody, and thank you very much for joining us; I'm Miles Roberts, the CEO, and I'm joined here by Adrian Marsh, our finance director. We'll have an opportunity for questions at the end of the statement but I would like to first just raise some highlights on the trading update that you will all have read this morning. And in that statement you would have seen that group performance remains fully in line with our expectations. We have seen good growth across all of our regions, together with improving return on sales and return on capital. The market and the business trends we discussed at length at our interim management statement in September have also continued. And we are pleased to announce the acquisition of Andopack, a Spanish corrugated board producer, costing us around about £35 million. Andopack is very well invested; it's a growing business with very good access to the key markets in Barcelona and Madrid. This acquisition is customer-led; our customers want us to have a strong presence in Spain so we can provide them our unique services and offering that we provide in the rest of Europe. As I've said it's a very high quality asset and it's an asset from which I think we can grow further as we expand into this attractive market. So looking ahead, our outlook remains positive as the business continues to grow and we expect continued performance in line with the group's medium term targets. Thank you. I'm now happy to take any questions people may have.

OP Thank you. Ladies and gentlemen if you would like to ask a question please press star one on your telephone keypads. If you change your mind and wish to withdraw your question please press star one again. You will be advised when to ask your question. So our first question comes from the line of Barry Dixon from Davy, please go ahead with your question sir.

BD Yes, good morning gentlemen, three questions if I could; the first is just on corrugated prices, we've seen the €30 a tonne, roughly, of containerboard prices going through. One of your competitors yesterday said that they didn't think that they would be able to recover that in corrugated prices, just wondering your own thoughts in terms of the prospects of recovering that 30 in corrugated prices as we head into 2015? And secondly, on OCC prices, just maybe your thoughts on that, what you're seeing in that market, if that stability is remaining. And then

just a quick question on Andopack in terms of what kind of capacity and tonnage does that business produce annually? Thank you.

MR We absolutely are right, Barry, we have seen an increase in testliner prices of about €30 a tonne, we haven't seen anything in Kraft, we don't expect to either. So when we look at our raw materials there has been an increase. We have contracts and we have agreements that allow costs to be generally passed on, but we'll be doing everything possible to mitigate that. And as long as our customers see we're doing everything to mitigate any residual we think we will recover. But there's an awful lot that we can do to mitigate that increase and we'll be doing that.

In OCC prices, they have been stable now for about 20 months.

AM Since I've been here, yes.

MR They don't seem to be moving at all. Who knows what's going to happen in the future but I can't really see any particular reason why that will go up or down. Our collection rates are good, we look for new sources and they're coming on, demand for testliner is reasonably healthy, but that improved collection and the way OCC is used means prices remain stable.

But with Andopack, it was constructed about seven years ago so it's pretty much a new facility and they've been investing very heavily since then. Today the factory is less than 50 per cent utilisation. We already supply Spain from facilities we have elsewhere in Europe due to our customer demand and we can see very good opportunities, not only to improve the cost base of this factory, but to start to use the considerable capacity that it has. So you think about its current turnover, it represents about 70 million square metres, and we think that just its existing capacity can more than double that. But as I say it's our first move into this market, it's customer-led, and I look forward to further expansion there.

BD Okay, thank you very much.

OP Thank you, and our next question comes from the line of Catriona O'Grady from UBS, please go ahead with your question.

CG Morning Miles, morning Adrian, thanks for taking my call; I've just got three questions if I may? Just in terms of the general performance of the business, are there any countries stand-out performances as you look across Europe? Secondly, am I right to assume there isn't a significant overlap in customers between your customers and the Andopack customers? Then thirdly, can I just ask about the rest of the M&A pipeline, are there still other opportunities in there that you're in discussions with? Thanks.

MR Yes, countries, as I say all our regions are in growth but some are more growth than others. And typically if you go into countries, or regions, like France, we're growing but it is more modest. We absolutely lead the industry there in FMCG with our businesses, so we have a very significant market share. The economy is difficult but we are growing but it's more modest. When you come up in to Eastern Europe our growth there year on year has been absolutely tremendous and we see that continuing as the big pan-European customers just want that consistent offering in these new markets. So particularly central and eastern Europe where we've grown through the SCA acquisition, we've really seen very good continued growth there.

In terms of Spain, you're right, the business we bought is a local business, it's very well-invested but its customer base reflects its independent status, so it is a lot of local customers. So there's very little overlap in our customers, and I think that's a real opportunity for us. We have, as I say, quite strong demand from our existing customers to support them in Spain, they're obviously keen to get the DS Smith service and products. But we're pleased it's got a lot of free capacity.

And Adrian, on M&A?

AM M&A is as we described in the last call that we've got a lot of opportunities we're looking at, we continue to do that. These take a while to close, particularly where they're private businesses and you have to go through a series of iterations with them. We've bought in a professional head of M&A, we hardly ever see him. He is spending all of his time in dialogues at the moment, so there's a lot ongoing but they take a while for both parties to agree on a valuation that makes sense. We have extremely tight return criteria and clearly when you're buying a private business they have a view on value in their own minds and quite often the starting point is a big gap. So it takes a lot of work, there are a lot of discussions going on, we're very clear strategically where we're looking to grow, why it's important. We consider always the alternative investment case of greenfield, and we look at that in a number of opportunities, especially where we have gaps in our portfolio, and if we can acquire a business with the right assets, the right way of operating, and feel to it, then we're going to push ahead on those. But there's a lot happening at the moment.

MR I think we're quite pleased with the pipeline that's in front of us. As Adrian said you've got to bring them in but we're quite pleased with that.

CG That's great, thank you very much.

OP Thank you. And our next question comes from the line of Justin Jordan from Jefferies; please go ahead with your question.

JJ Thank you and good morning everyone. I've got three questions if I can; firstly can we just turn to FX, and I'm assuming your guidance of £1.6 million EBITDA impact to every one cent euro movement still applies? Secondly, can we talk a little bit about M&A opportunities in more colour, particularly Eastern Europe, which I know you mentioned as being a rapid growth area, there are assets like Durapak coming to market later this year, one of your competitors yesterday was talking about intense competition from private equity for attractive assets and I'm just wondering whether you're seeing that. And finally, I just wanted to return to something regarding continued rationalisation and portfolio M&A post the foam disposal that you did, are there any other imminent opportunities to rationalise the portfolio, I'm thinking potentially some of the smaller French mills, are they really core to your businesses?

MR Do you want to take the FX?

AM Yes, in terms of FX I would use at this stage...we'll revisit it at the half-year, the exact guidance you've got. So clearly you've got the position as you described on the euro impact, and it's fairly obvious where the euro is today against sterling, and then to consider the split of currencies that you were given at the year-end, so I would use that at the moment. Clearly FX has an impact on our sterling reported numbers and I think we've given a very good way of getting pretty close to what the impact will be. What were the other questions? Oh, disposables.

MR If I do that first then you come onto this; so just on the M&A bit, you talk about Eastern Europe, we're finding very strong growth there for us. You've got a market that's growing overall as well so it's the sort of market that can take new capacity. So if we look at our position at the moment; we have spent a considerable amount of our CAPEX in increasing the capacity, we virtually built a new plant in Western Poland over the last two years and you'll see further moves there, so it's not just about M&A when you've got a good growth market and a requirement from our customers to have very high-quality facilities. As I say some of our most modern and most productive facilities are in Eastern Europe. I think we've got probably the strongest footprint of ourselves, which means in the industry in Eastern Europe.

You asked about PE, we don't actually see PE being around these assets because they don't have the synergies and they haven't got the customers, and I think there are a few PEs who've come into the industry, and I wouldn't say it had always been a sparkling success for them, so generally we don't see a lot of PE interest. So Eastern Europe, yes there are assets there, there are also new build; there's not a lot of PE. You've mentioned Durapak, it is an asset, I think they looked to sell it a while ago and then it was withdrawn and we hear different things. You know, we'll look at everything that's coming up but we have a number of alternatives in that region, and as I say our pipeline was reasonable there, definitely.

AM As you said Miles, the default option is we look at greenfield, we look at expanding capacity, we look at assets that are available for sale. I haven't come across, on the fibre side, PE at all. Obviously you see them when it's shiny plastic assets like SIG or aseptic packaging assets, but nothing on the fibre-based, and it would be hard to imagine that. In terms of the disposals we have, as we said before, we continually look through the portfolio, we're going through the strat plan at the moment. In terms of small French mills, whether we would dispose of any, the answer is we would. We've made no secret that we're looking at our paper assets in totality but again it's a question of whether we would get sufficient value from selling them versus the cash we generate from keeping them. So it's a very economic calculation and for the reason that we described in the previous answer about why you're not seeing a lot of demand for paper-making assets, particularly in Europe, so it's something we continue to look at. We disposed of the Nordic foams business, it didn't fit within the portfolio, i.e. it wasn't going to attract enough capital from us in our resource allocation to continue to invest and grow in it, and therefore we exited it with a good valuation. And that's broadly how we will look at things going forward. So if there's a part of the business, or a specific area that doesn't fit, it's not going to be able to attract capital from us in our allocation process, we will consider disposing of it.

JJ Great, thank you Adrian.

OP Thank you. And our next question comes from the line of Fabio Lopes from Bank of America Merrill Lynch; please go ahead with your question.

FL Hi, good morning, thanks for taking these questions. Just a couple of questions; one, regarding the acquisition, what is a typical customer for Andopack, for the end market? And the second question would be have you recently seen any changes in the margins in the collection business? Thank you.

MR Their existing customer is predominantly in the agricultural sector. This is what we mean by that local market, they're in there, they've got very good facilities, and they're providing corrugated boxes for agriculture, which is absolutely fine. It

tends to be a little bit more seasonal because of that, so the first half of our financial year, leading up to the end of October, is a very busy time for them, it gets a little bit quieter for them during the winter months. And that's where we see the opportunity because we're far more about the larger pan-European customers and I think it's extremely complementary. And then on the recycling, the prices for the end products have remained stable and typically, in a stable pricing you tend to get margin erosion, just typically. However our margins have been maintained and the reason is as we source different routes for fibre we found that there's a very good opportunity there to obviously increase collection, but also to create value. So we've seen the margins hold very well, we made an acquisition in Italy which gives us a very good position there, particularly up in the north, for collection depots etc., and again there, as we've brought our collection expertise the margins have held up well. And as we all know it has a fantastic return on capital.

AM I think maybe you have to look at our collection business is much more than just a waste management business, it's providing a lot of services to retailers in terms of optimising their waste utilisation and therefore the value back, consultancy services on their whole eco supply chain, so it's not simply collecting the waste. So the contracts they have are much deeper than just a discussion on price.

FL Okay, thank you.

OP Thank you. And we currently have no further questions coming through, so one final reminder for you ladies and gentlemen; if you do wish to ask a question please press star one on your telephone keypads now. And we do have a couple of further questions coming through, the first one is from the line of David O'Brien from Goodbody, please go ahead with your question sir.

DB Hey guys, just one from me; just if you could give us a comment on how plastics is maybe performing in Q2 please.

MR Within plastics, as you know this is predominantly around flexible packaging, it's the bag-in-box concept, we're the world's second-largest supplier into that market, we've continued to see growth there. In terms of our own business, as you know we're restructuring quite heavily, really creating a number of new facilities, and that's all progressing according to plan. So I think we're expecting a very modest improvement this year with all that change, and that's where we are. But the end markets continue to be very supportive of our offering, yes; market demand is going very well.

DB So it would be fair to say that volume growth is above and beyond that you're seeing in corrugated?

MR That's very interesting, actually it is a little bit better but that's more of a country exposure. Now our business there is in North America, Europe, and the Far East so it is growing faster but that's more regional. When we come into Europe it is slightly better but our corrugated growth is pretty good as well.

DB Great, thank you.

OP Thank you. And our next question comes from the line of Jolyon Wellington from JP Morgan; please go ahead with your question.

JW Good morning, I've got two questions please; I just wondered if you could comment on what you're seeing in the industrial segments in terms of growth and how that compares to your FMCG segments. And the second question is just on

energy, I'm assuming that's part of your pass-through in terms of the usual lag that you see, I just wondered if energy prices were to go down if you'd see a short-term benefit on your profitability?

MR Yes, energy prices have been coming down, we'll see where they go. We use a lot of energy so that can have a short-term improvement. But obviously it's a long-term business and we have long-term supply agreements in place so we don't see the volatility coming through to us, whether up or down, so there can be a slight improvement but we do contract and we do look for longer term supplies. So a bit of benefit but I wouldn't say significant.

AM No, if you look at it year on year, absolutely, and you're always managing your energy exposure and your locking out forward periods of time. So Miles is right, if you have a massive spike up and down within a period you don't tend to see any impact of that. If there's a structural move over a period of time then clearly that benefit comes through.

MR And then on industrial; it has been a bit quieter, industrial, there's no doubt about it. If you look at the European industrial market, principally led by the German economy, it has certainly quietened a bit and when we look at our customers there and we understand their demand I think there's a combination of a bit of Europe generally, but clearly Russia and the exports to Russia, and the decline in the Russian economy and the decline in investment in Russia has certainly had an effect. As you know, for us we are hugely overweight in food and drink so we aren't significantly affected but it's certainly there and our outlook is for the end markets to remain challenging going forwards. We haven't changed our view on this for probably four years now; unfortunately we don't see any really encouraging sustained improvement in end demand.

JW Okay, that's great, thank you very much.

OP Thank you. We have no further questions coming through so I will hand the call back over to you for any concluding remarks, thank you.

MD Well thank you, everybody, for your time and we greatly appreciate that. We've continued to grow volumes, margins, and returns, and we're delighted with the Andopack acquisition, which I'm sure we will continue to grow from. Thank you very much for your time everybody.

AM Thank you, bye-bye.

OP Thank you, ladies and gentlemen, for joining today's conference. You may now replace your handsets. Thank you.