

## DS Smith AGM Trading Statement

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### Conference Call Transcript

#### Speaker key

OP Operator  
MR Miles Roberts  
AM Adrian Marsh  
DO'B David O'Brien, Goodbody  
BD Barry Dixon, Davy  
JJ Justin Jordan, Jefferies  
HF Hector Forsythe, Stifel

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

MR Good morning, everybody, and thank you for joining us today. I'm Miles Roberts, the CEO of DS Smith, and I'm joined here by Adrian Marsh, our CFO. Our Trading Statement, released this morning ahead of our AGM later today, relates to the period of trading since 1<sup>st</sup> May, and in that time we've made good progress. Performance has been in line with our expectations, volume growth remains good, really reflects the continued customer support for our unique product and service proposition right across Europe. Our return on sales and return on average capital employed have both shown further improvement versus the comparable period last year, and this reflects the ongoing benefits of our scale, which gives us the opportunity to lead the market in quality and innovation, while of course remaining very competitive on price.

Over the period, just as a reminder, we have continued to strengthen our business with a number of transactions. On 31<sup>st</sup> May we completed the acquisition of Duropack, a recycled corrugated packaging business with market leading positions across Southeastern Europe, and we're very pleased with the reaction from the employees and customers, with a limited impact on volumes from customer overlap. The integration work to date has progressed very well and we now expect cost synergies of €15 million per annum and cash synergies of €18 million to be delivered within three years of ownership compared to the original estimates of €12 million and €13 million respectively.

And on 31 July we completed the acquisition of the corrugated activities of Grupo Lantero. The business is well invested with a strong focus in the FMCG sector and significantly strengthens our business in Spain, an important and growing market, increasing our market shares to approximately 10%, and again, we're very pleased with the progress we've been making on integration. The response from our employees and customers has been tremendous.

So, looking ahead, our outlook remains positive as volumes continue to grow despite the ongoing challenging market conditions. The Board expects continued performance in line with our medium term financial targets. We have a clear vision of further growing DS Smith, both in geographic scale and quality of

service, and our most recent acquisitions, together with the customer and market opportunities for growth, give us real confidence for the future. Thank you.

I'd now like to invite questions, which myself or Adrian will be more than happy to answer.

OP Thank you. Ladies and gentlemen, if you'd like to ask a question please press star one on your telephone keypad. If you change your mind and want to withdraw your question please press star one again. You will be advised when to ask your question.

The first question is from David O'Brien from Goodbody – please go ahead, David.

DO'B Just a couple from me, please. Firstly, just on the synergies in Duropack. Can you give us a sense of is there additional cost to come with the extra synergies you're gaining there, and indeed, what is the one-off cost associated with the integration of the Duropack business? Specifically on Lantero, I guess could you give us a sense of what the absolute amount of synergies you expect to extract from that deal as well? And I suppose thirdly, just on the closure of the Wansborough Mill, what are the costs and savings associated with that?

MR Adrian, are you happy to...?

AM Sure.

MR Just in terms of the original cost of the synergies of Duro.

AM Yes, in terms of the current level of synergies and the increase, there's no increase to what we set out as our original estimate on costs, which we described as around €13 million, which we believed to be a representative number – we haven't changed that view. The additional synergies now, it's much more a reflection of the fact that when you look to buy a business you set out what you think your synergies are going to be. We know the industry obviously well enough and we know where we believe we're going to get opportunities.

Once you come together and in that first 90 days, which we're just coming up to the end of now, and the teams are working together you actually hear of what you believe the opportunities are from the perspective of the company you've bought, so it's just a fine tuning of the number, which in any case can only really be an estimate when you make your business case together, and it's simply reflecting now the ambition of the Duropack team as well coming in. And it's pretty much across the board, there's nothing specific in there and, as I say, there's no change in the cost.

In terms of Wansborough, it won't be a significant number – the cash costs will be relatively small and we'll describe that at the half-year. We're obviously at the moment going through a consultation process so we're slightly restricted on what we can describe at the moment, but we have no anticipation of a significant cash cost – in fact, we know it won't be.

DO'B And just the absolute savings in terms of Lantero?

AM Well, as I described to you, the process we're going through on the Duropack acquisition in terms of the teams are coming together and we're working through the synergies, we're currently in the middle of that process now. We took the business beginning of August. August is obviously a significant vacation period in Spain, so those teams are working through that at the moment, and again, I'll update that when I've got a number that I can give.

DO'B And maybe just one final one on how you see the prospects with the testliner and price increase in September, and maybe how corrugated prices are reflecting the current dynamics in container ware.

MR Yes, there has been further announcements on test, and we are in September and it will be discussed, etc, going through in September, so it's too early to say definitively what will happen. But what we can say for our business is demand remains good and demand for our paper remains very strong, so we'll wait to see what happens but I'm not totally surprised that there's a further increase going through.

DO'B Great, thanks.

OP And the next question is from the line of Barry Dixon from Davy – please go ahead.

BD Yes, good morning, gentlemen. A couple of questions, and maybe just a follow-on there from David's question on what you're seeing on corrugated prices at the moment. How soon do you think you'll start to see those corrugated prices reflect the increase in contain ware prices, the previous increase in July/August? And I suppose related to that in terms of how are you... it's impressive that you're reporting an increase in margins given I suppose the input cost headwind that you must be facing given that rise in recycled and kraftliner prices from earlier in the year – you might just talk about how that margin is improving in that backdrop.

Secondly, you talk about volume is good, and I don't know how to read good. I think you talked before that volumes were up 3 to 4% when you get the full-year results. Is that what we should read as good, that 3 to 4 is still that kind of level, or has it accelerated anything from that? And just finally, in terms of the recycling business, in terms of OCC, any sort of change in trends in OCC prices over the last month, given the turmoil in Chinese markets and the devaluation of the currency? Thank you.

MR So, in terms of pricing on the corrugated, everybody knows we have a short paper position so we try to limit the exposure of our shareholders to it's a notoriously cyclical business, but prices have been going up in test. I have to say we haven't really seen very much at all on kraft but on test they did go up a while ago, and that feeds through into pricing. Some of our pricing has already changed, we're very clear on our recovery periods and we are recovering in line with our traditional recovery period.

But as we said, we have an underlying improving business because of the proposition that we give to our customers so there is a period to recover the increase in costs, but our margins are still improving on the back of that proposition. And of course we did increase our medium-term target for return on sales at the full-year and remain working towards that target.

The volumes have remained good, we're quite pleased with that. I think for the last full-year, we were just over 3%, and we're pleased with the progress that we've made in the first period of this year. We do have some new businesses that have just joined us and we're working through where they are, etc. If you remember, when we bought SCA that business had been losing volume for a number of years, and within a few months we'd turned that round to a positive and it's only improved since then. And we're working through the new acquisitions, exactly where they are and what's going to happen there, but overall we're pleased with the progress that we're making on our volumes.

[Unclear] is difficult, but packaging has never been more relevant to our customers and they continue to see it's important – it's important that affecting their rate of sale at the point of sale in the retailers.

And on recycling, this is the cost of fibre – again historically it's been quite a volatile business, although for the last couple of years it's been very stable, the price of OCC. There has been some recent very modest increases and these are partly effected by exchange rates as there are different markets that people can buy in, so the price has gone up over the last number of months by a number of euros a ton and at the moment the price in some markets has been stable, the price in some other markets has come off very modestly, and frankly, who knows where it's going to go, it's always a volatile position. But I think when we look going forward we don't see any particular pressure on OCC – it's been pretty stable for a long time and we don't see any particular reason why it should increase.

BD Sorry, Miles, did you say that the price on some markets were off modestly in recent weeks?

MR Some of them are modestly, yes. We're only talking a few euros, it's nothing... and it's come off of course, but it's gone up recently so it's a little bit volatile, but in quite a tight range. We're talking very modest numbers, is it €3 a ton on the price of 130 or something, but really it's pretty stable. I have to say, looking forward you don't expect it to come right off at all or actually increase. It has been stable and we expect that to continue going forward.

BD Okay, thank you very much.

MR Thank you.

OP The next question is from Justin Jordan from Jefferies – please go ahead.

JJ Thank you, and good morning, everyone – and obviously, well done on the positive start to the year. I'd just like to push you for just a little bit more granular detail, if I could. Obviously in the first half – sorry, in Fiscal 15 you reported 3.1% organic corrugated volume growth, and obviously that improved in the second half of Fiscal 15. I'm just trying to get some more granular detail in the three months of Fiscal 16, where are you in that, let's say, 3 to 4% range that you were delivering in Fiscal 16. And secondly, just so I'm clear, when you talk about return of sales improving year on year, that's in relation to an improvement on the 8.9% operating margin that you delivered in the first half of Fiscal 15 or should I clarify that you're guiding to above that year in year in the first six months of this year?

MR We're saying that our margins in our trading year-to-date are better than the margins we recorded over the comparative period last year, so you can see how the first half is better than the second half because our volumes are heading in the buildup to Christmas, and therefore we're seeing this first year being better than the last first year, so on a weighted average, if that all continues then you'll see a progress on the margin for the year-to-date if that all continues, but we're pleased with that continued good margin growth, and that is partly because of the operational gearing on volumes now just due to the movements that can affect our business in any one or two month periods.

We don't give a breakdown of volumes on a quarterly basis, and as I said, we do have the new acquisitions coming in and we're just seeing exactly where they are and what their outlook is for volume, but overall we're pleased with progress. The business continues to grow, the customer response is very good, but we'll be

able to give a lot more information at the half-year when we understand exactly where all these new acquisitions are going.

JJ Okay. And just to push you a little bit further on the M&A part, and obviously as you quite rightly say, two acquisitions completed in the last six months and pleasing to see the synergies in Duropack, but can I just push you for some more colour on the pipeline of M&A opportunities and geographies that you're looking at? There's been some market speculation of potential opportunities in North America that might be of interest to you, or is Europe still your focus for M&A?

MR Well, Europe is very much our focus because you have such strong synergies and the customer reaction is absolutely tremendous, particularly when we go into new geographies where you haven't been before the reception from the big customers is absolutely tremendous, so because of that the shareholder returns we can generate from acquisitions in Europe is very strong, and the pipeline is good. We have a very strong team there – as you say, we've completed a number recently, and a number of people have come to us after those announcements, there's been a lot of ongoing discussions, so we feel quite positive about the opportunities there and the ability to us to pay a decent price to the owner, but most importantly, deliver a stronger business model for our customers and strong shareholder return so, as I say, we feel quite positive there.

But the pull from our customers for our offering into other markets remains very strong. We are doing more work in North America but just really on the service provision, so we don't have any facilities there in corrugated, this is all about how we give all the design and the frontend services to the big customers, and we're delighted to receive that strong pull. So, that's really how we're looking at that market, starting to service our customers, but our main M&A focus remains very much about continuing to consolidate Europe and good opportunities that can deliver a lot of value.

JJ Thank you, that's great.

OP The next question comes from the line of Hector Forsythe from Stifel – please go ahead, Hector.

HF Thank you. Morning, guys – a couple of quick ones hopefully. Obviously the Wandsborough Mill announced for closure – where are you in terms of the rest of the paper assets, are there any other intentions for exits or tidy-up in that portfolio? And the second question is can you refresh my memory as to where you've got to in terms of the pursuit of assets that you were looking at in Turkey/Greece?

MR The paper business sector, to remind everybody, is very much around the return to get on that business and its cyclicity, so we like to be in as short a position as possible, and that whole portfolio remains under active review and it always will. We set out a number of mills for disposal post the SCA acquisition. A number have been sold or closed. The remainder of the mills we have, as I said, there's always an active review, but there's nothing imminent on that. With the new acquisitions that we have made, one of them has a small mill and a larger mill and we're just working through exactly what the future for those assets remain. But the point is to keep our shareholders exposed as to these assets to the minimum that's needed, and we'll never stop reshaping our asset portfolio, as in line with how we see the future, but there's nothing imminent that's going to come along in the near future.

- HF Just on that, you're about 55% covered for own production at the moment I think and you had in the past a strategic target of around about 50% – is that still the case?
- MR Yes, that's where we'd like to get to. We are in the 50s – it sort of bobs around a bit – but I think we're in the 50s at the moment, and I still feel that the 50% is the ideal number. But you have to be able to get there and some capacity is a bit lumpy so it's not exactly a smooth progression, and that's why I say we keep that portfolio under active review. So, we're currently in the 50s and as our packaging business grows to refine production, etc, then I hope to see that number continuing to fall back. But it was around 70%, SCA, so not only have we delivered all the synergies and more on SCA and really grown the packaging and delivered the results, but we've also come down now quite considerably on the balance of paper to packaging, which I think is what I'd assume actually is a long-term and a good position.
- AM Just on Greece and Turkey, Hector, we obviously have been cognisant of what's been happening in both countries over the past few months. We've put in a good understanding of what we think the value for the business is. The other party who's selling has their view and at the moment they're not close enough to each other, but we remain very interested and we think there are good opportunities there, but we're pretty financially driven and we know what we can pay and we know what we can't pay.
- HF Okay, thank you, that's the answer that I was expecting.
- AM We know exactly how much we'll pay, yes.
- HF Okay, thanks, guys.
- MR Thank you, everybody, for your time, we always appreciate your interest and comments. Just to say, looking ahead our outlook remains positive as volumes grow despite the challenging market conditions, and this, together with our geographic scale, quality of service, falls from the recent acquisitions, gives us real confidence for the future. Thank you very much.