

**DS Smith Year End Trading Update  
Conference Call Transcript**

**Speaker key**

MR	Miles Roberts
AM	Adrian Marsh
DB	David O'Brien
OP	Operator
JJ	Justin Jordan
AL	Alexander Mees
BD	Barry Dixon
JT	Jake Thomson
HF	Hector Forsyth

OP Good morning, ladies and gentlemen, and welcome to the DS Smith year end trading update call. My name is Raji and I'll be your co-ordinator for today's conference. Throughout the call your lines 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 \*0 on your telephone keypad and you'll be connected to an operator. I'll now hand you over to your host, Miles Robert, to begin today's conference.

MR Good morning, everybody, and thank you very much for joining us this morning. I'm Miles Roberts, the group chief executive, and I'm joined by Adrian Marsh, our group finance director.

So our trading update, which was released this morning, relates to the financial year that's just ended, that's the 12 months to the 30<sup>th</sup> April. We'll be announcing our full results on 25 June and that will have all the usual detailed announcements and accompanying presentation. But today's update is really to give you a flavour of how the last 12 months has progressed, and we're pleased with it. There's no doubt we've had a good year. It's been a busy year. We have continued to rationalise and improve our business portfolio with a number of transactions, such as the proposed acquisition of DuroPack, in addition to the acquisition of Andopack in Spain last autumn. And then we've also had some small divestments, such as the Nantes paper mill and the foams business, all in line with rationalising our portfolio.

At the same time we've also been investing capital in the business with a number of new facilities to drive growth both on the manufacturing side but also in the roll out of our design centres to get our innovation even closer to our customers wherever they are throughout Europe. And we're delighted that we're getting very good customer traction and this has driven continued strong volume growth. We'll provide more detail in June but by way of an update the business and market trends that have been consistent with those reported in February and the second half volume growth has been ahead of the first half and well ahead of the prior year. And growth has been across all of our regions. So throughout Europe we're growing and we're growing ahead of the half year and growing ahead of last year.

The return on sales and the return on capital employed have also continued to improve. We've continued to integrate our business but the most exciting part is increasing our value added customer proposition. I said it's unique in the marketplace and we're seeing that come through not only in the volumes but in the margins as well, and this is accompanied by continuing very tight working capital management. And with DuroPack all is proceeding as planned. We're currently waiting for completion clearance and in the meantime plans for integration are in place from completion. We remain very excited about developing and growing this business.

So overall, we see the business is in line with our expectation, strong underlying growth, offsetting or much more than offsetting that continued strength in sterling on the translated results. So the progress being made with customers, the opportunities for growth gives us confidence in the prospects for the business. Thank you, and now myself and Adrian are welcome to take any questions that listeners may have.

OP Thank you. Ladies and gentlemen, if you would like to ask a question please press \*1 on your telephone keypad. If you change your mind and wish to withdraw your question please press \*1 again. You will be advised when to ask your question. We have a question coming from David O'Brian from Goodbody; please go ahead.

DB Hi, folks, just a couple from me, please. Just your comment that performance is in line with expectations, would it be fair to interpret that, if we go back to the December stage, I think Adrian outlined that the split of profits H1 H2 will be broadly 52% 48%, so you're happy with that same type of split?

AM Yes.

DB That's very clear, thank you.

AM I can go on a bit longer but that's fine. There's nothing that can take away from that and if you want any specifics you and Rachel and Hugo can have a chat afterwards.

DB Great. And could you give us a little bit of colour on what you're seeing in corrugated price trends and how you've seen the testliner price increase in Q1 and into the second quarter unfold?

MR Yes, look, prices move about throughout the year and what we're really coming back with now is to say that we've had lots of change in paper prices, we've had a lot of change in currency and we're absolutely where we expected to be and it's because of that value proposition. So I think it depends where you are. We've seen some erosion in test liner prices at the start of this calendar year. Recently people are talking about another increase. I think some of it will probably go through, but it just remains a very fluid area. As you say, whatever it is we're showing how we can cope with that with our short paper position combined with our performance packaging approach. It just allow us to mitigate these effects. It's really so powerful and our customers are responding as we expected.

So, yes, there have been some changes, but we are in line with our numbers. We'll see where the latest gets, I think some of it probably will stick but obviously what happens in the medium term, who knows.

- DB Maybe just on OCC, I get your position as the largest collector and seller in Europe. How are you seeing that market at the moment and are you seeing it tighten up?
- MR Yes, look, we collect from all the major supermarkets across Europe. As you say, we are by far the largest. The demand for paper has been reasonable. The high street remains difficult. So it's very important for us to carry on increasing our collection rates just so that we can hold on any... we can just keep ourselves well supplied. At the moment it is demand for OCC is good but we're finding that we're able to get a very good supply at the same time. There was a bit of talk, is it going to go up a couple of euros, €3, €4. It's marginal changes at the moment.
- DB And is the demand you're seeing predominantly improvement in the domestic demand or how the export market looks?
- MR Yes, with the weakness of the euro the export demand has improved not only for some paper but also for OCC compared to sourcing from the US, so that's probably what's driven some of the recent demand. We'll have to see; it's a very fluid market. We don't see any medium or long-term increases, but there are always spikes.
- DB Thanks very much.
- OP And the next question comes from the line of Justin Jordan from Jeffries; please go ahead.
- JJ Thank you, and good morning, everyone. I'm just wondering if you can give a little more colour on the acceleration of volume growth that you've seen in the second half. I know obviously it was 2.3 in the first half, can you give us some more quantification of what you've enjoyed in the second half?
- MR Yes, if you go back over quite a few years now we've seen half year on half year our volumes, our like for like has been improving, and that trend has continued into the second half. And again, all regions are in growth. Where we're seeing the main improvements it's really around the large customers. As I say, we have a very, very unique offering and they increasingly turn to that, so large customers wanting a single supplier.
- Regionally the markets, I think, still remain quite challenging. There's no doubt that some markets have definitely stabilised. We've had for a number of years a very weak underlying market in places like Italy, like Spain, and those economies certainly seem to have been far more stable over the last six months. Let's see where they go in the future. If those economies improve then obviously it's a driver for growth, but we're not expecting that, it's far too early to call that.
- So at the moment it's really large customers, it's customers wanting to mitigate as far as possible any inflationary increases, and that comes to the offering that we give them. And then regionally there's just a little bit more stability in some of the markets, but too early to call it a European recovery.
- JJ But would you describe your volume growth as GDP plus one, the sort of metrics you've previously outlined it as?

MR Oh, it's better than that. No, certainly it's definitely better. It has been for a while and it's certainly better than that at the moment. And I think the overall market is probably moving at around about GDP, perhaps slightly under. So on a European basis we continue to see a market share gain.

JJ Great, okay. Just a quick, I think maths question, really, for Adrian. If you look at the really helpful table that you provided at the bottom of the release this morning, am I right in thinking you've had something like a 6% FX headwind in fiscal 15, if you look at average rate, and if you look at closing rates that would imply something like a near 5% FX headwind assuming closing rates were sustained throughout fiscal 16. So potentially something like a 5% FX headwind to EBIT in 16?

AM Yes, your maths is absolutely right, Justin. It's a 6% impact and you can work that through on the average... work our way through, which gives you colour about how the underlying business has been performing. In terms of next year, none of us are any currency experts but on the translation impact, as you take closing to average and that average impacting, slowing through in its entirety for the year, then you're seeing exactly as we do in our models at the moment.

JJ Great, thank you.

OP And the next question comes from the line of Alexander Mees from JP Morgan; please go ahead.

AL Good morning, Miles; good morning, Adrian. Three quick questions for me, please. The first one just with regard to DuroPack, I wonder if anything has surprised you positively or negatively over the past couple of months of getting to know that business. Secondly, I wonder if there's any further colour you can give us on which regions are performing more strongly and less strongly than others. And thirdly on the plastics business, I just wonder given the sharp fall in the oil price whether that's had an effect on margins.

MR With DuroPack, so obviously we announced that and we are at the competition commission at a European level and going through that, so we don't have by any means full access to the business. Everything is monitored as to what we can see. But there's absolutely no doubt we are delighted by the response of the DuroPack organisation to our intended acquisition. We're absolutely delighted. And the customer reaction as well, it's the same as when we went into Spain, the customer reaction is very strong. So in terms of employee engagement we're very pleased with that, and customer engagement as well.

In terms of how we can be stronger with both businesses together, obviously we'll come back and outline that when we've owned the business for a while, subject obviously to the competition clearance, but we're very, very pleased with the employee and the customer reaction. It gives us a lot of confidence for how that business is going to perform.

And in terms of regional growth, it's back to that previous discussion, where we've taken over businesses and been able to put in our offering, and in the real legacy regions, we've seen a lot of growth. So if we look into Eastern Europe, if we look into Italy, if we look into Germany the growth has been very good. In some parts we are extremely busy,

particularly in those regions. Now, the economies are okay but this is just our offering into that market. So a little bit into Germany, but particularly Eastern Europe and Italy has been very good for us.

And in plastics, as you know, we're undergoing a huge reorganisation there. It's the construction of basically three new facilities. This is all around bag-in-box. We operate in North America, Europe and the Far East. It's an area we see long term value. We're the world's second largest supplier. The first is a US business. And so we've been undergoing a huge reorganisation. The oil price, as you say, has fallen. That doesn't necessarily translate into some of the materials we use, particularly things like PP. So there isn't a straight correlation. So we've seen that business continue to, the underlying business is doing absolutely fine. We've got a reorganisation but we're going to see that business, really, all the new factories perform into next year. So it's been good but it's nothing dramatic because of the reorganisation we're going through. We should really see those businesses perform in anger next year, all as we planned and said before.

AL Thank you very much.

OP The next question comes from the line of Barry Dixon from Davy, please go ahead.

BD Hello, can you hear me? Morning, Alex, morning Miles, apologies. Just two questions from me, please. One on corrugated pricing. A number of your peers have talked about weakness in corrugated prices. Can you just give us any sense as to what you're seeing on prices at the moment. And then secondly on Kraftliner prices, it looks like... I know you mentioned earlier about testliner prices being variable, but Kraftliner prices looks like they have gone through and I suppose the question is, how difficult is that for you in terms of margin pressure and how do you offset that?

MR It's interesting, Barry, we haven't seen any Kraftliner increases. And it's because we replaced so much Kraft with test. So we've got a huge change programme driving out Kraft at every opportunity and replace it with test. Maybe that's why, I don't know about other people obviously, but we haven't seen that.

And in terms of corrugated pricing, it really is around the value add. What we're seeing is our margins continue to increase. On an overall group basis we've seen the value added being paid for by customers. As you know, sometimes there's an ebb and flow on the paper price but I wouldn't say we'd seen anything significant on that recently. What would you say, Adrian?

AM I'd be similar with that, Miles. In terms of the mechanisms and the opportunities we use on pass through and the way we're working with customers on performance packaging and to mitigate movement, continues. I haven't noticed anything specifically. I'm not sure which peers you're talking about in terms of weaker corrugated pricing. Clearly all the markets you operate in at the very local and small customer level are highly competitive at the moment. They have been certainly in my time at DS Smith and as I look back. So that's not surprising. But I think it again really talks to the way we're trying to differentiate.

BD And I suppose maybe a related question is just in terms of the competitive environment we're hearing anecdotally, particularly say in places like Germany, that the market on corrugated pricing has become very competitive, and I understand in terms of your value added proposition and all of that, but just I suppose on maybe a like for like basis, have you noticed an increase in the level of competition given the increase in corrugated capacity that's happened in that market?

MR Look, you're right, Barry, there has been some significant investment by some local companies. I think it's probably added 3 or 4% to capacity in that market, something like that. Being absolutely straight with you, it remains an extremely competitive market. I wouldn't say it particularly hotted up but it always has been very competitive. How we try to work with that is on that pan-European basis but also with that technology that we've talked about. So it remains very competitive. I don't think that's going away. I think some people have talked about some other capacity, but this is why it's so important, about that customer proposition. Capacity is one thing but it's the proposition to the customer which we try to focus on.

So it's competitive, there is more capacity. I think it will remain competitive but we do have a way of working through that.

BD Okay, thank you very much.

OP The next question comes from the line of Jake Thomson from Odey; please go ahead.

JT Morning, Miles; morning, Adrian. I think most of my questions have been answered so I just really wanted to ask you one question on the transactional impact of currency on your business and really talk about... it would be great to get some colour on the impact the currency's had on trade flows within your geographic footprint, particularly given the strength of sterling relative to the euro, what's happening in UK prices.

AM Classically you can describe the business as having very limited FX transaction exposure for a number of reasons, not least transport cost of moving paper per se in general, corrugated in particular because of the relative cost in addition to moving it, so you don't tend to see it. Of course where you have a significant, rapid structural change in two currencies where there's only a small space of ocean between them you would get a level of impact. We've certainly seen that in the UK, imported paper prices into the UK have obviously come down and our business has responded accordingly there and it's reduced input prices. We have seen that starting to change and prices ticking up again.

But undoubtedly where you have such a big impact... we look at it more as an economic exposure rather than a transaction exposure because we're not generally buying or selling so much between different currencies and your cost base tends to be where your revenue is. But the economic exposure in the UK and how you manage that business on the packaging side has certainly had to be highly conscious of the euro weakness or the sterling strength, and such a rapid change. And when it moves back the other way you see the opposite in place.

But in terms of real transaction exposure, we don't have so many, but the economic exposure in the UK, absolutely, you're bang on. It's there, it's

being managed and our business is extremely experienced in how to deal with it.

JT So I suppose the next logical question is, how canny are your customers, or rather how sticky are your contracts in terms of should we see that hitting parts of your UK P&L in the second half of your fiscal year?

AM Sorry, go on, Miles.

MR No, you finish, I'll chip in at the end.

AM I was just going to say, in terms of where you have situations with major customers and you're linked to industry prices of paper clearly what drives those industries will have an impact in terms of what your input costs are. Where you're dealing with customers that are only mindful of short term, spot buying impact then it has a different impact. The business challenge is how you manage that. Clearly it will be impossible to take long term purchase contract based on a spot price of paper against the euro at the moment because that could move overnight. So it would be unlikely that people will be locking in anything other than short term margin impacts on that, I couldn't see anything long term on it. But yes, there'll be an impact and the businesses are managing their way through that, but it's nothing that we've focused on or that we've seen in terms of any concern on UK performance or UK margins, but you're right, it's there.

JT Okay, thanks. And then lastly from me is a question on your Western European business. Clearly your Northern European, German exposed business is doing well, you're taking share and volumes are doing well. But how's Western Europe faring given France and the issues in the Benelux?

MR All regions are in growth, and that includes Western European business. It does remain very competitive but you've seen our results in that region over some time now and the margins have held up very well. Now, the outlook is for the economy there to remain difficult. We aren't seeing any real change in the underlying economic conditions but we continue to grow and the margins have been resilient. It's quite interesting, just talking to customers we often talk about pan-European but on a national basis, again, our customers are looking for a common solution. How can they drive out wastage and increase innovation from their supply chain? And it's a national not just an international... and obviously we absolutely lead the market in that region in terms of consumer goods packaging. We've got fantastic businesses there and that's what really keeps is alive, continue to grow, but the economy has remained difficult.

JT Okay, thanks.

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

HF Morning, guys. Three questions from me. Just talking about segmentation of sales, can you give us a flavour of how the non-FMCG proportion of sales is trading? I guess there we're talking about industrials but also some of the online packaging.

MR Look, we have been growing the FMCG part of our business. As you know, before SCA we were up to 70%, we're now in the early 60s. In the

industrial side the volumes have been growing. We tend to focus very much on the less cyclical parts of industrial, so we don't try to get behind housing and things like that. We are into pharmaceuticals, we are into the spare parts for machinery, cars, etc. and we also put e-commerce in there. Those are the areas that we focus on and they're all growing, partly because the underlying businesses are growing, the underlying markets, but again, we're taking some share there, as we're able to offer our customers across a number of countries.

The online, it continues to grow strongly. It's still a relatively modest proportion of overall sales. If you take the area that's most developed in, things like grocery, I think it's averaging in the UK about 7%, 8% of sales now, and that's in the most vibrant, large category. So it continues to grow at about 12, 13, 14% a year. It's only about 7% of the market but it's an area that we continue to focus very heavily on, particularly around occasions, gifting, all to do with matching up the online to the consumer's particular choices there. So we're going to continue seeing that growing and we do well in it. But there's a lot of work still to do.

HF Okay, thank you on that one. That sounds very encouraging. And then just on the development of the balance sheet through the year end, Adrian, is there anything you can say in terms of how the level of leverage has ended the year?

AM Yes, at the half year we were very happy with where our net debt was. We described the second half as always being harder than the first half so we're going to have to work hard to maintain that. We have worked hard. I have ran around everyone, as you can imagine, on the last day of the year just checking that things were in line with what we're expecting and I was encouraged by the phone calls I had. Clearly everything needs to be added up and reported on but there was nothing in that that gave me any concerns to put at risk the hard work that's happened through the year in terms of the focus on cash management. So I'm relatively relaxed sat here at the moment.

HF That's very good, excellent. Then finally, in terms of the financial metrics you've been driving the business to over the last, it seems several years, is there any prospect of you having another look at those in terms of maybe raising the bottom rung or even pushing up the top of the range that you're targeting?

MR We keep them under review. Now, pre-close, isn't the time to discuss them, but I can assure you, Hector, they're kept under review; but it's not the time to discuss them today.

HF Okay, thank you very much for that.

OP We currently have no more questions coming through. Just a reminder, if you'd like to ask a question please press \*1 on your telephone keypad. We have no further questions, so I'll hand the back to your host to conclude today's conference.

MR Well, thank you very much, everybody, for joining us this morning. We very much appreciate that.

In summary, overall the performance is fully in line with our expectations. There's been a strong underlying growth, partly offset by the strength of



sterling on those translated results. But the progress we're making with our customers and the opportunities for growth really give us confidence for the prospects for the business. Thank you very much.

OP Ladies and gentlemen, thank you for joining today's conference; you may now replace your handsets.