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DS Smith AGM Trading Statement

Participants

Miles Roberts – Group Chief Executive

Adrian Marsh – Group Finance Director

Operator: Hello, and welcome to the DS Smith AGM Trading Statements Call. My name is Rosie, and I'll be your coordinator for today's event. Please note this call is being recorded. And for the duration, your lines will be on listen-only. However, you will have the opportunity to ask questions at the end. This can be done by pressing star one on your telephone keypad to register your question at any time. If you require assistance, please press star zero and you'll be connected to an operator. I will now hand you over to Miles Roberts to begin today's conference. Thank you.

Miles Roberts: Good morning, everybody, and firstly, thank you for joining us today. I'm Miles Roberts, the Group's Chief Executive, and I'm joined by – with Adrian Marsh, our CFO. Our statement today covers trading for the period since 1 May.

I'd like to start by saying, I really am very pleased with the progress that we've made in the financial year to date. We have continued to build on our strong customer relationships, resulting in really excellent volume growth right across the business and good progress towards recovering the increase in cost of production through higher prices.

Our box volumes have grown very strongly versus the comparable period last year and also versus 2019. And whilst this growth has been across all parts of the Group, it has been especially strong in the US and Southern Europe and also with our large FMCG multinational customers.

As I've mentioned, the input costs have continued to rise, with some notable increase in the cost of energy and transportation. These, combined with the cost of OCC remaining high, has resulted in further significant increases to the price of paper. But given the strong demand for our packaging, we see really very good progress in recovering these costs through increasing prices. So consequently, overall trading continues to strengthen in line with our expectations.

We continue to invest in the business, and I'm pleased to say that the development of the new packaging sites in Italy and Poland, is proceeding to plan, and they're expected to begin operations in Q4 of our current financial year. Both have already received advance commitments for over 50% of their capacity.

These new plants are in part, being funded by the recently announced proposed disposal of our non-core De Hoop paper mill. Our investment plans continue to prioritise meeting the growth of our packaging customers, both for now, the near, and the medium term.

So over many years, we've built a business that is ideally positioned to benefit from the long term structural growth drivers of fibre based packaging, exemplified by the e-commerce and sustainability trends. And these trends have really been accelerated and continue to be accelerated by the effects of COVID, so causing – whilst the macroeconomic environment remains uncertain, we remain confident about the prospects for the business for this financial year and beyond.

So, thank you. I would now like to invite questions which Adrian and myself will answer between us. Thank you very much indeed.

Operator: Thank you. So, as a reminder, if you would like to ask a question, please press star one on your telephone keypad. Should you wish to withdraw your question, you can press star two. You will be advised when to go ahead, and the first question comes from the line of Cole Hathorn, from Jefferies. Please go ahead.

Cole Hathorn: Good morning, Miles, good morning, Adrian. I've got two longer term questions that I'll ask one at a time, and I hope you can help me on those. So the first one's on, you know, how DS Smith is positioned to invest and manage box volume growth medium term. And the second one is on how you will manage your containerboard or your paper supply to your box plants.

So, on the first question, now with structural tailwinds of e-commerce and sustainability, so that kind of the plastic to paper, now I'm in the camp that medium term, the industry box volumes could be slightly better going forward than they were in the past. And we've got your competitor like Smurfit Kappa that's announced a €500 million corrugated investment plan over the next few years.

So, I just want to think, if we think about DS Smith, you are ramping up the box launch in the US, you've positively called out that 50% of your two new box launched in Italy and Poland are filled, how do you – how do you think about your growth plans and how are you positioned to make sure that you get your fair share of industry growth? And importantly, how do you grow in the right segments? Is the first question

Miles Roberts: Thank you, Cole, it’s a very good question, indeed. You know, we if we look at our growth, we're very pleased about how it's really coming from the FMCG sector. I mean, this is a long term structural growth business we see are very high volumes now. It's not really a bounce back of the industrial part because that's such a modest part of our business, it’s building longer term contracts with more of our FMCG customers.

They're growing for a number of reasons that, you know, sustainability, et cetera, they're coming out of plastics and other formats, and we're seeing the growth in our business. So I’m certainly with you that we would expect growth over the medium term to be – certainly to be healthy.

You know, this is all part of our long-term planning, and we set this out, 11 years ago, about the expected growth in fibre based packaging, the sustainability angles, that large customers. And we've been investing considerable sums, really, ever since. If we look at where we are today, we're really benefiting if we take southern Europe from the Europac acquisition and its substantial capacity, free capacity in their packaging plants, and we still got some way to go, to fill that up. There's obviously a greater operational leverage from that.

I the US, again, you know, we do have the box plant there, which we're filling up very nicely. We are really very pleased with the growth there and I should say the profitability as well. But in time I could imagine us needing another plant. We've got our two new box plants as well coming through.

Looking over further ahead, we do see a number of opportunities, though, to increase capacity elsewhere. Firstly, it's about putting on extra shifts, which we have been doing a number of plants for quite a few years, and there's still some – there's still further to go. Secondly, this whole digital revolution about understanding more and more about your assets, you know, the amount of data we're getting and how we can see to control those assets even better than we have in the past, through this new – just through the availability of data now and the control of the asset base, we think, is going to give us more capacity.

But in time, you know, I wouldn't be surprised if there were some more – if there were some more box plants investments in Europe, it’s not now, I think we're looking over the next three, four or five years, and we think we can manage those quite adequately within our stated financial ratios. So, it's getting the benefits of the investment that we've made.

Adrian Marsh: Yes, we have invested heavily over the last 10 years in growth capacity, probably more so than other companies. So, we're seeing the benefits of that coming through too.

Miles Roberts: And you asked another question, Cole, about containerboard. As you know, we have a position where there is substantial free capacity in Germany and there's a load more paper capacity coming on stream. We contract with these independent paper producers for the short, medium and long term. We have deep relationships with them. And as our packaging business grows, we call off more paper from the increasing supply. And that gives us – I mean, certainly, demand has given us a very – very secure supply.

Now going forward, we expect, as I said, more capacity to come on stream, particularly around Germany. Hence, we have a short position there because, why build our own assets when we can just – we can buy the paper? And as you know, the German market is probably the most, well, it is certainly the most cyclical market. But elsewhere, we have invested in paper assets and we continue to invest to keep them in the – producing the right grades that we need. We have disposed of De Hoop mill because it's a non-core asset, it makes heavy grades, it’s not part of the future. There's plenty capacity coming on stream. So, again, you know, as I said, we've put a capital allocation out of De Hoop into the packaging plants. But at the moment, we're calling off the paper that we – that we need to supply our customers. Thank you.

Operator: The next question comes from the line of Lars Kjellberg, from Credit Suisse. Please go ahead.

Lars Kjellberg: Thank you, and good morning. I just wanted to put some extra colour of what you just said about paper availability. There's been, of course, all sorts of article talking about very tight supply that is equally driving prices in a very, very strong way. And of course, there has been a huge amount of capacity coming on, but operating rates are extremely high. But what you're saying is, you are comfortably supplied. Does that mean that other players in the market aren't getting paper because you've contracted the volume? So how should we view this, or are you saying the market isn't tight?

Miles Roberts: No, Lars, I mean, we see the paper market as a market overall, is extremely tight. We've seen numerous price increases going through on paper, and I wouldn't be surprised, although I'm not saying that will happen, I wouldn't be surprised if they were further increases, because it is so tight. What I'm saying is, whilst the overall market is tight, we have deep, long term relationships, we've contracted to take certain supplies, and then we have floating arrangements as well.

So, the price of paper has been going up, but you know, we continue to pull the paper that we need, because we are, I think, probably the world's largest buyer of paper, and we continue to grow, and our supply chain wants to work with us, I mean, it's no different from calling off on inks or, you know, start suppliers, et cetera.

So, I really can't comment on what other people are finding and how they're being supplied, but you know, I mean, you know, we're very comfortable with where we are, to always – every now and again, there can be some issues. A few issues with transportation over the last couple of months – and of course, a few very short term logistics issues. But in terms of the paper, we know we have – we continue to get what we need. Absolutely.

Operator: The next question comes from the line of Michael Doepel from UBS. Please go ahead.

Michael Doepel: Thank you. Good morning. Just a couple of questions. Firstly, on the demand side of things, I would you like to ask about e-commerce, growth trends that you see right now, in Europe, how are things trending there? I would assume that the comps are perhaps becoming a bit tough there, but if you could talk a bit about what you see in terms of e-commerce growth trends in Europe, and your expectations going forward. Also on the growth aspects, and secular trends about the plastics to paper substitution, how much incremental growth would you expect that this trend could bring to the market, and to you, over the next couple of years?

And then finally, on the containerboard markets, what kind of an export-import dynamics are you seeing in Europe right now and how is that impacting the market? Thanks.

Miles Roberts: Thank you, Michael. E-commerce, we had a sort of a capital markets evening, a few months ago where we were talking about this, and we said that we – during the pandemic with e-commerce, it's really brought forward a lot of future demand. But the actual penetration of e-commerce in retail, in the retail market, was something that we absolutely expected to get to, just got there a little bit earlier. And we said that we expect e-commerce to continue to grow even when the pandemic – the effects of the pandemic - have softened.

And that's exactly what we're seeing. We have some very tough comparators in e-commerce, but it's continued to grow, not at the same level as it was during the height of the pandemic, but it continues to grow. And I think, you know what we really try to bring out in that capital markets evening is, yes, you've got the big e-tailers, you're very successful, but you have the branded companies, are setting up their own e-commerce operations. They want to have direct access to the consumer.

We're going to see a long term move, particularly in convenience shopping, into e-commerce, which is, why go to the high streets unless it’s for more of a sort of an occasion. And that continues to drive the growth. So the big e-tailers have done extremely well, and I'm sure will continue to, but these branded companies and the smaller start-ups, we've seen very strong growth there and that continues to grow.

And when we look at the trends, and just coming on about the cyclic trends in plastics, the whole sustainability debate, particularly in the recycling angle, that circular economy, has significantly moved up the agenda. When we look at our larger FMCG customers, we feel that we're in a very special position being Europe's largest recycler of fibre, you know, with extensive operations, we can show them how we pick up all the old refuse and it's all recycled using our own infrastructure.

We are trialling with some customers how we actually can look at their actual packaging and where it actually goes and how that's recycled, and we've seen this whole sustainability angle, particularly the circular economy, really rise up in all of the renegotiations that we've had. Whereas before, perhaps it was number three or four on the agenda, now it's number one on the agenda.

And we're seeing one of the reasons we've been growing I think so well with a lot of our large customers, taking share of their business and longer term contract, is because of this move to a greater focus on sustainability, particularly that circular economy where I think we're so well positioned.

In terms of plastics, yes, there's a lot of discussion about plastic replacement, we have certainly seen that increase, we've got some really great new products that are coming onto the market and you will see them over the coming months. Some really big branders are coming out of plastic containers. It's really very exciting, indeed.

And we anticipate that the plastic replacement could ultimately mean about a 10% increase to the volumes of fibre based corrugated packaging over the coming years. And then just lastly, in terms of the import and export, the paper market is very tight. Exports of paper from Europe and I'm including Turkey in Europe, I don’t know your jurisdictions, but I’m including Turkey in that, we have seen that still some quite large exports go into the Far East, particularly, Turkey and some of the new capacity there.

From Europe, it's obviously, the exports obviously hit, are lower where it's more of a sort of spot arrangement because of the increase in price in Europe. So overall, you know, we see less supply to the Far East at the moment, despite good demand from, sort of, central sort of Europe. But Turkey does continue to supply some quite large volumes are still going out there. But the demand is – the demand is very strong.

And then from the US, on Kaf, the demand is very strong, but the volumes are very contained, the volumes are tight coming out of the US into the Far East. Thank you.

Operator: The next question comes from the line of Sam Bland from JP Morgan. Please go ahead.

Sam Bland: Hi, good morning. Can I ask two questions, please. The first one was on cost inflation. I think OCC is obviously the most obvious bit, but could you talk about how much cost inflation there is, from other cost lines, whether it's in transport or energy or anything else?

And the second question is on volume. If you look at your volume versus, let's say, 2019 levels, have you seen any slowing in growth, versus that 2019 baseline yet? And if not, do you think you could be taking some market share there, you know, some market data have maybe said the market's starting to slow a little bit. Thank you.

Miles Roberts: I'll take the volume in 2019, can you talk on the cost?

Adrian Marsh: So, yes, on cost inflation, I think it's impossible to give a specific number. But you're right, in terms of energy cost year-on-year, they're higher and you can see the market indices of those, and we'll be no different, other than obviously, and you can see from our annual report, you know, the amount of hedging we have against energy. So, we do have protection there, but we're not immune to the rise in prices.

The bigger issue now is particularly distribution, transport and logistics. In UK, there's a national extreme that you can read in every newspaper at the moment. In some ways, we're very fortunate having our own fleet. But, you know, clearly there's a national shortage of lorry drivers. You know, we've got a very good logistics team and we're working around that. But again, we're not immune to it.

In Europe, again, across Europe, there's an issue, it's not as extreme as in the UK, and then in North America, we're also seeing, you know, significantly rising logistics costs. We manage that through our usual pricing mechanisms, as you would expect, but they would be the main two that I would call out year-on-year, energy and logistics. But across the supply chain at the moment, there's a global shortage of products and we're seeing that filter through and that's what's resulting in our higher pricing as well in terms of box prices.

Miles Roberts: On the volume, again, it's very interesting, and the devil is really in the detail here. We continue to see very, very strong demand. We are very focused in the FMCG sector, and we can see that demand is really, taking a greater share of our customers' business, but also our customers growing as well. If you look at the industrial sector, which is smaller, there's very strong demand there, however, some of that sector are having their own supply chain issues about getting components, et cetera. So there's a bit of a sort of a clogging in some parts. But when we look at our business, which is so much in FMCG and those big customers, we aren't seeing a slowing in demand, it remains very strong. But I can understand why some piece, some suppliers may be feeling that their industrial customers could be – could just be suffering from some of the supply chain issues that are out there. I mean, this is a completely separate sector, supplies in the car industry and their supplies are down. And essentially, those car manufacturers are at the – after well-publicised issues. I mean, it's fantastic consumer demand, but a bit of sort of – a bit of friction in their supply chain. Thank you.

Operator: The next question is a follow up from the line of Cole Hathorn from Jeffries. Please go ahead.

Cole Hathorn: Good morning, thanks for taking the follow up. Just one quick follow up on the first question on – sorry, on the second question on containerboard supply. Could you just give a little bit of colour around how you secure some of that supply?

Is this offtake agreements that you've agreed with some of these independent mills that give you security of supply for the exact right types of paper that you need for your various box plants? Is the first one.

And then just following up on the last question around the industrial recovery. Are there any areas where, you know, if there is supply chain issues, there is an opportunity for you to expand that business? Or do you continue to remain focused on the FMCG side of things? Thank you.

Miles Roberts: with our paper supplies, we will be discussing with them our needs of paper for many years in the future, I mean, it can be one, two, three, four and five. It's not a sort of guaranteeing that, but we'll be talking to them. And on the back of that, a number of those customer – a number of those suppliers, have invested in new capacity, and indeed in some of these suppliers, we can take 40% of their outputs, some very, very high percentages based on the long term commitment, a long term relationship and understanding of how we work. And it's worked extremely well for us. A lot of these suppliers, particularly in Germany, have a very, very low cost of capital.

They are happy to invest in new plant, machinery and paper making at returns that our shareholders wouldn't be very, very happy with. And we call it off. I'm thinking about one particular supply coming on stream at the moment, and we first discussed it with them four years ago. So it's all about that. And we're very happy with that, indeed, I think it works extremely well.

And in terms of the industrial, you know, for us, last year, during COVID, our volumes increased by 3.5% in our last financial year. That was a full year of COVID, you know, we had a whole 12 months of it. It's not as if you've got a calendar year end where we had a few months without COVID, we had a full 12 months and our volumes were up 3.5%, but the FMCG sector never stopped growing. One quarter to the next, the next, it was always positive. So when we look at our business, we remain convinced that our best opportunities for our shareholders, to secure that, you know, the volume and getting the right sort of the asset utilisation, remains in the FMCG sector.

Now we do obviously work in the industrial sector, that's using some spare capacity that we may have at any time. But you've seen that just shrink as a proportion of our business as the FMCG has grown, and I expect that to continue roughly 80% in the FMCG, and I wouldn't be surprised over the next few years that got up into the 90%s. Thank you.

Operator: We have another follow up question now from the line of Lars Kjellberg from Credit Suisse. Please go ahead.

Lars Kjellberg: Thank you, I just had two follow up questions, one being, Miles, if you can put a bit more colour on what you said about sustainable packaging. You talked about 10% over the next whatever period that was, if you can sort of lay out what sort of period we're looking at, and number two, are you actually – that's the first question, combined actually, the sort of growth contribution in the current fiscal year, is that actually sustainable packaging contributing or we're going to see that really coming in at a later stage, given the tightness of the market? And plastic seems to be in good demand as well.

The second question relates to OCC, as the biggest European recycler, what are you seeing in those trends? Are we seeing a stabilisation there, and what is your best guess for over the next three to six months for OCC? Thank you.

Miles Roberts: Thank you. When we talk about sustainable packaging, that's about re-use, it's about recycling, it's also about plastic replacement, but plastic replacement is just one part of it. It's a much, much broader discussion with our customers. And in fact, they would argue that the biggest contributor, an equal contribution to carbon reduction is in greater recycling of the existing of packaging.

The Ellen MacArthur Foundation has shown that half of carbon reduction can come from much better recycling rates, more efficient recycling, and we certainly support that conclusion. So when we are growing with our customers, the whole sustainability debate, frankly, that's what they're talking about, how can they ensure that their packaging doesn't end up in a beach in India or Thailand? How can they show that it is being reused, recycled, and the carbon effects of that? And because of our positioning, and our technology and as you know, we've been here for many, many years, we are only a fibre based business, we don't do plastics, I think our expertise in this area, is certainly being recognised by our customers, mainly the larger customers, as they move that whole sustainability debate up the agenda. Plastic is obviously a very visible part, and you know, there's a long term problem with plastic that we all know about.

The 10% increase in fibre based packaging, to replace plastic comes from our look at five particular segments within retail. And if we were to replace those current plastic solutions with fibre, it would take 1.4 million tons out of plastic, into fibre, and that translates into about a 10% increase in the volume of fibre. It's called The Tipping Point, we've got a whole study on that that's been independently reviewed and commented on, it’s on our website. The timing of that really depends on – partly on our customers. We haven't given a timeframe. We think that it's probably going to, you know, it's not – it's going to certainly be in the medium term. And I think what is encouraging is, some of the new European legislation on plastics and single use plastics, the taxation there has certainly started to level up the costs between plastic and fibre, so that's where it comes from. Yes, that's – retailer pressure, that's where it comes from, but the reports are on our website. Thank you.

On the OCC, forecasting these prices is – my goodness me, I think, when we look at ourselves, we think they're probably going to be broadly stable for the rest of our financial year, so over the next six months, probably broadly stable, but that's our sort of central view. I have to say they are higher than we thought they were going to be, but our view is stable, towards the end of the financial year maybe moderating slightly. But that's I, you know, it's extremely uncertain, extremely uncertain to – but that's kind of where we are.

Operator: Our final question comes from the line of David O'Brien from Goodbody. Please go ahead.

David O'Brien: Good morning, guys, thanks for taking my questions. Just three for me, please. Firstly, could you put some numbers, please, around the volume growth experienced in the first quarter, just to give us a sense of what the momentum is like. And similarly, on corrugated box price, what has the either sequential or year-on-year improvement of box price been heretofore? And how has the experience varied between indexed contracts and open market negotiations?

And then finally, look, clearly, you're flagging a challenging cost backdrop. When I think back to the full year results, you were calling it a nice sequential improvement in the margin into the second half. What are you still doing in terms of margin for the first half of 2022? Is there still improvement there because box prices is coming through, or should we be taking a little bit of a step back?

Miles Roberts: Thank you. Look, our Q1 volumes were very strong. They're well up in the double digits in a Q1 – on Q1. And it really builds on all the momentum we saw in the last financial year or second half was 8.2% like-for-like volume growth and it's obviously continued to accelerate, as you move through the year, obviously you get some tougher comparators.

The corrugated price increase have been going very well. We're very pleased with that. You know, it depends when your sort of start and end point is, but it depends on the market. But you know, we're now – you know, every quarter, prices are going up, and they're going up actually on the market by around about 5%, something like that, as each quarter rolls through.

And depending what happens on the price of paper, you know, up until the end of the first quarter, we were looking to get box price increase of sort of 10% to 15%, something like that. If paper rise again and you can – you can put further increases on that. You know, I won't be surprised, but it's going very well. It's on the obviously on the price of paper, but we're also negotiating other further increases for other increasing costs such as transportation. So, you know, the recovery is going well.

And obviously in terms of profit, then we do expect to see a significant, a very significant improvement of profitability this half compared to the first half of last year, very significant. Further increases on the – for the reason we talked about, you know, the volumes and the pricing et cetera. So we continue to see very good profitability coming through and we haven't changed our outlook for the half of the full year, despite all this increasing costs because of the price recovery, and the strong volumes.

Operator: Okay. So we have reached the end of the Q&A. So I'll now hand back to Miles, for any closing remarks.

Miles Roberts: Just to say thank you very much for your time today. As I said, I'm very pleased with the progress we've made during the year to date. It's really built on our strong customer relationships, excellent volume growth, and good progress in recovering the increasing input costs. Thank you very much for your time.