DS Smith Half Year Results
Conference Call Transcript

Speaker key

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OP	Operator

MR Good morning, everybody. Absolutely delighted to see you here. We appreciate the time that you take to come listen to our half year results and an update on our strategy. To those who are new, I'm Miles Roberts, the CEO, and I'm joined today by Adrian Marsh, our new Finance Director who will be presenting all the numbers and also joining me in questions afterwards. As you know, health and safety is at the top of our agenda and we aren't expecting any fire alarms and for the sake of Adrian, it's his first time here, I'll repeat my joke. If the fire alarm goes off, follow me out. And thank you for the laughter.

Right, so we have the results for the six months to the 31st October. If you remember, we acquired SCA back in July 2012 so, obviously, we have a full six months of the results. And what are the results? You've obviously seen the announcement but cutting to the chase, they're sustainable results and they're strong results in a time when Europe's very difficult. So we're pleased with them. They're absolutely what we expected to deliver and they've been delivered. Not only are we delivering the synergies but we're starting to see top line come through. We're starting to see the growth – organic growth – coming through, but it's still early days for us. We're still really binding the organisation together, not from our perspective, but from the perspective of a customer and what the customer sees and the absolute seamlessness between the new companies. Now, they're starting to reward that with accelerating organic growth.

But, frankly, it's based on our business model: fibre-based packing is taking share, recycled packaging is taking share within fibre-based and we're taking share within the recycled market. We are focusing in the areas that we believe, structurally, have the most attractive growth prospects for our customers and so we have an unmatched, unique offering to our customers in our industry – there's nothing else like it – based on understanding of our customer; a real understanding of the issues they're facing. Our pan-European approach, reaching into all the markets that our customers work in, those new areas that came to us with the SCA acquisition and you'll see in our investment, we're really building a very, very strong asset base. We've never taken our foot off the pedal. We continue to invest in our business and we're seeing the benefits of those assets coming through.

So the strategy is working and you can see that our earnings are up 30% and our dividend up 28%. But when we look into the future, we do expect Europe to remain very difficult; maybe a little bit more positive than it was six months ago but we're all dancing around that zero percent. It's difficult and will remain difficult but we're positive in our position because of that focus in the growing areas, because of the uniqueness of our offer and the responsiveness of our customers to it. As of today, we have a very positive outlook for the future. Adrian.

AM Thank you, Miles, and good morning everyone. It's a pleasure to be here today presenting the results for DS Smith for the half year to 31 October 2013. What I'd like to do is, first, run through the numbers, then, as this is my first time presenting DS Smith results, to take a few moments to offer some of my initial observations. Most of you are familiar with these five financial metrics that we set out three years ago as the key financial measures that we should be judged by. These measures were valid then and remain valid now. Our ability to achieve volume growth describes our winning in the marketplace. Our return on sales is a measure of both our efficiency and our added value. Return on capital employed describes our ability to deliver above our cost of capital. Cash conversion represents our ability to create liquidity to grow the business. And the net debt/EBITDA ratio is the expression of our leverage.

I'm delighted to report that, once again, we've delivered on every one. You can read all the figures but the ones I'd particularly highlight are volume and ROACE. Volume has been very strong; well over our GDP + 1% target. This gives me real confidence we're winning with our customers, gaining market share, particularly in the new markets opened up following the SCA acquisition. For ROACE, we're within our target range despite the initially dilutive effect of the SCA Packaging acquisition. And, for me, the most important thing about the fact that we've hit all our targets is that we believe that this performance is sustainable.

Moving to the financial highlights, the income statement is strong and does include the effect of this period containing the full six-month contribution from SCA Packaging compared to four months in the prior comparable period. FX for the first half has been favourable and operating profit is up 31%, which also includes a margin improvement of 40 basis points. This uplift in EPS then flows through to the dividend which I'm delighted to report as 3.2p, which is 28% up on last half year. You can also see a 30 basis point improvement in ROACE versus a pro forma figure to 31 October 2012.

Looking at the revenue bridge, you can see the contribution from the extra two months of SCA Packaging and, as I mentioned earlier, the real headline here is that we're gaining volumes in corrugated packaging at a faster rate than even we anticipated. At the same time, we can afford to be selective in our business and have ceased some production and not renewed some unprofitable contracts. Going to the profit bridge, you can see, again, the impact of the acquisition. You can also see the headwind of increased input costs that we're still working hard to recover. This lag in recovering costs, whilst totally expected, has impacted our profits by approximately £15 million in this period. We've been able to offset this through realised synergies and the net effect of volume lost and gained has driven a very strong result for the period, considering the challenging market conditions; with further benefits from a positive foreign exchange effect, as well.

Turning to the individual divisions, as a reminder, where we have paper manufacturing, it's our aim to utilise the output as effectively as we can within our packaging business. In this particular period, with paper prices rising and a lag in recovery in packaging, there will be a more positive result in some regions than others. The UK has seen an improvement in margin, principally due operational and market improvements in our paper business. Whilst it's still below where it should be, we're encouraged with the direction of travel. It's worth remembering, though, that that UK has not benefitted from any of the integration synergies and has, indeed, had to weather the impact of the post-acquisition remedy disposals. The operational efficiency work in Kemsley mill should ensure this margin improvement continues in the second half.

Western Europe has seen some margins increase modestly as synergies have come through, which has broadly offset the lag effect of paper price rises. Volumes have been flat, reflecting both the overall difficult trading conditions and some specific instances of dis-synergies which were anticipated at the time of acquisition. By contrast, the performance by DACH, Northern Europe, Italy and Central and Eastern Europe has been impressive by any measure. In DACH and Northern Europe, volumes are strong and this has been accompanied by growing margins. We've been winning with our customers and I know Miles will want to talk more about that later.

In Central Europe and Italy, again, volumes have been good and there's also been a modest improvement in margins, reflecting strong market share gains together with a good paper performance. In plastics, the results are a little mixed. The rigid plastics business, based mainly in Europe, has had a very good year so far. In liquid packaging and dispensing – LP&D – after several years of good margins, there's been a small number of one-off events that have modestly impacted the growth we've previously been used to. We don't expect these to recur and, at the same time, we're undergoing a reorganisation of our European manufacturing operations to improve profitability and restore margins to the levels we've used to.

Turning to free cash flow, you can read the numbers on the page and in our statement. I would, however, like to draw your attention to working capital. The working capital inflow last year was substantial and against a backdrop of paper price rises and increased volumes, to have achieved another, albeit, much smaller inflow is still a tremendous achievement. The proportion of working capital to revenue has decreased once again to 3.6%, which is well beneath our target of 5%. Net debt has decreased to £773 million, resulting in gearing multiple of 1.9 times EBITDA for the last 12 months. Again, this is well within our target of being less than two times and demonstrates our commitment to prudent balance sheet management.

On technical guidance, these figures are consistent with previous guidance. Capex has remained around £160 million including investments in specific projects supporting our pan-European customer offer and this is some £30 million ahead of depreciation, which is about £130 million. Our effective tax rate will be on or around 23% which, again, is a slight improvement from last year and mainly reflects the lowering of the UK tax rate. And we anticipate our second half total finance charge, including IAS 19, to be broadly similar to that of the first half.

The group has built, under Miles' leadership, an impressive record of sustainable returns within the parameters of our dividend policy of a 2-2.5 times dividend cover. For this period we're announcing an interim dividend of 3.2p per share, which represents an increase in the prior period of 28% and, again, you can see on the graph the continuous growth over the period. Outlook: we've delivered a robust performance in the first half of the year and we are comfortable that we're well placed going forward and that's in the statement you've seen already.

So, a little bit on my first thoughts. A number of you have already asked me this, so I apologise if I'm now repeating myself. I joined DS Smith at the end of September from Tesco. Tesco, despite its own challenging market conditions, is a deeply impressive company, one which is built around the quality of its people, strong leadership and providing innovation and value to customers. What impressed me the most about DS Smith, prior to joining, was the absolute drive and passion that Miles has to create a truly European business that provides both innovation and value to the most demanding of customers, such as Tesco. Actually, I can remember speaking to a senior commercial director about DS Smith when I was thinking of joining and his assessment was that DS Smith is a fantastic business that really gets it and understands how to build genuine mutually beneficial relationships and I can assure you, if you know this gentleman, you'd realise that that was praise, indeed, and the highest possible compliment that he could have given.

Since joining, I've not been disappointed. There's no doubt that Miles has created an environment to match the very best of companies. Employee engagement is high, there's a palpable service culture and a serious investment in R&D. Those of you who have visited our Innovation Centres will know very well what I mean. What you probably are less aware of is the absolute dedication to reducing accidents and improving service levels. Our strategy on being fully committed to investing in and building out the business and staying totally focused on Europe is resonating with our pan-European customers. The innovation which then gets created and shared with our customers is, from my perspective, an enduring business model that will deliver sustainable results.

The business drivers and key targets have been well-calibrated and there's no doubt there's a culture here of delivery. I've reviewed the corporate plan and ambitions for the business and can confirm I fully intend to keep our focus on capital discipline. To me, this about improving capital efficiency and our asset turnover and remaining focused on working capital. Whilst our working capital ratio and performance isn't bad and may well be first class in packaging, we're still well short of best in class for other industrial companies, so there's still improvement that we can get in my mind. We'll keep our focus on capital structure and ensuring it's fit for purpose and efficient at the various points in the cycle. Right now, I believe the focus needs to remain on deleveraging and creating headroom for growth. Our ability to further improve ROACE will be a key metric in demonstrating our ability to deliver sustainable improvements in shareholder value. I believe the short paper model adopted by DS Smith will prove itself and allocating capital to paper production would, in most years, prove value destructive. Capital allocation for us is key. We have a robust process whereby divisions compete for capital with allocations based on delivering challenging targets and sustainable returns.

Looking at our financial resources, as I mentioned, I've looked closely at our capital structures and sources of liquidity. We will continue to work hard to delever and create headroom to prudently finance growth opportunities and also to make sure that we can access the full range of capital markets. To this extent, I can confirm our leverage targets remain as previously stated and our intention is, in the absence of making further acquisitions, to continue to delever and demonstrate our good investment grade credentials.

Lastly, I want to briefly touch on operating efficiency. I've been really impressed with the SCA Packaging synergy programme. Synergies were comprehensively identified, plans drawn up and then fully implemented. These programmes are continuously measured and management are held accountable to deliver to their targets and that they most certainly have done. Whilst trying my best not to sound too Churchillian, I think we're now broadly at the end of the beginning. The synergy programme is embedded and truly part of business as usual. What I will now be doing is taking a good look at our infrastructure, organisation and costs and, again, I well realise that many a CFO has regretted making similar pronouncements in other companies and I'm keen to avoid setting any expectations here. However, it's not surprising that when two small business form to create a big business, there will inevitability be opportunities to do things more efficiently and effectively and we're no different. So this will not be another big bang programme but will be a systematic effort to optimise our G&A costs in a way which supports the ambition of the company.

So, in summary, I'm really fortunate to have worked for some truly impressive companies and I don't believe DS Smith is any different and I'm very excited about supporting Miles and the rest of his team in the next stages of our journey. With that, I'd like to hand back to Miles who's going to talk more specifically about how we're going to that and deliver our strategy.

MR Thank you, Adrian. So, about our strategy: you've seen this before because the strategy remains the same and it remains the same because it's working. This is our journey so far as we seek to create a business that every year generates above cost of capital returns. It grows ahead of GDP and it builds its return on sales. The short paper position; absolutely no doubt whatsoever for our shareholders, is delivering value. The long recycling, nearly six million tons we collect and deal with every year; long, long recycling position, unparalleled in the industry is adding a lot of value, and a wonderful packaging business focused on the FMCG market; we're starting to see that come through. So the right mix of business and then how you differentiate yourself, how you're able to add value to your customers that other competitors are unable to. That starts with an understanding of your customer and we're going to talk a lot more about the uniqueness of our offering.

But, before we do, let's just have a look a little more about the market share gain because we are very focused here on the financial results of the half year. But I would just like to talk about all our stakeholders because this is about the sustainability of the business model. If you're going to make long term, sustainable return to shareholders, you've got to get all of your stakeholders happy. It's easy to disadvantage one stakeholder to the advantage of another but it's only going to be short term. How often do we see companies pulling back on R&D to flatter the short term results and then 18 months later they find themselves lagging in their market share? Or where employees aren't engaged. Fine, you get a short term benefit but, again, you start to get industrial disruption later on.

But at DS Smith, we're very focused on trying to get it right. So, in terms of our people, our engagement is working very well. Our absenteeism is down. The health and safety, a key metric for us, another 35% reduction in the accident rate. We're investing heavily behind this. We had over a 30% improvement last year and a 30% improvement the year before. We're now getting down into the top quartile performance and that's across the group; that's every acquisition that's come in. We've made a huge difference to the accident rate. For our customers, our service and our quality, we're investing behind those as well, so we're measuring the quality, parts per million, we're seeing a significant improvement in that and on the environment, whether it's water, whether it's CO2 or landfill. Again, all of those measures are moving in the right direction so we can hit our target of another 20% improvement. Behind the market share, we believe we're trying to get all of our stakeholders comfortable in the direction we're going in.

When we look at the market share, it is 2.2% growth. Remember, last year it was 0.6%. For the previous 12 months where we brought in SCA, we grew market share, we grew our volumes despite the two businesses coming together and the overlap and we're now starting to see that accelerate. I believe it does come from increasingly getting towards our objective of really being the supplier of choice. It's the supplier the customer wants to come to because they know that we'll understand the challenges that they face. Many of you have seen our wider management team at our capital markets day. Look at the companies they've joined us from. They come from our customers. They understand what they're after but we need people who can take that experience and gel it will the packaging business. Understand your customers' problems because that's where the value is. That's what they want you to solve. You solve it, they'll pay you for it. It's as simple as that.

We have seen the GDP markets grow 0.3%. Last year it was slightly negative. This is the bouncing around the sort of zero percent. There's no doubt that the UK is picking up a bit. France is difficult. Germany is a little bit positive But Italy and Spain, etc, are pretty flat and we expect that sort of environment to continue. So we're seeing GDP come up. We're seeing fibre-based packaging grow ahead of that, as we expected. But then you're seeing recycled grow within fibre-based and DS Smith take that leadership position.

We're going to talk now a little bit more about why this is happening. These are our three circles. You'd have seen them before, the same circles, because this is a consistent strategy and we believe it works: focusing on the service and product innovation; focusing in areas where we're unrepresented, Germany and Central and Eastern Europe; and then focusing where we've got a structural advantage on pan-European and FMCG, an unmatched position. Let's just talk about the service model. This is about understanding our customers. It's not just about the box. When you look internally, we can make wonderful boxes. So can other people. It's easy. It's internal.

It's understanding the external environment that's important and we show here the supply chain that our box goes through. It's a wonderful product because it touches every part of our customers' operations. In fact, it touches more parts than their product does. This is critical to our customers; getting their product used, displayed in the shop properly, getting there in perfect condition.

We put a few quotes up here from our customers. Nestlé: it's essential to reducing food waste. Unilever: good packaging design helps use a product efficiently. And, obviously, Danone looking at the upstream and downstream capacity. But let me just bring this to life for you because at one of those customers they were talking about the supply of new boxes and we said to them before you look at the box could we look at your line run speeds in your factory which the boxes flow through. So we had a team there for three months and we worked with them and they were so surprised at the results they then moved that throughout some other parts of their UK operations. So we said to them, the single most important reason for your lines to stop running in your factories is because the boxes jam in your production line. And do you know the cost of your lines breaking down because of the box, the cost of that loss of production is more than the cost of the entire packaging. So we're standing here asking for a few percent reduction, yet you're wasting more money than the total packaging in your line. They hadn't looked at it.

They went away and did a worldwide study and they came back and said the bad news is, DS Smith, you're wrong. The box jamming isn't the single most important reason, it's actually the second most important reason, globally. But you're right in that the cost of that breakdown is more than the cost of the packaging. Then they said they'd rated all their suppliers and they said their best supplier globally for quality and the lines not jamming is DS Smith and, in fact, the factory they have that's the very best supplier to them in quality is a DS Smith factory in Fordham, a factory that many of you would have been to. This is just one small example of understanding where the value is in our customer. It's so much more than the box and we have an unparalleled position there. You run through that supply chain and I'm going to talk in a little while about the co-packing; the huge cost that our customers incur in packaging the product ready for display and the customer; and, at the end, that recycling. We're simply the only supplier who can do that. So let's talk a little bit more in detail.

We're growing in recycled and this is Nestlé. Don't forget Nestlé have said we are their number one supplier in corrugated; not by volume, this is on the quality of what we offer them. That's their criteria, their reward and that's what they give us. We are a recycled packaging company. That is their statement on packaging. They want recycled. If you're not in recycled they're not going to be very interested. The supply cycle thinking: box through to paper back into recycling. We're the only people who offer that. There's nobody who's thought to offer it, but that's what they want. It's understanding your customer. What does this mean in terms of how we can adapt our model? Well, because we're short in paper, we can shift the grades we use. Recently, Kraftliner has gone in price. That's simple. We're going to switch 20% of our Kraftliner usage into testliner; it's all recycled. And it will never come back. So we've shifted 126,000 tons. We're Europe's largest buyer of kraft paper and that's accelerating now into recycled. It adds value for our customers. We don't have kraft and that builds our market share.

Developing our network of design and Impact & Innovation Centres; this is how we get our innovation to the marketplace. We want no customer to be more than a two-hour drive from a design centre that has all of our systems; the design teams that will help solve the customers' problems. We have 15 and we're expanding to 30. I think it will go beyond 30 because the value we create from them is so strong. And on the Impact & Innovation Centres, again, a number of you would have seen these up in Ely. We have three, we're going to ten. I actually think it will go further than that. These are our own supermarkets that we set up. Our customers can see how their product is working in a supermarket. It's our supermarket. They're our shelves. It's their product. We show how it works. So how do we get the route to market? On a scalable innovation, R-flute, we've rolled it out now in the majority of the ex-SCA business. That R-flute saves 20% on distribution cost and 20% on warehousing to our customers. That's a huge cost for them. The distribution can be 15% of the total cost of packaging. And increased R&D investment. You can see our margin progression. You can see the synergies that we're spending more on R&D than the two companies did before hand.

So what does this mean for a customer? I've taken an example, here, of Nestlé and here you see this is a Point-of-Sale display. These are becoming increasingly important when you go into a retailer. So you walk in. It's all about that Point-of-Sale. How the product appeals to you. These are becoming a greater and greater proportion of our customers' sales. And we talked to Nestlé about this. Their biggest issue on this display is actually putting the product in the display. So if you go back to that supply chain, this is all about an RDC – the regional distribution centre – and the co-packing cost. The total cost of the packaging here is about £1 million a year. It's not a particularly big contract but it's a very nice contract because in one small element, just the cost of co-packing, working with them, understanding their problems and designing a product because we have the people who come from the customers, we saved them half the cost of the packaging, just in putting the products in the right position. How you manage RDC's, let alone the lightweighting, let alone the R-flute, let alone the line run speeds, let alone the on-shelf display. You can start to see the value that can be create there. It's not just about the box. It's about the total supply platform.

And this is how we work with them. With Nestlé we split up the whole process. We allocated responsibility, every part of producing that display. You can see we allocated, right at the start, who was going to do it and you can see there's joint working, there is single working. It's an outstanding result in one of their top brands. Look at how their pet food has been growing for Nestlé. Look at Purina. Look at the way they're selling and the margins they're getting from that. I'd like to say we were the driving force behind it but I'd probably get into trouble for saying that. So that's that first bubble about understanding our customers' problems; the innovation and solution within a simple example.

Let's come on to our next about growing with our large customers. This is what our customers are saying to us. They are looking for leadership. It's very simple. They say we want leadership in this industry and they want it to support them across business. They're looking for best practice to be applied consistently across their operations. It's best practice – not the same box – it's best practice of how it's delivered, the line run speeds, how we monitor it, how it goes to shelf. They want best practice. There's a reduction in living standards in Europe. We read about it every day. The way you overcome that is through efficiency, cutting out waste. That's why they want best practice. They do want fewer, better suppliers. In more countries there is a consolidation going on at the moment. We are seeing it. The large customers using fewer suppliers, because it's much cheaper to work with one. You've got one design, one solution, one invoice plus; in terms of traceability, you only go back to one supplier. So the regional guys are really starting to struggle to compete here.

Building on existing relationships. So you've got to be there. You've got to be trusted and they want see that long term stability. I think Adrian outlined it in his presentation when he talked about our focus behind these customers in Europe. You look at investment that's going in. You look at our financial leverage, our long term stability. This is what they're looking for. As they reduce the supply chain they want more stability in that supply chain. That stability starts with a strategy. We're focused in Europe. They can see our returns. They see our financial leverage and they want to come behind this and we are growing with them.

Then, lastly, I'm going to talk about Europe, I'm going to talk about Central and Eastern Europe. We talked about it at our capital markets day. We said we're going to have a heavy focus here because these are predominantly the new areas that came with SCA. We should be able to do better shouldn't we? We set a target. We're going to grow, in the medium term, 5% volume organic growth in Germany and 8% in Eastern Europe. That's what we said and here are the first results coming out. This is Germany. The first bar that sort of drops below the line that was when we'd just bought the SCA business. And, in fact, if you got back to the previous quarter it would be negative again. So we've done a lot of work. We immediately rolled out R-flute. We immediately started working with our customers from the UK and France into Germany. So, almost instantly, we've turned that position round as their customers there started to come to us and that's accelerated. In the last six months we've had 8.5% organic growth in Germany and as the margins in the group are going up. This isn't about giving it away. In the last 12 months we've grown, organically, 6%.

This is a simple example of why. Pan-European customer; we work with them already in UK and France; they're in Germany and Holland; and they said, all right guys, we want the same. We want the same. People talk about the industry being commoditised. If it's commoditised why do they just want the same solution? Why do they want to just move you in immediately if it's just the same product? It's not just about the box. Intersnack, it's super business there. You see the Point-of-Display. You can see those chips – crisps, as we call them – which are, I have to say, very nice. Double-digit sales growth, even ahead of the 8.5% in Germany.

Then we come into Central and Eastern Europe. We've always done well here. In the first half we had a business there ourselves. We grew it 8.5%. As you've seen in our segmentation, growing margins as well. Historically, very strong but we've now been able to move into Hungary, Romania, Czech Republic where we didn't have a position and you can see that we started off slowly as we were bringing them around into our product range and now we've seen that accelerate. Over the last year we've grown it just over 3% but we're pretty confident we can get back to that sort of 8% medium term target, organic growth.

Here's an example of the reason why. It's Danone; Danone in Poland. Well, of course we've worked with them extensively in France. We're their largest supplier. France, Belgium, Holland, Germany and obviously now we've been able to expand our presence, a new factory in Poland. We've taken business there as well. These are well known products to us. It's a well known solution. You can see it's a stacking solution here. It's not about the box. It's actually the way that stacks so that when you put it in a lorry to distribute it, the stability of the load is very good. It's a heavy product because it has a lot of water in it, so stability in the lorry is very important. All those things interlock. They're quite expensive to produce but it means they can stack more on the lorry therefore they get more of the lorry filled. Transportation is a huge cost for them. The cost of that packaging vastly offsets the efficiencies they get in transport. Same solution across Europe. That's why we're growing through innovation and the service. This is why we're growing with the pan-European customers and this is why we're growing in Germany and Central and Eastern Europe. This is the position of our competitor base. It remains extremely fragmented. That place, that contraction in the supply chain and that fragmentation is something that we're very excited about.

So, in summary, you're seeing the efficiencies coming through on the cost space. We said we'll get the top line right. As always, in the background, we're starting to see it come through. We're seeing that organic growth through that service and product innovation. As I say, I'm very excited about that; the FMCG’s and the pan-European customers; Germany and Central and Eastern Europe. But we are delighting our customers. Our service and our quality is improving. The contact scores we get with our customers are improving. Our proportion of their business is improving and we're delivering on our financial results. So that strategy is working. But we're most excited about the future. We've got a great platform for growth and we're determined to use that. Thank you. Are there any questions?

OP Ladies and gentlemen, if you would like to ask a question please press *1 on your telephone keypad.

AM A couple of questions if I may, just firstly, can you comment on the relative performance FMCG and industrial packaging during the period? Is one notably stronger than the other? And, secondly, with regard to acquisition and your acquisition strategy, can you comment on what sort of balance sheet firepower you consider that you have and where are you focusing? I would assume Germany and Central Europe but if there's anywhere else.

MR If I answer the first part and Adrian will pick up the second. Just on our performance, I think that's a very good question because it's one we challenge ourselves on, in the company, quite hard because it's that word sustainable results. And, to be quite honest, if we'd recently been focusing more in some of what we think are more cyclical areas the growth could have been quite a bit higher but we purposely haven't because we think those sectors are inherently very cyclical so, for example, housing. There's no question housing has absolutely picked up but it's just not where we're focusing. We're seeing some pick-up, as well, in some sort of other quite heavy industrial areas. There is pick-up but it's just not where we're focusing. We just don't believe we'll get the return on capital there over the life of the assets, etc. So, for us, with our industrial base, yes, there's a pick-up but we're mostly focused in that FMCG sector. We're overweight in it. And this is food and drink. And, of course, people don't suddenly consume a lot more, unlike housing starts, etc. So, yes, industrial is up but I have to say we are mainly focused in the food and drink sector and so the growth has come from share builds and that shared build can be from replacing other formats, etc, predominantly in the FMCG and that's what we'll continue with. So, as markets remain difficult, things go up and down, we know we're going to be using our assets. We are a return on capital business. That's our primary focus. How do we make that return every year; every year above cost of capital; not through a cycle; each and every year?

AM In terms of acquisition firepower, I'm sure it will be no surprise to many people in this room that pretty much any bank that happens to walk through the door is happy to lend us money at the moment. We look at our balance sheet and we say to ourselves, okay, we've got a target of 2 times, if there's the right opportunity what could, again, a sensible capital structure move to in order to accommodate that? Well, clearly, around the 2.5-2.75 with a glide path down, wouldn't be unreasonable and I think would be very supportable by a banking group. So you can work the maths out. So I think, as we deleverage, we just increase and increase that capacity again. In terms of areas we're looking at, well, again, we're a European business. We're focused on Europe. You can work out the markets we're not in and you can work out the markets we need to increase our presence in and which are the highest growth to us and, clearly, that's where the strategy is sitting at the moment. So, there's a lot of opportunities. Miles put up the slide. Still highly fragmented in Europe. We're looking but it has to be on the right return. We're not just going to buy assets for the sake of it.

CO Hi. It's Catriona O'Grady from UBS. Three quick questions from me. Firstly, in terms of your pan-European customers, can you give any feel around what percentage of our volumes are now going to those pan-Euro players versus the kind of local players? Also, can you talk a little bit about maybe your e-commerce volumes in terms of the… because I understand that goes to the industrial side of things, so it will be interesting to see if you've seen a pick up there? And, finally, any more colour you could give on the licensing deals that you talked about at the full year results. Thanks.

MR The pan-Europeans, the truly pan-European customers, the ones that operate in a genuinely pan-European nature are about 25% of our turnover. Those that operate between two or even three countries you can add on another, broadly, 10% to that. It's not dissimilar, obviously, to the end markets and that's where we're underweight because if we're broadly in line in terms of those customers' penetration of the total market, if we're a pan-European supplier, we should be overweight there. And this is the legacy of having a more fragmented supply base but that's the opportunity. It's quite interesting. Your next question is probably going be where do you think you'll get it to? It's a question that I'm asked by my board; actually, a few times. We think we can drive that a lot further through a combination of being overweight because we should be because we've got pan-European supply, secondly, because they're coming to fewer suppliers so we think we can drive that quite strongly. And that is exactly what we're seeing; that consolidation.

On the e-commerce, it's quite interesting because we do include that in industrials because our strict definitions which follow into a definition that's used in the industry is that is part of industrial, so we can compare like-for-like. It's growing very fast. It is one part of our industrial sectors that we think are good news for our shareholders because the demand we get is not just growing. There's some very consistent categories in there. There are other parts of industrial where we focus on, as well, like spare parts for cars and pharmaceuticals. We're very sector specific in each region and some areas we're really not focusing on, some other areas we are focusing on more industrial but the huge focus is on food and drink. But, in those sectors we're focusing on, we are seeing growth; so car spares, spare parts, pharmaceutical and e-commerce. E-commerce is a really, really exciting area. They are ruthlessly efficient. They are looking for solutions that just aren't there at the moment and we're delighted about that.

Our largest customers in this area are the largest customers that you would expect us to have. We have a tremendous position there but the challenge for us is to add more value to that. There's a lot of value in the manufacturing and in their operations, how you actually wrap the packaging around different size of products so you don't get a big box with loads of packing and little pea in the corner in the product, so that it rattles around. You've got to be much, much more efficient than that. And why do need the same strength of box no matter what's inside? There's a lot of work going on there. But I still feel there's a whole problem – not problem – there's a huge opportunity in the display of the packaging when you receive it as a customer. When you go online and it's got, do you want to buy it, yes, do you want packaging? It actually has, as the packaging, it has do you want it first class or second class? It doesn't say, is this a gift? Do you want some fancy packaging here? Do you want to make it more of an experience for the person who gets it?

That's where we want to push them. We think it's good news and we think it's good news for us because there's much more value add at that customer end. We're also working with them on the recycling angle because what's happening is more recyclable material is being collected at home now. So our recycling position, we are pushing that more into the household side to make sure we can pick it up so that nothing goes to landfill; again, the only company that does this, who looks at the whole supply chain. How you actually capture that recycling position, as well. So, we're growing well. We've got a very good position, it is in industrial. I think there's a lot of opportunity there but it's an opportunity we really haven't fully exploited at the moment. It's a fabulous area.

And, on the licensing deals… Do you want me to take that, Adrian? On the licensing, we have licensed into this year another company called Rengo in Japan. They are the largest supplier in Japan. They're an absolutely fabulous company and they're using our technology, not only in Japan but also in some of their other territories, obviously all behind those global customers. As they say, we don't only want those solutions in Europe, we want them in the States. So, we've supplied the licensing to RockTenn and now we're licencing it in Japan, as well. So, we're building up quite a nice platform in the three economic hubs of the world in terms of consumer markets; North America, Europe and most parts of the Far East. We're now getting quite a sort of a very nice global position there on this technology. We're not going there but we're supplying it there because it's a further extension of that best practice and it's all about how their factories work and the efficiencies there and how they can exploit best practice, not throughout Europe, but globally. That licensing is in. We do very nicely from it because it's just a license income but the real advantage is, suddenly, it's our technology that's being used on a global basis and it's branded DS Smith. We're unaware of any other company that has that on a global basis, let alone between continents. And it comes from understanding the customers' problems. It increases cost for us but it reduces, massively, the cost for our customers and that's the kernel of it; absolutely fascinating. I sound about excited about that. I apologise. I do apologise. Three great questions.

BD Hi. It's Barry Dixon from Davy. Three questions, also, if I could. Just in terms of corrugated pricing, Miles, could you just comment in terms of how successful you have been in pushing through the recent increases in containerboard prices and maybe give us some colour around it by region? We're hearing that markets are quite competitive in Germany at the moment given the new corrugated capacity coming on there. And maybe a slightly related question in terms of the acquisition strategy, I presume it's going to be mostly downstream in terms of converting capacity rather than upstream. And then, finally, just a broad question. Just your experience in terms of the growth in the recent business and your day in Brussels in terms of the capital markets day. I suppose the question is how does the industry… or do you feel that this industry can get paid for the amount of innovation and development that you're actually doing and when should we start to see that coming through in terms of either the contribution in terms of the price mix in terms of the margins? Thank you.

MR Do you want to do the acquisition part, in terms of downstream? Yes, look, our results, as we say in there, we have suffered in those results from the lag in paper. It is the consequence of our business model that when paper prices go up, kraft prices, etc, it squeezes us. So the 40 basis points increase in margin is actually with that squeeze and Adrian highlighted what that squeeze has meant to us and we've suffered from that. I have to say, all as expected, but as you rightly say, we've now got to recover that. The recovery has started. As you know, we have quite short contracts, so that recovery is coming through as we expected. But, as always, it is a fiercely competitive market. There are many suppliers out there and the general markets are very difficult. If you're taking share, then other people are losing and that means they're facing a problem. In terms of pricing, we have had a headwind in these results. We'll see where paper goes in the future. As I always say, I have no idea where it's going. If I had to call it, I think it would probably be stable but it's notoriously volatile. The issue for us is the short recovery periods. That's what we focus on. So, whatever happens, our shareholders are only affected in the very short term. That's exactly what's happening and we are seeing the recovery coming through. It does remain competitive but we feel confident we'll get a full recovery.

That competitive position is exacerbated in some areas. You've highlighted one, Germany. There is new capacity coming on. If you look at the German market, I think the new capacity, there's all independents building it; predominantly family-owned businesses. There's been, in the last year, we estimate about an extra 6% capacity coming on stream in Germany. 6%; these are long term investments. If you look at the German market over the last five years, it's grown on average over the last five years, by about 4% or 5%, so you could say, 7%, that's a couple of years' growth. But it's very high quality capacity that's coming on. These are new plants. We've looked at those. I think, if you're in the more commoditised areas where it's just about the box, I think it's going to be very difficult. I think margins will be constrained because of this new capacity. But if you have some differentiation to your offering, like a pan-European basis, like understanding the full supply chain, understanding really where we can take out of this cost to our customers, I actually think the German market is a market that will respond very well to that, and we've seen that. So the new capacity is coming on. It will be difficult. We are growing nicely. You've seen our margins are going up. We don't expect that to stop but are fully aware, as we say, the markets remain very, very competitive. But it's just volume producers – it's volume – and we're moving away from that. So we'll just try and sort of sidestep them and I think we can do a lot there. Acquisitions?

AM Yes, so the question is are we more focused on downstream than upstream? Yes, is the answer. Clearly, when you look at businesses you can't always just cherry-pick out assets. So, if we came across a good opportunity that had a level of integration and was further upstream than we'd want it to be, would we walk away? If we could get good synergies, if it fitted strategically, if it was able to support a pan-European business, no, of course we'd look at it. But that's not the primary focus. The primary focus is looking at the businesses that will fit in with our short paper strategy.

MR And you asked a final question about growth and we set out here about our growth aspirations and what they're built on. We've talked about growing ahead of more than 1% ahead of GDP or 100 basis points more than GDP and starting to increase that headroom and that's where we remain. We think because of the offering, the understanding, the consolidation, we think that that's fully achievable and nothing that has happened in the last six months has changed my mind, notwithstanding what are obviously are significant competitive pressures. But, on the other side, the feedback from our customers is really interesting. We do all these surveys. We did the first one a couple of years ago. Apparently, it was first survey they'd ever been asked for; customer survey. It's very interesting what they say and we've basically been building on that. You saw at our capital markets day. You had a top customer appearing there and saying to everybody, we want leadership in the industry and we've had it from people who understand our problems. Our problems aren't about the box. They understand how the way it works. That's what she's saying.

The wonderful thing about customers, if you ask them they'll tell you because they're working with you, so they want you to improve. It's not like a casual relationship. They're reliant on you and they come and they give you this feedback. So now we hold regular customer hubs to tell what do they think? What are their issues? And they tell you. Actually, some of our guys now are going to some of their internal conferences – they're invited – and they tell them their problems. They talk about falling living standards and what they need us to do. And then we get into hubs with them. And they'll tell you what their problems are and where they're facing the issues. That example of Nestlé came out of that. It's not just about boxes, it's the whole supply base and that's, for us, the opportunity and that's why we're bring the people that we've brought in, that's why we're investing in this design centres, innovation centres, the marketing of the group. You can see some different colours on DS Smith. The first thing you think, oh crikey, they've changed their logo here but it's very important to us to actually make a very clear statement to our market of what we are and what we're trying to offer and it's been very, very well received. So that's where we think the opportunity is: solutions. Hector, and then we'll come over to you, Mike.

HF A couple on cash flow to start with and then one for you, Miles. Can you just say on the working capital, to start with, that you're down to, I think, 3.6%. Is that an enduring number because it's below your 5%? Are you going to reset the target? And where do you think you can get to? And then, the second one is on the capex side. You spent, I think, 55 million in the first half. It will still guide you to 160 million for the full year. Can you give us a pointer as to where that capex is going and what might be ahead next year?

AM In terms of do I think 3.6% is an enduring target to go for, generally, I do. I think that there's enough in the business to go for. Again, without wanting to use a previous employer too much, if you look at how Tesco manages its inventory and how its distribution operates it is, without doubt, the most efficient and effective system you can see anywhere in pretty much any company in the world; certainly in the UK business. I think we're now getting to a place where we've centralised a lot of our supply base and certainly our paper supply base and we're only starting to see what could be possible on inventory going forward. Where we're at our best on finished goods, we're excellent. If we would replicate that through the rest of the business, we'd be outstanding. Could we collect our receivables faster? Yes, normally. Normally, you can. You're certainly not going to be anticipating those to get worse. And, likewise, on how you manage your creditors. We are working hard on that. We continue to work hard on that. We sit one side of FMCG on receivables, which is never an easy place but we have other business, as well. So I think 3.6 is a pretty good outcome, don't get me wrong. I think we could do better. I think the target of 5% is sensible. For argument's sake, if there was a way of optimising through our supply base on paper, we might want to do something strategic on that at a point in time which could challenge, partially, the ratio. So, I wouldn't want to leverage it down for all of the wrong reasons but I think generally speaking, yes, we should be in a position to go at that and work out ways to sustain it.

The second was… what was the second question?

HF Capex.

AM Oh, capex. Why is going to be nearly three times for the rest of the year. Yes, it's a reasonable question that we've asked ourselves. Again, part of the success of our pan-European strategy and our customer strategy is we are, as we build positions with certain customers to look after more than single countries, we're going to have to put down some investment to support that. Part of the success of the business is that we're getting longer contracts, we're getting across more countries but it requires a little bit of an investment upfront. So, I'm reasonably confident we'll get to that capex target but it does appear slightly punchy when you think of where we are at the half year but certainly in the plans I've seen it unfolds.

MR If you go back to last year, the first half of last year was also not half of the full year. And that's on a pro forma basis, as well, so it's not untypical but it really is tied to other business coming in, etc.

HF The bigger question is do you see capex coming back towards depreciation in the next year?

MR It will come back to depreciation. It will come back but there's just some short term…

AM Our plan doesn't have it rising; put it that way.

MR No. It'll come back to down to the 135 level and we've just got this and next year but we recognise the question you're asking.

HR Okay. Thank you very much for that and, Miles, just, on you. You've described the revenue progression as accelerating. I think the trading updates that you've done through the course of this year, although you haven't had numbers, would suggest that the revenue growth has got a little bit quicker, sequentially, through the course of the period. Can you give us some ideas in terms of possible exit rates in terms of growth on volume and maybe a bit of colour by territories?

MR I'm going to have to sidestep this. How do we get round this question? It's been going well. It's been going well. You know, it exited at a higher rate than we started. We are in Europe. It is fiercely competitive. There are other companies out there. We're not talking about intergalactic or anything but it did exit at a slightly higher rate than the average. But Europe is a very difficult place. I think Adrian said, we have actually been better than we thought. The response has been better but we are conscious of the competitive environment, so we're not sort of charging ahead of ourselves. We're still putting a lot in to get the service and the quality, the systems in the business, the consistency in the sales team. So there's a lot to do. Then sometimes we hold ourselves back. We have an absolutely fabulous opportunity with a customer – I mean it's absolutely, unbelievable – but we said just hold it back for three months. Give us time to get those systems in place. So we are excited. It did end at a better rate. It is fiercely competitive, so we're not running away with ourselves but there is a positive momentum there. I think I've sidestepped it but given you some sense of the… it's in a good trend. Mike.

MM Mike Murphy at Numis Securities. Three questions, please: first one on the time of the savings. At the 60 million, are we still looking at 20 second half and then 40 next year and would expect that be equally split between H1 and H2? So, ie, has there been any change? Secondly, on Western Europe, can you just say whether these expected synergies and the exit from the lower margin businesses is now completed or will that continue into H2? And on the plastics business, can you say a little more about LP&D and that restructuring again? Actually, will that move out of Rugby and the European operation? And you've alluded to the profitability of the US business. Can you just throw some further light on that?

MR Do you want to do savings and I'll do Europe, the synergies and then do LP&D?

AM Just to slightly context to what I'm saying. I haven't been part of the history of what has been said on savings, historically. I think, broadly speaking, what you're saying is right. This year we will deliver what we said we will for the full year and likewise on next year. So, the savings total we remain committed to. What I can't give too much colour on, simply because I don't know, is what the splits will be in each half next year. What I do know is what was achieved this year. What I know is what's rolling out on the second year. But we haven't been or I personally haven't sat through the detailed budget yet of how that unfolds next year other than I can confirm it's in our number.

MR It's actually, as Adrian said, it is 20 in the second half. For next year, because we're into the final stage, then, of the synergies and this is really restructuring now, slightly backend loaded into next year but there will be a further 40. We review this regularly. They're all on stream. It's just simply the timing of when various closures and restructuring is completed. So 40 this year; 20-20. Next year it's 40 but it's slightly backend loaded.

On Europe, the negative 30 on revenue, it's just all the dis-synergies are in the growth number of 2.2% in box. So where we've had the overlap of business, where we've had business we deliberately want to exit, if it's in box that is in the 2.2%. So that's a net figure. Hector is now going to ask me what's the number before but that's another question. So the 2.2 is the net. The 35 is actually… is it 35 in your graph? I think it's 35. That figure, there, is on sheet but it's also on paper with revenue it came off and it's some other smaller business. But if you look at paper; paper was increasing but not all grades of paper, etc, and we're exiting some paper as we've talked about; closing out that capacity. So that's the volume reduction there. And both feed down to the profit/growth figure on the subsequent slide.

On LP&D, the issue the lease is up at our factory in Rugby. We are out of capacity there, anyway, so we're picking that whole factory up and some other factories and we're moving it to our facility in Bulgaria. We've had a long term facility there – obviously, the costs – and as the production all moves over and assets, all as planned, then there some additional costs, etc, that we are incurring which is predominantly behind that. But that project will be completed. The second half then should start to improve again but it's all as planned. I think the profits were flat in plastics, weren't they, but the margin came off slightly due to these expected costs.

MM So, then, in terms of the second half of the year, expecting a similar performance. Did you just say, actually, that the restructuring would be completed?

MR No, the performance is now starting to improve, second half.

MM So it's started? Okay. It finished at the end of the first half?

MR It isn't finished but some of the costs and the disruption, etc, we're through that difficult part, so now we're into delivery - Bulgaria's coming on stream so we start to see the improvement coming through in the second half. It's all as planned. The profits are flat when you come out of capacity and inevitably move and try to consolidate in larger factories. We've got a cracking facility in Bulgaria and we're expanding that aggressively at the moment. It is a bag-in-box concept which is growing very well; very well for us.

MM Thank you.

ET Eshan Toorabally from Goldman Sachs. Just two questions from me. Firstly, you mentioned the market share gains that you've had, so could I ask who you actually gained market share from? Was it sort of the larger players or more regional players? And then, secondly, in terms of the FX benefit that you had, given the movement in sterling, was that something that happened later in the period and, if all things remained constant, would you see a bigger impact in the second half of the year? Thanks.

MR Yes, it's an interesting thing. We don't particularly look too much at our competitors. We worry more about our customers and what they're doing. But, broadly, the customers come to use us wherever their suppliers aren't able to offer them the best practice across Europe; the quality and the service. And I have to say, from our position, it's coming from any company that doesn't offer that and it is a mixture. When we look at it from the other way about consolidation, we are seeing that there is a shift away from the more regional players. So, I guess that's probably where it is but, frankly, it's anybody who's not able to offer this. Yes, that's the answer.

AM On the FX, I'm pretty sure it's a lapping at the first half which, at the moment, where rates are today, won't be repeated in the second half. So you can look at that, as it stands, as a one-off impact in the first half.

MR One last question. Can we go to the people on the telephone and see if there are any questions?

OP We currently have no questions from the phone lines. Thank you.

MR Well, look, I'd just like to thank everybody for your time. We really do appreciate your time. Good half year, the strategy is working and momentum into the second. Thank you very much for your time.