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DS Smith Full Year Results 2018/19

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MR Firstly, good morning everybody. I'm Miles Roberts and I'm joined with Adrian Marsh, our Group Finance Director, and, firstly, welcome. Thank you very much for spending the time to come to our presentation for the results for the 12 months to the end of April and also an outlook for the coming year.

Let's get straight into it; a year of real change, development, growth, progress. We've really developed our strategic agenda, really trying to get the right assets in the right places, positioning us for what is an extremely exciting market going forward.

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With the acquisition of Europac significantly boosting our presence in Iberia, we're very pleased with that initial performance; just over three months, absolutely in line with our expectations but, of course, we're even more delighted with the synergies. Further upgrade, a 20 million upgrade, a 40% upgrade in our synergy target from €50 to €70 million. Outstanding work there, outstanding support from our customers and all of our new colleagues there.

Secondly, the sale of plastics being sold for 9.5X last 12 months EBITDA. It will be completed by the end of this year; all on track, as we expected. So, strategically, creating a group that's more focused, more agile, ready to take advantages that the market is offering us, as I've just spoken about.

Operationally, we've had our growth at 2.4%. All regions were in growth. E-commerce was very strong. FMCG was also strong, consistently throughout the whole year, but we did see some weakness in industrial, particularly in Germany. We believe it is short-term and I'll talk a lot more about that in the second half of the presentation.

In the US, we've upgraded the synergy target twice. You've probably had a quick look at the results. We're extremely pleased with the delivery of that business. Again, huge support from our customers, our new colleagues showing in that improved margin and synergy delivery.

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Financially, I think if we look at the last year, it's really been a year where we started with some rising input costs and we finished the year with some falling. That puts quite a bit of volatility there, but our pricing discipline has been absolutely excellent, really first rate in recovering everything on the way up and holding it on the way back.

That value orientation in the company is working very well. It has delivered an operating profit, organically up 9%, overall up 28%, a record margin of 10.2% which is a 130 basis point improvement. And, on the back of that, we're really delighted to say, whilst a few years ago our target range for return on sales was between six to eight, we then went eight to ten, we can really see our route now to being between ten and getting to 12%.

It's not only about the profits, it's also about the cash flow. You see a significant improvement there again, as we said we would; an 84% improvement in our free cash flow. And, on a pro forma basis, with the disposal of plastics included, our net debt to EBITDA falls below 2.0X. So, with that Adrian, I'll hand over to the financial results.

AM Thank you, Miles, and good morning everyone. I'm going to talk you through our results for the year. As usual, unless otherwise explained, changes referred to are on a constant currency basis. I will also be talking about the group on a continuing operations basis, so that's excluding plastics, which is treated as discontinued.

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Here are our financial highlights. Revenues up 12% and operating profit up 28%. I will take you through bridges for the key line items in a moment. We've achieved a record margin and Miles will also talk more about this later.

This improvement has flowed through to earnings per share, up 8% on a constant currency basis. The reason that the EPS growth is lower than profit is that the rights issue took place in July last year, ahead of Europac completing in January of this year.

Dividend per share is up 13%, ahead of the EPS growth, recognising the importance we place on shareholder returns. Return on capital performance at

13.6% is in the middle of our target range, reflecting the full diluted impact of the Interstate acquisition and partially for Europac, the full effect which will be in next year's average capital employed.

Walking through the revenue. This is on our continuing operations excluding plastics, as I've mentioned before. For comparative purposes I split out the impact of Europac and other acquisitions; essentially, the four months we didn't own Interstate and also a contribution from EcoPack, EcoPaper and Corrugated Containers in the prior year.

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Contribution for organic growth was £66 million, with a negative balance on other volume principally from the impact of China on lower recycling sales. The increases from sales price and mix is driven principally from increases in box prices recovering the negative impact of rises in underlying input cost. Overall, that results in a 3.3% organic rise in revenue.

Turning to EBITA, there is the contribution from acquisitions, as I described already, and the synergies coming through from the Interstate resources, as planned. The volume contribution you see here is a net of the positive from packaging, which had a similar drop through to previous periods, partially offset by the decrease I mentioned in recycling sales.

We believe our 9.4% organic growth is a testament to our focus on pricing discipline and you can see the full benefit of sales price and mix improvements coming through, which more than offset the increased costs we experienced.

The £146 million is a net number, comprising higher input costs, of which the substantial element is paper, with, as you'd expect, some benefit from lower OCC prices and higher paper integration.

Margins by division have all improved this year. The UK, despite the overhang of Brexit, performed very well, delivering strong results both in terms of organic growth and delivering on previous restructuring initiatives.

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Western European margins remained below the group average, due in large part to having less paper capacity. The organic growth was decent and the addition of the Europac assets now provide an excellent springboard for further growth and margin progression.

Within DCH and Northern Europe, Germany was weaker in the second half and Miles, as he has mentioned, will talk more about that later, but it clearly has had an impact on both group volumes and the overall performance of the country.

Central Europe and Italy continue to deliver good results. And, the US, again, is the standout region as it has benefited from synergies coming through, as well as strong underlying trading. Whilst the greenfield operation in Lebanon, Indiana will initially be slightly negative on margin this financial year – the financial year we're just entering into – because of the start-up losses, the additional capacity it provides is much needed, and in a full year of operation we'd expect this to reverse as the facility fully ramps up.

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Overall, then, we achieved a record margin result and we've taken the decision to stretch our ambition further, with an upgrade of our medium-term target to 12%.

Following the acquisition of Europac we've decided to simplify European business to drive organic growth and operational efficiencies by amalgamating existing spans of control into three new regions; the North, covering the UK, Scandinavia, Benelux and Germany; the South, covering France, Spain, Portugal and Italy; and, possibly, rather unimaginatively, the East, covering from Austria and Poland, all the way down to Turkey. From the half year we'll be reporting on this basis and will, of course, provide the relative comparatives.

We've consistently delivered on an upgraded expected synergies from our M&A. Europac is no different, and following our detailed post-acquisition work, we're now confident to upgrade our cost synergy target by €20 million to €70 million.

The eagle-eyed amongst you may have already flipped to this year's technical guidance and have spotted a small increase in capex for Europac which we've assessed is required to fully deliver this. Whilst it is still early days at Europac, I can, without equivocation, report that integration is going very well. The quality of our new colleagues is high and the enthusiasm shown to work together to identify value-creation opportunities has been extremely impressive.

Likewise, a significant momentum generated from the Interstate acquisition has remained and the opportunities for further profitable growth are compelling. We also have a strong track record in driving efficiency in our business and capital allocation.

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Miles will talk more about paper strategy going forward in a minute, but in addition to this, we believe we've some significant opportunities with our enlarged business, to make some meaningful improvements in our SG&A cost base and also in our asset optimisation, driving sustained long-term profitability for the group.

By way of quick update on disposals, both the plastics and remedies disposals remain fully on track and exactly as expected in terms of value and timing and the proceeds from these will be used for deleveraging as previously indicated.

Last year we described our disappointment in our cash flow performance and set out what we would do to improve this. I'm pleased to say that these actions are delivering tangible results with further progress planned for this financial year.

EBITDA increased following the good business performance and this was accompanied by a strong underlying working capital inflow. You can see that we've also reduced the amount of receivable factored under our three-year committed facility by around £82 million. The balance last year was £559 and the comparable this year is now £483 million. In addition, we've acquired a balance of £42 from Europac which will be absorbed into our programme.

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Capex has come in as guided and was a reduction from last year despite us now being a larger business. The tax and interest cash cost is higher, principally due to increased profitability and hence, obviously, increased tax. Overall, we're much happier this year this year with free cash flow up 84% and have plans in place to continue this momentum.

Moving to the cash flow bridge, the picture is dominated, obviously, by the Europac acquisition and the rights issue to fund it. The other items are as previously described. We ended the year with leverage of 2.3X, which is 0.2X less than we anticipated when we announced the acquisition pretty much a year ago today.

On a pro forma basis, if we take into account the plastics and remedy disposals, we're at less than 2.0X although, as I always point out, you should consider the Interstate put option when looking at implied leverage and we ensure we have the liquidity to cover this should it be exercised, which is an annual option each August. This would add a further 0.2X to our leverage and is fully considered in our credit rating which we've just been advised by Standard & Poor's remains at investment grade and has returned to a stable outlook.

Our gearing, then, sits at 2.3X based on the balance sheet or less than 2.0X if you include the plastics and remedy disposals. We expect to continue degearing through ongoing cash flow. Following the Europac acquisition we financed our bank debt and have no meaningful redemptions until 2023.

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And, at danger of repeating myself, we're confident we have meaningful opportunities to reduce working capital. An operational management reward is now directly linked to achieving this.

So, overall, it has been a good year making good progress in relation to our medium-term targets. Volume continues to be ahead of the market, albeit we did see some weakness in H2 in our industrial sector, particularly in Germany.

And, as I said, Miles will talk more about that in a minute but we believe we've got clear routes to make further meaningful organic growth.

We're very pleased with where margins now are and work is well-advanced to further improve this over the coming years. ROACE is right in the middle of our range despite two recent acquisitions which obviously add goodwill to the calculation and will improve over time as synergies and scale benefits get delivered.

We've also now taken our plastics which had a particularly impressive ROACE but not longer sat strategically in our business model, so we've now recognised the dilutive effect of removing that.

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Net debt to EBITDA is 2.3X but, following the plastics and remedy disposal, takes us below 2.0X on a pro forma basis, and our target of below 2.0X should be fully achievable in the short term.

Here is the usual technical guidance slide. Essentially, the only real changes are to reflect a full year of Europac, with everything else consistent with the year just ended. As a point of note, a large proportion of those M&A disposal costs you see related to plastics and can be assumed to be part of what we've guided to as net proceeds for the plastics disposal and will obviously be more than offset by the significant exceptional credit on completion.

The put option unwinds only cash when the option is exercised and can be assumed to be part of that cash impact of the put option exercise which I described previously, leaving around about £50 million of cash-adjusting items which include £18 million of restructuring which has been set aside to focus on particularly Germany, and to some extent, France.

On IFRS 16 guidance, we'll be adopting IFRS 16 in this current year, so we've provided some guidance as to the effect. While there still some moving parts, in summary there is a very small impact on our ROACE and no impact on our leverage ratios, and the outcome is consistent with adjustments which S&P have historically made to determine our credit rating. Whilst there will be no impact anyway, it's still worth pointing out that our financial covenants are calculated on a frozen GAAP basis.

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Finally, as always, my favourite slide which sets out our track record and the progress in this year which continues to add the upward trajectory in earnings per share and dividends per share. I'd now like to hand back to Miles who will talk a little bit more about the drivers behind our resilient and growing business.

MR Thank you, Adrian, for taking us through the results. You can all see about the progress that has been made, not only financially in the strong results, but also operationally, as well.

If we just stand back for a while and just think about last year, it was a year, really, as I said, of two halves in terms of volatility. We started with some very strong increases in the macro environment, but I think over the last six months we've seen the macro environment just quieten down a bit. We've seen some change there but the results have shown how we've been able to deal with that.

Fundamentally, over the last year, there has been a huge change, continued progress in the way that everybody is consuming, shoppers are buying, how our customers are thinking about the products that they need for the future.

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It's really been an enormous change here, this whole consciousness of the environment. We've all known about it, but over the last year it has taken on a completely different perspective with our customers.

Last week, I had a good few hours with the CEO of our largest customer and all he was talking about was the environment and he was showing how all the blogs on their company are showing pictures of their products, of their packaging, lying a beach. And underneath, it's got from their consumer saying, is this yours? This is your rubbish, it's got your name on it, and I found it in a beach in Indonesia. So what are you doing about it?

So, it's not only about a nice to have, this is becoming an imperative for business. We're seeing legislation coming up banning the use of single-use plastics, around plastic plates, around straws, around cutlery, around single-use plastic cups. That is going across Europe. The UK will adopt that. We'll see what will happen in the UK but I think it will stay aligned with Europe in terms of the environment.

This is starting to affect everything and that structural change in the market is sort of really playing to what we've always built our business on over many years, about that whole circular economy. So, that gives us confidence about the underlying growth, the structural drivers and how well we're positioned; and these are the main drivers.

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I'm going to talk more about e-commerce, but it is growing all the time. We're hearing constantly about the high street, about high street shops are having to restructure themselves to cope with the reduced footfall. There has been a lot of recent press about this and reduced rents, etc, because the high street isn't as valuable as it used to be because of the growth of e-commerce.

But, we're also finding the high street is also fighting back. Whilst the sales in the high street may be flat, how does a retailer fight back? Once you've got the consumer in your store, how do you delight them? How do you get more? How to increase the value of their shopping basket? What do you do to excite them?

Over 60% of purchases – in the UK it is over 70% – the purchase is chosen at the point of sale and that means the packaging. Now, we're seeing growth there, we're seeing growth in convenience. We're seeing growth in the discount sector. You've all read about that. This all means new packaging. This all means new requirements.

We're talking to one of customers. They have to repack over 60% of their products. The box they leave the factory in has to be put into another box, and that is increasing. Now, we're seeing big growth there.

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And, obviously, on sustainability, I've mentioned it already, it's not just about us, it's about how we connect with this wider economy. We're a global partner for the Ellen MacArthur Foundation. It's a foundation…. we work jointly with some of the world's leading companies there; people like Unilever, like SC Johnson, like Danone, like us; with NGOs. Because however much we do, we can create the solutions, but we need the infrastructure, we need the awareness of all of our consumers, awareness of government to pick this up. And, we're working with them, joining up the circular economy. We believe not only is it the right thing to do, it's a major boost for our business.

On that sustainability, when we see our retailers they're all talking about how they can replace plastics. 81% of our industry uses recycled material. It's not that it can be recycled, it's that 81% is recycled.

You've heard in the UK Government, they're talking about legislation; if it's got less than 30%, you're going to have to pay more tax. We're 81%. We're way ahead of the rest. It's 14 days box-to-box. Of our products 100% are recyclable. We've recently undertaken a study across Europe looking at the supermarket shelves and about the opportunity to replace plastic with corrugated.

And, there's an immediate opportunity to replace, with the technology that we have today, 70 billion units of plastic that are currently on supermarket shelves in Europe. That's 140 per person throughout Europe. That's 1.4 million tonnes of plastic. Europe only makes 20 million tonnes of plastic. The problem is it lasts for 5,000 years. So, use it for five minutes, you've got it for 5,000 years; and this is the challenge, this is where we see that opportunity.

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And, of course, when come into e-commerce, we have experienced consistently throughout the first and second half of the year, double-digit growth. We've seen the shares improving, we've seen new entrants coming into this market, new customers, particularly e-pharma, more on grocery.

But, whilst we have grown double-digit, we have very recently been awarded a further major expansion of our business here by a leading supplier here who looks at the innovation, the quality and the service, and we're absolutely delighted to have such a vote of confidence in us, which will be a major boost for our business in the coming year.

And, that has partly been enabled by our acquisition into Spain because a lot of that is in the Spanish market. We've now got the capacity and our customers are rewarding us with it.

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On innovation, our 700 designers but it's these nine major innovation hubs. We're increasing our spend. Last year is more spend than the previous year. We've got some really exciting moves here.

If you look at e-commerce, it is about the void space, but I've talked about e-pharma, as well, about people having treatments at home. They don't have to go to hospital or have to go the doctor and wait in a draughty waiting room, catching illnesses from everybody else there; you treat yourself at home.

But, of course, the product then has to come to you. Maybe it has to be temperature controlled. Maybe it has to be in packaging that is fully recyclable, that can be picked up. So, we're seeing not only a real growth volume there, but a real growth in that value-added opportunity.

It's not just about getting your book delivered at home, it's about getting your medicine, that product that you absolutely need in perfect condition, and how we can deliver that, properly temperature-controlled, properly tracked, traceability in there, signed for. And, then, linked to how you then have to take that medicine through the app once you've been delivered it and reminded you when you need to take it. Very, very strong, very nice margin, and we're delighted the way they working with us. That's innovation.

Barrier technology; how we replace plastics; how we can start to print on our material, on our fibre, make it impervious to the ingress of fat and liquids, etc; long-term trends. We are doing very well there. And, of course, how we increase the performance of our packaging, so we can take more paper out, we can take more fibre out, use less energy than ever before.

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It's come along very nicely and it's all backed-up, of course, by our scale because this is what we have build over the years. Let's not forget that. We've come from just a UK company to being the leading company across Europe, serving every market with scale so these innovations can come at pace.

One of the reasons we've had this, say for example, this major new award on e-commerce is because we can supply absolutely consistently the same solutions right across Europe, and the customers want this. They are consolidating their supply chains. We're seeing that steadily and that all comes into our FMCG focus.

This is where we were in 2016/17, you can see we had about 67% of our business in FMCG – very resilient, constantly growing – and 9% in other consumer. So, there were up to 76%. Two years later we're up to 80%. We can get that to 85% in the medium-term, further squeezing that industrial part.

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It has been a major part of our strategy. Years ago we were at 60%. We've been driving it and we think we can drive that, that much further because when we look at our volume growth, if we look at where we were, 2.4 for the year, 3.2 first half, that's 1.7 for the second half. And, the second half was a low figure compared to where we've been before; there's no doubt about that.

But, again, it's a story of two halves. When we look at our FMCG, that grew consistently, half year-on-half year, no change, consistently well above 4%, doing very nicely in the first half and second half. With our multinationals, we're actually growing at 7% as they're consolidating their supply.

We grew our margins in that, as well, because of more value-added; a really excellent pricing discipline in there. You have to recover. When your materials are going up, you have to recover the price. You will always, always, always take a volume hit to get the price, even if it means a delay.

And, our pricing discipline has been excellent. You saw it in the first half results, how we recovered everything. But, despite that, we still grew very strongly. I think the issue that we've known about is in the US where we have been capacity constrained. We cannot keep pace with the demand that is put on us and that has held us back. But, despite that we've still grown consistently, first half, second half, over 4% and we expect further progress in the coming year. It's really exciting.

With industrial customers, the half one was flat. The second half was negative, particularly in Germany. As I said, we've been reducing our exposure here. We've seen some supply chain compression. We think that it is pretty short-lived. We've been very disciplined in pricing.

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If you look at our margin analysis, you would have seen despite the fall, the profitability and the margin in Germany, in that region, has gone up. So, it's about value-added. We've seen a 120 basis point improvement in that margin despite the lower volume. It's the right decision and we'll do the same.

But, looking forward, we expect the first half of this year, certainly, to be better than the second half of last year and we expect the full year of the coming year to be an even further improvement on that, as well.

If we look at margins, you're seeing we've put here our margin over many years going back to 2009/10. We've also put in here a track of some underlying paper prices. We've used this many times. And, you're seeing really pretty consistent margin progression.

We have seen, recently, some volatility in paper prices but we think that follows a normal cycle. We don't see anything particularly unusual about that. Indeed, there's quite a bit of stability at the moment. So, that's been the progress on margins.

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When we look at our drivers, of how we improve that, we are seeing the economies of scale coming from our business. We are seeing this increasing value-added proposition for our customers where we're winning. That pricing discipline is working well because of the value we're adding.

And, we're also seeing a contribution from both North America and Europac, with the higher synergies coming through. We were above 10% last year, and we can see ourselves getting up towards 12%.

Delivering in the US. Again, we completed this acquisition back in September of 2017, so this is our first full year. You see the results of it. You see the return on capital in our first full year of ownership; way up into double-digit returns. We are very, very pleased, and we're pleased because of the support we've had from our customers and from all of our new colleagues.

The $40 million synergies are absolutely being delivered. We've made a very modest acquisition, again, just giving us more capacity. But, as we have said, we are capacity constrained. We have not been taking new orders for quite a time, so it means the like-for-likes have been more modest and that's why we need the new factory.

This new factory, that's the state of construction as at the end of last week. This is Indiana, near Indianapolis. It is very close to a number of our customers. They are very excited. It's all on track. It should come onstream in October.

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It actually adds a third more capacity to our US business, so we think this will give us substantial capacity in that region and hopefully provide a footprint for further expansion in the US. Construction is going well, the operations, as well, but we're pre-selling the volume and it's getting order support, so we should see more growth coming out of the US.

Europac, you've seen the initial results. This is exactly what we expected when we made the announcement of the proposed acquisition last June. Basically, the business is pretty much as we expected. We've got some very good paper operations. If we look particularly around the Viana mill in Portugal, it's very good. We've had no paper capacity at all in Iberia. This is now giving us that opportunity.

In terms of the packaging assets, we thought they were poor; they were poor, no doubt about that, but we've dealt with all those things before. It's exactly the same as when we bought into Lantero and Gopaca, etc, in that region, how we bring those margins back to the group average.

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That Western European business is already contributing to our margin analysis. You've seen the margins improve and I have to say we're already seeing quite turnaround in those packaging assets and with some of those new awards, as I've said, I think we're going to see a very strong performance there. Delighted with the employee engagement, delighted with the customer reaction, as well, giving us confidence in those synergies.

But, of course, at the time of the acquisition we said, you know what, this has given us a bit too much paper; not paper in these extreme regions, it's our overall balance, and therefore we have to reduce that.

We particularly have to reduce it in and around Central Europe where there is excess capacity; that's where a lot of the drivers of paper are coming from. So, this is pretty much the graph we presented.

This is a graph showing our actual position on paper. We've come to about 80% of our packaging needs providing internally. We need to reduce that towards 60%. We are looking at how we do it through the growth in packaging and optimising our paper footprint, just in and around Germany.

We're well-advanced on that and we expect to make some good moves, bring it back toward 6% and just rebuilding our short position, exactly we said at the tie of the acquisition, really giving us the right assets in the right position.

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Our outlook for the current year, we continue to see good structural drivers for growth. We expect the growth certainly to improve from the second half of last year. We think we can really see where that was and what's happening. We've got very good growth with our FMCG side.

We're delighted with the pricing, our share holds as we're entering the year, with a strong pricing on our end product. It's essential to get that right and we feel very pleased with the work that's done. It's only possible because I think our customers recognise the value that we add.

Continued focus on driving the cost and the cash generation, which Adrian has talked about, I think, as he said, there are further good opportunities there. We are very convinced of that and we will see that coming through. So, we expect FY20 to be a year of good progress for DS Smith. And, as we take questions, I will leave you with our value proposition which remains the same. Thank you. Alex.

AB Thank you very much. Alexander Berglund, Bank of America Merrill Lynch. If we can get started a bit – I know it's topical – on box prices. What have you seen so far in your business? Have you seen any reductions? I know you pointed to your chart where it showed a robustness through the paper cycle. If I think about your margin outlook, the raise from 10% to 12%, do you believe that you're able to reach that, even in the upcoming years, the next year, despite the reduction in paper prices and potentially box prices?

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Secondly, on your volume, do you expect to reach your target of 1% above GDP next year? And, then, just finally if you could give us a bit more colour on the point you made on integration and becoming more short. Is that just a function of you increasing your box volumes over time or you're looking also at potentially selling or shutting down some lines to get that short position? Thank you.

AM In terms of box prices and whether we're seeing reductions, as it stands today, box prices have held very stable across our business, so we haven't seen an impact. Clearly, paper prices have come down. Pricing announcements that we've seen published show prices going up again on the paper side so, at this stage, we haven't seen a reaction.

Clearly, if they went lower and held lower for a sustained period of time you would inevitably see a response, but at this stage we've seen nothing. In terms of the margin target and the margin guidance, we set our ambition at 12%. That's a medium-target so I'm not going to sit here today and say my expectation is to achieve that next year or it would have been our short-term target. However, we set a floor at 10%; that is where we now have set the range.

So, I'm very confident that we will achieve margins within our target and, clearly, the ambition is to hit the stretch and everything that we're doing around asset optimisation, around cost base, around organic growth is designed to deliver to that stretch target.

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MR And, on the volumes we do, we have a target. We've consistently delivered against it. I think in the second half of the year we were behind that. It's really one particular issue, it's on industrial. We have seen a softening there. We are reducing our exposure all the time to that. But, the FMCG has stayed incredibly strong all the way through and that's what we're trying to say; there is a bedrock of demand there which is going up and all the time our exposure to the more cyclical areas is reducing.

Now, we're at 80%. Would I like it to be 90%? Yes, of course. We continue to strive for that. Europac actually boost that slightly further, as well. They've got a good balance there.

So, we do think we will be able to be there. We think the first half will be better than the second half. [Sound slip] for certain, but we feel reasonably confident about that and coming back to our target. Now, it's back with some of the awards that we can see.

But, those awards and the growth, as Adrian said, it is on pricing and we've stayed very, very disciplined to that. There's a lot of poor volume out there. We could quite easily have come back this year and said, you know, what our volume shot the lights out, margins have deteriorated.

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It's about getting both and there is always a bit of a balance but you have to get the price right. That's what you set the new year up on. Having got the price, we carried on increasing prices into February. As, Adrian says, we haven't seen price falls, we're actually increasing them. Over the last couple of months, where haven't been increasing them, as Adrian said, it's [sound slip].

But, on the integration point [sounds slip] it is really around having [sound slip] elements in there. There is the element of [sound slip]. It's too early to say [sound slip] but I think we've got a good opportunity [sound slip].

AL Thanks. This is also Alex. This one is at JP Morgan. Two questions. Firstly, just to maybe echo the previous question around the GDP+1% target. I wonder, given the focus of the business these days, particularly with the rise of e-commerce, it's very much about value-added. Given you're not prepared to chase price, I wonder about your thoughts as to whether it's actually a valid target, if you're thinking about organic volume growth anymore?

And, secondly, just with regard to the upgrade to synergies from Europac. I just wonder about the source of this. Is this coming from the packaging side and sorting out that underperforming packaging businesses or are there extra costs you can get out of the paper side of the business?

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MR If we look at our business, what we're seeing in the FMCG is more an absolute level of growth. The economy has been volatile but we've seen consistent growth in the FMCG over many years now because of all the factors that I've talked about, sustainability, e-commerce; it has stayed very, very strong with the big customers we've consolidated and we've grown in others. That's absolutely typical for us.

I think looking forwards, as that percentage improves, it will move more to an absolute. We haven't moved there yet because we still have 20% of our business – okay it's a modest amount, but it's still 20% – and we've said that can vary from plus five to minus five. We haven't lost share in that market. The market has just been very difficult.

It's why we want to reduce our exposure and going forwards you'll see further and further compressions of that business as Europac comes in. So, that's when I think we will be able to move more to an absolute. It should be really between this range [sound slip]. We know what we want there.

AM With the synergies, Alex, there's a proportion of the upgrade that's simply taking away probability, so it's where we originally thought and we're reducing the probability that we had to apply because it was a class one.

00:45:13

So, there's an element of that and then there's an element that's split probably half and half between packaging and our supply engine, and part of it within the supply engine, where our paper capacity sits, part of that is also, interestingly enough, a reverse synergy. There's some aspects of what Europac do that now we've got into understanding them, and particularly in Viana, that's extremely helpful within our US business and some items within our European recycled, as well.

We often find that. We certainly found it with Interstate, as well, and we certainly found it with SCA before. There will be things that you can take and you can reverse back into your organisation and you just don't know what they're going to be upfront. So, there is an element of that.

Then, on the packaging side, there's one plant where we found that, in our view, it is operating at a level that is nowhere near how we would operate at. We believe if the quality was enhanced, and that is going to require a level of capital investment which is in our guidance, we will really turn that to profitable operation quite quickly.

So, it's a split through various things. We haven't really touched in here on the synergy upgrade. In revenue synergies we don't really ever do that. We normally only talk about cost synergies and how we're upgrading those.

Part of it is the probability coming up and then roughly 50/50 of the balance between paper and reverse synergies and operational improvements and on packaging, particularly around one location where we think there's a massive opportunity to turn that profitability, and we know how we'll do it.

00:46:59

We've had some very good quick wins and fairly obvious ones as well from how we've managed the overhead quick quickly. We're also getting another reverse synergy thinking about it. We've taken the Europac service centre and we've wrapped our operations into that. They had a very good operation in Dueñas, in Spain. We've shut down ours, pretty much day one; not quite day one, but within the first 90 days. So, the runs on the board have been coming pretty quickly and it's a good business.

RC Hi, Rob Chantry, Berenberg. A couple of questions from me. Firstly, on volumes, a 74 million increase in corrugated volumes on the chart but only seven million growth in EBIT as a result of that, implying quite a low drop-through. I think in the past through years that drop-through has been 25-30%. Can you just talk through why that drop-through is different and how we should think about it going forwards?

And then, secondly, US Indiana facility, obviously a huge project, lots of capex going in, one third of capacity being added. Could you talk about how that should move through the US numbers in terms of ramp-up. I think there was a comment talking about 15 million or so ramp-up costs but then, clearly, you've got scope to add a third to the size of the business there; how that maps out in terms of when you expect it reach efficiency production, etc. Thanks.

00:48:36

AM Yes, so box will drop-through as you would expect. There is an impact in on recycling as well, where we've talked about the volumes, the revenue from recycling being impacted. In China, that's a much lower contribution business, as you'd expect. But, the gross box drop-through would be as you'd expect. It will be offset by other volumes. We can bridge that view if you wish, Rob.

MR With Indiana, as we've always said, we're staring this in October. There is a ramp-up. We think it will reach breakeven in the very early part of the new financial year when it's been up and running. It's all on plan for that. When it is running at full tilt which won't be for probably three years, 3.5, something like that, it does provide a substantial expansion on [sound slip].

The reason we're building new is our customers there, to put it bluntly, they want the solutions that they can get in Europe. For that, you need the sort of assets that we have [sound slip], the ability to really produce performance-based packaging, digital printing.

All of the capex for it, it's all in our numbers; it has been. We spent a considerable amount this year; that's in our numbers. [Sound slip]. And, we think this could give us very good [sound slip] and enable us to supply this demand in the US in our highest margin [sound slip].

00:50:59

We do have a paper mill there because, in the US there isn't really free paper capacity like there is in Europe, so you've got the security of supply. It does mean a ramp-up in paper production there. [Sound slip]. Building it, as I said in the presentation. We're pre-selling the volume now. We're already going out and talking to customers.

Of course, these are the customers we've talked to before we even decided to build it. These are the customers that said if you come we will reward you with this business, and they've done. These are the customers, when we said we are going to Iberia, they said we will reward you because there's nobody else who can supply these solutions. So, it's a very consistent model and [sound slip] to bring it on stream.

JJ Thank you. Justin Jordan from Exane. I've got three quick questions, please. Firstly, on slide six, your EBIT bridge, you've got 174 million positive sales price mix in fiscal '19 and I think, from memory, 204 in prior years. So, that's cumulative 378 over a two-year period.

00:52:21

Can you just give us some idea? That's basically the impact of 8-10% box price increases over that two-year period. I'm just trying to work out the operational gearing the box price movement for the business going forwards. You've got a larger scale with Europac but it would imply that possibly every 1% in box prices pre any offset is about 45 million of EBIT. Can you just confirm that?

Secondly, on factoring, it has come down. What's the view on factoring versus traditional RCF going forward? Do you have a change in policy going forward? And, thirdly, just on slide 14, the exceptional costs of 76 million guidance in fiscal '20, that's certainly slightly higher than many of us would have expected. There seems to be an increase in the Europac exceptional costs that you're talking about here. Can you just explain that a little bit please?

MR We can do a further analysis. Sometimes it's slightly difficult because if you've got a customer and you say I need this price, the price is up but we're going to introduce a new product, as well, sometimes the absolute split, a lot of it is price but there's a good amount of mix, that's why you're getting the market share gain, as well.

So, we can do a further analysis but it can be a little bit muted. You've got a new product, better price, but it's a better product. Is that mix or is it price? Frankly, we're not too bothered. We're getting a better price for that product.

00:54:08

JJ I guess what I'm getting at really is that going forward, clearly, you're going to have the benefit of reduced raw material costs and reduced OCC prices. You're going to have a benefit on your 20% short paper in Europe, of reduced whatever you're buying in but, and the big but that everyone is worry about and the reason why your shares are down 35% in the last 12 months, is the impact of reduced residual volumes and, more importantly residual prices on an aggregate basis. I'm trying to get a sense of what the impact of that will be on your business.

MR The impact is less than you are suggesting. There are quite a few compensating factors. You're just picking on one factor. We've actually got the price retention, which again we've got the further value but, of course, there are other input costs as well, say, for example, what's happening on OCC in there. So, the relationship isn't as clear as that.

JJ Can you help us on the factoring?

AM On factoring, Justin, there's no conscious move from one to the other. What we decided to do when we were talking to a number of investors last year, we said we felt we're very comfortable with it, as they are; that they understand it, they understand the economic benefits and the liquidity of it and it's committed and everything.

00:55:38

They said where do you feel that the right number is? And, we said we probably feel it is around about the 500 million, probably starting with a four not a five. And, that's all we've done. We simply moved it to that level and we've generated that through working capital.

We're comfortable where it is. It's well-understood by the rating agencies. It's well-understood, we believe, by companies that know us well. As we've just shown, you can switch it around relatively easily. Don't hold me to a number for the rest of my life now, but we think around about the 400 to 500 million feels reasonable. It's relative to the quality of receivables that we've got.

As the business grows, we might re-reflect on that but as it stands today we're comfortable with that and that's where we'll keep it. So, if the question is are we looking to materially take it lower, the answer is no.

In terms of exceptionals, I'll have to come back to you on Europac and guidance. I don't think we're inconsistent with guidance but can I double-check my numbers on that, on integration?

JJ Because when you purchased it, you guided to 70 million of exceptionals of which 30 million was additional capex and 40 million restructuring.

AM Correct.

JJ How much was the Europac-related restructuring cost expense within the 40 million?

00:57:06

AM Give me two seconds and I'll come back to you on that, Justin. I don't think we're out of kilter on guidance but I don't want to sit here and make a number up. I have it and I'll come back to you on that but I think we're relatively consistent.

DO David O'Brien from Goodbody. Just a couple from me, please. Firstly, it's always seeing a margin target increase by 200 bps. Can you give a sense of the 200 bps improvement, what is actually organic and what is obviously going to be an uplift from acquisitions? If I look at that margin uplift, what's preventing you from the same type of uplift on your returns on capital?

Secondly, you've spoken to stability and pricing. On the paper side in Europe, we've seen Mondi, Hamburger and Burgo all come out and announce price increases. What has stopped you in your tracks in terms of announcing yourselves?

I'm sorry to labour the point on box pricing as some of the guys have asked. It's clear that pricing discipline is the centre of a lot of the strategy for the next 12 or 24 months. If we sit here this time next year and look at our bridge charts, are you expecting that to be a positive contribution for the full year?

00:58:21

MR On the margin side, there are two questions in there about the margin, what gives us the confidence, acquisitions, etc, and then the about the return on capital. The simple theme on return on capital is we're selling some very mature assets like plastics which hasn't seen much investment. It makes a return on capital of over 30% but it's a long historic asset base. And, we're replacing them with new assets where we start with a return on capital of 9%.

Now, when we buy them, I think if you extrapolate up the Europac acquisition, it's only three months but you can see we're making actually, initially, quite a reasonable rate of return but it's not where the group has been historically at 14-15%. It's purely a function of the mx of assets you have going forward.

We don't push above 15% because we think there are opportunities to carry on investing in the company that make very value-adding return on capital that our investors are very happy with, that aren't 15%.

For instance, with Europac, we went to them and said we think it will be above cost of capital in the first year. That's fine but it's not 15%; no, but you're value-adding. That's fine with us. We want to keep the company in range of 12-15%. That's what you're seeing. It's purely a function of the age of the asset that you've got and when you've bought it and when you've got the goodwill.

Don't forget many people also have written off a lot of goodwill in the past. We haven't been doing that. It's just come on to the balance sheet. So, we've comfortable with the return.

01:00:09

If you look at the improvement in the margin target, you'll see the forecasts that are out there for return on capital show a similar improvement in terms of the rate of progress but, again, we don't have a particular ambition to go above 15%. Interestingly, if you look, therefore, if you're in this range, you got back to the SCF position, we're probably making 17% or 17.5% on that. Of course, we start at 9% on Europac and just over 10% in the first full year of ownership with the US, but those assets will go on and on and on producing better returns.

In terms of the margin uplift, I'm sure if you do the maths you could start to get yourself to say why aren't you going to 13%. If you add in all of this you can get there. But, we feel for where we are, with the environment that we're currently working in, with 10-12%, it does bring in synergies, it does bring in the increase in value-added and the operational leverage that comes from the business as we continue to grow.

And, when you bring them all together, we're comfortable with that range. You can cut it many different ways. We tend to take contingencies over all of these things – a contingency on this or a contingency on the growth – and that brings what we think is a material uplift and it's something that's sustainable.

01:01:39

In terms of the paper prices, for what it matters, we never predict the future. Anything can really happen here. It's up to us to run the business whatever happens with the paper prices. Interestingly, we have seen stability. We're actually raising our price, as well. We don't make public announcements about it but our demand is pretty strong, so we're raising prices. What happens in the next three for four months is anybody's guess but that's where we are at the moment.

Some of our suppliers have been pushing through increasing prices to us, as well, and we can see what's happening and we've been paying them. So, it's a very, very fluid thing. That's why I said earlier, I think where we are is in sort of a normal cycle; cycles that we've dealt with.

Time will tell. We are not forecasting paper prices. We don't know. It's up to us to manage the business, really, whatever they are but at the moment we're seeing upward pressure.

DO What scale of pricing have you had to absorb?

MR Well, it depends on the exact grade and where it is but typically 40-60 is the sort of thing people, the last month, have been talking about. I'm not giving that as a prediction. That's just what they've been talking about on the back of, actually, quite reasonable demand. So, stocks are falling. We need this paper, our customers need it and we're happy to buy it.

01:03:11

In terms of how these things feed through, as I was speaking with Justin, there are a number of things that affect our overall profitability. One is input costs but that's on many things on input costs, including OCC and other things, as well, so there's a whole balance there.

What we are seeing is we've been increasing the prices to [sound slip]. About 40% of our business is what we call on indexed deals, and these indexes start to change, on average, about four month, the large customers, there will be some pressure there, but that's 40%.

The remaining 60%, more proportionally, is what we call fixed; it needs to be fixed for six months. The other 40% out of the 100% is what we call freely negotiated and this is where the customers need to come back to us. And, that gives us an opportunity to discuss about the value that's added, the other issues that we deal with, etc.

And, if we are more competitive, we can provide better value than anybody else, then we'll keep those prices and those customers, and that's where we are. Some people do ask, it's 1% here; really, you've only got 40% of the business that has these sort of indices and even they can be very varied, as well, on what they work on.

01:04:46

DO Is the customer profile, for the large part. European? Do they tend to be more indexed?

MR They are, yes. The large majority.

AM Just to your question, Justin, 22 in the year to do with the financing and 13.7; so, if we call it 14 to do with integration.

MR Well, look, we're few minutes over. Are there any last questions? I'd just like to say thank you, once again, for your time. We're very pleased with the results and we're looking forward to the coming year. Thank you.