

# DS Smith Trading Statement Conference Call Transcript 1 November 2013

## Speaker key

MR Miles Roberts  
AM Adrian Marsh  
RE Robert Easton  
BD Barry Dixon  
CO Catriona O'Grady  
JT Jake Thompson  
ALM Alexander Mees  
OP Operator

MR Hi. Good morning, everybody, and thank you very much for joining the call today. I'm Miles Roberts, the CEO of DS Smith, and I'm joined today by our new CFO, Adrian Marsh. As you know, Adrian joined us towards the end of September. Prior to us he was at Tesco for many years, where he was the Head of Corporate Finance, Tax and Treasury. And I have to say we're absolutely delighted that he's joined and already having a very good impact into the company.

So this morning we're very pleased to release a period-end trading statement for the six months to 31 October. The full results of the half year will be published later on, on 5 December. But I'd just like to take a few minutes to run through the highlights of today's trading update, after which both Adrian and myself will be delighted to take any questions you have.

Quite simply, the business is performing very well. It's fully in line with our expectations and every part of the business has performed well and is improving. The market of business trends from our... that we announced in our September IMS have continued.

So in terms of trading, our packaging business has continued to gain further market share. And the feedback from our customers is very much they appreciate the differentiated proposition that we're putting to them. And the corrugated volume growth remains well in excess of our GDP-plus-1% target. And I'm particularly pleased with the growth that we're seeing in the legacy SCA Packaging regions. We'd always target them for growth and we're seeing that growth come through.

The emphasis for us, as always, is on service, quality and innovation and as we leverage our enlarged geographic footprint and continue to focus on the FMCG business. So we're building resilience into the growth that we're seeing, resilience in terms of demand, resilience in terms of the pan-European stretch. And as we know, input costs have been increasing. They've been increasing pretty much as we have been expecting. And we're recovering those input increases, again all in line with our expectations, although there is, as usual, a small lag. Return on sales, despite the increase in volume our return on sales continues to grow, well in line with our medium-term targets.

And with regards to the outlook, our outlook remains positive. The acquisition cost synergies are all on track and will continue to be delivered progressively through this year and well into next year. And while the European market remains challenging we remain confident of strong progress this year and remain very excited about the growth opportunities for a group. So to remind you, we'll be announcing our interim results on 5 December.

But if I can turn to the operator to take any questions, to handle any questions that you have for us. Thank you.

OP Thank you. Ladies and gentlemen, if you would like to ask a question please press star one on your telephone keypad. If you change your mind and wish to withdraw your question please press star one again. You will be advised when to ask you question. The first question comes from the line of Robert Easton from Goodbody. Please go ahead.

RE Hi. Good morning, everyone. Just a few questions, firstly in relation to the volume environment. Can you just give us a bit of flavour in terms of how different it is across your different countries that you're operating in and has there been any noticeable changes in those trends at a country level?

My second question is in relation to containerboard price increases. We've had a second announcement from the various players and I was just wanting your view on your confidence that that second increase will be passed through.

And just thirdly, just your comfort with current consensus of... I think it's about 21.5p for the current financial year. And I think that implies about 20%-plus growth. Will that growth be evenly split between H1 and H2?

MR Well, look, if I just split the questions, if I talk about the volume and our recovery and Adrian will take the EPS and the H1, H2. When we look at the market overall in Europe we see in the market overall there's been some... overall, some very modest growth in corrugated volumes. By modest we are talking perhaps 0.1, 0.2, 0.3% for the market overall. When we look in regions, we've seen a little bit more stability in some markets that have previously been in decline. Markets like Spain and Italy as a market overall have been more consistent than they have in the past. But when we look at ourselves, we get quite a different picture because we have some very strong positions in countries like... regions like the UK and France, where we clearly lead the market there and those regions have just seen some very modest uptick.

But as I said, for us, when we look at Central and Eastern Europe and Italy, these are regions that we've really been able to expand into because of the SCA Packaging acquisition. We've targeted them for growth and we really are seeing growth come through very nicely indeed, well ahead of the market.

So overall, I think there's a bit more stability in the market than we've seen over the last few years. Growth overall is slightly positive, a little bit more in Germany and Eastern Europe. But for us, a couple of really quite stable, good positions in the UK and France, with some good, stable positions. But really quite exciting prospects in Central and Eastern Europe, and we've seen that coming through not just in the last quarter, but I have to say in the outlook going forward as well in terms of what our

customers are saying to us, what they want us to supply to them. So our outlook is for that to continue, certainly over the coming six, nine, 12 months.

When we look at containerboard, I'm afraid we hear so many different things from so many different people, prices going up, prices being announced here and they come in differently. I think all I can say is that we have seen a number of increases in the prices of containerboard. As you know, with paper we have an overall short position. We saw some very large increases a while ago in kraft paper. We've seen those come off now. We are switching huge volumes out of kraft into containerboard.

In containerboard, we're doing a lot of work to lightweight, to reduce the paper content to mitigate these increases for our customers. But there's no doubt there have been some increases. There have been some other recent announcements. Frankly, we'll just have to wait to see if they're going to stick. I wouldn't be surprised if they did, but equally, I wouldn't be surprised if they didn't. I'm sorry to be so vague about it, but it's extremely difficult to call.

But there's no doubt there has been some significant increases and many of those have stuck, and we'll just have to see where we get to with the very latest one. And I wouldn't be surprised either way. If I had to call it I think there will be some increase coming through and some of that will probably stick. But it's notoriously difficult to call, which is why we have a short paper position.

Thank you. Do you want to talk on the EPS?

- AM Yes. I think the question, Robert, was are we comfortable with our guidance at around 21.5 pence for the full year? And from my perspective, perfectly comfortable with that as guidance at the moment.
- RE And given that that represents I think around just over 20% growth, should we be modelling similar growth H1 and H2, it'll be evenly split, or is it biased towards H1 as more of the synergies of SCA are in H1 versus H2?
- AM It's more the other way round, to be honest. I think historically if you looked at our split it will be about 55/45 half one/half two. Given the profile of the synergies in the lagger sectors putting through price rises, as Miles described earlier, I think we'll be looking at more of a balance or certainly less of an extreme 55/45 in terms of the split. Synergies do come through progressively through the year, so the historic phasing is definitely changing. The extent of it I can't be 100% sure about, but I would look closer towards a balance now.
- RE That's brilliant. Thanks a lot.
- OP The next question comes from the line of Barry Dixon from Davy. Please go ahead.
- BD Good morning, gentlemen. Two questions, if I could. Miles, you talked about containerboard pricing. Could you just give us some sense as to what's happening with corrugated prices themselves and how successful have you been in terms of pushing through higher corrugated prices to offset the higher containerboard prices?

And just on input cost and in particular raw material costs around OCC, any thoughts there in terms of how those prices remained remarkably flat through the year? Do you think those... the pressure's likely to be upwards or downwards on OCC costs? Thank you.

MR Well, firstly on the cost recoveries, you know we do a lot of work here. I have to say our cost recovery is absolutely in line with our expectations. There is always a huge amount of pushback from customers on these things. The European economies are in a difficult position. Nobody wants to see price increases. But our contracts are clear. We do a huge amount to mitigate this and I think that's well received by our customers.

So it's all on track. It's as we expect, but, as always, customers don't want to see this when the economies are difficult. But we have been and we remain confident of getting our price increases through. And sitting here today, that is exactly what's happening.

But it's an interesting question about OCC because it has been flat, quite flat, and despite the increase in test liner prices. Overall, when we look out over the next few years we expect to see some modest increase in the price of OCC for a number of reasons. We don't expect to see it roaring off. We don't think there's a particular issue there, collection rates, etc, light-weighting. The use of different technology to make paper means that the OCC can be stretched a lot further than it has in the past.

So it has been relatively flat. There's some modest increases coming through and I don't see any reason why that modest rate of increase won't continue going forwards over the next number of years. Now, that is obviously only a forecast. Different things can happen. But as you know, we deal... we collect over 6 million... or just under, sorry, 6 million tonnes of OCC a year. We're by far in a way Europe's largest recycler. We handle more than anybody else by a country mile.

So I think we've got a very good handle on this and understand how we can improve collection rates, how we can get more out of the supply chain, how it can all be sorted in a much better way and how we can keep the cost effectiveness of OCC going. So modest increases going forward, but I have to say even increases we have, if you go back six months, a year, it's pretty much what we've been expecting. But time will tell. You can always get short-term spikes, but overall I don't see a massive change there.

BD So just a follow-on in terms of the corrugated prices, would you say that... how would you characterise them in terms of the sector, your second quarter versus your first quarter? Would it be flat or slightly higher or lower?

MR In terms of containerboard pricing?

BD No, corrugated prices.

MR Higher.

- BD Higher, okay.
- MR Yes. No, we're getting increases coming through in the second quarter definitely.
- BD Okay, thank you.
- MR Oh yes. No, the prices are certainly up.
- OP The next question comes from the line of Catriona O'Grady from UBS. Please go ahead.
- CO'G Morning all. Just three quick questions from me, if I may. The first one, just could you give a bit more colour around the end-market trends that you're seeing, both in terms of the FMCG 60% and the other, and industrials?

Secondly, in terms of the market share gains, can you just give a bit more information about who they're actually being... who the market share's being won from? Is it still the local players or are you starting to win business off the larger either regional or pan-regional players?

And finally, in terms of the switching point that you made, Miles, can you give some examples of the types of packaging applications that are being switched and how much further do you think that switching has to go before we start to see people... that profile levelling out? Thanks.

- MR Yes, the end-market trend, you can look at it by type of customer in terms of the size, you can look at regions, you can look at the sectors they're in, but keeping it to a relatively high level. I've outlined the countries and how we see those moving previously. There's no doubt there is an uptick in some regions in the industrial sector, and by industrial I'm talking particularly about some construction, some capital equipment, overall, even in things like automotive, and actually the aeronautical industry is also doing better.

The FMCG market, the reason we target it is because it's resilient, so it doesn't rise and fall at the same sort of volatility as you see in the industrial sector. So in fact the growth that we're getting, we're trying to build in resilience into our growth and not just trying to ride on the back of a housing upturn in the UK, which is very nice while it lasts, but how long does it last for, etc? And it's notoriously volatile. So the FMCG market is showing some modest growth, but much more modest than the market overall, which is why we like it.

But we are seeing continued gains from the larger players. Their volumes are certainly improving, pretty much at the expense of some of the smaller players because they have the economies of scale, the end markets are very difficult. And if you look in the results of a lot of these FMCG companies you can start to see that, particularly when you compare them to some smaller players. Obviously niche is always very... are difficult. So we are seeing more stable positions I said in places like Spain and Italy. We're seeing a bit of growth coming through in places like Germany and Eastern Europe. There's certainly a little bit more in the UK as well.

We're seeing the industrial sector in the categories I've talked about growing more than the FMCG. But in the FMCG we're seeing more growth of the larger players because of their economies of scale. So when we look at where we're gaining share, it is with those larger players. It's no surprise because they told us at the time of the SCA acquisition it's exactly what they wanted. They want a pan-European supplier who's focused on them. That's what they want. They told us that.

They told us they didn't see that in the marketplace and they told us if you do expand they will reward, and that's exactly what they're doing because they want to see companies trying to mitigate the cost increases through the use of different papers, that they want to see the service and the quality come up to the levels that they have to supply their customers. And this is very broadly why we're taking share, and we're taking that share from people who don't supply that. Now, whether large or small, I'm not particularly bothered.

We're taking the share from people who are unable to offer that. We've seen it now building over a time. We've never had a decline in volumes in the FMCG sector since we started measuring in the year 2000. They have never gone down. And now we're seeing certainly an acceleration as we've... because of our enhanced offering. And it is from the people who aren't able to offer that. I have to say, generally, the smaller, more regional players are going to find it more... increasing difficult because it's the larger FMCG companies who are taking share, the ability to give them the long-term support they really want, long-term product development. So I'll say we're taking more share from them, but at the same time, as I say, we're taking it from anybody who doesn't offer what we do.

And we're talking about some of the switching. It's quite incredible the opportunity to supply a service, a solution for our customers and really start to engineer the products. I'll be quite honest with you - I'm still relatively new to the industry - I'm absolutely amazed how much opportunity there is to really provide a different solution to our customers. I've mentioned kraft papers before. It's almost unbelievable the opportunities there are to add value to our customers. We don't have kraft. We don't want kraft. We don't want to push kraft. Today, a huge amount of papers are kraft papers, and I literally can see only very limited reason as to why that's the case, certainly more from a performance for our customers.

So we're seeing huge volume switch-out and I'm afraid there are huge volumes to go, and long may it continue for us. It's just all about the solution for our customers. That's what it's about, the best service and the quality and obviously at the best price. And I think there's a lot more to go at. I remain really quite optimistic about that.

CO'G Great. Thanks very much, Miles.

MR No, not at all.

OP2 The next question comes from the line of Jake Thompson from Odey. Please go ahead.

JT Good morning, Miles. Two questions, if you don't mind. One, given your large position in recycling, could you give us some colour on the cost impact of the

Chinese Green Fence and how your recycling contracts might be structured to deal with increasing cost of contamination?

And secondly, when talking about the higher engineered products that you're now offering, do you share benefits associated with them and with your customers, say, for example, from light-weighting? Thank you.

MR Thanks. Look, two very good questions. But on the Green Fence, just so everybody understands, China has put in place some restrictions on the import of waste into China, whether it's waste metal, glass, fibre. They've put some pretty significant restrictions on what can be imported into China. And I have to say it's not a total surprise because of the environmental problems that some of the import of waste has caused in China.

We are far and away the largest recycler of fibre in Europe, but we focus very much on the collection with the major retailers, so our source of fibre tends to be very clean. So we have had the Green Fence put in place. In terms of our business, in terms of what we export to China and how that's treated, we had an initial delay whilst all the paperwork, etc, was looked at and reviewed with the authorities and that was basically it. We haven't had an effect because we haven't exported low-grade fibre full of contaminants because we collect most... a huge proportion of what we supply we collected ourselves directly from the retailer, so we know it comes from a good source.

You've heard me say many times we do all of Tesco's work throughout Europe. We work with the retailer to collect the fibre at source, so it's very clean. So we've been able to really... we have been affected, but really to a very slight degree. What we've seen is that the prices for highly contaminated waste in Europe have fallen because that waste can't be exported to China. But as we haven't delved in it, it hasn't made a huge impact for us. But we do see the price of low-quality fibre and other products really coming under quite a sustained pressure in Europe, but it's not really a market that we work in.

I think quite interestingly, what it could mean longer term is a little bit more sorting at source in Europe, and that actually could increase the flow of OCC back into Europe rather than being exported to China. What China does accept I think is another question. I know they're sourcing more fibre from the US for various reasons.

So in summary, for us the Green Fence has had an effect on us. It was short term. It was about paperwork. We've had no medium or long-term impact on that. We deal in a different type of fibre, a very clean fibre, although we have seen the price of really highly contaminated stuff fall and there is certainly a glut of that. And indeed, when you look at some recycling companies and the effect it has on them, part of it we suspect is because they deal more in the more contaminated areas.

And when you talked about the benefits of the value engineering, we absolutely share them with our customers. We think that's part of our... the way we add value to them. We show them that value in terms of the quality of the products, etc, and what it means for them, on-shelf display and about storage and their line run speeds, etc. And we share those benefits with them. But as you say, share.

If you think about containerboard, it can be, say, 50% of the price of a box. You start making an improvement in that of say 20% and you share that, let's just say 50/50, you're talking about a 10% improvement in paper, which is a 5% improvement in our cost base that's retained in the business. So it's a huge opportunity when you compare that to our return on sales, and that's one of the reasons why not only our volumes are growing but our return on sales is growing at the same time. It's this value-add, and we certainly share it and I think it's.... well, I know it's very well received.

JT Thanks, Miles. Just one quick follow-up then on your first comment about the Chinese Green Fence, does that mean that the markets become more bifurcated and that the higher quality types of fibre are seeing prices pushed up if on aggregate OCC prices are flat as a whole?

MR Yes, there is a differential and there is certainly more demand for the higher quality fibres and less on the poorer quality. There is certainly a divergence there. The comments that I made earlier about seeing some modest increases, I'm actually referring to what we are using. So we have seen some modest increases there. If I looked at... if I was talking about the low-grade stuff I'd be saying we're seeing reductions. But those increases are the ones that I was referring to.

It's not catastrophic or anything, so it's not huge, but there is certainly some modest upwards pressure, which we expect to continue. We don't see the Green Fence going away. In fact I think some other countries could actually follow that. And we're not... we just feel that we've got a very nice ownership of that fibre stream. It's always been a key part of our business model. It's a key differentiator for us with our customers. I don't know of anybody else in our space that has the recycling position anything like it in our industry. And we continue to build it. We're expanding to France at the moment, expanding into Italy, more into Eastern Europe. We're extending that whole platform into Europe. It does take a while to build, but it's a key plank of our business model.

JT Okay, great. Thank you.

OP Just a reminder, please press star one on your keypad to ask a question. Your next question comes from the line of Alexander Mees from JPMorgan. Please go ahead.

ALM Good morning, Miles. Two quick ones for you. Just on the paper manufacturing business in the UK, could you just comment on how that's performing given the movement in paper prices?

And secondly, if you wouldn't mind commenting on your acquisition strategy as it stands at the moment. Do you think you're ready to make another move?

MR Yes, the UK, our UK paper position has strengthened quite significantly. It's obviously one... it's one marketplace, but it's really the northern European market which it operates in. And we've seen some closures by... I think there's been some closures, some temporary closures across northern Europe, so the supply position has certainly tightened. We have... as you know, it's an important asset for us in the UK. We've done an awful lot of work there in further operational and paper grade



and performance improvements. We're now making papers out of the UK that go head to head with kraft papers, whether it's white top, a traditional stronghold for kraft, or in the browns as well we are making some outstanding papers there now that are allowing us to switch out of kraft.

And as a consequence of those two things our position has strengthened quite significantly, not only in our market share but in terms of obviously the profitability. You then add on the price increases that have come through and it is quite a strong turnaround. But as you say, the main part of that is a focus on these different papers to go head to head with kraft. And we're absolutely delighted with that.

And in terms of the acquisition, absolutely, we continue to bed down the SCA Packaging acquisition. The cost synergies are all on track. That's been the heightened expectation, the synergies, working internally, getting the platforms right, the platforms in terms of people, in terms of IT, in terms of finance, in terms of procurement, in terms of those. The corporate functions really are developing very well and our customers are rewarding us.

We're not just making the cost; we're seeing the revenues coming through as well now. And our customers, putting it bluntly, are saying, we would like to see you in some areas, DS Smith. In Europe we'd like to see you extending further. We like what we see. And they are certainly encouraging us to continue to grow. And we are out there. We do it as a team, together. It's one of the reasons, again, we've asked Adrian to join. He's got some outstanding experience in this area and he's already having a really super impact into that team.

So we're out looking. We know what we want and where, the support of our customers, the systems underneath to support that. But at the end of the day we've got to make money for our shareholders. And some people we've been talking to want some very high prices, which we're not going to pay. But I think we'll... I think there are a number of opportunities there and we'll come back in due course.

ALM Thanks very much.

OP Just a final reminder, please press star one on your keypad to ask a question. Okay, there are no further questions, so I will hand you back to your host for any concluding remarks. Thank you.

MR Look, firstly I'd just like to thank everybody for their time this morning to join this call. In summary, we're pleased with the performance in the first half of the year, not only with delivery of all the cost improvements, the continued gain in the market share coming from the support from our customers. We remain confident of strong progress this year and we remain very excited about the growth opportunities for the group. But I very much look forward to meeting you all in person when our half-year results are announced on 5 December. Thank you very much again.

AM Thank you.

OP Thank you for joining today's conference call. You may now replace your handsets.