LLOYDS BANK PLC

Moderator: Emma Hayward

DS Smith Host – Adrian Marsh – Group CFO

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Operator: This is Conference # 35347628

Adrian Marsh: Good afternoon, everyone, and thank you for joining the call. I do see a number of you starting to – or have picked up the transcript of our results presentation last Thursday. So on that basis, what I intend to do is run through some slides that have been circulated.

I'll quickly go through just to summarize where we are on performance and the highlights from last year from a results perspective, and then I'll open it up for questions, which I think will probably be a much more efficient use of everyone's time.

So last year -- we reported last year on Thursday. We were very encouraged with the results. We described our volumes up at 3.1 percent with growth in all of our regions, particularly driven by our pan European customers, which is an essential part of how we're developing the business model. We made five acquisitions last year, increased our presence in 13 countries, 4,000 new employees. And then on the day we also announced two small acquisitions; one in Portugal and one in the U.K.

All of our financial metrics have been delivered on. Return on sales up 50 basis points, return on average capital input up 70 basis points. Leverage now standing at two times in line with where we have as our target and an earnings per share growth of 16 percent at constant currency.

If we go through on to the financial highlights, revenue was up to over GBP4 billion and there's a slide that bridges the impacts of that; operating profit up 16 percent, and again, there's a slide that bridges that. EPS we've talked about up 16 percent, return on sales up and dividend up and return on average capital employed up.

In terms of the bridges on where we are in terms of particularly what's driven profit growth, you can see on your slide six it's a combination of obviously organic and inorganic growth with a significant drop through from the volume growth, which is what we really have as our main describer of business performance.

Overall revenue will, to some extent, correlate itself with the price of paper, which is the largest input cost within packaging. So for us the most important area is how much added value we're getting within the business and what is our volume growth. You can see on cash flow, again, a decent performance on working capital. Clearly the expenditure on acquisitions and the translation impact on currency towards the end of the year had an impact on overall net debt with acquisition spend coming in at around about GBP434 million.

We've been continuing to invest in the business. We're very proud of our capital record in terms of how we're growing. We have very strict criteria both on internal CAPEX and external M&A and we're very true to those criteria. We've got a strong balance sheet. We talked again with S&P; we took them through our business plan, our strategic plan and all of the moving parts in the last year, particularly around acquisitions. And broadly on Thursday that was all we had to talk about.

Clearly a day has passed since then and Friday has come and gone and we're focusing on describing to our equity investors, and I'm sure you'll be as interested today what the implications are of Brexit and the vote that took us all a little by surprise, to say the least, during the day on Thursday.

As a business something on or around 15 percent of all our business is based in the U.K., the substantive part of our business is in Continental Europe. Five years ago it was the opposite way around to that. We have, in terms of structural issues, very little impact – packaging doesn't travel very far, therefore there's little cross channel flow between the U.K. and the continent. So the impact of whatever happens, and we have no idea more than anyone else what will happen, is going to be relatively limited on a transactional basis.

In the euro zone as a whole, including the U.K., with the recent weakening of both currencies against the dollar, again we have limited impact of dollar related product into the business. We have little impact on commodities that price off the U.S. dollar, the most obvious one being, for us, fuel within the transport part of the business. And again, it's a relatively small element -- well it is a small element of our cost-base.

So in terms of how we're structured, we've also matched our balance sheet assets and liabilities so we have predominantly euro denominated debt offsetting our euro denominated assets and a euro denominated cash flow. The dollar debt that we have has been swapped back into euros and we have a limited amount of sterling that covers the U.K. business.

So the treasury function has well matched the balance sheet. Where we had committed transaction exposures, they were all hedged, so there's going to be no shock or surprise through that. And at the end of the hedging profile, the items that we were looking at from a transaction perspective, we have the opportunity to consider where pricing should be for those, and indeed, in what currency and from what country.

So all of that side on Brexit, I'm relatively comfortable that we were, A, well prepared and, B, there's nothing -- knowing now the outcome, we would have done differently. However, of course, I can't comment simply because I have no idea on what the wider implication is in terms of the economies of Europe and what it means from a business perspective.   In all of our scenario planning over the last six or seven years, we've only ever assumed low growth at half percent of Europe, in continental Europe. So we haven't been optimistic and the model hasn't relied nor has it anticipated growing demand or growing GDP.

The biggest part of our business, about 70 percent relates to FMCG food and drink – the food and drink sector, which is growing each and every year regardless of the economic cycle. So in terms of a natural hedge against cyclicality, we believe we're well placed there, too. We have a very limited exposure to industrials and cyclical industrials. There is some exposure, but it's very small and it tends to be particularly around heavy duty packaging. But it's relatively limited and we feel we're well managed on that.

Of course, we still do have a level of paper exposure; it's small. Certainly, the short paper position is exactly where we want to be. And therefore, we have a limited exposure to the commodity price of paper. What that does in the future is very hard to predict. Certainly, in our last financial year on recycled it went up EUR40 and down EUR40. Prior to Friday, it's moved in a relatively tight tram line. What will happen in the future we generally don't know, but it's hard to imagine at this stage there'll be a material change to it unless there's a significant event driven downturn in Europe. And anyone's prediction is as good as anyone's on that at the moment.

So that's broadly a summary of where we are. We had a very good year last year. As a board we're extremely happy; the shareholders have been very happy. We delivered on all our metrics; the business has been significantly strengthened. From a treasury perspective and a financing perspective, obviously, we launched our euro bond which we are extremely happy about. We've extended our debt maturity profile. We have a good duration of liabilities; we have a strong balance sheet. We're in a good position, in my opinion. And on that note, I'll offer it up to any questions.

Operator: Thank you, sir. At this time, ladies and gentlemen, if you would like to ask a question, press star, one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from the line of Rebekah Dance of UNUM.

Rebekah Dance: Hi guys, thanks very much for the call. I just have two questions. One, I just wanted to talk about the plastics business. I know it's a smaller portion of the portfolio, but just trying to understand kind of your view on the business and if there are any synergies with the plastics business along with the rest of your corrugated business, and if you had any thoughts of potentially divesting this asset down the road if you saw the opportunity.

And then my second question is just noticing this year that CAPEX stepped up a little bit; I'm just trying to understand what all was in there. If you could give me some color on the primary growth projects, and then just a reminder of where maintenance CAPEX tends to run. Thanks.

Adrian Marsh: Yes, OK. No problem at all. In terms of plastics, we're very happy with that. The profitability of the division has tripled in the last few years. We entered into a major restructuring of our European flexibles business a couple of years ago, and we're starting to see the benefits coming through the 160 basis point improvement in margin this year and we think there's more to come.

It's a very good well structured business providing on the one hand, bag in the box solutions and fitments, and on the other hand we've got a rigids business which deals with, amongst other things, returnable transit packaging and also a certain board that gets used within different applications.

In terms of synergies, that's a reasonable question. I mean, there's not a huge synergy across the business as a whole. There's a definite synergy within the bag in the box area, and we see that coming through. And increasingly, as we look around on packaging solutions, the two businesses operate extremely well together, but it will be hard to describe a large monetary value synergy between the two.

That said, they have very similar characteristics and we manage them in a very similar way, particularly around the customer and particularly around how we drive the performance. Any asset within the Group, if we believe we'll get to a point where the value will be greater realized with the asset disposal, we will do and we have done in the past. We're not at this stage at the moment.

Could I say we could be at some point in the future? Well, I think just have. So it's not on the decks now, but if the business grows and if we feel we're at a point where we can add no further value to it as a management team under our ownership, then clearly we will take a look.

I think the other question was around CAPEX and what's happened to that. We've invested heavily behind two of our core strategic ambitions at the moment, one of which is point of sale and display, and the other is around e-commerce. Point of sale and display, we see this as a business where there's huge growth opportunities now, and particularly around our pan European customers as we increase our volume of conventional with them. Point of sale and display is increasingly relevant in the retail space where now more or less all decisions are taken on buying decisions at that point of sale within the retail environment.

So we've looked at statistics and you can believe them or not – and we will all have a view on stats, but about four or five years ago if you were in a retail environment and the brand you were looking for wasn't available, there's a one in four chance that you'll switch to another product. That's now closer to 50 percent. The whole way brands are marketed and displayed and described is changing and it's changing rapidly. And this is a product that's good added value and it's a way that we work much more closely with our customers in terms of how we can positively contribute and drive those sales.

So we've made an investment behind this business by building a green field factory in Germany like nothing else. I mean, it will be head and shoulders above anything else in Europe. And the important thing on display as opposed to conventional is that it will travel. So you don't have to have the manufacturing close to the final customer. And we think that there's a great opportunity within this business.

The second main strand of leadership we're taking at the moment is around e-commerce, and we've made some investments in preprint digital printing. So we have a unique relationship with Hewlett Packard where we're developing a preprint digital solution, which basically means the printing will happen as the corrugated is made; i.e., before it's cut into boxes. We think this gives us an enormous opportunity – opens enormous doors with e-commerce business going forward around what you can do with the packaging and packaging becoming the best form of advertising allowing you to personalize. To have a box for one concept, i.e., you can lay on as you're making the corrugated whatever personalization you want.

And there are lots of examples you can look at now where it's possible, but it's only possible, A, at a relatively high price and, B, it’s small scale. This will give us, we think, a considerable advantage within the e-commerce channel and as that changes. So that's really the driver between of growth CAPEX. And the splits we spend about 30 percent, 30 to 35 percent on maintenance CAPEX, including health and safety. Bear in mind how important this is and IT for that matter.

Bear in mind, whenever we make an acquisition, the chances are 100 percent. For what it's worth, we will need to invest in the health and safety equipment within the factories we bought. They will not be to our standards, they will not be the level of guarding that we look at, they will not be the level of process needed from a health and safety perspective. So there is always an investment behind that.

About a third of our expenditure is on efficiency where we're looking at how we can take cost out of the business and we can improve the efficiency of the business. So it’s a return generating capital. And about another third is also in return generating capital around growth, which I've just described. So it does actually come out at about a third, a third, a third with two thirds generating returns. One third of that, or half of that, the efficiency is much shorter term returns and the growth is longer term. So hopefully that answers your question.

Rebekah Dance: That was great, thank you.

Adrian Marsh: OK.

Operator: Your next question comes from the line of Gene Greiman of Mutual of Omaha.

Gene Greiman: Thank you for the call. Just a little bit more color on Brexit, if possible. Do you think there'll be any impact on your processes or procedures?

Adrian Marsh: No. I think for us on Brexit the only issue, I mean, outside of what happens with contagion and global markets, which I'm not the best qualified to talk about. If we sit down as a board and we when we were looking at scenarios, the biggest impact for us is what will it mean, and again, we don't know the answer to this, but what will it mean in terms of movement of labor and free movement? Because that will clearly give us a bit of an impact.

That said, we have a significant head office in Brussels and we can mitigate against it. I mean, we only have a relatively small head office in the U.K. of about 50 to 60 people and we have to think about that. Other than that, from an economic crisis perspective, it doesn't really matter to us. As we said, product doesn't travel particularly out of the U.K. or into the U.K. within packaging. Paper or reels of paper can do so, the raw material can, too.

We have manufacturing of paper in the U.K. It's one of the areas we do have an asset that makes paper. And from with what's happening to currency, it's actually an advantage to us at the moment. But I would prefer not to have had that advantage simply for certainty over what the European environment looks like. But we're not a company where it has a big impact.

We tend to manufacture and sell in local markets. The product doesn't travel long distances because just the freight weight rate is uneconomic because you're moving relatively low value product big distances, and it just erodes. So 200, 300 kilometers tends to be the range. And then if you're going to have to move it across an ocean, it changes it still.

Gene Greiman: You said only 15 percent of your sales are in the U.K. with the balance in the E.U.?

Adrian Marsh: Yes. Predominantly the E.U.. So it's around about 15 percent is U.K.-based, and the balance is a combination of the E.U. and the U.S..

Gene Greiman: OK. Thank you.

Adrian Marsh: The lion's share is the E.U., yes.

Gene Greiman: Thank you.

Adrian Marsh: OK.

Operator: Your next question comes from the line of Cory Darrington of Principal Financial.

Cory Darrington: Yes, hi. Thanks for taking my call. Can you guys maybe just talk about the acquisition pipeline you guys are seeing right now? Obviously it was elevated last year, maybe how you see that progressing over the next few years.

Adrian Marsh: OK. I mean, your voice was faint, but I think the question was how do I see the acquisition pipeline going forward. Well, it's still very strong. We have a very tight financial discipline over what acquisition we look at and what we'll pay for an acquisition. Europe's still a very fragmented market.

We have really focused on growing the business in Europe and we see opportunities all of the time. Most of them tend to be private companies. You don't tend to find financial buyers for fiber-based assets in Europe. It will be strategic buyers and it's pretty much always just us.

Going forward, people have asked me the question do I see a change in valuations? I'm not sure I do to be honest. I mean, if you're buying a private company they'd always have a high expectation of price and we'll have our expectation and until you can take the time to work that back to a sensible number, these things take a little bit of time.

What I do think may well happen now is certainly amongst within private companies, the propensity or the desire to sell will probably get higher with more economic uncertainty. And where they're considering or thinking that they might put an asset for sale, I think the likely that is just a bit higher now. So we see no issue in the pipeline.

That said, these tend to be small acquisitions and we'll manage and we're very focused on what we can do on our balance sheet, what the existing cash generation of the business is and we won't not look at any opportunity that comes on. However, we'll remain disciplined both in terms of what we'll pay and in terms of our balance sheet.

Cory Darrington: All right, thank you.

Adrian Marsh: OK.

Operator: Again, if you would like to ask a question, press star, one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your next question comes from the line of Jeff Hughes of AB.

Jeff Hughes: Hi, thanks for the call. Just a quick couple of questions. Could you talk a bit about market share and where things are at the moment in the corrugated side in your major markets, and if there's been any movement over the past year or so in regards to share versus your major competitors?

Adrian Marsh: OK. I mean, the first point is that Europe's still very fragmented. So we have something like 15 percent market share, there's another competitor that has a broadly similar number, and then the next biggest is only five percent. And so there's a long tail still in Europe.

So where we have strong positions in major markets we obviously have good market shares, but there's still, you know, Europe as a whole is very fragmented. Where we've been and where we've acquired somewhere where we haven't been, so Spain, Iberia, is a good example; we've moved from 0 to 10 percent share through the acquisition.

What we tend to be targeting internally in a market we want to be strong in is to get to a share over 20 percent. And that tends to be the sweet spot for us in terms of the penetration and the scale of the business that you're getting. Because at 20 percent of the market where there's only a proportion of the market we really want to be going after. So there'll be another proportion that actually is more local business that doesn't really sit within our model so well.

If you scale that to Europe, it’s similar; I mean, we'll be happy to get to early 20 percent market shares on a consistent basis and we think that then defines the roll out having rolled out that model. And it will be difficult to get more than that, and arguably we wouldn't want to either.

Jeff Hughes: Yes. And then …

Jeff Hughes: And then just in relation to the negotiation with your customers, has there been any change regarding the length of contracts and/or intensity on the discussion around pricing?

Adrian Marsh: I'd say yes. I mean, the contracts we're getting are longer, that there's no doubt about, certainly compared to where the market was three and five years ago. And intensity on pricing, I mean, these are big, big multinationals. I mean, you wouldn't expect me to say that these guys are going light and are now taking it easy on pricing, absolutely not. I mean, everything is a highly commercial discussion.

But it's around what you can build in terms of partnership. What you can build, what you commit to in terms of quality, in terms of service, in terms of spread, in terms of reach. Pricing is always going to be an important part, but what can you help – what can you do, not just in a country but across the region to drive sales? What is it that you have to do that?

And so, I mean, in the end everything always boils down to a big discussion on price, but we think that we're pretty transparent on that and we explain with our customers what we're doing, what they're getting, and then what the benefit of scale becomes. And being able to plug into our stream on innovation, our stream on best practice and the various services that we offer around packaging and packaging solutions now. So it becomes quite a big partnership.

We had a capital markets day last year where one of our customers, Nestle, came along and said DS Smith as a company, do it like nobody else. I mean, it is a proper partnership towards mutual benefit. And we have a significant share of their business.

Jeff Hughes: And you mentioned that the contracts have lengthened in duration. So a few years ago, let's say it was one to two years on average, where would you put that today?

Adrian Marsh: I would say it was closer to one year a few years ago. We're now much longer we're signing contracts between three and five years. I mean, it's not as a matter of course; there are still ones that are shorter. But where you've been able to develop a meaningful relationship and a commercial relationship you can see three and five year contracts being written. That's not abnormal anymore.

Jeff Hughes: OK, thank you.

Operator: Again, if you would like to ask a question, press star, one on your telephone keypad. And there are no further questions at this time – excuse me -- we do have a question from the line of Rebekah Dance of UNUM.

Rebekah Dance: Hi, just a follow up question. Seeing a margin expansion this year, particularly in the U.K. and northern Europe; I was hoping to get just a little bit of color on what's driving that perhaps acquisition synergies. And then if you could also give us a sense for how much of your cost is coming from fuel. That would be helpful as well.

Adrian Marsh: OK. In terms of the margin drivers, right? That's predominantly operational gearing kicking in. So it's the returns from previous investments around efficiency and around effectiveness and how we operate. So the more volume you get it's just getting – it's just leveraging your cost-base better, so mathematically you drive a margin improvement.

I'd like to leave you the impression that all of the time, I mean it's one of the areas of key focus for us how we address structural costs within our organization and how we manage that margin as well as we can do. The most important metric for us though is not margin, it's return on capital employed. So we could have plenty of assets earning great margins, but really low return on capital employed because they're not used. So for us, our business and our major focus is on return on average capital employed.

In terms of our expenditure on fuel *per se* in totality, it's not a material number. It will be in the low tens of millions out of our cost-base. Largely the contracts you wrap up it into an index basis with your haulier, which mean of course you benefit on the way down and you take a change in cost on the way up. But it's not a needle to move, though, for us. Energy is a big cost for us. Most of the energy in Europe is sort of locally priced.

There's a little bit that gets influenced by what happens with the dollar, but generally for us, we're using natural gas and that's a bit less dependent on the dollar on its pricing, and it, you know, for the last few years has been historically quite low. So we got a benefit this year over last year of about GBP8 million in our total energy spend. As of Thursday, my prediction was that will be broadly flat year-on-year; we're quite well hedged. What it means now and with the current market volatility I genuinely, genuinely don't know, but we're hedged through the year. I think we're

73, 74 percent hedging at the moment. So I wouldn't expect a big impact on this year's earnings. OK?

Operator: And there are no further questions at this time.

Adrian Marsh: Great. Well, thank you very much for taking the time out to listen in. And clearly, if you have any follow ups, if you route them through the team and we'll pick anything up.

Operator: Thank you. Ladies and gentlemen, this does conclude today's conference call. You may now disconnect.

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