

DS Smith AGM Trading Statement Conference Call Transcript

Speaker Key:

MR Miles Roberts
AM Alex Mees
BD Barry Dixon
DO'B David O'Brien
HF Hector Forsyth
TR Thomas Rands

MR Good morning everyone, thank you for joining us today. I'm Miles Roberts, CEO of DS Smith, and I'm joined here by Adrian Marsh, our CFO. Our trading statement, released this morning relates to the period of trading since since 1 May 2017. It has been an encouraging start to the year with trading in line with our expectations. We are delighted with the continuing strengthening of relationships and progress with our customers. This is being reflected in the strong demand for our enhanced packaging solutions across the business with the rate of like for like volume growth being well ahead of the comparative period last year. Progress with our pan European and ecommerce customers was particularly strong again and the recovery of recent increase in paper prices is progressing fully as expected, and the impact of any short-term recovery period is continuously mitigated by the operational leverage coming through from our strong top-line growth.

And as you will have seen, we completed the acquisition of Interstate on 25 August, ten days ago. Trading at Interstate in the calendar year to date has been fully in line with our expectations at the time of the acquisition and this fully supports our confidence in this business. Integration work by experienced team is already well underway and a further update will be given at the time of our preliminary, our interim announcements in December. We are very pleased with the reception by our customers to our continued development of market leading packaging solutions. These solutions are increasing in value to help our customers to improve their own sales, reduce cost and mitigate risk. The response from the employers and customers to our acquisition in the US has been very pleasing. Our outlook is therefore positive and we have confidence in the future. Thank you for listening to our statements. We're now very happy to take any questions you might have.

OP Okay, so the first question comes from the line of Alex Mees. Please go ahead, Alex.

AM Thanks. Good morning. Just wondering if you could give any more...

MR We saw last year's like for like sales being stronger in the second half and I have to say the first half has been very strong indeed. That's pretty much across the board. The UK is interesting. There's no doubt that some of our customers are withholding

investment decisions within the UK, because of all this Brexit stuff, so the outlook is... we'll just have to wait to see what happens. But we are growing in the UK. We're very focussed on food and drink. People haven't stopped eating and drinking. A lot of our customers are continuing to consolidate their supply chain and we're benefitting from that, so we are growing but there's no doubt there's a bit of uncertainty in some parts of the UK economy. I have to say, across the whole business we are very busy. There's no question about that.

AM And then just on Interstate. Obviously very, very early days, but I just wondered other than the comments that you shared at the time of the acquisition from Mondelez and Nestle. I wonder what the customer response has been so far.

MR It's been excellent. Absolutely excellent. There's no question about that again. Things don't change overnight, but we're very well-known and it's a new venture. I think there's a lot of excitement within the company and with our customers and we're very, very pleased about that. We're here for our customers and the relationship and the services that we provide is what allows the company to grow and continue responsibly in everything that we hoped that it would be. Huge market, huge opportunity, a great place for us to be.

OP Okay, so the next question comes from the line of Barry Dixon, so please go ahead.

BD Hi, good morning. This is Barry Dixon from Davy. A couple of questions now if I could just on corrugated pricing and recovery of paper prices. Could you give us a bit more specific... or a bit more colour in terms of what level of price increase you have achieved to date on corrugated, especially in terms of raw material costs? There's been lots of chat about OCC prices, which were very strong in the first seven months of the year, seem to have come off in August. Maybe just give us your thoughts around that as a sort of big recycling... a parent recycling market. What are your thoughts around OCC prices and supply/demand dynamics around that and in particular the export demand? And then thirdly on kraftliner and I think you're a big buyer of kraftliner. We've heard lots of commentary about how tight the supply is on kraftliner and certainly prices on that up above €140 per tonne to date. Again, maybe give us your thoughts on that and the possibility of supplying some of your acquirement out of the Interstate facility. Thank you.

MR If I take them in reverse order, it all sort of builds up to your first question on pricing. On kraftliner we have global sourcing. There is no doubt that prices have risen. I have to say, in terms of our suppliers etc they've been holding up pretty well. We bring a lot in to Europe from around the world and it's worked well for us. The prices are certainly higher. Where will they go in the... ...who knows in the future, and it's pretty much the same with the testliner. It's again with [unclear] prices have risen. At the moment there's more stability coming into the market. Again, I think all we're finding is this demand very... they have been very affected by the Chinese National Sword we've talked about before. There are import restrictions in China for mixed and lower quality waste paper. They of course the price of higher quality OCC in Europe has increased quite dramatically and also in the States, so the prices are higher, but it also means that the Chinese have been looking to buy paper or paper testliner from outside of China. Demand for paper is

very strong. Demand for fibre, we've seen restrictions for high quality fibre, it's very strong. A lower quality fibre, it's much weaker. So, you've got a different basket of fibre, it's moving quite a bit. You're right, it has stayed below in the last few weeks, but I think that's more... we've been very driven by what's happening in China and that could change tomorrow. They could start buying again, National Sword have come in, what's going to happen then in the future? What's important for us is that we have an extensive recycling platform, which we've always had. We've talked about it for years, the importance of this, our access to that fibre, which is serving us extremely well in very challenging times. Again, we're quite pleased with what we have there in our reach in recycling, that we shall get the right supplies at the best prices. But the price of paper has gone up and those increases are coming through, and corrugated pricing.

We are very busy. We are gaining volume and we're getting our price increases that we need. That's quite an interesting question about, what is the level of increase, but if we think about the price of paper we are fully recovering that in line with our expectations. So, the price of test has gone up 80, 90, 100 over the last eight months, then we are proportionally through that increase and that will work out at about [sound slip]... on average that's about... fully recovery is going to be about 8 to 10% on the price of packaging [sound slip]... to see very strong demands.

OP Okay, and the next question comes from the line of David O'Brien, so please go ahead.

DO'B Hey, guys. A couple from me please. Just drawing on your comment to say that operating leverage can mitigate this short-term cost squeeze. If we look at the evolution margins in the paper packaging business through 2017, I think in the second half you're looking at a 50 basis points or just less to 50 basis points, declining in operating margin in the second half. How should we expect that to evolve in the first half of this year and then through the remainder of the year? And then secondly, during the Interstate acquisition and the amount of average debt that's been taken on with it, what are the prospects for M&A in the short-term? Are things on hold? And how does the pipeline look in the US and Europe?

MR In terms of where we got or where we are on margin and what are expectations are there [sound slip] they're clearly at the [sound slip] the year end we talked about the squeeze or the impact you will see in each one and the recovery as you recover through the paper cycle. That doesn't change. That scenario is exactly as we described it when we finished last year, because it's very obvious, it's very visible and every time you have an increased input prices and you pass through there's a lag. So, that's well-known. Where we do get benefit, as we said in the statement, is through our operation leverage. So, with strong volume growth and the ability to drop that though, we are able to and we have done as you'll see last year through the whole 12 months, is to significantly mitigate how that impact lands and that's the same this year. So, we're looking at consistent margins with last year, but there's clearly an H1, H2 impact and we described that last year. In terms of leverage and our ability for M&A, we see no great issue at the moment. In terms of the lower, smaller sized M&A that we've conducted successfully over the last four or five years we still have sufficient head-room to cover that. In terms of

large-scale M&A, should those opportunities present themselves and they're financially attractive, we've already enjoyed significant shareholder support as you saw on the Interstate acquisition and we've no reason to believe that that will be any different going forward. We remain financially prudent, we have investment grade credit ratings, we made sure the refinancing we carried out a couple of... well, just over a month ago now, we remain very positive about our ability to actually achieve our M&A, witnessed by the amount of inbound enquiries we currently have.

DO'B I just want to follow up on operation leverage. What kind of sustainable or average rate do you think sales should drop through to profit?

MR We did say we're not going to be describing precisely how the mechanism operates. We'll go through the bridges and you'll see a reconciliation through that. But it's entirely consistent with previous years. We've had a good drop through...

OP Okay, so the next question comes from the line of Hector Forsyth. Please go ahead.

HF Morning, guys. On sales from Amazon. Can you describe how much of a contribution that has made to the business and also the wider ecommerce and can you give us any update on the relationship with Amazon? Maybe, has it spread a little bit across Europe?

MR It's very difficult to talk about any one particular customer. However, our ecommerce group has been absolutely tremendous and a lot of the work that we have been awarded has not come on stream yet. There's a substantial, a very, very substantial piece of work we've been awarded on long-term contracts. We have the whole build-up at the moment. We're starting thinking about the Christmas shopping period, that final quarter in the year, and that's yet to come through. So, overall ecommerce is very positive. It continues to build as a portion of our sales and a lot of our work we've won across Europe has not come on yet. This is a very busy time for us. We're heading into very exciting times as well, because we're starting to see the evolution about some of the new solutions. We've talked about having our machines in customers' factories, packing all of the products, they're now being trialled. They're up and they're running, and the reception of our customers is absolutely tremendous, these sort of solutions that take out substantial costs from their operations and we feel in a commanding position there. So, yes, a very exciting time and I think the opportunities are only starting... we're at the beginning of this opportunity.

HF Okay, thanks very much.

OP Okay, and the next question comes from the line of Thomas Rands from Investec. Please go ahead.

TR Good morning, Miles. Could you give us an update on what you're seeing within the point of sale market and what sort of utilisation the new or new-ish German factory is now at and what you're seeing please?

MR Yes, in the German factory we've fantastic progress there. It's an unparalleled asset in Europe and we're very pleased. We've obviously built this with a number of years of capacity in it, so as a building the assets that are actually in there will build over a number of years in terms of machinery as demand falls up. I have to say, we're very pleased with the rate of... with the customers... on the rate of order of activity. Generally, point of sale continues to grow. It is an important part of our business. Sales up quite nicely on last year. It's working pretty much as we expected, but of course it's still early days in our forming this whole business across Europe etc, so again we're pleased with the progress and remain optimistic about the future. But I have to say, in Germany, particularly it's a super asset and it's getting the recognition that it deserves. Yes, very pleased.

TR Great, thank you. And just a follow-up question on the back of Hector's ecommerce. You talk about very strong volume, guys. Could you quantify? Is that double digit growth?

MR Oh, in ecommerce? Oh, yes, yes. Oh, goodness me, yes. What we're seeing is the UK has the highest penetration in Europe, but the UK is growing very strongly. It's growing double digits easily in the UK and now we're starting to see Spain and Italy, particularly Spain coming on and again the volume changes are enormous. As the ecommerce solutions focus more on their intimacy in terms of customer reception, so you're seeing 20 or 30% kind of increases. Yes, it's enormous. And now of course we've all read about some of these big internet companies, how they're moving into grocery, and again these sorts of foods use quite a bit of packaging. If you go on one of the most publicised ones at the moment, you're given your groceries in a cardboard box and we're absolutely delighted about that. Absolutely delighted.

TR Right, thank you.

MR Thank you again, everybody, for your time. We'd just like to reiterate, we're very pleased with the start of the year, our volumes are very strong, we're recovering the price increase with our customers in full as expected. Interstate, so far it's everything that we expected it to be, so we look forward to the future with some confidence. Thank you very much for your time.