

**DS Smith AGM Trading Statement
Conference Call Transcript**

Speaker key

MR	Miles Roberts
AM	Adrian Marsh
ALM	Alex Mees
RE	Robert Eason
JJ	Justin Jordan
KF	Kevin Fogarty
KH	Kevin Hellegard
HF	Hector Forsythe
RS	Rachel Stevens

MR Good morning, everybody. Thank you for joining us today. I'm Miles Roberts, the CEO of DS Smith, and I'm joined by Adrian Marsh, our CFO. Our trading statement released this morning relates to the period of trading since 1 May 2016. The business has made good progress since the start of the year and our performance has been in line with our expectations. Volume growth remained good, every region is in growth, and we're particularly pleased with the ongoing growth from our pan European customers who continue to benefit from our increased scale and coverage, reflecting our investment in quality, service and innovation. Our return on sales and return on average capital employed have both shown further improvement versus the comparable period last year, reflecting the benefit of operational leverage and the strength of our business model.

Since the start of the year we have continued to invest organically and also acquire businesses in attractive geographies and market segments. These include e-commerce and display, and they build on the five acquisitions we completed in the last financial year. We have subsequently announced three further acquisitions so far this year. The proposed acquisition of Gopaca in Portugal will expand our position in Iberia and complement the operations we have there already. The transaction is expected to complete during the first half of this year. Acquisitions of Creo in the UK and Deku-Pack in Denmark have both been completed. Both of these are focused on display for FMCG retail and media markets and they build on our already significant capability and it is a very important, attractive and growing market.

So we're pleased with the start of the year and momentum within the business has continued. We're growing organically and through acquisition. Obviously notwithstanding the increased political and economic uncertainty within Europe, our outlook remains positive. Packaging has ever-increasing relevance in a dynamic retail and consumer environment and our recent acquisitions, together with the market and customer opportunities for growth, give us real confidence for the future. Thank you. I'm now very happy to take questions which either myself or Adrian will answer.

- ALM Alex Mees of JP Morgan. Good morning, Miles. Good morning, Adrian. I just wonder if you could provide a bit more colour on your acquisition pipeline at the moment. What are your priorities for acquisition targets and what financial capacity do you think you have given where your gearing is, please?
- MR Adrian will comment on our financial position, but the pipeline of acquisitions remains good. There's quite a bit out there. We're obviously very choosy. All of the acquisitions we made last year are performing well, fully in line with our expectations. I'd say we're quite excited about the new ones this year. There's a lot of work to do. We're pleased with those. We think we'll make very good returns from them, all in line with our medium-term targets, and the pipeline is good. We still remain about 16% of the European box market, so we think there's plenty of room to continue growing and developing. I think I have said before we're seen as a consolidator of choice and I think that's as true today as when we said it. What about gearing, Adrian?
- AM Yes, on that, Alex, as you know, the company has been and remains very focused on deleveraging to give us the capacity and the headroom to grow. We are geared at about two times. I think we've always said we can go to around 2.5 times before we start getting too focused on where things are. That said, the acquisitions we've made so far are relatively small. I think in total it's about 70 million, something like that, Sterling. The business is cash generative. The focus remains on generating cash to give us that opportunity and if something significant comes along, then we'll look at how we finance that.
- ALM Excellent. Thank you, and good luck for the rest of the half year.
- AM Thanks.
- RE Robert Eason from Goodbody. Hi. Good morning, everyone. My first question is just on the general pricing environment given recent announcements from container board producers of an increase in the coming weeks and how you see that panning out and, more importantly, how you see it filtering into box prices. My second question is around the acquisitions. Quite clearly you did five acquisitions last year and you've done a further three this year. Can you just give us a few financial metrics around them in terms of what is still to come from the five acquisitions last year in terms of sales and EBITDA, and what should we be pencilling in on an annualised basis for the deals that you've done year to date?
- MR Robert, if I just take that pricing and then Adrian will take you through the financial returns. Look, on pricing, as always there are a number of moving parts. Currency is starting to play quite an issue here, particularly in the UK where Sterling has obviously devalued against a number of currencies. This has resulted in some price momentum in the UK in paper prices. Where does it go in the future? I think it very much depends on the strength of the UK demand, but also on currency. Now, look, the prices have gone up and I suppose our model is that we pass the money back to our customers on the way down and we recover it on the way up. We always have and we fully expect to do that in the future.

I said our margins have been going up year to date. When we come onto the continent, there we've seen reasonable stability in paper prices over the last few months. Demand is okay. There's new capacity coming on. It's

difficult to say. I don't see prices falling particularly, but depending on demand the paper price will respond accordingly. The Euro did fall against the Dollar; that put some pressure on import costs. The Euro is now back to pretty much where it was against the Dollar at the time of the UK referendum, so I think we just have to wait and see what happens on some of these currency moves. But from us, we have the mechanisms in place. We pass it back when the price goes down and we recover it on the way up, and we don't see any change to that.

AM Yes. On acquisitions, look, we're happy offline to go through any assumptions that you've made and to have a look at where we feel they're sensible or not. In terms of what you should be expecting, though, we're very focused on the financial returns that an acquisition has to make. We look at how quickly we can get to delivering in excess of cost of capital on the acquisition and generally speaking it will be unlikely if that's less than two years on the acquisitions we're making. Clearly some will be slightly longer than that and clearly some will be slightly lower. It depends precisely the type of acquisition it is, but generally speaking we've a pretty strong feel of the synergies we're going to generate from them, and track record to date has been that's delivered in line with what we've been expecting. But if there are some specifics on that, we can pick that up with you later.

RE Okay, thank you.

JJ Justin Jordan from Jefferies. Thank you. I've got three very brief questions. Sorry. Firstly, Adrian, can you just reconfirm that number? I think you said 70 million of M&A spend year to date? Secondly, can you just comment on impact, if anything, year to date post 23 June of Brexit on 22% revenues for DS Smith from the UK?

AM So the answer to your first question is yes, it is around about 70 million Sterling, Justin.

MR Just on Brexit, as DS Smith we're working in Europe and Europe is a very uncertain place and it has been for many years. We've had the Catalonia issue, we've had the Greek issue, we've had all of these economic issues and now we've got this UK vote on the referendum. We have no idea where it's going to end up and what exactly the final trading relationship between the UK and Europe will be, but we've always planned for a difficult market. So 78% of our volumes are in what we call very resilient categories, predominantly food and drink, and the UK is no exception. The UK makes up about, last year I think 16 or 17% of our profits, so if the UK does suffer the delta is on 16 or 17% of the group.

You can see where we're expanding and growing in the recent announcements and we think those categories also have quite a bit of resilience in them. Lastly, the degree of intercountry trade is generally pretty limited, so it's not as if the UK is very heavily dependent on being supplied from overseas. There are not a lot of currency movements at the finished goods level, but obviously there's something on the raw materials side. So overall I think we're well-positioned to weather a storm, but obviously we don't know what that storm is going to be, hence we say notwithstanding. But at the moment I said all regions are in growth and I have to say the UK in terms of volume and moving forwards, it continues to do well. So we'll just have to see, we've designed the business to be resilient and that's how we expect it to perform.

JJ Sure. Just one final question; benchmark OCC prices in Euro terms are up, I think it's some 18% year to date. Obviously with 16% pan European market share, you're one of the biggest buyers of OCC on a pan European basis. What have you seen and what's your ability, if any, to recover that in terms of that potential margin squeeze via higher testliner prices?

MR Well, look, on OCC, we look at things in a constant currency basis and overall for the world there's plenty of OCC. There can be local increases in demand. It can push up price very locally. Prices of OCC in the States are falling because obviously the Dollar is very strong. That 18% increase is on the back of a deterioration in Sterling and the Euro against the Dollar. The Euro is now back and we'll see what happens to OCC prices going forward. It may not be certainly as strong as it has been in the past, so we have a currency issue there.

I think that is certainly one of the factors behind the increase in the UK price of paper and indeed may lead to some in Europe as well, so we have this currency issue. As I say, we source across a number of continents and we're aiming to iron out some of these inefficiencies between markets. We haven't completed that work at all, but clearly our increased size and scope enable us to source more widely. The headline prices in any one market don't tell the whole story.

JJ Great. Thank you.

KF Kevin Fogarty of Numis. Hi, guys. Morning. A couple of questions have obviously been answered already, but just a few specifics. Just taking up that point on pricing, have you got to the point yet of raising prices, or you anticipate that coming down the line given what we've seen in OCC pricing? Secondly, I guess a bit more colour on the acquisition pipeline in terms of the scale of opportunities you see there. Are there material opportunities you see? It's just really I guess in terms of the mix of what you see in the pipeline would be helpful. Thanks.

MR Yes, so on prices, the prices of paper in the UK have gone up and we expect to recover that. We don't see any reason why we won't. We have a series of mechanisms to do that. We've got excellent relationships with our customers. We've given it back to them when prices go down and we'll recover it on the way up. It's a bit early to say on the continent, but indeed some of the pressures may indeed push some prices upwards, but it's too early to say.

Yes, on the acquisitions, you can see I think last year we spent €600 million. We spent another 70 so far this year in Sterling, so you can see we've put quite a bit of investment in there. When we look at the size of opportunities, there are a number. There are things around 30, 40 million, but there are things that are quite a bit larger. Last year Duropack was around €300 million and we do have a number of opportunities. There isn't anything enormous, but there are some that are quite significant and that gives us that confidence in that pipeline.

KF Sure. That's very helpful. Thanks a lot.

MR A bit of turmoil just sometimes freezes a few things.

KF Yes, sure. No, that's understood. Thank you very much.

- MR Thank you.
- KH Kevin Hellegard, Goldman Sachs. Good morning, guys. I was wondering if you could just add a bit more detail maybe in terms of which regions you see most potential for M&A and what the total amount could be to stay within the leveraged target, or the leverage range you gave?
- AM Yes, I think in terms of the regions, we've been pretty consistent around the whole German, Polish industrial corridor remains a strong focus for us. You'll have seen us building up in Iberia; that remains a market of focus for us. They tend to be where we're most interested at the moment. That said, we saw a very attractive Scandinavian business in display to strengthen our portfolio there, so I wouldn't say we're totally agnostic. We have an area of strategy we're very interested in and then we have specific business types that we're particularly interested in, and that's where it's less obvious from a geographic perspective. In terms of acquisition headroom, I think I said 2.5 times is about the level we feel comfortable for, so if you add half a turn onto our EBITDA, times our EBITDA, you can see broadly the additional capacity over and above the cash generation of the business that we feel we can sensibly acquire to.
- KF Thank you.
- HF Hector Forsythe from Stifel. Good morning, guys. A couple of very quick questions to start with. Capital markets day you mentioned at full-year results, is that still on?
- MR Absolutely.
- HF Do we have a date?
- RS Invites will be going out in the next few weeks.
- MR Yes, so you'll receive an invite very shortly.
- HF Fantastic. A slightly different tack here, pension deficit. Adrian, can you talk us through what has happened in terms of that over the last few weeks and months?
- AM Yes. Yields have gone down so liabilities have gone up, not unsurprisingly. The investment return has been reasonably positive so the deficit has gone up, Hector. I haven't got the precise figure at the moment, but when I last looked it was an increase of 50 to 60 million, but we will be going through a valuation process fairly soon anyway. But, yes, as you know, it's not a huge deficit in the scheme of things, but clearly when yields come right off you'd expect your liabilities to go up and that's exactly what's happened at a higher rate than the investment return. But it's not a shattering number, but clearly it's on the negative.
- HF You've got a significant amount of liability hedging in though, haven't you?
- AM Absolutely.
- HF So that reduces the headline effect, if I'm right.

AM You're absolutely right, it will do, but you still can't get away from the fact that when yields come off you have an impact on how you value those liabilities. But, yes, clearly actions we've been taking over the last three to five years have significantly reduced what the impact could've been, but you're never going to totally de-risk a scheme like ours, neither would you want to. We're in a last man standing scheme so the liabilities are quite long into the future.

HF No, that's absolutely fine. Thank you for that. A couple of other things. Some of the themes of the questions have been asked. Can you give us your net paper position in the UK?

MR In the UK we are producing... in terms of test liner you've got about 600 odd thousand tonnes of test liner. There are some other products that we make as well. They're outside of packaging, it's like 600. Our UK business consumes in total about 6-700,000 tonnes, but not all of that is test liner, so therefore we have a slightly long position in the UK. It's a consequence of the Kemsley business, it's size. So the overall UK market position is the UK is a net importer, so we're able to sell our paper to other suppliers. With the recent strength of Sterling opportunities to sell on the open market overseas have been more limited.

However, we do supply our Nordic businesses with paper from Kemsley because it's so close. We do hedge forward various things, but the reduction in Sterling and the value of Sterling obviously makes that export market slightly easier for us, albeit the price of fibre has increased. So we do have a slightly long position in our business, the UK market is overall short, but obviously we supply our Northern European business with that paper as well and that should hopefully strengthen slightly given the current weakness of Sterling.

HF So net-net a slight help in the UK margins?

MR When everything feeds through, yes.

HF That's terrific. And then the last question is regionally in terms of trading, it's such a short period of time, but any changes and particularly in Northern Europe where it was a little bit harder going through the end of last year?

MR Look, every region is in growth for us, if you talk about pan European, and overall volumes are growing very nicely. There's no doubt that up in the Nordics, etc, we are doing better for various reasons. That's very positive. A lot of the Southern European markets have done particularly well recently as part of the ongoing economic recovery, and places like Spain there's no doubt it's benefited from a very strong tourist season, and because there's been food and drink that's probably added just a little bit more gloss on that number. France, we're growing, but the French economy is difficult. Our Central European business with Germany, again, we are growing but the German economy has been a little bit quieter as well. So good overall growth, but as always there's a slightly mixed picture, but obviously within the realms of each one of our regions is growing. It's Europe, there's a few differences.

HF Okay. Guys, thank you ever so much for that.

MR Not at all.

- JJ Justin Jordan from Jeffries. Thanks, guys. Just one very quick follow-up. You've talked in the past about customer pull into new geographies and I guess Iberia is a good example of that where you've done several transactions in recent years to satisfy customer demand. When you think about potential expansion outside of Europe, you've talked at the year-end about North America, about the Indian subcontinent, about Asia Pacific. Where are you on thinking about expansion outside of Europe and I guess particularly potentially M&A in North America?
- MR You're right, at the year-end we talked about some of the progress and that progress really has continued. The ongoing feedback, particularly in North America from our customers is very positive in how we're helping them because, as they say, they want our solution in those markets, and these are quite a number of very substantial customers so we remain very positive on that. We're not at the end of our thinking as to how we are going to serve them, support them in that market, but it does look encouraging.
- JJ That reads as an inference of nothing immediate.
- MR No, we're not at the end of our thinking. Ultimately, here we have to make the right return. That's what we're here for. We're very clear on it and just going through how we solve that. It's a very big market and there are many ways of sorting this out, so again, we remain very positive on that. I'm sure it could be a good opportunity for us.
- JJ Great. Thank you.
- MR Thank you, everybody, for your time. We greatly appreciate it. All I can summarise is we've started the new year well and momentum within the business is continuing. Thank you very much.