

9 March 2016

DS Smith Trading Statement Conference Call Transcript

MR Miles Roberts
AM Adrian Marsh
BD Barry Dixon
TB Tom Burllton
JJ Justin Jordan
DO David O'Brien
HF Hector Forsythe

Good morning, ladies and gentlemen, and welcome to the DS Smith Trading Update. My name is Fay and I will be your coordinator for today's conference. For the duration of the call you will be on listen-only, however at the end you will have the opportunity to ask questions. If at any time you need assistance please press star zero on your telephone keypad and you will be connected to an operator. I will now hand you over to your host, Miles Roberts, to begin. Thank you.

MR Good morning, everybody; thank you very much for joining us today. I am Miles Roberts the 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 1 November. In the second half of the year to date the business has continued to progress in line with our expectations. Volume growth has been good, particularly in Western Europe and South-East Europe where, as expected, customers have reacted very positively to our business offering, including access to our design and innovation capability.

Revenue growth from pan-European customers continues to benefit from our increased scale and coverage and reflects our continued investment in quality, service levels, and innovation. Our return on sales and return on capital employed have both shown further improvement further the comparable period last year, again reflecting the benefit of operational leverage and the strength of our business model. We have also strengthened our business with the completion of the acquisition of a specialist corrugating packaging and displays business in Istanbul. This we announced in December; integration is progressing as planned and we're absolutely delighted with the initial reaction from our customers.

We're pleased with progress in the year to date as we continue to grow organically and integrate the businesses that we acquired over the past year. Our outlook remains positive as volumes and financial returns continue to grow despite the ongoing challenging market backdrop.

The board continues to anticipate performance in line with our medium-term financial targets and views the remainder of the year with confidence. I would now like to invite questions which myself or Adrian will be very happy to answer. Thank you.

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 your question. And the first question is from the line of Barry Dixon from Davy; please go ahead.

BD Good morning, Miles, morning Adrian; thanks for taking the call. Just two questions, on the volumes you say that volumes continue to grow, Miles, maybe just give us some colour around that, either in terms of the rate of growth or at least whether or not growth rates have continued at the pace that you saw in the first half, that kind of three per cent-ish kind of level. And then the second question on corrugated pricing; we've seen some reports that the corrugated price has increased by about one per cent in the fourth quarter of calendar 2015 and that there was an expectation of some further price increases in the first quarter of this year, of 2016, you might just talk about corrugated pricing and how that's evolving, particularly in the context of container board pricing which looks a bit wobbly at the moment. Thank you.

MR Well, with the volumes, we're pleased with the progress we're making; we set a target of growing ahead of GDP by at least one per cent and that's where we are. The volume growth has been good in a number of areas; I have to say we're very pleased with the reaction in the newly acquired areas of our customers there, obviously we have a very unique offering in places like Spain and South-East Europe where we've recently entered, and into Greece, and we're very pleased with that.

So turning those businesses round that have historically been losing volume into growing volume, it's been good. I mean there's no doubt some other areas are more challenging; we continue to suffer the effects of a bit of the fall out with trade sanctions etc., particularly around the Nordics. Some of you may have seen recent embargoes or more trade sanctions in Kaliningrad to the Baltic States so this does have an effect but as you can imagine it's not a very big region at all so overall it continues to grow.

But we are food and drink and as Europe continues to eat and drink we continue to grow. There's a huge appetite from our customers for our services, particularly in understanding how the consumer is shopping. We've just been through the first real internet shopping Christmas and we're absolutely delighted with the reception of our solutions in this fast-growing and really quite exciting area. We're going to come on to talk about pricing, we continue to grow our margins and recover our costs as we need to. Paper prices go up, they go down, they go sideways, that's not an over-arching issue for us because you know we run a much less integrated model so final pricing isn't the be all and end all for us.

I think again our offering with our whole sort of performance packaging, where we're really able to engineer the product not only to optimise the use of fibre but also to help our customers to reduce logistics costs etc. continues to be well-maintained. So I think overall we continue to recover what we need and work with our customers; that's broadly where we are, Barry, and as I say paper prices go up, down, sideways, you know, we try to limit our exposure to that. It's not so much a can we recover ups and downs, it's can we absolutely maintain the value that we're adding to our customers and we can.

BD Okay, thank you very much.

Thank you. And the next question is from the line of Tom Burlton from Bank of America Merrill Lynch; please go ahead.

TB Morning guys, Tom Burlton here, Bank of America Merrill Lynch; just a first question on input costs, if you could go through the effects you're seeing perhaps on the various lines so in terms of energy, starch, and perhaps topically kraftliner where we've seen the price come down about five per cent year to date. And then second question, another topical one, perhaps if you could comment on the potential implications of Brexit if we get that, please?

AM In terms of inputs costs and line by lines, this is just a trading statement so you wouldn't expect us to go through those. Clearly the environment for energy is favourable and it has been year on year, we hedge out 12 to 18 months in advance so you get a delayed effect but the environment is positive rather than negative. The starch environment has been marginally negative year on year, marginally, and kraftliner obviously for us has been positive, as you rightly say prices have been coming down. So in general terms clearly when we get to the full year results we'll be more specific but I guess that's what you'd expect me to say as well on those major line items.

TB Sure, sure.

MR And on Brexit it's very interesting because the UK is obviously one of the countries that we work in, we've got a fabulous presence here and absolutely it's a very important area but at any one time we have quite a few local issues, we've just had one with Catalonia and people wanting to break away. It is possible that 200000 votes are reached in the Netherlands and the Netherlands go for some sort of referendum, we've got Tyrol etc. At any one time when the economic environment is difficult we face these countries potentially breaking away. It doesn't have any particularly onerous near-term consequences. I think we tend to produce and supply in a single country, obviously where there are borders in Europe you get more flows but the UK is certainly a more contained market because you just can't transport the corrugated packaging really cost-effectively across the Channel.

So we don't think it will have a material effect on us, certainly in the short-term. I think in the longer term it just depends what our customers do, if they start to shift production overseas; if they do, then obviously we will seek to rebalance but I think that will be in the longer term. We do plan for these things; we plan for it for Catalonia, we plan for it for lots of places, we planned for it for Scotland. We work with our customers on a pan-European basis and obviously we're in Greece as well; we're the market leader in Greece by some way and we worked very closely with our customers there when I think there was a real danger that it was going to come out of the Eurozone but we planned for that and worked with our customers and they were very clear with us that they have manufacturing centres around Europe, they pay us in a certain currency and whether the economy is in or out it doesn't make very much difference.

We work in Turkey now and we are using that facility to supply into Europe. In some of their products they are very specialist products; I just think we're working more on a European basis.

AM We manage the balance sheet accordingly so we don't foresee issues on that front. Our businesses are headquartered in Europe, in Brussels. The UK for us is a head office and a local market but as Miles said, we plan for it, we work through the consequences. It's a question we get asked a lot, a lot of shareholders are interested; I think we give reasonable comfort that...You don't know what you don't know but in terms of how it will impact our business, we see it as negligible if at all in the very short-term and then as Miles said longer-term for the UK specifically, I mean there will be issues around capital investment and where some of our customers locate but the advantage of having as much pan-European business and in Europe as we are, we think we're pretty well insulated.

TB Okay, perfect; that's very helpful. Thank you.

Thank you. And our next question is from the line of Justin Jordan from Jefferies; please go ahead.

JJ Good morning everyone; two quick questions if I may. Firstly just on outlook; your statement this morning refers to challenging market conditions, now that reads to me like a slight downgrade to the outlook comments you gave at the interim results of ongoing challenging economic environment in some markets so am I right to infer that volume growth may have eased slightly from the 3.1 per cent that you reported in the first six months?

MR No, no.

JJ And secondly can I just talk about M&A pipeline; there's nothing materially new in the statement this morning. You previously announced the Turkish deal. Can you just talk about the pipeline of M&A opportunities; are vendor expectations changing or are you seeing more competition from private equity or other buyers for opportunities? Can you just give us an update on that?

MR Well firstly on the outlook, that really refers to the general economic environment; it's not us at all. We say we're positive on the outlook and that is absolutely unchanged. As I said we continue to grow as we expect; it's just more of a...call it general economic environment, what does the EU do? What's happening here and there? It's just generally an uncertain time but we've shown over the years...lots of things have come and gone over the last few years and we've never failed to grow and improve our returns and obviously the dividends etc. so it's more of a general point about the overall world economy. But no specific concerns for us at all.

And with the M&A pipeline, it remains very strong; we have spent €700 million, something like that, in the last year. The pipeline is very good; again I think we're seen as the consolidator of choice, that's what people tell us. The integration is going very well. I think there are many advantages for our customers, for the employees of the acquired businesses, and obviously for our business and therefore shareholders. So we're pleased with the outlook and we certainly expect

to make further progress with M&A. It's always a little bit...the timing is never certain but we're very pleased with the pipeline, very pleased.

JJ Great, thank you.

MR Not at all.

Thank you. And our next question is from the line of David O'Brien from Goodbody; please go ahead.

DO Hi guys, thanks for taking the call. Firstly just on kraftliner; when we've seen the price increase during 2015 you guys reported you probably hadn't experienced the same uplift as maybe benchmark prices alluded, can you confirm the level of decline in kraftliner prices that you've achieved in your system, and maybe just leading on from that, the ability to hold on to those benefits. Is it any more different than testliner dynamics that get passed straight through? Do you have a greater hold on the kraftliner benefits? Secondly, just on a stronger euro; outside of the translation benefits back into sterling, could you give us a sense of what the impact is on trading dynamics in the UK market specifically from a stronger euro? And maybe just finally give us an update on how the Lantero business is and whether or not you're in a position to give us the synergy number there yet?

MR Do you want to take the euro and Lantero and I'll just talk about kraft?

AM Yes.

MR With kraftliner you get all sort sorts of talk in the market etc. about things and indices, you're absolutely right; people say it's going up but we didn't see that. But I think that's partly because of our size. We've been very clear that overall there's quite good capacity on a global basis and I think we are able to take advantage of that and our work in this area has progressed very well. We obviously have some existing legacy supply contracts and we're obviously working through those but what I'll say is we are very pleased with the progress that we're making. In terms of pricing, our customers are often very big, multi-national companies who are absolutely world class organisations and if it's one type of input cost or another I can assure you they know an awful lot about these sorts of things. That's why we have to concentrate on the added value. It's not about input costs, it's about the value that we bring to them to increase their sales, reduce their total costs of supply, and reduce their risk. So we're pleased with the progress, we work with outstanding customers, we don't see a big difference between this or testliner, we move quite freely between the two but we're very pleased with the value that we continue to add.

DO More about the pricing, margin; does that make it more difficult to get recognition from customers of the value add you're bringing through pricing or has it purely been a value benefit?

MR Well look, with volatility it really does depend ultimately on the customer but very generally the way we try to sell is, the cost to pay is what it is, kind of what it is, let's work to reduce the total cost of supply and that's what we want to be paid for. So if we can reduce the paper content, we're seeing the differential between kraftliner and test fall quite significantly, and that's partly the way we continue to

shift out of kraft into test because we sell on a performance basis, we don't sell on sort of a legacy specification, we sell on the performance basis. So the volatility is there but in some ways with our customers it just sort of plays this how do we add value? How do we work with you in these generally challenging times to add value? So I wouldn't say it had a particular effect; if anything it kind of plays a bit more to our added value concept. But look, it's uncertain. In pricing you look at these things, I wouldn't be surprised if there was more volatility going forward. It's just very difficult to call.

AM I think in terms of the bands of volatility, volatility on recycled and on testliner has been relatively narrow-banded where kraft has probably been a bit more downward trending from what we've seen. But in terms of translation, which is the other question, obviously the way sterling has moved against the euro in the last few weeks has a small negligible impact on the average rate for our financial year as you exit the year, however potentially it has more of an impact next year, depending where currencies end up, but obviously that's...you're talking about volatility, currency is the area of volatility at the moment and it's quite hard for us to call and I think it's going to be a brave person who does ahead of June 23rd.

DO Is there any benefit when there's less paper coming into the UK given the strength of the weakness of sterling? Does the dynamic improve for you in that regard?

AM Yes there's always around the margins an arbitrage play one way or other so when the euro is particularly weak against sterling then of course the propensity to import spot volumes is higher and that there's no doubt about; and we saw that. Likewise it works the other way round; when sterling is particularly weak against the euro paper to that extent will flow out again. These are around the fringes and it's marginal volumes but you see it and there's no doubt about it; one see it, the UK and having two different currencies and the transport, you open and close opportunities at different times. We noticed it for sure when sterling was through the 140 to the euro during the year, I mean it was noticeable. Can I say at the moment I can notice?...well it's been a relatively short period of time so we haven't seen that yet but it will happen because guys that are trading will suddenly be caught the wrong way round on a position and what they're offering becomes less attractive price-wise. So yes, there is an inevitability but it is on the margin but it's noticeable for sure. There's no doubt about it, we prefer stable currency than volatile currency; it doesn't add to how easy it is to manage a business or not.

MR Well the hedging works well and hasn't caused us a particular issue.

AM In terms of transactional, for us there's limited transactional impact because we don't flow two ways particularly.

DO Great, thanks. And just finally maybe just comment on Lantero and probably synergy potential there.

MR Yes we'll come back at the results on Lantero and describe it more fully; it's not really the time to do it on this call now, other than it's integrating very well and we've been extremely pleased with the management, the workforce, the enthusiasm, the passion that we've acquired. I mean it's been really eye-opening

and we've got some very exciting opportunities. And certainly we're seeing some very interesting areas that they've been working on that we think we can reverse the other way too. It's been a really good acquisition and as I say we'll take you through the details of it when we get to the full year.

DO Okay, thanks guys.

Thank you. And our next question is from the line of Hector Forsythe from Stifel; please go ahead.

HF Good morning, guys; can you just flesh out a little bit the regional comments about trading, so in Western Europe if you can identify the countries in Western Europe and South-East Europe as well. And I'd also be interested to hear how trading is going in Germany.

MR Well look, taking the regions; we've acquired particularly into Iberia and South-East Europe. Those businesses had been in decline so we start off with a slight negative and then we start to put in much more of our technology etc. and talking to customers. And the response is excellent; we've been winning new business in those regions that those companies have just never worked with those customers before, hence we turn the negative into a positive. If you look at their economies as well we have seen a gradual recovery in the Spanish economy over the last probably 20 months, GDP has moved into positive and it's been increasing so we have a benefit there as well. Where that goes in the future in terms of the economy, there's a bit of a political impasse at the moment and we'll see what happens in the formation of the new government or whether there's another election or whatever. And then we come down to South-East Europe, if you look at Austria and the countries going down to Greece there, the economies have always been reasonably resilient; they haven't had quite the ups and the downs as some other parts of Europe. So the economies have been resilient, plus we've gone into that region so again we get quite a positive effect but starting from a position where the business was in decline so we feel quite pleased about that. We do say Western Europe and that includes France; the French economy isn't really showing any great signs of improvement but we continue to grow there. We have, as you know, vastly the majority of our business is food and drink with pan-Europeans and we continue to grow very nicely and it continues to be a good market, as is Italy.

You mentioned Germany and there we are performing as we expect; the economy has been a little bit up and down for various reasons, exports to China, exports to Russia, some of the car industry etc., obviously the well-publicised VW issues etc., it can have some short-term influences but we're sort of where we expected to be. It's not a fantastic growth and equally it's not particularly poor, it's just where we expect. The Nordics continue to be affected, particularly in the Baltics and Finland, by Russia. We'll see what happens; it seemed to be easing a while ago and then very recently it seems to have ratcheted up again so we just have to see. The UK economy continues to move forward but because we're food and drink we don't see the same sort of increase that the general economy if it's tied to things like housing -we just have far less exposure to that category by design. We have long-term assets and we need a long-term business and cyclicalities isn't really what we want. Poland, excellent, excellent; very positive. Even some of the more spicier areas - South-East Europe, Greece continue to move forward quite

nicely for us, as it is in Turkey. But it really is around the food and drink and the bigger customers, the innovation etc. so it's more of a sort of market share than I think the overall category moving forwards.

HF That's fantastic; thank you ever so much for that.

Thank you. Ladies and gentlemen, please be reminded if you would like to ask a question please press star one on your telephone keypad now. Just another quick reminder, if you would like to ask a question on today's call please press star one on your telephone keypad now. We have no further questions coming through.

MR Okay. Well look, just say thank you very much everybody for your time today. In summary we're pleased with the progress in the year to date, our outlook remains positive, and we anticipate performance in line with our medium-term financial targets and we view the remainder of the year with confidence. Thank you very much.