DS Smith Half Year Results – 6 December 2012

Speaker key

MR Miles Roberts
SD Steve Dryden
DP David Philips, Citibank
BD Barry Dixon, Davy Research
AL Alex Hugh, UBS
AM Alexander Mees, JP Morgan Cazenove
MM Mike Murphy, Numis Securities
UM Kartik Swaminathan, Bank of America, Merrill Lynch
OP Operator
DO David O'Brien, Goodbody

MR Good morning everybody and, as always, thank you very much for coming. We really appreciate you taking the time out to come and see our results. But it's only two months since we last met. Two months ago, when we talked about the 100 day updates following the acquisition of SCA, we said we'll come back in 100 days. We came back exactly 100 days afterwards and we talked about the improvement in the synergy targets, improvements on the cost synergy, improvement on the cash and improvement on asset disposals. Of course, they were all promises and today we're going to show you the first signs of what can really be achieved in the new enlarged business.

So we're talking about our half year results, to the end of October, six months of which four months included the SCA acquisition, and that we're pleased. There's no doubt about it. You've doubled the size of the group. The good news was we had nearly a year to think about the SCA acquisition, from when we first thought about it to approaching SCA, to completing the acquisition. So it's been a lot of planning. We're pleased with the progress but it's all due to the planning. Since 2010, we have continued to grow, both organically – consistent organic growth in volumes across our markets... We've grown again, despite the inclusion of SCA who've always been at a flat position. Despite exiting business, we've continued to grow. We've improved our business mix over the last two years. We used to have Spicers. We have some more paper assets and we've really been focusing into the FMCG sector in packaging, all behind that business.

Differentiating to adding value; the way we're thinking of our customers, improving the service, bringing more product development in what is a very exciting area of packaging development in a market that's been so fragmented it's always suffered from a lack of real innovation and investment in the right products and services for our customers. We have built the pan-European supply base with the acquisition of SCA and, prior to that, the acquisition of Otor, and we've started delivering returns. It's a very, very tough market out there. We set objectives two years ago – return on sales, organic growth, return on capital employed – and we'll see again how we've got on in that. But I do think it's a start.

We've had SCA for four months. We're pleased. The integration's going well and there's momentum in the business. It's a very challenging environment but people in the company know they're winning and there's nothing like success to build further momentum and further opportunity.

So what are those results for the half year? Well, our operating profit is adjusted for amortisation. It's, prior to the exceptional costs, up 57% to £123 million and it's a 7.4% return on sales. Remember SCA last year was 5.8. We're just over 7% so we've driven that return. PBT up 62%. Our EPS up 16%, despite the dilution. For two months in May and June they'd obviously raised all the equity for the SCA acquisition but we didn't have the earnings. Our primary measure that's return on average capital employed is up 80 basis points, so 13.7%. The free cash flow, you know we focus on this. We've talked about it before. It's up 175% to £150 million in the six months to October. The net debt, again, getting the balance sheet strengthened 2.1x. EBITDA, we've set the target for 2x by the end of this financial year and, on the back of all of that, we've put the dividend up 32%. We've got a very clear dividend policy and that's fully in line with what we've stated before. Steve?

SD Good morning. I'm Steve Dryden. I'm the finance director at DS Smith. I'm pleased to report another six months of consistent value creation. Strong cash generation has allowed us to pay down debt, following the acquisition of SCA Packaging. Free cash flow is up 175% to £151.8 million. Free cash flow per share is 16.5 pence and the significant benefit there is coming, as I'll show you later on, from working capital reduction. This strong cash flow means that net debt to EBITDA is now 2.1x. So we're well on track to be below 2x by April 2013. Return on average capital employed is 13.7%. That's 80 basis points up. That's despite the inclusion of four months ownership of SCA Packaging. This return is significantly ahead of our cost of capital of 9.5%. In the margin improvement in packaging, that's been subdued by the paper performance but, just remember, this is very much as we expected. This time last year we said to you all that we expect in this financial year paper will be breakeven and we set about making sure in terms of costs and efficiencies and structure that the company was strong enough for that. Lastly, dividend growth 32%, as Miles has said. That's completely in line with our policy but well ahead of the earnings per share growth.

Obviously, revenue and profits are up strongly but I'll wait until we come to the revenue and profit bridge slide so you can see the drivers behind that quite substantial increase in both revenue and operating profit. The margin at 7.4% is within our medium term target of 7-9%. Then you've got the strength of the DS Smith business and you've got the lower margin SCA business, as the synergies come in and start to build up. Adjusted earnings per share; a £33.5 million increase. That's actually a 70% increase and you can see there, when you look at the growth in earnings, compared to earnings per share, the effect of having that dilution at two months, without SCA Packaging in but having the additional shares in issue coming from that rights issue. Asset turnover maintained at 1.9 times. Again, I think that's a great result, given the inclusion of SCA Packaging, which had a much lower asset turn. Return on average, that's the average capital employed of every single month, is up 80 basis points to 13.7%. It's important to see that we're focusing not just on profit and synergy delivery but also driving cash out of the balance sheet every single month.

If you look below operating profit, I think one of the things is net interest is only up £4.3 million to £14.8 million. Obviously, the finance costs for the SCA Packaging acquisition are in there but they've been partially offset by hedge ineffectiveness benefit of £2.4 million. That's just a one-off in terms of this first six months. Amortisation has increased significantly by £13.7 million to £18.2 million. It's really the provisional fair value estimates of customer relationships and other intangible assets, spread over a life of between five to 20 years. There's actually a slide in the appendix just to show you how we have arrived at that non-cash charge on the income statement.

Tax charge is 24%. It's calculated on the £87.9 million of profit before tax. It's completely in line with our previous guidance. The SCA acquisition integration costs, again, are in line with previous guidance and there is a slide at the back, just to break that out in more detail for you. Finally, profit from associates, that's the share of our after tax profit of the 49.6% investment that we have in RKTK. That's our Ukrainian based associate.

Now the revenue bridge slide. That's in a format that I hope you're all familiar with. Last year revenue was £1,035 million. Price reductions flowing through were £36 million. The box volume, as you'll note, was up £6 million. Paper volume was down £34 million and the foreign exchange, because of the movement in the euro, from a €1.14 average to a €1.25. That reduced our revenue by £61 million. Finally, SCA Packaging; that contributed £762 million for the four months of the six months that we're reporting that we owned the business. So we finished those six months with revenue of £1,672 million.

So, in the same format, here's the profit bridge. Last year we reported operating profit of £78.3 million. As in the previous pages, you'll remember it is our business model, to look to fully recover cost increases but, similarly, in a time of falling costs, we passed these nearly fully through. The corrugated box volume; that contributed £3.3 million to profit while reductions in paper volumes reduced profit by £14.4 million. Again, that is as we expected this time last year. The efficiency programme that we put in place, that contributed £3 million and foreign exchange reduced our translated profits by £3.5 million. Finally, for SCA Packaging, those four months contributed £45 million of base profit and £10.5 million coming from the synergies. Again, I've showed them coming across from SCA. The reality is that's across both SCA and the DS Smith, across the combined business.

This is your first chance to look at some of the segmental performance of the combined business. There are a few things I'd like to bring out. The UK margins have fallen by 250 basis points but you should remember that, in the UK, we have a long paper position. So, as expected, that's what's reduced our UK margins. Western Europe is improved, with a much better business mix flowing through from Belgium and the Netherlands. DACH is Germany, Austria and Switzerland but also in there we've combined Northern Europe, predominantly Denmark and Sweden. It delivers great returns. The reality is last year, when you actually look at the quantum of the numbers, it was a very, very small comparator. The actual magnitude of the returns is obviously held back because in there we have our paper business, based in Germany, and that is a very competitive market. Central Europe and Italy delivering good margins. They are reduced from last year because, if you remember, we always explained to you how DS Smith made good margins in Italy and made great returns in Poland. So, obviously, with the SCA business, as we explained, it made lower returns in Italy and lower returns in Eastern Europe and that's one of the areas that we're seeking to improve.

Finally, plastics with a 9% margin. That's another strong six months performance from our liquid packaging and dispensing business or bag-in-box, as you more commonly see it described. Free cash flow up 175%. You can see there the strength of the cash flow coming through from the excellent working capital improvement, with an inflow of £79.7 million. I've got a slide later on just to show you the areas of that working capital improvement. Pension payments sees a like for like of the same, year-on-year, but there are various sundry asset disposals in there, just pulling down this year's cash payment. CAPEX was up £28.1 million to £65.4 million. This is really important because we are continuing, on the basis of this strong cash flow, to invest in the business, primarily thinking about our FMCG customers and how we support them. Tax paid increased very much in line with profit. Interest paid is less than what you'd see on the income statement. That's due to the timing of the interest payments and the acquisition debt that we took on to finance the acquisition of SCA Packaging.

So free cash flow £151.8 million, 175% higher than last year. Free cash flow per share is up 7.7 pence to 16.5 pence. You see here the scale in terms of the working capital improvement. Just to remind you, in terms of the last financial year, DS Smith was at 4.9% monthly average working capital to sales, SCA Packaging 10.3%. For the last 12 months, our working capital to sales, we've got it to 5%. That's coming across all three areas – stock, debtors, creditors. I think one area of improvement I would highlight is the stock. It's not the biggest but it is the most difficult because it requires us to get commercial, operational and supply chain to start working together. That's something that we're just starting to really develop. So it's really pleasing to see the DS Smith debtor days at 27, the SCA at 25, come down together to be a combined group debtor day average of 23.2. That's a significant improvement.

Just looking at net debt, we've started the year with a cash surplus, really the funds from the rights issue and the disposal of proceeds from Spicers. Obviously, we invested in SCA Packaging. It's £1.3 billion of cash outflow. £152 million of free cash flow, paying that down. SCA acquisition integration costs which flow through into the first half on a cash basis of £38 million, other cash exceptionals at £9 million, meaning that we're finishing the year with net debt of £857 million. Net debt to EBITDA is 2.1x and our interest cover is 11.x. Quite importantly as well, we've got committed borrowing facilities of £1.4 billion sterling and our next material on refinancing is now 2016. So the group has got strong, secure funding taking us through until 2016.

As we do every six months, we test ourselves on how we've performed against our medium term targets that we set ourselves almost two years ago. So, on volume, our target is GDP plus 1%. What does that actually mean for DS Smith? It means our target for volume growth, in terms of the markets and the economies that we're operating in, should be plus 0.2%. We've actually delivered 0.5%. This is actually a good result because, behind it, we've got a growing DS Smith, with now a flat SCA

Packaging as we start to develop that business commercially and, equally, we've been looking hard at some of the lower margin business. As we said last time, we don't think it's going to deliver good returns for shareholders and, gradually, that's reducing.

Margin is 7.4%. That's in line with our 7% to 9% range. Return on average capital employed at 13.7%. Again, that's in our range of 12% to 15% and I think that's a great result when you consider that our investment on SCA Packaging, in terms of year one, was we will achieve our cost of capital, which at that time we said was 10%. That's a good return on capital employed performance. Cash conversion of 176%. Again, that's well ahead of target but we're still continuing to invest in the business. The net debt EBITDA is above target, 2.1x, but we're committed to delivering that below two times by the end of April 2013.

Then the synergies; this is very much the synergies that we set out two months ago in this building and talked to you about. So, on cost savings, our target is €100 million and, in the first four months, we've delivered, actually in the profit result, €13 million. Again, that's coming evenly from SG&A and procurement. Cash savings; we said €130 million. We've delivered, in the first six months here, €60 million – so, a good, strong start there. Finally, disposal of assets. The cash benefit in the first six months is nil. What I'm pleased to say is recently, over the last two or three weeks, for the remedy disposals, which you'll remember that's the three businesses that the EU required us to dispose of within six months of acquisition, we've actually entered into contractual commitments and that should deliver €55 million of income. So a good start against our target of £100 million there and, again, we got some of the surplus properties to come through there where we're making great progress.

A little slide now on technical guidance. No change in the CAPEX. We reduced that when we last spoke to you from £160 to £150 million. Interest rate; no change there. It's 4.4% for this financial year. Tax rate, again, no change there at 24%. One of the things I'd like to say on the amortisation, effectively, when you do a fair value exercise, particularly when you've only owned the business for four months, there's an element of it being provisional. So we've made estimates on things like customer lists, goodwill, intangibles and we'll look to refine and make that more accurate through the second half of this year. Net debt to EBITDA, which is seen very clearly there, less than 2x by April 2013. Pension interest charge should be £6 million for this financial year.

Lastly, just thinking a little bit about the seasonal split, if I may. Normally, with DS Smith and the type of business and the markets we're operating in, we'd expect to see the H1, H2 split to be somewhere between 55% to 60% in H1. This year it's quite different in the sense that we've got four months of SCA Packaging in the first half, six months in the second half. So you'd expect to see that H1, H2 split to be far more evenly balanced.

Dividends; our strategy is very clear – improving returns, reducing cyclicality. From that flows a stated dividend policy of two to 2.5x cover through the cycle. So, adjusted earnings per share are up 15.8%. Our interim dividend is up 31.6% to 2.5 pence and the compound annual growth rate on the dividend over the last three years is 36%.

MR Thank you, Steve. That was excellent. So, coming on to our business model in our review, this is a familiar slide to many of you – consistent GDP plus growth, less cyclicality, higher margins, higher return on sales and above cost of capital. Each and every year of our operation, those are our objectives. I'm just going to run through, in the following slides, a bit of our business mix, where we are. We've got a lot of work to do there to get it right but more about our differentiation with our customers and how we're going to grow there and about our synergies and some opportunities for further development.

So the markets are tough, huh? You've just seen how Steve put up in his graph about how the weighted average GDP growth of the countries we operate in was -0.8%. So it's a very tough environment. That's the bad news. The good news is that's exactly what we expected. I think when we were here two months ago we said, on the SCA acquisition, flat markets, maybe over ten years 5% growth. The maths isn't quite right but perhaps that's roughly 0.5% per annum, and that's exactly where we are. So what do we do about that? We focus on the resilient areas. It's a very straightforward strategy. With fast moving consumer goods, this is food and drink, people don't stop eating and drinking. We're finding that our corrugated demand, demand for corrugated packaging, continues to grow. It's taking share. We are increasing our exposure to the largest markets in Europe, particularly in Central Europe, and also some of the faster growing markets, such as Poland, which has never gone into recession. So that's at the front end and then it's all about the synergies coming through, that self help as we improve the balance sheets and we improve our cost base. We continue to invest heavily at a time when our competitors have cut back on investment. This is investment behind growing businesses. There's a lot of new technology coming through. It's what our customers want to see and we're very happy to invest in it and I'll come back later on and just talk about the level of paper integration. We are short but we are not short enough.

So the first point of that is business mix, with 60% of our revenues around FMCG. Our top 75 customers represent 25% of our turnover. If we go back to old DS Smith, our FMCG was over 70%. If we go back a couple of years, it's actually just over 50%. So we grew it significantly over the last few years and we aim to grow that again. We aim to grow the proportion of our business with large customers who feel underrepresented there. They want the pan-European supply. We're starting to accelerate the growth of our recycling model on the Continent, which I'll talk more about later. We collect the fibre for the retailers, drive the growth of the use of corrugated in the retail supply chain, and we'll talk about paper. So we are focused on packaging. That's what we're about. Short paper, the recycling model supporting that, and the regions that we are reporting against – the UK, Western Europe, DACH and Northern Europe, Central and Italy – and Plastics. It's all focused. Everything is to deliver up to packaging. The bottom platform of that is on recycling.

Why do we like this? Well, first of all, what is it? It is closed recycling. So we collect all the refuse from the major retailers. We don't just source it. We collect it. Our lorries, you've probably seen many of them driving around, every Tesco, Morrison, Audi, Primark. They're all there. We collect them every day and this gives us the security of supply in fibre. It gives us the ownership of the raw material. What it also does is allow us to work with the retailer to show how corrugated takes cost out of their operations. It reduces the amount of warehouse space they need to store. Typically, in the past, it would've been perhaps plastic pallets, plastic containers. It allows them to increase the rate of sale through the front-end because of the shelf-ready packaging. So the product's always displayed properly. Less cost in loading up the shelves. We show them how to use corrugated. They then demand that their suppliers – Procter, Unilever, Kraft, Nestle – they demand that they supply the product in shelf-ready packaging. This is why we use the recycling. It drives the growth of corrugated. We've got a fantastic position in the UK. We have a model that is just way out in front of anybody else and, when we look at the Continent, we can see how to establish that as well. So we've now got the operations work in Eastern Europe, every Tesco store throughout Poland, into Hungary, Czech Republic etc. We now work with other retailers in those regions and we're focusing very much in France and Italy as well and we're pleased at the response we're getting there. It fully supports the growth of our corrugated business. The retailers want us in there. We've got people on the ground there and we expect to see that grow over the next few years. Differentiation through recycling. Differentiation through a very short paper position. Today 70% of our packaging requirements are produced internally. That's too high. In the past we've been 40% to 50% and we're assessing how we drive that lower. The reason is very simple because the returns in paper are not attractive to our shareholders. We do not invest in building this. We do not believe it is a vital part of the business model at all because you do not make your cost to capital on that. So our investors will not see us put in continued investment and growing and developing that business. It's short but, as a proportion of our packaging, it will be shorter.

Transforming our commercial position, we now have a true pan-European footprint. Previously, we were in seven markets. We're now fully operational in 15 and, particularly, when you look at the split of business, how it tapers into some very large areas, and not just large in themselves in terms of they're just large and unattractive, they're large and many of our major customers can be centred there. They have their packaging or their supply chain operations there and it's brought us right into their heartland. We are very pleased at the response that we've been getting from our major customers. We thought, when we made the acquisition, we thought we'd lose business because of an overlap. We've actually gained business.

Then how do we actually make use of these markets? Well, we are seeing a corrugated volume growth in FMCG. It's been pretty consistent for us. In fact, when we made the acquisition of Otor in 2010, we showed our shareholders how FMCG volumes had evolved over the last ten years. Consistent growth year on year, without interruption, from 2000 to 2010, right the way through 2007/8/9, the volumes never stopped growing. This is the beauty of the market because people don't stop eating and drinking and we expect that growth to continue in FMCG corrugated, particularly as we use our recycling arm to show the retailers how it takes our cost, how it means less carbon for them, how it increases the rate of sale in their stores. We think there are significant opportunities for us to not only be part of that market but to grow our share with our existing customer base. We're going to come back in the first half of our new financial year, in our next... It won't be our 100 day update. It will be our sort of 300 day update or however many days it is. We're going to talk about our revenue side. When we're much more embedded in terms of our marketing, the product development, we'll come back and talk to shareholders about that but there's no doubt we're pleased with progress. Again, these are some of the things we're pushing very hard – mandrel construction, developed by DS Smith France. This is not about the box. It's the way the box is formed in the facilities of our customers. So, if you're someone like Procter & Gamble, it's one thing to supply the box but how is the box constructed in their plants. In many ways, they're not so worried about the box. They're worried about the speed of their lines. So we supply the machines that go at the end of their lines. We're the only company who does anything like that in packaging. How we then work with those customers, using the construction of the box in their plants, that improves their line run speeds, quite significantly. We've been very, very pleased with the way that this has moved forward and, indeed, the very attractive licensing agreement we put in place with RockTenn in the States, the second largest supplier in the US, coming to DS Smith for our technology. They're now installing that in the US. In our fleets, we've installed it. We've talked about this a number of times. We continue to be very pleased with the progress about new types of fluting. It doesn't take any cost out for us but it takes a lot of cost out for our customers. That's why they want it and that's why it's grown so nicely for us and we continue to roll it out in the rest of DS Smith business, installing it in some of the SCA plants because our customers say they want it.

Plastic packaging is a business that has become an increasing part of DS Smith. We're world-leading bag in box technology and the reason we find this so attractive is because corrugated is underrepresented in the transportation of liquids. The obvious reason is you've got a cardboard box. If it gets wet, it tends to fall apart. The beauty of a box is it is a box and it's got a very good shape for transportation. You compare that to, say, a wine bottle, the bottles are round, which isn't a good footprint. It sort of narrows up to a neck, to a very thin neck so you're missing all that space as well. Compare that to a box, it's a much more efficient way of transporting liquids. We're seeing continued strong growth in that market. We lead it. The margins and returns are very attractive. It is highly fragmented and we think that's going to continue growing. We really do. We're very pleased we've got that and the main point is the complementarity with the corrugated box.

We've talked about our commercial position, our business mix. Just in terms of the synergies, which Steve's outlined, just where we are with SCA Packaging, we have doubled the size of the group. The integration process is all going to our plan. I remind all our investors, the way we work is about learning from the new business. It's not about being twice the size. That isn't attractive to us. What is attractive is how much stronger the business model is and that comes from learning from each other. The reason we upgraded the synergies isn't because we sandbagged in the first place. It's because we asked the SCA guys what they think they can save with us, how they could be better. We took their ideas and we built them with ours and that's why the synergies went up by 33%. So we're creating a stronger business. You've seen the cash. The cost synergy is coming through as well, as Steve's outlined. The strength of that business is coming through and, when we look at the segmentation that Steve put up in the return on sales, when we first announced the deal, we said the problem areas/returns for SCA were in France and in Italy and in Eastern Europe but we said we'd put our management across there. It was about how we were going to embed those businesses and how we know that we can improve them. That's exactly what the shareholders are now starting to see – how we build a stronger business, even when those businesses are being problematic.

Our customers are good. The most encouraging thing is our employee buy-in. Without getting that sense of momentum, in terms of belief, in terms of success, it'll all start to peter away but we continue to see very strong employee buy-in. We've recently done our employee survey, a few months after the SCA acquisition. 87% of all our employees took half an hour of their own time to fill it in. 87%. There are some challenging questions in there and we're delighted to receive them. It's about buy-in. It's about belief in the model.

Let's not forget, it remains a highly fragmented market. We're still only number three. We're just below number two in Germany. SCA have lost considerable volume in that market over the last few years. We think there's a lot of opportunity there, particularly as our model, the larger business is stronger than the smaller players. So just remind people of that sense of fragmentation in the market.

In summary, for us, for the half year, we're pleased with the returns and you can see that in the dividend, up 32%. The business is growing organically but we're strengthening the model as well, and you'll see that in the return on sales and return on capital. We've got a lot of self-help initiatives. We've just started on the synergies. This is a three-year plan to see those coming through year on year, delivering what we said. As we said in our outlook; current trading, everything is exactly as we've set out before, no changes to anything, even though the markets are very difficult and people talk about them coming off. We can see that. It's a very challenging environment but it's going exactly where we've been before. Thank you very much for your time everybody.

Now, we're very happy to take any questions people have, either myself or Steve. A microphone will come over. I'll just ask you to say your name and where you're from and we'll take it from there.

DP Good morning. David Philips from Citi. Can I just ask you about the top 25 customers and the rate of growth in volume there? I think you put a slide up in last year's full year, talking about the rate of growth you were achieving. How has that been and has there been any acceleration in Q2 or in Q1?

MR The work over the last four months has been to build one front-end for these customers. So previously shared customers, we had to bring them together so we've got one point of contact, one sales team, one innovation team etc. That took one or two months to put in place. During that time, as I said, we've seen continued growth with those customers and, in fact, their growth for the half year exceeded the growth of the group quite considerably. It's partly because they're taking share and we're taking share with them but it's very early days and what we really need to do is to build up exactly where we think we're going to go, what opportunities there are, and we will be outlining a lot more about that in the first half of next year. But it's been positive. We never assumed anything in the acquisition case. It's early days but it's going as we expected.

DP Okay, thank you. You've done well on the price adjustment to cover all your raw material. Have you given any sort of guidance for how you see the second half developing on that front? Do you think it's more of the same or are there a few headwinds we should start thinking about?

SD My slight problem with that is two weeks ago was OCC, with our input costs going up, and as of Monday the debate was, is it coming off? The visibility on input costs is apparently quite low. So I think the key issue for me is if our business model can react to those changes. As you know, in DS Smith, we spend a lot of time getting that period of price recovery down from six to three and we've got to do the same with SCA. That's something we're working on. So the key thing is visibility, frankly, of input costs. Movement is low, therefore the ability for the business model to react, and either pass back or recover is what's key. That's what we've set out to do.

DP Can I ask about the comment you made about increasing your investment in recycling on the Continent? How much capital do you think you would put in there on a 12, 18 month view? Is it going to be buy and build or do you think you can do a fair bit of it organically?

SD The organic side is really low in the sense that the business makes very, very attractive returns on capital, if you think about it, with very low asset intensity because things like forklift trucks or vehicles will be leased or contracted out. So the capital intensity to build the business organically is low. One of the interesting things we have managed, with the SCA acquisition, to have a number of physical locations but there's not enough there so there will be some acquisitions but they'll be relatively modest and building a network of locations, as opposed to necessarily trying to buy huge and what can be quite expensive recycling businesses when they get to scale, as we have. So you'll more see us building out in countries, physical infrastructure, either by bolt-on acquisitions, which will be relatively modest, or by fixed asset investments. Again, they'll be relatively modest compared to the returns on capital that we're getting.

DP Is 18 months, that time horizon, a reasonable estimate for meaningful activity or should you be thinking a bit longer?

SD No, I think the interesting thing is we started in Poland as old DS Smith and it tends to be quite customer led. As Miles told you about that close link, we've got great relationships there to the FMCGs. This is more about some of the recycling business building and strengthening their relationships with the retailers and establishing that close link on the Continent. It takes time that. We're going in with a service offering that they may not have been used to previously, that whole close link concept, and that takes time to sell through. Equally, once it's in, it's an incredibly strong proposition for people that come in and challenge against.

DP Thank you.

BD Thank you. Good morning. It's Barry Dixon from Davy Research. Three questions, if I could? Under working capital, a very impressive performance, clearly, in terms of the working capital inflow. Steve, could you give us some sense as to the numbers around the debtor and creditor days and, I suppose, ultimately, is that improvement sustainable?

SD Stock £25 million, debtors £20 million, creditors £35 million. Stock is, by virtue of being the hardest, is the most sustainable because it's quite hard to achieve.

Therefore, once we've changed businesses processes, it's going to be more solid. Debtors is perhaps this ever vigilance on overdues and keeping people to terms returns and resisting the extension of terms. Creditors, and also some of the things on the supply chain; so, when we were doing exports to China, we were making sure we get paid when the boat leaves for the UK, rather than when it arrives in China, for instance. On creditors it's linked through to the procurement team's efforts. When we talked on that 100 day announcement, it's not just about unit cost. It's about extending terms. So as they are just going through that whole supply base, they are trying to renegotiate not just unit price but also another 30 days on returns and they're doing well on that. Again, it's a continuous process of going through and it's building.

MR I think what Steve is saying is he doesn't believe those numbers will be sustained because they'll be better. I'll speak for him.

BD Thank you. The second question is on the mandrel construction. Just, in terms of the locations where you have installed those, because clearly it probably improves the level of lock-in that you have with that customer, have you noticed an improvement in volumes in that they're presumably more tied into you and, therefore, less likely to go to other suppliers?

MR It is a specific type of construction and it's not a short term put the machines in and take them out. Some customers, just in principle, won't install our machines because then you're tied to that particular type of packaging. There are other customers and, actually, an increasing number of customers who just see the advantage. It's patented. It's protected. There's nothing else near that and they can see the huge benefits that it gives them and, obviously, we enjoy very, very long term relationships with those customers. But it's not a short term just put it in and see if it works. This is a long term trend behind an ongoing investment. We were very pleased with the way that RockTenn has taken this up because, as you know, in the US, the volumes are huge. The investment decisions are enormous and you want to sign it up for quite a long time. So it's a very attractive business for our shareholders to be behind.

BD Just a last question in terms of looking at the next six months or 12 months in terms of a bridge. How much, in terms of revenue growth, do you think will come from corrugated volume improvement and how much will come from organic price versus an improvement in the mix as you move toward that FMCG business model?

MR Well, over the next six months... The questions you're asking are very good questions. Without knowing an awful lot more about those, when we come back with a whole sort of revenue picture because, whilst we have our targets, you've really got to see them coming through. As we know, with revenue, it's more outside of your control than cost but we are seeing improvement in the mix, as we cut out business and people take more on. In terms of the markets and the volume, we've seen it's going to remain very tough. The -0.8% was probably worse than we expected but broadly expected to be pretty awful. Unfortunately, we're in this position where we kind of plan for the worst and hope for the best and we just don't see Europe really improving over the next six months to a year. We'd be delighted if it did but we can't see the catalyst. Our customers aren't telling us that. It's a difficult position, us continuing to grow, driving some improvements in mix but we will come back and outline in a lot more detail about this segmentation, where we're going to be focusing etc in the first half of next year.

BD Okay, thank you.

AH Hi, it's Alex here at UBS. I've got two, if that's all right? The first one; I just wonder on the working capital side, the proforma numbers, if it was on average over the last 12 months, what would the working capital to sales be?

SD Well, effectively, they were twice our sum. So, as a scale, they were at 10%. We were at 5%. Revenue was the same. Pro forma would be 7.5%.

AH Okay, but if you just averaged it for the last four months, would that...?

SD That was seven, in terms of four-sixths of SCA Packaging.

AH Okay, thanks. Then, on the RockTenn side, I wonder if you are able to talk more about the revenue opportunity and maybe whether or not anything is in the numbers for the last few months?

MR Yes, we've talked about it. Indeed, RockTenn have made quite an announcement about this, not only to their shareholders but to their customers, and the way it's structured, there is some income from us in the first half. We don't outline it because it's not particularly material. It's all about the growth of that market and, as they're out there marketing, as I said, it's not a short term somebody's just going to take it and try it. People are going to be looking at this, examining it and, actually, the real potential to us comes over a number of years, just as it does with our existing business. We have hundreds of machines that have been installed throughout Europe. Interestingly, some of our customers have taken the machines themselves outside of Europe but, again, we just have to come back when we can really see who is going to take that and that's where the revenue opportunity is for our shareholder. You can imagine what the return is on those revenues because there are very few associated costs. It's quite an interesting model, isn't it, the licensing, the technology that we're developing outside of Europe, limited cost, straight revenue into us? That fuels the research and the investment budgets that we have.

AH Thanks very much.

AM Thanks. Good morning. It's Alexander Mees from JP Morgan Cazenove. A couple of questions for you. Just, firstly, with regard to the underlying pricing for corrugated to the extent to which you are able to tell whether you're increasingly able to command a premium in like for like pricing because of your innovation and your market position. Is that coming through?

MR What we see is we're not so integrated and when we compare our margin to similar sort of business then our margins are doing quite well. You only really know that, of course, if you'd get a competitor to open up their books, which of course is not going to happen. Of course, we saw it very nicely with the SCA business and about how we supply and how they did and the relative prices etc and what customers really value. So we can see the opportunity there and that's why we have industry leading returns on capital. Those returns you'll see with a huge acquisition in there. Last year, on the legacy business, we were just under 15% in a difficult period. With more efficiencies coming through on the legacy business, I think we see it in our results. We see it in our market share growth but, ultimately, unless we take somebody over, we don't know what the comparative prices are.

AM Secondly, on paper in the UK, it's clearly been a difficult period, not making any money in the first half. What is your medium term outlook? Do you expect this to be a driver at all or should we just expect this to be breakeven for a while?

SD It's a breakeven environment. People who study the paper cycle would say it doesn't last like that for long but, equally, their ability to predict when it changes is limited. At the end of the day, we're running a business set out to continue to grow our returns. We're not relying on paper to do that.

AM Then, just finally, I notice on slide 27 you talk about revenue synergies over the medium term. I don't suppose you'd care to quantify that?

MR We're just reminding people that we've grown very nicely. We do have to come back next year. It's only because of the transparency and being able to show people where it is etc and what it is and, at the moment, we're pleased with the response but we do have to come back, I think, with a bit more flesh on the bone, rather than just a few short term numbers, and we will be doing that. I think we've really got to understand where we are and what the business plans are we've built with each of the customers and put some real substance behind it. That's our reticence. We say things and they've got to be delivered, not just sort of vaguely. That's where we'll come back next year.

AM I'll ask it again next time. Thank you.

MR Look forward to it. I think we've got just two more and then we'll wrap up and we'll be done within the hour.

MM Three questions, please. Mike Murphy at Numis Securities. First of all, on research and development of the combined group, what are you doing because I understand both businesses had a strong research and development effort? Secondly, on the plastics packaging, can you say, of that 13.6% increase in revenue, can you split that out between volumes and prices and also FX? Thirdly, you've alluded to, in the presentation, acquisitions and the fragmented nature of the European market. Wouldn't now be a good time, given the weak economic background, to be pushing that forward?

MR I'll take the easy one, the last one. We think now is the time, most of the economies spend most of their time out of recession. We actually think that the product we sell, what we're selling, has a long term demand and future and, therefore, you build and you develop your business within light of that. We think that the opportunity to build a stronger business is absolutely fantastic today, particularly for DS Smith, with the wonderful support that we get from our banks and our shareholders. So the opportunities are there. In terms of our corrugated business, we've actually nearly tripled the size of it over the last two and a half years, and we're aware of many more opportunities. But we have just doubled the size of the company. We believe there is substantial value to shareholders to really developing and building a stronger business and that's what we're focused on. I have no doubt that there will be opportunities in the future but we really have to get our business properly functioning, at its optimal level, repaying the faith, the trust the shareholders have shown in us, through the results, through dividends, through cash flow, and we just need a longer period to really show that. But those opportunities are there. The trouble is you never know when they're going to come along and sometimes they come along when it's not the optimum time and we're aware of that.

SD FX on plastics, Mike, is 6.4 million negative. Volume is quite difficult because am I selling a 500ml or one litre bag, does it have a tap or not. We track the individual product lines on that. To try and come up with a meaningful weighted average, volume movement for plastics is, in any plastic business I've ever worked with or in, it's very difficult. FX is 6.4. R&D you're actually right about SCA Packaging actually spent a lot of money on R&D. It wasn't necessarily... Rather than from the technology to final customer, we tend to work from what the market want back. In any of the synergies there, there's nothing in there for R&D. So we're not trying to cut R&D to deliver those cost synergies. In terms of absolute amounts, frankly, I'd rather go through a budgeting process, which is what we'll do by the end of April. So I'll feel more comfortable in terms of quoting amounts there because there is R&D at the centre, there's R&D in the individual businesses, there's R&D in the region. So I'd feel happier quoting them after we've been through the budgeting process.

MM Thank you.

KS Kartik Swaminathan, Bank of America, Merrill Lynch. Thanks for taking my question. I was just curious as to a potential timeline for reducing your exposure to the paper cycle and I understand that the management are very committed to it but a bit more colour on when that could materialise and in what form would be useful.

MR We're saying where we want to get to, not actually how we get there and over what time period. We've not outlined for a number of reasons. All we can say is we are very focused on it but that's all that we're able to say today. Nikki, are there any phone calls?

OP We have a question from the line of David O'Brien from Goodbody. Please go ahead.

DO Hi guys. Just two quick questions for me, please. Firstly, just on the Italy business, we note that you're going to exit the sheet business there. Could you give us an idea of the scale of that in terms of revenue and profitability or volumes? Secondly, just on the operating profit, would it be possible to get that for the UK division?

MR What we've said on some of the sheet business, we're saying it's not attractive for shareholders as in today, next year or the foreseeable future. We've cut it out of a lot of DS Smith and we need to do that in SCA. It actually amounts to 4% of revenues. It's not going to be immediately. There are contracts there etc. But we are saying it will be up to 4% of the revenue will come out as we move from that business. Equally, we are growing elsewhere. So, if we look at it over the last few months, we’ve grown volume despite some of the exits. There aren’t any, we haven’t announced any closures of any plants because of the sheet feeding issue. We haven’t announced anything on that. There’s no public announcement.

SD Just on the UK division then, all of that drop is due to paper. If you think back to what we’ve said about, in DS Smith, the scale of the paper business, all of that drop was in the first half.

DO Okay, and was there much of an offset from declining OCC prices versus your paper prices going up as well?

SD Yes, well, effectively, there you see declines in paper, declines in OCC in terms of half year on half year.

DO Would that affect through to corrugated prices as we move to half?

SD Yes, a small amount, not significant though. Don’t forget; we’re trying to improve he mix all the time of what we’re selling.

DO Thank you.

MR Because the business isn’t so integrated, the price of the box isn’t so important to us because it doesn’t show the value capture. What’s important to us is the value we add in the box. Whether paper is high or low, it’s passed forwards and backwards. So we don’t have that same level of exposure.

If that’s everything, I’d like to thank everybody for their time. We’ll be around here afterwards, myself and Steve. Our chairman, Gareth, is here, as always, but we’re absolutely delighted to see you today and we’ll keep you updated of future progress. Thank you very much.