DS Smith Pre-Close Statement
24 April 2013

Speaker key

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SD	Steve Dryden
LR	Louise Richardson
AM	Alexander Mees
DO'B	David O'Brien
DP	David Phillips
MM	Mike Murphy
HF	Hector Forsythe
CO'G	Catriona O'Grady
JJ	Justin Jordan
KS	Kartik Swaminathan

MR Good morning, everybody and thank you for joining us today. I am Miles Roberts, the CEO of DS Smith, and I'm joined by Steve Dryden, our Group Finance Director.

So, this morning, we are pleased to release our Pre-Close Trading Statement, and I would like to take a few minutes to run through the highlights of that statement, after which Steve and I will be delighted to take any questions that you have.

But, before getting into some of the details, I will say that we really are very pleased with the substantial operating, financial and strategic progress made by DS Smith in the last year. It has been a transformational period, not only for the group, but for everybody who works in DS Smith.

We've strengthened our commercial proposition to our major customers, from whom we continue to receive a positive reaction. In addition, the new management structures are working well, and we have been encouraged by the level of employee engagement across the enlarged group, so in terms of trading and looking at the group as a whole, for the financial year, we expect to deliver operating profits fully in line with expectations, but with earnings per share towards the higher end of expectations. Revenues are expected to be around £3.7 billion, which is a near doubling of the size of DS Smith.

As in previous announcements, the original DS Smith business really has continued to outperform not only the market, but the average for the group, but we're now starting to see an improving trend in the ex SCA packaging businesses, as we apply our expertise, systems and structures and continue to get a positive reaction from our customers.

We continue to make strong progress in the early delivery synergies associated with the integration, and we are on track to deliver costs and tax synergies as previously advised, but with about €40 million of cost synergies this year, versus the original guidance of €25 million.

We also expect to return above the cost of capital in the first ten months, which is the 30th April, a year earlier than we originally announced with the SCA acquisition. The business continues to generate strong cash flows, and we expect net debt to EBITDA to be below two times by the 30th April.

Steve and I would now welcome any questions you may have, and are reminded that our full year results are on the 27th June, so as far as 2013/14 and the outlook, that's more for the full year results but I would highlight that we're saying we look forward to delivering substantial progress next year. Questions?

AN The first question comes from Alexander Mees from JP Morgan, please go ahead.

AM Good morning, gentlemen. Just a couple of quick questions for me, the first one, could you make some comments on the end markets as you're seeing them at the moment, and also your share of those markets, are you gaining market share at all?

MR Yes, look, we're principally in Europe. Our main markets are UK, France, Italy, Germany, and then Eastern Europe, principally Poland, and Europe overall remains very challenging. I think the second half of the 2012 was more difficult than we expected, and I think that's really been led in France. The second half of last year was just a bit more of a down tick. I think we saw it in Germany in the final quarter as well, and then coming to the first quarter of this calendar year, we see things remaining difficult.

Italy is slightly negative, France is, Germany is stuttering a bit. The UK seems flat, not particularly better or worse and Eastern Europe continues to move ahead very well, so difficult markets and overall GDP is down. We expect that to continue, we're not seeing any light at the end of tunnels etc, at all. We've always thought that, we've planned for it, but it has been a little bit worse than we were perhaps hoping for, even though we planned for a difficult position.

In terms of our market position, we've grown ahead of GDP. We're positive growth, we've seen the regional DS Smith business, which is primarily UK, France and Italy, grow very nicely, therefore, and Eastern Europe, and therefore that has continued to take share.

We've seen the SCA business really starting to move from having quite a few years of some modest declines in volume and market share, we're starting to see that flatten out now, and as we get into it, overall we have across Europe, we have made a modest gain in market share. It's not huge, but then we've had to reverse the situation of SCA, so let's say modest gain in share. But, of course, we're more able to serve the pan Europeans. We are highly credible, they desperately want leadership in this industry, and we continue to get a positive response, so a lot of hard work. A huge amount to do, but it's...we're getting a positive reaction. Is there anything else to say on that, Steve?

SD That's a good summary of all the markets that we're in.

AM Great, and then just secondly, maybe a question more for Steve, just with regard to the changes to IAS19 pension accounting, I know you've given guidance in the past, but I wondered, Steve, could you just remind me what that guidance is for next year's finance and costs?

SD Yes, it's all about changes of IAS19 and that, you have to show the expected return on assets, at the same rate as how you charge the return or the cost of the liabilities, and the guidance we've given, some of the analysts have reflected it, and you can see there's a marked, if you look at it, different people's models. Some people have either got £11 million in or they've got £6 million, in other words, £6 million is the same as this year's charge, so people just need to factor in that there's an increase to IAS19 under that £4 million on the finance line, and about £2 million on the operating profits.

I think that's no different for any company whose year-end starts after the 1st January 2013, so it will affect us from the 1st May 2013.

AM Thank you very much.

AN The next question comes from the line of David O'Brien from Goodbody, please go ahead.

DO'B Hi guys. David O'Brien from Goodbody, could I just get some colour perhaps on trends you're seeing in OCC pricing, kraft pricing and also then into corrugated box?

MR Yes, again, because we have far less paper than we need, it's all about a good relationship with the customer, and how we pass it on, whether it's positive or negative. What we're seeing is a little bit, that things changes week to week. We have seen some increases in fibre, modest but there have been a few pickups recently. We've seen some increase in paper prices, in OCC and kraft, but it does tend to move around quite a lot. Exactly where it's going to go, we're unsure.

If they increase, then we have to, then we'll need to...the relationship we have with our customers that we're looking to pass that on, if it reduces, then obviously we'll be passing that benefit onto our customers as well, so we have seen some up tick, but it's very difficult to call where it's going to go, because the end markets remain very soft, and obviously then things like krafts increase, all we do is replace krafts with OCC, so it's a little bit of a fluid situation at the moment.

The end markets remain weak, and so I don't think you're going to see any sustained increases, but difficult to call.

DO'B Okay. And just one comment, maybe, H1 I saw a very strong performance in working capital. You might give us a comment on how that's performed in H2?

SD Yes, it will continue. I think in H1 we knocked off quite a lot of the easy things, in terms of the SCA working capital and we also continued to make improvements on the DS Smith working capital base. In H2, we'll continue to make improvements on both of them.

The big challenge is actually always inventory and that's the hardest to achieve, but it's also the one that's obviously the strongest position that we can do, if you can make your whole supply chain more efficient, so I think really what we're starting to work on in H2 is inventory, which does take longer, but there's a significant opportunity there.

DO Thanks very much.

AN Next question comes from David Phillips, from Citi, please go ahead.

DP Good morning gentlemen, can I just ask about revenue losses from existing customers, at the time of SCA acquisition, you flagged that there was some contingency in your numbers from customers who may not decide to come across, but it looks like that's been a bit better than expected, is that a fair summary?

MR Yes, in some regions, there was some overlap, and we did assume that we would lose some business. And, indeed in some areas, where we've had a huge proportion of our customer business, they have introduced another supplier, however that, the amount that we suffered from has been less than we expected, and indeed the conversion over has been slower, and we continue to grow, so in fact, these numbers that we're seeing might have spiked. Some overlap, but it's very modest.

Our actual determined exit of business that SCA had was not in the interest of shareholders and we've proved to you now, that we can live with the exit business mounting to about 4% of their turnover, that's in there as well, and we've had the difficult markets, and we've continued to grow, so it is a challenging backdrop, but as we've said, we continue to receive a very positive encouragement from our customers, because they want leadership in the industry. They're desperate for it.

And, we're now able to give that to them there, and we're getting a very nice response.

DP Would you put a figure on growth, as your largest top 30 customers. Is that materially better than the GDP plus one?

MR Yes, our major growth is with the large guys has and continues to outstrip the average for the group, absolutely. It's a...they're a very good proposition. You'll see our return on capital as well, you'll see the returns we make on our business, we believe it's attractive. It's not win business at any cost, at any price. This is about winning business that's attractive, that adds value to our customer and adds value to our shareholders.

So, you're going to see that in our return on capital. We will outline more about this in the first half of our next year, a lot more about this. It's such an exciting area.

DP Just to put the last one for me, on SCA settlement accounts, is there any timeline you can give us on that, or anymore colour?

MR No, yes, I think we have, we're going through and ticking things off, and some of these issues are long term liabilities around environmental, cost, etc, and we're going through and are sorting them out and it's not been leading to a great rush etc, and we'll go through it, and we're fine with that. That's what it is.

DP Don't expect anything too imminent before the results or anything like that?

MR No, I mean, I think we understand more about this, and what we have here, there's some long term liabilities we have, and we are just sorting out the exacts, making sure that we are getting the money that we should get for those. There are some things that will be settled in a shorter term, some things will be longer, because they can take ten years to come out.

These things are long term liabilities, on some of them. It's not going to be some massive dollar pot of money. People say, we'll pay for the life of this when it comes out, and that's absolutely fine with us. These are the dangers of these things, that get outside or get into the press. Not everybody understands all of the issues behind them, and as I say, some of them are longer term liabilities, so some of them are shorter, and all the work is the same, just as you would expect.

DP Thank you.

AN Your next question comes from the line of Mike Murphy, from Nomura Securities, please go ahead.

MM Yes, morning guys, two questions please. First of all, when you say we're seeing an improving trend in the ex SCA packaging business, are we talking volume there on a quarterly basis, and/or improved added value with those businesses, and then secondly, on the cost savings, I mean, I suspect you'll be giving us an update in June, but you previously guided it was €100 million and that balance, €25 million by the end of April 2013. Clearly that's come in at €40 million, with a balance spread evenly over the following two years. It looks as though you're considerably ahead of that guidance, if you can add something to that at this stage, that would be helpful.

MR If I take the first one and Steve, you can come back on the synergies. With SCA, when we're saying the progress it is in its market proposition, and we've had a business there that has lost quite a bit of share over five years, and other suppliers have benefited from that. Now, we're actually seeing that rate of decline basically starting to slow, from the day we took the business over, and we're now starting to see an improving trend, as our whole proposition is stronger.

In terms of added value, of course we've got the synergies and what we're seeing is the profitability or the added value of the SCA business on a constant market background is improving as well.

That's a constant market background, and there are always short term buffeting from a number of issues, like input cost, etc, but in terms of the value that we're adding from the business we're winning, it's certainly improving on a level field. Most certainly. We're pleased with that. Anything to add?

SD Yes, on the costs, obviously you'll remember we had €13 million in the first half, that was in the first four months.

MM Yes, €40 million for the year.

SD €40 million for the full year, so clearly we're pleased at the rate that's coming through, and you're right to say that's ahead of the initial guidance, of the €25 million that we expected, so we're pleased there, but I think the time to give you the update on the cost synergies, don't forget also the cash synergies, we'll do that at the full year results.

MM Okay, so obviously it's all going to come in, in June?

SD Yes, but really we're very pleased with the rate of the costs and the cash synergies that we've had.

MM Okay.

AN The next question comes from the line of Hector Forsythe from Oriel.

HF Good morning, guys. A couple of questions, just on the cost synergies. Just asking in a little way for a little bit more guidance. It's clearly the accumulation of a number of projects that you're running through, are you seeing individual projects yielding a little bit more than you were expecting, and are you seeing opportunities, smaller opportunities for cost savings coming through, as you're progressing, in terms of new projects, etc?

MR Yes, Hector, to me, I think there's two things to think about. As we integrate the business and get to work with the teams in the individual countries a lot more, we're finding out they're coming up with ideas and synergies of how the two businesses should be put together, so in a sense, almost the longer we own the business, the more we know and the more ideas, and we can see opportunities to improve the combined businesses, so that's one factor in there.

I think the other factor is some businesses, we've had a very challenging time, and there's nothing like a challenging time to make you work faster and harder to look for synergies, and that's what we are doing, so it's a combination of owning the business, working with people for longer, to find more synergies and secondly, the environment suffers, and that forces you to go faster in terms of some of your synergies deliver plan.

SD Just one thing to add to that, I think when we look at the individual projects, they've all delivered as we originally assessed, and I think the actual success rate has been very high in delivering what we said we'll deliver and then more projects have come forward from the employee engagement that we've had. I have to say I'm particularly pleased on the execution ability of the company.

We saw it in Otor we saw it in disposing of Spicers and we've seen it again with the integration of SCA, about how the projects are targeted, how they're run, how they're managed and how people deliver what they have said they're going to, and that is really down to the company.

HF Fantastic, that's exactly what I wanted to hear. Then, just tidying up one from you, Miles, can you say anything on the progress of finding a new Finance Director?

MR Well, it's come along quite well, it's a difficult thing to say. We're looking for a hard act to follow, but as you would expect, we're an exciting company for people to join. We do, we've got a very positive outlook in terms of moving the group forward, and further development of the group, and we are going through that, but it's fine. Unfortunately sometimes it's just amazing how long it can take, just diaries and getting people together, but you know, we are coming along absolutely fine, and we'll make an announcement in due course. Everything in the company is going along as you'd expect.

HF Fantastic, and the final wrap up one for me, is do you have a date yet for the presentation that said you're going to be doing in Q1, sorry H1?

MR Yes.

LR Provisionally, we're looking at the 5th or 6th September.

HF Fantastic, and that's to run through the deal and the revenue synergies, etc?

MR Absolutely. What the proposition is going to be for the market, I'll talk to you more about that, where we're standing, how we're see it playing with our large customers, and then obviously how we see that, what that means for shareholders.

HF Wonderful, thank you.

MR No, thank you.

AN The next question comes from the line of Catriona O'Grady from UBS, please go ahead.

CO'G Hi there, just one quick one from me. You mentioned earlier about some modest cost inflation coming through, can you just touch on the progress that you're making, on bringing down the pass through time at SCA, and on the back of that, how do we think about the outlook for quarterly profitability in terms of that little squeeze?

MR Yes, there is some input, and as you say, SCA have had longer contracts than the original DS Smith, and that work is coming along. I think we're going to have to, we don't have obviously the final figures for the full year, we'll know those by the time we announce, so progress is certainly being made, but I can't give you a figure to just where we're going to be. It's one that will have to wait for the full year results, to give you that, but it is longer than DS Smith, so that's yes.

CO'G Perfect, thank you.

AN The next question comes from Justin Jordan from Jefferies, please go ahead.

JJ Good morning, gentlemen, and I have to say well done on over achieving on the cost and cash synergies. I've got a quick follow up question which I think is to David O'Brien's earlier, if you look at, I guess, benchmark pics indices year to date, we've seen pulp, OCC and testliner prices all up about 5%, I'm just wondering whether you could show us, you've talked about cost pressure but what box price increases have you been able to achieve with customers, in light of that input cost pressure, and just the timing in terms of your ability to pass through increased raw material prices to customers, in terms of increased product prices, and just whether that's leading to, excluding the benefit of the cost synergies and savings, a margin squeeze within the business currently?

MR One of the things, we are short in paper, and when the price in paper goes up, we do have to recover it, and that does, in the original DS Smith, that will cause a contraction of three months. Paper prices, as I said earlier, they have risen modestly. There are a few things that we can do about that. Kraft goes up, so we replace kraft with testliner. Their performance is the same, we are principally in the tertiary packaging, and our customers are very happy to accept that.

So, there are quite a few things we can do to mitigate these increases, but ultimately on some contracts it does mean that prices have to change. Some of those contracts are negotiated, in which case we're out there and we're talking. Some of them are in indices and some of them are just coming up for renewal on a, part of a negotiation when they come up.

I think again for the full year, we always outline this, in terms of cost inflation and price recovery, but the recent price increases come on the back of a period of falling paper prices, so we've actually seen box prices fall, we've recently seen some modest increases in paper prices, so whilst that will come through into box prices, there is the customer delay there, and we're seeing that.

Now, for us, we know these things happen. We plan on this basis, we have all our costs in due, coming through and a growing business, but if there's a sustained increase in price in the price of paper, then we will have to go out and get a price increase, which we've always successfully achieved in the past.

And, that will cause a three month squeeze typically, but we have to see where paper goes. If 5% isn't enough, then it's more than that we need, then we haven't seen the sustained increase in the price of paper yet.

JJ Thank you, just one follow up if I may. Obviously you've set out your store very clearly, in terms of being a short paper business, does that strategically leave the board thinking about further mill disposals?

MR Yes, it does.

JJ Within any particular time period?

MR Yes, we have an ambition to reduce our paper from currently about 65/70% of our paper that we need to produce internally, and we'd like to get that down below 50%. Our Q3 IMS highlighted the issues with paper, and the return on capital in these businesses, we just don't think it is attractive to shareholders, and therefore we are looking as to how we can get back to where we have historically been, at below 50% of our paper that is produced internally.

And, we'll come back and explain exactly how we're going to do that, in the coming year.

JJ Thank you.

AN The next question comes from Kartik Swaminathan from Bank of America Merrill Lynch, please go ahead.

KS Hi there, Kartik Swaminathan from Bank of America Merrill Lynch, I just had a quick question. If you could please remind us of the seasonality across your different geographies, and how that might have changed, post the integration of SCA. I ask because you've got quite a lot of synergy realisation coming through and that somewhat obscures the underlying performance, but just any kind of colour on that would be helpful.

SD Yes, if I may, I gave some guidance to this at the half year results in December, in the sense that traditionally DS Smith would have been somewhere between 55 and 60% in the first half, but because of the acquisition of SCA. The reason it's 55% for the first half, is there is inherently more energy cost in the second half, and also in terms of selling, the activity etc. The other reason, but for this financial year, it's more 50/50 with the guidance we gave, because if you take this year, we have six months of SCA in the second half and only four months in the first half.

KS That's great, thank you.

MR You then go by division, you have to then assess which divisions have got no paper, Nordics, or which regions have got some paper, so UK, little bit in Germany, bit in Italy, and nothing in Eastern Europe. You have to build that factor in the energy equation.

KS Great, thank you.

AN There are no further questions, I will hand you back to your host to close today's conference.

MR Well, firstly thank you everybody for your time this morning. We do appreciate it, and in summary, looking further ahead, it is a very challenging environment and there are some early signs that seem very recent signs in paper pricing increasing, but we anticipate further growth in our packaging business, as we leverage off our enlarged strength in geographic footprint and further develop our commercial positions, particularly with our strong European customers. So, we are looking for substantial progress next year, and we look forward to updating you more on that on the 27th June. Thank you everybody for your time.