DS Smith Half Year Results

Thursday 10 December 2020

Participants

Miles Roberts – Group Chief Executive

Adrian Marsh – Group Finance Director

Miles Roberts: Good morning and welcome to our presentation for the half year results to the Saturday, 31st October 2020. My name's Miles Roberts. I'm the Group Chief Executive, and I'm joined here by Adrian Marsh, our Group Finance director. Well, first it's been obviously an unprecedented period, but in that period, I think our purpose of the company has never been more relevant. Redefining packaging for a changing world has put us in a strong position to focus on our customers, on our people and the communities in which we work. And I've been delighted by everybody's work throughout DS Smith. It's allows us to keep all of our plants open. Any furlough money that we've received is all being repaid because we don't need the money. There's been company-wide recognition schemes all towards recognizing how everybody's worked in the company, because that's allowed us to deliver for our customers.

Our customer's needs have changed rapidly during this period, and we've been there to service them. Our levels of service have remained high throughout the whole six months. Our product quality's been the best we've ever achieved. We've allowed some of our customers to move from selling fragrance to packaging for hand sanitiser, and obviously we're very proud to be the first company in the world to be supplying the packaging for the new vaccine that Pfizer is rolling out into the UK as we speak.

But of course, none of this would be possible without the support of our communities. Every site's been involved in their local community, supportive during this period, whether it's from providing furniture, packaging for food parcels, providing staff and support for their health services. We've had a tremendous, tremendous response to this, but of course we've received support back and that support has been allowing us to stay open and all of our factories operational throughout this period.

So how has this translated into our first half performance? The half year is really a story of two quarters. We saw the volumes reduce in May compared to May last year by minus 4.7%, but then increased strongly throughout the six months, such that by October, we were growing at 3% and that continued into November where we grew at 5.7%, and December started very strongly as well. And that's really been aided by some very significant customer rewards, not only in Europe, but very pleasingly, some super rewards coming into the US. Overall, we fell 1%, 1.0% in volume over the six-month period that compares to 3.3% negative growth for the market. But actually, as we sit here today, our volumes are actually on accumulative basis. They're now ahead or the comparative period last year. And this is also reflected in profitability. We saw in Q2 a really strong rebound in profitability on those better volumes, but also, we

didn't have all the investment costs we put into Q1 enabled to keep all of our staff and factories safe and open.

We say within that performance has seen a good improvement in the US. We're very pleased at how that's coming through, really aided by the Indiana plant progress. And of course, underlying all of this is the cash generation. Our cash, our free cash flow is actually considerably ahead of the six months last year. So, based on the performance of the half year and a very encouraging outlook for the remainder of this financial year, we've reinstated our dividends. Exacted the policy we had before at between two and two and a half times cover on a full-year basis, and that's translated into an industry in dividend for four pants. I'm now going to hand over to Adrian Marsh to take us through the financial results.

Adrian Marsh: Thank you, Miles, and good morning, everyone. I'll take you through the financial results of the half year. Unless otherwise stated, I'm referring to the results on a constant currency basis. This year has been by any measure, an exceptional one, given the global economic situation driven by the COVID-19 pandemic, which has of course, impacted our business, particularly in quarter one, where most countries in Europe were in lockdown. Revenue is down 10% and operating profits down 35%. I'll take you through bridges for these key line items in a moment. Margin for the half is 8%, but even within the half, it's been very much a game of two halves, with quarter one, particularly impacted by the challenges during peak COVID where supply chains were heavily disruptive for our customers, which was reflected in the volume of boxes we sold to them. We also had the spiking of OCC costs, weak paper prices, and the largest element of our COVID specific costs as we ensured all of our factories remained open and our colleagues remained safe.

In quarter two, when lockdowns were lifted, supply chains were refilled, OCC costs normalised, paper price has strengthened, and our volumes more than recovered with margins returning to around 9.5% in the quarter. Earnings per share shows the flow-through of profit return on capital performance at 8%, 8.7%, which was around our cost of capital is clearly below our target range due to the substantial dent in profitability, which on a rolling 12-month basis, will also have an impact on the full-year ratio.

We have a very clear plan based on the returns coming through from our investments made particularly in North America and the economic environment progressively improving, which will see us returning steadily back to our target range of the next 24 months. I genuinely do not expect to see the combination of events which happened and impacted our first quarter repeating again. Having now navigated through the extremely volatile and uncertain conditions we faced in May and June, we have confirmed again our dividend policy of two to two and a half times cover on an annual basis and announced an interim dividend to full penance, which should equate to around a third of our total dividend for the year. This will be paid on the usual payment date in May.

Turning to revenue, this declined £21 million in relation to corrugated box volumes of minus 1% with a further negative balance and other volume principally from increased integration in paper and recycling and lower sheet volumes. This increased integration meant we can see more of our own paper internally and so less on the open market. We likewise bought and sold less paper for recycling or OCC on the open market. The majority of the reduction from sales price and mix is from the fall in packaging prices as the impact of lower paper prices from previous periods rose through into downward pressure on box pricing.

Overall, the decline in box prices is less than might have been expected, given the scale of the paper reduction seen in the past two years, and we're satisfied with our ability to manage box prices and the added value which we've been able to deliver to our customers. Over the remaining six months of the financial year, there'll be the tail end of these price reductions rolling through, although the recent paper price rise seen in Europe and the US will undoubtedly now stabilise box prices and provide an underpin against the price erosion and put in place and repression box prices towards the end of this financial year and into next year.

Turning to EBITDA, we can see that Europe pack has continued to deliver against the acquisition case, with synergies coming through as we expected. The decline in volume seen in the revenue bridge comes through with the usual drop through effect into profit. As mentioned earlier, the volume decline was very much a quarter one event for us, with quarter two seeing us return to positive growth and with October show and corrugated box volume growth of around 3%, and now nearly 6% in November. The sales price to mix effect drops through in full principally relating to box pricing, as I described a moment ago.

The partial counterbalance of that has been the cost of paper as an input cost, which flows into the £55 million favourable variance in the cost bar, along with some other smaller items. Also, within this cost bar are the additional direct and indirect costs associated with keeping all of our factories open and our people safe during the COVID-19 pandemic, which we estimate to be around two thirds of the £30 million guidance I gave at the year-end results presentation. The greatest impact of this occurred in quarter one, and whilst there's still been impact in the second half of this year, it will be significantly less than the first half.

As I noted earlier, whilst margin is lower than the comparable period and to the last full year, the two quarters have been materially different. Quarter one took the full impact of lower volumes, higher COVID specific costs, higher ACC and low paper prices maintaining the deflationary pressure on box prices. Quarter two margins, however, were around 9.5% as volumes for COVID, OCC pricing normalised and rising paper prices started to reverse the deflationary pressure on box prices, and COVID-specific costs were lower than the previous quarter. There was also a negative mix effect on margin as our customers largely suspended promotional activity in quarter one, which impacted both conventional box and point of sale and display businesses.

We also had an impact from reduced volumes in higher margin industrial categories. These trends are now reversing as industrial activity picks up and promotional activity in retailers returns to more normal levels. Our North American businesses cope very well with the significant disruptive effects of COVID in that region. And the business has performed better than the second half of last year, and following the recent paper price rise will, will it improve profitability further in the second half of this year, which will also continue to benefit from the ramp up of our Indiana Greenfield, which is still on course to be profitable in half too.

We have, as you'd expect being laser-focused on cash management in this financial period, with tight control, the working capital and discretionary spending, including capex. As a result of free cash flow has increased despite the fall in EBITDA as I said out earlier, which is a tribute to the efforts of everyone in the company. At the same time, as I previously described, our sales of receivables has remained broadly flat in constant currency terms from the balance of the year end. I confirm, again, this is set at the level we target to remain at.

Facilities under which we operate this factoring facility committed for three years. So, the target is between £400-500 million. Overall, I'm pleased with our focus on cash and the improvements we've made of the last couple of years. Whilst not at the end of the journey, I do not expect further material improvements other than those which will be a factor of our short paper position, which benefits working capital when paper prices rise and is a headwind when paper prices fall.

Moving to cash flow, the main inflow was free cash flow. The £88 million in the acquisition line relates to the interstate resources put, that is the 20% stake that remained in the buyer's hands back in 2017. We've now bought back half of that, with the bulk of the proceeds paid in quarter one as I set out on the chart. After other items and the majority of which is FX, our net debt has again fallen. Our gearing now sits at 2.37 times calculated code into our banking covenants, which, as a reminder exclude the effects of buyer for 16.

This is substantially under our covenant of 3.75 times, and we've a strong balance sheet with substantial long-term liquidity with no further meaningful redemptions until 2023, and £1.4 billion of our bank facilities are undrawn. At the start of the pandemic, we arranged for CCF facility of £300 million, which has remained undrawn throughout the crisis. We expect a similar leverage ratio at the full year with more material to leveraging going forward through ongoing cashflow in their cover of EBITDA. I've often been asked by investors how we would perform in a recession given the businesses materially different now than in the global financial crisis of 2007. It appears to me that the last six months has given us tangible evidence, and whilst our leverage has increased slightly, I feel we've managed well, I can look forward with confidence in the robustness of our business model.

So, I described it at the beginning. I welcomed the resumption of dividends in line with our existing policy of dividends per share cover of two to two and a half times on an annual basis. These are the usual items that you've come to expect. Over the notes, you'll see the capex is now expected to be around £330 million, still a reduction on the prior year of £360 million, but higher than we initially indicated. This is due to the confidence we have in the recovery of the business and the opportunity to invest by find growth areas, which Miles will talk more about later. I'd add that I expect the new investments to be paid for by recycling capital from non-core disposals and are delivering trajectory to continue. The other line items are largely unchanged but reflect our best estimate on both absolute amounts and currency impacts. I would now like to hand back to Miles.

Miles Roberts: Thank you, Adrian, for taking us through the financial results. We're well positioned for future growth. I'm going to take you through how the repositioning over many years has created such a strong platform. Our differentiated offer, it's a solely fibre-based offer. We don't have plastics in our business. Our agility, our responsiveness, and how we work responsibly as well. How all of this leads into future growth for the company.

The repositioning of our group over many years has created a strong platform. Comprehensive coverage for our FMCG and our e-commerce customers are now presenting at 84% of the groups, the highest it's ever been, and it continues to grow as the force of our business. And we're solely focused on fibre-based solutions. I'll talk more about that later. How COVID has accelerated many of the trends that we've been behind for many years. And again, I'll come back and elaborate on that further, along with our US business, that's really attracting those large multinational customers providing growth for our US business.

Underpinning this now the Europac acquisition we made nearly two years ago, that's given us the right extensive capabilities into Iberia and France, and we really started to see the benefit of that. And of course, as always, and you're seeing part of it now, the platform we've created still has a lot of opportunity to improve operational and balance sheet efficiency. We'll just turns to the first of those, our coverage and customer focus has allowed us to outperform the market in the six-month period. We declined 1%, the market was down 3.3%. During that period, our FMCG e-commerce portfolio grew consistently. We saw market share gains with our big customers. Our largest customers grew with us at over 8%. And as I said, we had a number of significant contract wins with those customers as they move to us based on our sustainability agenda, our innovation agenda, but also that security of supply, that outstanding service that we provided them has rewarded us with increased volumes.

But during this period, our industrial sector was down. It was in decline, but we're seeing that coming back as well. And we expect there to be that to be back in growth in 2021, giving us even more confidence for future growth from the extensive coverage that we have. And COVID has fast tracked a number the exciting trends that we've been behind for many years, not only about sustainability and security of supply, but into e-commerce as well. We can all see that ourselves.

Traditional stores are accelerating their online offering as well as online only has grown significantly. We've been a major part of that, and it is a structural change in the proportion of goods sold on the internet. When the pandemic ends, we expect a proportion of goods sold on e-commerce to remain structurally ahead of where it was prior to the pandemic and we have a lot of evidence for that.

I'm very pleased with the performance of our US business. There's still weakness in the export markets, the price of paper, but we've seen a strong recovery of our business in Q2, based on the performance of the Indiana plant. With those strong customer wins, we expect the plant to be 40% full by the end of this financial year, getting a positive profit contribution in H2, and of course it progressively reduces our long paper position. But let's not also forget, we've had some price rises in the US that will further boost the profitability of the US business.

Turning to our differentiation, two key parts I want to talk about here first on e-commerce, and second on sustainability. All on e-commerce is, you know, we're the, the leading supplier in the e-commerce field right across Europe, not only for the e-tailers, but also for the customers wishing to move from traditional bricks and mortar into an e-commerce supply. We established ePack, our online offering that anybody can access. You can buy one box, ten box, 50 boxes, 10,000 boxes. We'll print, we'll customise, whatever you want. We launched that in the UK in 2019. It's got off to a great start. Its growth this year has been phenomenal. We expect to be nearly 700% growth, this year. It's been so successful. Many customers have asked us to put it on the continent as well. We are now rolling it out across the continent with real customer support, backed with the DS Smith levels of service and product quality.

But our differentiation in sustainability, as I've said already, we're an entirely fibre-based business. It's not just a question of how you make your product, it's the question of the product you make. And we believe in focusing on fibre with a closed loop, looking at the circular economy, designing sustainability into the product in the first case, and then recycling it, is the strongest model for our customers, but also the communities in which we work.

We set out a new sustainability strategy that builds on the success of our previous strategy. There's been a huge consultation process across many countries with NGOs, governments, customers, communities, heavily supported by the Ellen MacArthur Foundation and it's moves us from looking at sustainability as being sort of a risk management to a real opportunity, and it highlighting our ability to work on this circular economy. We set out here five key targets for us by 2023. It is an industry leading status. 100% of our product will be the reused, all will be using recyclable packaging. We are just under 99% at the moment. So, we're nearly there, but our aim is to move ahead of that such that by 2030, all of our packaging will actually be recycled or reused. Our customers are really excited about it.

By 2025, how we can take a billion pieces of problem plastic off supermarket shelves. But of course, it's about education as well. It's not enough just for us to do this. You have to spread this message, to engage 100% of our people in understanding the circular economy then going out and educating 5 million young people on the street on the circular economy and circular lifestyle is how we have to live in the future. And of course, it's about driving carbon reduction. By 2030, based on a 2015 baseline, we aimed to reduce our carbon emissions by at least 30% per term. We're actually trending quite a good way ahead of that. We're actually trending just under 3% per annum improvements. That puts us really well on target to achieve that.

But it's not just about having a policy. It's about the actions, and in the first six months, we've taken over 22 million pieces of problem plastic out of the community, whether it's replacing plastic punnets for grapes with corrugated punnets all those plastics display units that you see in supermarket refrigerators for yogurts and cheese and processed meats, replacing all of those with corrugated. We're very pleased with that, but of course, we've got a target of taking a billion units out of society, and we will get there. To meet our customers growing demands and accelerating innovation. We do partner, jointly develop new products with other companies, bringing in new ideas to our business, such as Climacell, a temperature control packaging for things like meal kits that they use far more frequently now than in the past, or a virus resistant coating for packaging delivered to people's houses or a very exciting development jointly development with Hydropol about those biodegradable windows, those replacing laminate film. It's been such a problem that it's used in things like sandwich packs which are used, you know, throughout Europe.

Really exciting developments, accelerating that rate of change for our customers. We can all see this outstanding growth opportunity for DS Smith built on our outstanding coverage and relationships with our customers combined with those structural growth drivers I've just described. And whilst we have good capacity to in many parts of the company, we want to stay ahead of the momentum that's built in behind us.

So today we are very pleased to announce two really exciting new state of the art facilities that'll be constructed over the next few years. One in Italy, one in Poland - two fast growing markets for us, ensuring we stay right ahead of that momentum that's building into our business. We're very pleased in how our group has responded over the last six months. We've seen a strong rebound in profitability in Q2 that's continued into the second half, built on strong volumes, growing volumes, taking market share, not just in Europe, but also in the US. And whilst there's uncertainty over the macro economic environment, we have confidence in meeting our expectations for the full year, but very excited about the outlook for our group

going forward. Myself and Adrian are now very happy to take any questions you have. Thank you.

Operator: And as a reminder, if you'd like to ask a question or make a contribution on today's call, please press star one on your telephone keypad. To withdraw your question, please press star two. Please ensure your line remains unmuted locally. You'll be advised when to ask your question. So again, that's star one on your keypad. And the first question comes from the line of Alexander Berglund from Bank of America. Please go ahead.

Alexander Berglund: Thank you very much and good morning, everyone. Hope you're doing well. Two questions from my side. The first one on box prices, you know, from your initial comments, it seems we're talking more about the stability now. But if I may, what do you think we need to see to, you know, start thinking about box price increases? You know, we've had a recovery in container board. There seems to be talks about potentially another 30 years per ton now in December on the cycles. And is that enough or do we need to see further price increases on the paper side to really justify higher books prices? I'll let you answer that question and then I'll follow up another one. Thank you.

Miles Roberts: No, in fact, thank you Alexander for your question. You're absolutely right that we have seen paper prices increase in sort of September, October. They've gone up about 50. I mean it's absolutely certain – or at least looking almost certain they go up another 30 in December and then we'll have to see then. And it's always very, very difficult to forecast future movements in paper prices. What I would say is that stocks are extremely tight. The demand for fibre-based packaging is very strong. So, would I be surprised if there was another increase early in the new year? No, I wouldn't be at all, particularly as I say about industry stocks, how much that is– let's not speculate, but it's a very, very tight market.

We've looked back over many years and it's never been quite as tight as it is at the moment. It's great to see, you know, it's great to see the momentum that's building behind this fibre-based packaging. And obviously if you go up say €90 a ton, you know, on paper, that is a significant cost increase for us. And as you know, we've got 40% of our customers on index deals and those index deals will start to change over the coming months to start to reflect those changes. And then of course, the majority of our customers are what we call freely negotiated.

The price of paper has reduced over the last 2 years and there has been an impact on packaging prices, although we always seek to retain value and I think we have, as the price has fallen. Now, when it's going the other direction, then you have to start to start to increase prices. It does take a little while for this to happen. It doesn't happen immediately, you know, we hope we start to recover in a sort of a three-to-four-month period after a particular increase. And that's what we will be, obviously we'll be working on with our customers over the coming months. And let's see where these prices move. But we've been there before, and as I said, price reductions in the past, and now it's now it's going the other way. You said you had another question?

Alexander Berglund: Yes, thanks for that. Then my second question is a bit broader, I guess, on investments, on capturing the growth there. So right now you have Indiana, you have two new plants now in Italy and Poland but with, you know, the acceleration that you're talking about e-commerce and the increased focus on sustainability I wonder if you think that you need to kind of further increase or accelerate your investments to really capture this this opportunity

to maintain your strong position and down, you know, on that, if you, if you feel at any kind of constraint by the leverage position, that's constraining you from really kind of growing at the speed that you would like given the kind of environment where we're growing into now?

Miles Roberts: Certainly, we look at it very, very closely. Over the last ten years, we've built a very strong asset base. And indeed, if you just go back nearly two years, when we bought Europac, we talked about the spare capacity they had in their box plants to really enable us to continue growing in that market, particularly when e-commerce and our innovation was being put into that market. We could see a very really strong outlook of opportunity there. So, when I look at our asset plan overall, we're very pleased with that. We've continued to invest in it. Some of the acquisitions have brought in more capacity, and we also have the opportunity to move some of our facilities on to three shifts, whether it's three shifts, five days, six days, or indeed seven days. We have trialled that moving from almost like a batch process to a continuous process already, and a number of plants that's worked very well.

So, we think in parts of the group, we can continue to leverage the asset base. That's sort of what I meant on the first slide when I talked about the operational leverage, we can get out of the group we've created. You know, there are some areas where after years of growth, we are running short of capacity. In Poland where we have got a fantastic packaging business. It's just growing year on year on year. It's the same in Italy. Very, very good returns there. And so, we're now at a position where we need to make those investments. I think going forward, I think that there can be some others given the rate of growth that we've seen, but I think we can manage those out of our cashflow. If you look at the cash flow in the half year, it's strong. When you start to look into next year, you know, where people's expectations are, you can see there's a prodigious cashflow coming out of the group; we are very clear on the leverage that we want to have as well. We do have some asset disposals coming through. So, we think a combination of our asset base and changing the way we're working, these investments, the cash flow and some of the disposals coming through, we think we can maintain our market leading positions over the coming years. Thank you.

Operator: Thank you. The next question comes from the line of Barry Dixon from Davy. Please go ahead.

Barry Dixon: Morning, Miles; morning, Adrian. A couple of questions from me. To just follow the one from your last point there, Miles, about asset disposals, are you referring to the sales that you've talked about before the container board capacity in Europe, and I suppose in the context of where the market is on the growth dynamics that you've talked about, is that still part of your strategic thinking that you want to sell some container board capacity, particularly I say, given the tightness in the market? The second question I suppose, is really around that sort of – and you've talked a little bit in terms of the sustainability of the volumes. You might just give us a bit of colour on that, if you don't mind, in terms of how sustainable you think the increase in volumes are, say post-pandemic in an environment where we have a vaccine, do you think that this structural change can be sustained and maybe give us some colour as to how confident are your confidence around that statement? And then thirdly, on volumes you've talked about this sort of – the switch from plastics and to paper, can you maybe just give us a sense as to where you are, if you think we are in the market and that continuum and how much more potentially there is to go in terms of a structural improvement in volumes? I know it's a broad question, but any colour you would have would be great. Thank you.

Miles Roberts: Thank you, Barry. On the asset disposals, you're absolutely right. We are looking at disposing of some containerboard capacity. That is still our intention. As we know, there is a considerable capacity that has come online in and around Germany and it's still coming online and we feel we can get all the supply that we need from those markets and these container board disposals, it's grades that we don't think really match us going forward. So, we do still expect to complete that. It's not solely that though. There are also similar, smaller non-core assets that we've also identified and we're looking to dispose of those as well. And you know, hopefully in this different environment, the buyers that we have - those businesses will be in a much stronger position to complete them.

It's a very good question on the volumes. You know, the plus 5.7 for November, I'll be honest with you, that was more than we were expecting. E-Commerce is very strong in there, but also, we’ve seen a lot of people switching their income from spending on the sort of entertainment and the on-trade restaurants, et cetera because the lockdown more into the goods sector. So, do I expect that rate of growth to continue just under 6%? I don't know. I think that's going to build-up to Christmas.

When we look post-Christmas over the next six months though, we do see that structural change in e-commerce continuing. All the work that we've done in looking at other markets in places like China and particularly in the far east where I think most people can see that the, you know, the economies have sort of substantially recovered from COVID and they're backing growth and freedom of travel within those countries and the lockdowns are ending.

We’ve seen e-commerce remain structurally ahead – significantly ahead of where it was before. We do expect that to continue. So, do I think it's 6%? No, but it still looks pretty buoyant for the second half. But clearly there's always uncertainty of those things, it does look quite strong and you've talked about plastics. This whole sustainability agenda, as you know, we've been working on this for many years. The circular economy. Again, we weren't sure how customers were going to respond during the COVID crisis. We've got the different scenarios - do they back off it for a while, because it's seen as expensive or do consumers really want that?

But actually, the experience to date has been the other way. It's been actually a greater focus on the need to have a more sustainable solution, to switch out of plastics. We've seen a number of projects that have been there for perhaps the last two, three years actually really move forward over the last six months. I alluded to some of the big contract wins we've had with some really absolutely fantastic customers. I mean, really, really excellent customers with some great forward agendas. And one of the reasons we've been so successful is because of our sustainability agenda. I think we will see more switch out of plastics, I think it has probably been a little bit slow. The new legislations coming in the EU on single use plastics directive, that's going to put taxation onto plastics. That's causing a switch. We're seeing it's not just in the secondary, but it's also primary packaging into corrugated.

We'll come back and talk more about that, I think at our full year when we can talk about these products, but I think all the indications are that it is going to pick up a bit of momentum. We are in secondary packaging. There’s not going to be another 5% of growth per annum but it's going to be there. It's going to be noticeable. And I think it's going to continue for the next few years, but it's not going to be, you know, adding to the 2-3% to our growth, but there'll be a nice constant underpin for the growth particularly in the FMCG sector. Thank you.

Operator: Thank you. The next question comes from the line of Mikael Doepel from UBS. Please go ahead.

Mikael Doepel: Thank you. Firstly, a question on the market dynamics. What we see as I think about the container board markets in Europe, I guess one thing contributing to the bit of tightness are the increased exports going out to China. So, I was just wondering, you know, how do you see that part of the market evolving? I guess exports are up quite a lot this year. What do you expect for next year and how should we think about profitability on these exports? I'll let you answer that one first and I have one follow-up.

Miles Roberts: As we know, the Chinese market has been restricting the import of OCC or paper for recycling. That's been running now for a few years. They've said that there'll be no imports of OCC, mixed papers, et cetera in calendar year 2021. They seem to be absolutely following through on that, and we felt sometime that that will give them a structural shortage of paper in their market. Obviously, they're going to respond. You know, they used to import some years, you know, toward the 30 million tonnes. This year, maybe it's going to be six or 7 million tonnes, but there's still quite a gap to close. They are increasing their domestic recycling rates. There's been quite a bit of use of virgin material. There's been more pulping of OCC outside of China and then bring in the effectively the slurry into China. But there's still a gap. Our own estimate of figures (it’s notoriously difficult to get really accurate figures), but we think there's about a shortage of a couple of million tonnes a year. They're sourcing more raw material and more finished products from Europe. Over, we think it's about of a couple of million tonnes.

As the Chinese economy grows, and again, this is our view, we think coming back into growth, the end of COVID, demand for paper should increase. Whilst there is some – inevitably there'll be some other capacity coming on stream in the far east, we think there will remain a more buoyant export market for Europe into China over the coming few years. Now, then after that, we'll have to see, but we’re struck to see how China we're going to close that gap and we're not surprised they're in and they're buying and they're buying more strongly. We expect that to continue. One of the reasons for the tightness though in Europe is not that Chinese market because we have expected that to come. It's actually the demand within Europe that that's, what's changed our expectations. It's the customer demand for fibre-based packaging that has been very strong and that's what's tightening the market beyond our expectations.

Mikael: Okay.

Miles Roberts: You said you had another question?

Mikael: Yeah. Yeah. Just a small couple of small details. Firstly, I just looked at the receivables, which were up a bit sequentially. So just wondering what was driving that, and then secondly looking at the one-off costs, about half of that relates to some restructuring programmes. I was wondering if you could give some, some colour on, you know, what's that about what kind of a payback we can expect from that?

Adrian Marsh: I missed the second question, but in terms of receivables, there’s nothing at all unusual on that. I mean, on an average in basis for the quarter, it's been a pretty good performance. I wouldn't take anything on that at all. We've had our record ever collections of overdues in the half, as we've tightened focus. It's been a very good performance. And the second question is?

Mikael: The restructuring just wonder wondering, you know, what you had 11 million related to that in the period. Just wondering you know, what we can expect out of that? I mean, what does it relate to? Are we going to see some, some costs coming off there? So, if you can give some colour on that.

Adrian Marsh: Yeah, absolutely the costs will come out. Anything to do with restructuring, has a very fast payback. Anything slightly above 12 months, under 24 months, payback on restructuring. Depends exactly when in the period that occurred. What we're seeing now coming through on exceptionals is the last year of anything to do with the acquisition of Europac, the acquisition of Interstate and a programme we had, which we did describe previously regarding particularly the business in Germany. As we look forward, as we said before, next year, there'll be nothing more on any acquisitions because that's concluded and anything on restructuring that will be – that would come through as we're describing. We will give you the advance notice as we normally do and anything, you can expect the benefits to flow through.

Operator: Thank you. The next question comes from the line of Cole Hathorn from Jefferies. Please go ahead.

Cole Hathorn: Morning, Miles; morning, Adrian. Thanks for taking the question. The outlook for the North America division is encouraging to get back to that towards that 100 million profitability level. Could you give me a little bit more colour on that division just with regards to how the underlying business is doing excluding the Indiana box plot from a volume perspective? I know you were impacted in the first quarter with customers and then secondly, on export prices. I mean, they've been taking out from the US. Have you also been able to optimise some of your production, thereby selling more internally into the US there? And then looking into kind of the second half and the following you, as you ramp up the Indiana plant, I think you talked about 40% run rate at the end of this year and then full, I presume full run rate by the end of FY 2022? Could you just give a little bit of colour of that progression as you integrate volumes from that paper mill into the US? Thank you.

Miles Roberts: Thank you for the question. It is, as you say, as we've looked over the six months at the export prices of paper, there was a bit of weakness. There has been some recent strengthening. Overall it hasn’t particularly affected the half year. I think it will obviously improve in the second half as the recently announced price increases start to come through. We'll wait to see exactly what they are, but in the US, a $50 a tonne increase that's been announced seems very, very likely to go through and also expect to give part of that to this not to be reflected in the in the export prices.

In our US business, you can see the profits were down, not as much as the rest of the group, although we were hit pretty hard in the first few months with COVID. Some tremendous customers were forced to close because of the incidence of COVID in their workforce; in some of our customers in the food processing industry where their factories operate in a cold temperature environments and the incidence of COVID spread rapidly through their – all of their staff, which is obviously very regrettable and that caused a number to close, but they came back, they start up again. And so, we saw a very good rebound in in the performance there.

We've also still had some ramp up costs on Indiana. But those new customer wins are starting to come in, bringing some of that paper back board. We've been pleased. So, despite you know,

a very difficult COVID environment, you could see the profits have actually done remarkably well compared to the rest of the group. And there's still some Indiana ramp-up costs in there, and the COVID.

So, you can see the underlying position is actually really quite positive. And that's what gives us the confidence about continuing into H2 as the Indiana plant ramps up towards that 40%. You're absolutely right. A we get into next year – if we, in the first, basically the first year of operation get up to 40%, then we should expect at least that in the in the following year. And that does have, as you know, a very significant effect on the profitability of that of that region. And all of that gives us the confidence about, say H2, but also leading into leading into next year. So, pleased to see that turnaround.

Operator: Thank you. The next question comes from the line Sam Bland from JP Morgan. Please go ahead.

Sam Bland: Morning, I've got two questions, please. The first one is on the impact of OCC prices. I know this was kind of flagged for the first quarter. I just want to get a bit of a sense of how that developed through the half and in particular, was there much reverse sort of the impact in the second quarter or was OCC basically a neutral impact in the second quarter? And the second question I had was on the dividend. Obviously, nice to see it being reintroduced. I think one comment with having, maybe from some investors this morning is, was there a possibility of paying some kind of catch-up dividend? I don't know if that was something the board discussed, but any views on that and it basically why it was decided against if so, would be helpful. Thank you.

Adrian Marsh: Thanks for that. In terms of OCC, yes, we saw in Q1 as we called out obviously at the year-end results. We said we expected this spike OCC costs to be more normalised and they have done in quarter two. Now clearly, the second lockdown has seen – that there's been pressure on the outputs side of OCC. So, there is a slight headwind of OCC in the second half of the year, but nothing at the level that we saw with the spike. So, I would say yeah, not at all out of the ordinary.

In terms of dividends, we've taken the view, you know, we're looking forward now. We're very excited about the opportunities that we've got. There are a number of good organic growth stories. Miles has talked about two of those today. Putting a greenfield in Poland and the greenfield in Italy, we're extremely, extremely excited about the opportunity that we've got to grow the business. And we're looking forward with a lot of optimism there.

Operator: Thank you. The next question comes from the line of Justin Jordan from Exane. Please go ahead.

Justin Jordan: Thank you and good morning, everyone. I've just got a first question on containerboard with prices clearly after this sort of 50 euros or so that industry's achieved in terms of price increases in October, November. European testliner prices are basically flat year-to-date, depends slightly on which country you're talking about, but specifically for DS Smith, are you actually formally targeting a further testliner price increase with customers in December, given the strong volume outlook you're talking about and tightened race, have you actually announced a price increase to customers?

Miles Roberts: We don't formally make announcements, but our prices in DS Smith have gone up for December. That's right. It depends on the market so we don't know what's formally announced, but our prices are going up in December by around 30 euros.

Operator: Thank you. We do have a follow-up question coming from the line of Cole Hathorn from Jefferies. Please go ahead.

Cole Hathorn: Morning, thanks for taking the follow-up. Just on CapEx and your plans for Poland and Italy, I know e-commerce demand has seen good sustainability for the industry, as it's going to be a continued tailwind, but we have seen a few capex programmes from some of your competitors as well. How should we think about CapEx? And I'm thinking more on the corrugated side of the industry. Is it, you know, the bigger players like yourself and Smurfit Kappa that all just well positioned and wanting to grow while the smaller players can't deploy that CapEx so you're taking advantage of that growth, or how do you think about the market being able to absorb increased corrugated and box capacity going forward? Thank you.

Adrian Marsh: Yeah, I think it's – I'll take this, Cole. I think it's really difficult to talk about competitors. I think when we think about ourselves and what we've got in terms of latent demand and built-up demand, you know, we're very confident about where we'll put down new capacity. You don't tend to see a lot of it in the converting side because you need the customer demand to justify it. You have to have the orders and you have to have the confidence of the order. So, it's kind of difficult for me to answer that for someone else, but from our perspective, you know, we're extremely confident about how we know we're going to fill the plants.

Miles Roberts: A lot of it is being pre-sold. A lot of it's being pre-sold to big customers.

Operator: Thank you. We do have another question coming from the line of Mikael Doepel from UBS. Please go ahead.

Mikael: Thank you. I just really want to briefly come back to e-commerce. Was wondering about if you could perhaps share some sort of a number or indication of where you see e-commerce as a share of your sales right now, or maybe perhaps for this year and where it was last year. And then also in terms of e-commerce, how would you compare the paper volumes and maybe profitability as opposed to the brick-and-mortar sales? Thanks.

Miles Roberts: Thank you for the question. If we look at the e-commerce of our non-industrial business, it's about 16-17%. Of our total business, it’s just over 15%. It's obviously grown very strongly. It's grown by 30% compared to this time last year. So, you can see sort of going from about 13, up to about 17% of the non-industrial business. Now, when we look at different markets across the world, we can see that countries like China, their eCommerce sales, goods sold on e-commerce it's now up into the sort of 40%. So, we think we have some way still to go, because of course, our 17% of non-industrial volume, so that e-commerce, you've got places like the UK, where it’s very strong, and we have some other countries in Europe where it’s really still quite limited, like places in Eastern Europe, parts of Italy, even parts of France as well.

It's still there to grow. So, we think that 17 over the coming years, we would expect that to get up towards 30%. And that has been our view for many years. That's why we moved into this space very early on. I think it's a wonderful sector to be in because of the growth, but the profitability in the sector, whilst for us it's about the average for the group, I think that has

opportunity to grow because there will be more customisation, more specialisation, more track and trace, more plastic replacement, more personalisation, all of that is coming, and that is about more value add from us to our customers.

And they pay for that because we are adding more value. So, it's less about how much paper it's using. It's that value-add. For a lot of our customers' e-commerce we are heavily rewarded for our level of service and needless to say, and if we don't deliver the boxes, they can't distribute products for Christmas.

So that service is of critical importance. And I think we have an outstanding position there, based on a lot of the systems we use, how they integrate with their systems, and these things are only going to develop for us. I think it's a really, really exciting area, not just in the volume, but the opportunity to add more value for our customers. To be honest, over the ten years we've been in this, it's gone faster than we thought. But our end position still remains that we should – see lots of growth yet to come.

But I'm just conscious of the time. We've done our hour. I'm sure if anybody has any other questions, we'll be happy to take them offline, but I would just like to conclude, therefore, just by thanking everybody for your time today. We're pleased with the progress. We invested a lot in Q1, and we did have some lower volumes, but the way Q2 came back with the volumes and into the new year, gives us some confidence in our expectations for the full year and excitement about the years ahead. Thank you very much for your time. Thank you.