26 June 2014

DS Smith 2013/14 Full Year Results Conference Call Transcript

Speaker key

MR	Miles Roberts
AM	Adrian Marsh
JJ	Justin Jordan
BD	Barry Dixon
CO'G	Catriona O'Grady
HM	Hugo Mills
HF	Hector Forsyth

MR So good morning, everybody, and firstly thank you very much for spending the time to come and hear the presentation that we have for the full year results to 30 April. Health and safety is the forefront of our business. We're one of the top performing companies in this area and today we don't have a fire drill planned, so it if goes off, the exits are marked. So I'm joined today by Adrian, our finance director, who joined us last September and has made an absolutely tremendous start with us, so delighted to be here with Adrian today, and also members of our board; with Gareth, our chairman, Jonathan Nicholls and Chris Britton is somewhere else in the audience as well, sitting at the back there working out what questions he's going to ask.

So a year of real progress for DS Smith. It's the first year with 12 months of SCA in it, the acquisition we completed nearly two years ago. So what is that progress that gives us confidence in the future? Well, firstly, there's been a very substantial growth in our profits, our earnings, the return on sales, the return on capital, and that's resulted in a 25% increase in the full-year dividend. But what gives us the confidence to increase that dividend? Well, it's the sustainability of the result. What are we building these returns on? Firstly, it's organic growth. You've seen the like-for-like volume growths coming through and when we compare that to the overall market, we see once again we're taking market share.

We're building on the benefits that have come from our focus on recycled packaging for consumer goods and really harnessing the benefits of the old legacy DS Smith business together with the SCA business, that real integration of getting the best of both of building a platform for the future, and it's on all our stakeholders – we'll talk more about that later. But we only have a sustainable financial performance if we get it right for the customer consistently, for our employees consistently, and in the environment, not just the environment in our emissions, etc, but the communities in which we

work where we rely on their continued support to enable us to grow and develop.

And our strong position in Europe; we have a very and an increasingly differentiated offering to our customer. It's on our supply cycle approach, it's different, it's new, it's exciting, it's adding value and we're seeing the benefits from that reinforced positive customer feedback, giving the industry what the customers have said they've always wanted. They want leadership. They've never had it. Years and years of paper pushing, trying to push paper into the market. How do we lead the industry to provide the customer with the true value that packaging can provide? On the basis of that we continue to invest, so we invest heavily again in our capabilities with our people and our capex, and I'm delighted we'll talk more later about the four new factories that we're building at the moment that will further accelerate our growth. So a year of progress. Adrian, you'll take us through the financial results.

AM Okay, thank you, Miles, and good morning, everyone. I certainly feel very privileged to be here today to describe to you the results for DS Smith for the full year to 30 April 2014. Turning to my first slide, at the half-year when we first met I described my intention to continue the initiatives around driving margin and to bring even more focus to capital discipline. As you can see from these highlights, we've met all of our targets, even on a pro forma basis made considerable improvement on our two key ratios of return on sales and return on average capital employed. For me, the most important thing about the fact that we've hit all our targets is that the business is, we believe, well-configured to deliver these targets on a sustainable basis.

If we turn to the next slide we can see the progress we've made on all our key ratios. Now, I believe these are good results by any measure, but when you take into account the continued difficult economic environment we're operating in for most of last year, we also had rising paper prices, these end up pretty impressive indeed. Revenues grew by 10% due to organic growth and the contribution from the legacy SCA Packaging business for a full 12 months. Operating profit increased 23% to £307 million, including the benefit of €40 million of cost synergies which we delivered as expected. Return on sales has improved by nearly 12% to 7.6% within our target range of 7 to 9%.

This margin increase has been achieved despite substantial short-term headwinds presented by the increase in input costs and the fact that the prior year only included ten months of the lower margin SCA business. Profit before tax has more than doubled and our 25% increase in earnings per share has been matched by a growth in the total dividend for the year to ten pence. Dividends have now more than trebled since 2009/10. Finally, our tight focus on capital has led to an 80-basis point improvement in our average return on capital employed which is improving steadily following the

initially diluted effect of the SCA packaging acquisition and remains for me the key measure of all our KPIs.

This is our usual bridge of revenue, which as at the half-year highlights the extra two months of SCA packaging, less remedy disposals. There's a minor classification of pass-through revenues in relation to tools and wastage which has no profit impact and that's the 65 million revenue reclassification. We can also see clearly here the benefit derived from the growth in volumes. Overall, there's a small FX tailwind, although without wanting to dwell too much on football, it was a bit of a game of two halves with the first half giving us a benefit from FX which is broadly offset in the second half.

In terms of our profit bridge, you can see again the impact of the SCA acquisition, as well as the benefit of volume growth, which together with our synergies have more than offset the rising price of paper during the year. Overall, our business grew organically and by virtue of owning SCA for a full period compared to the ten months in the prior year. They're good results across all of our regions, predominantly all of the regions, particularly where DS Smith had no presence previously. If we look at each of our divisions in turn, first of all as a reminder, where we have paper manufacturing in any particular period movements in paper prices will have an impact on individual divisional margins.

The UK has seen good growth in the corrugated packaging business and has rolled out substantially our performance packaging model. We've also continued to gain sales through innovation in our retail-ready capabilities. Margin progression has been good due to strong cost culture and some significant changes at our Kemsley Mill. One of the synergies which we haven't really previously described from the SCA acquisition was their papermaking skills and best practice benchmarking which has had a transformational impact at Kemsley.

Market conditions in Western Europe have been very challenging, with volume growth lower than the group average. Despite an increase in sales, operating profit has fallen by around 8% and return on sales has decreased by about 100 basis points, reflecting difficult economic and trading conditions, particularly in France. DACH in Northern Europe saw strong growth in revenues at 23% and operating profit at 52%, with growth driven by organic growth and the full 12-month contribution of SCA. The excellent progression in margin of around 180 basis points reflects the benefit of a large proportion of our synergies programme being realised in this region, together with organic growth and a positive impact from our two very efficient paper mills.

Revenues and operating profit in Italy and Central and Eastern Europe have increased by about 23% and around about 30% respectively, again reflecting the full 12-month contribution. Volumes in corrugated packaging have been excellent, driven

principally in Central Europe. We were substantially above the Group average which has again led to good improvement in our margins. As a reminder, our plastic business comprises principally of two elements; flexible packaging and dispensing, FP&D, and returnable transit packaging, RTP. RTP performed very strongly across the business, as did flexibles in the US. As we mentioned at the half-year, we've been restructuring within flexibles in Europe to increase both our effectiveness and our capacity. I'll talk more about this a little later, but that has reduced our margin very slightly year-on-year.

Our underlying cash flow remains strong, with the momentum of exceptional working capital performance in the prior year maintained, despite the backdrop, as I said earlier, of challenging market conditions, increased volumes and rising paper prices. I'd also like to draw your attention right at the bottom to our main working capital measure which is the average working capital to sales ratio which has improved 110 basis points over last year. We deliberately don't show year-end working capital since we believe that this is not the most reflective measure. Average working capital is what we focus our business on and, whilst this can still be described as leading in our industry, we believe we can do better and we challenge the business this year to do so.

Net debt end of the year broadly similar year-on-year as we sought to balance the use of free cash of the group generated between accelerating investment in restructuring within the group earlier than we'd originally planned, continuing to invest in fixed assets to grow the business, and providing returns to shareholders. Restructuring includes about 42 million in relation to the integration of SCA, together with other optimisation and rationalisation programmes, principally in plastics and a little bit in recycling. We'd anticipated completing the dispose of our Nordics phone business by the year end which would've broadly offset the cash we spent on acquiring our CHP plant in Italy. However, that was delayed for reasons outside of our control until in fact yesterday when we signed that deal, so there is a bit of a timing difference in the cash flow as well due to the dispose process not coming in until the beginning of this year.

There's not a lot I can add to this slide. The Group has a record of sustainable returns within the parameters of our dividend policy of two to two-and-a-half times dividend cover. We've already mentioned we are announcing a final dividend of 6.8 pence, making a full year dividend of 10 pence, which is about 2.1 times covered at an increase of last year of 25% which, as I said, matches our earnings growth over the same period.

When I reflected on the business at the half-year I mentioned the capital management and balance sheet focus is as key to me as driving hard on margin progression. I thought it might be helpful to dwell on this for a couple of minutes. We've reviewed carefully our

approach to investing in either capital or restructuring investment and have set clear guidelines around the required returns and cash paybacks within our business. We've likewise reviewed our capital structure during our strategic corporate planning process, the net result of which was a recent refinancing shortly after the year end which both extended the maturity of our facilities and will reduce our future interest payments.

As part of the strategic plan we also lifted the bonnet on every part of the business and described in detail what we want to grow, what we maintained as it is, what has good prospects if we fix it, and what we should exit. This then set the framework agenda for the next three years and drove our recent budget process. The allocation of capital then had to be prioritised because, as you can imagine, when you do a strategic plan there's any number of opportunities to spend capital so we had to set a basis for prioritising that and we adopted what we've called our three S approach. So each project is scored where it fits against our ambitions to be supplier of choice, supply cycle thinking, or sustainability. This creates an overall ranking for any capital investment with all projects still having to meet those financial criteria that I described earlier.

Following this process which we carried out earlier this calendar year, so around January time, we decided to accelerate some of the planned investment in rationalising our asset footprint, initially in the European plastics business where, as we mentioned at the half-year, we already had started a partial restructuring of that business. We see that as an extremely exciting business prospect in Europe. We're moving productions from areas now of low growth and efficiency to be closer to our customers in higher growth and more efficient factories in Central and Eastern Europe and we're in the process of opening two new factories; one in Bulgaria, one in Slovakia.

We've also decided to build a brand-new factory in North America where the business is again extremely successful and now totally capital constrained. This added just under 30 million of additional investment last year and we forecast as we roll this forward and look in detail through packaging as well around about the same again next year. The benefits from these investments are tail-end loaded naturally since they involve a lot of heavy lifting and in order to ensure continuity of business we necessarily have to build and run new facilities before old ones are fully closed, so the benefits drop into our earnings progressively towards the end of next year onwards.

The focus on fresh capital expenditure and the prioritising in packaging based on our rankings is predominantly around our leading display business with another brand-new factory close to our existing operation in Germany, so one marked on Hanau and also in our retail-ready capabilities, particularly in the area of high-

quality digital printing to help customers create packaging solutions to not just display their products but to positively drive their sales.

If I turn to technical guidance, pretty much all of these numbers should be in line with what you're anticipating. I'll draw you particularly to the last point on foreign exchange. We have as an appendix given a way of being able to tabulate the translation effect on our earnings, particularly of the euro which obviously with a substantial amount of our business in Europe will have an impact on how our results are translated.

In terms of outlook, it clearly is a tough environment for the consumer. There's no surprise if you look at what's happening with retailers at the moment across Europe and this will impact and does impact the entire supply chain. We're certainly not planning for that to change in the immediate future, but our innovation and customer focus, together with our rigorous capital discipline and actions we're taking gives me confidence in our model and our growth prospects. So I think that probably concludes all I've got to say, so I'll hand back to Miles to talk a little bit more about how we've been delivering on our strategy.

MR Thank you. So as Adrian has just taken us through the financial numbers I now just want to provide a little bit more colour to the operational performance of the company, particularly the markets and how we see the future. So let's just talk about this market backdrop because there's real opportunity for us here. So if we look across Europe we are broadly in our seventh year of an economic headwind. We still see some improvements, but overall growth rates unfortunately being where we expected them to be and that's low, particularly in places like France and Italy it's still very sluggish.

So when we look at the major retailers across Europe we see that the income of the final consumer is really being squeezed by a combination of inflation, together with taxation and other regulatory expenses, so the free disposable income of our final consumer is under increasing pressure. We're seeing that in reduced basket sizes in the retailers. We're seeing that in the reduced like-for-likes which include inflation. So if you see a retailer saying my like-for-likes are minus two, well, you can take off another one for inflation so actually they're minus three, and that's the general environment and we expect this to continue for a number of years.

We said two years ago we expect Europe to grow about half a per cent per annum for each of the next ten years and that's broadly where we are. There are some improvements, particularly where they're technology driven or where legislation is driving the consumer. But what does that mean for DS Smith involved in packaging? Well, it's tough but that's where the opportunity is. Underlying everything we do is the performance packaging. You cannot go to your customer and say my costs have gone up,

therefore I want a price rise. It doesn't work. The old way has gone. You have to put in the performance packaging to mitigate the effects, to drive value into their operations, and we see a number of areas that this performance packaging is particularly relevant to.

Firstly, with the growth of the convenience and the discount sector this is all about the smaller basket size, customers having less choice but better value, less costs of getting to the store and also a lower basket price, so there's a real opportunity for shelf-ready packaging in these very space-constrained stores. Secondly, on display; if you've got a new product and you want to get a share of the customers' attention it's all about the display in the store. Price itself isn't enough. You've got to get the attention of the customer and we're seeing a significant long-term opportunity here. Then we've got technology driven, about online, because everything goes in a box. Then we have the sustainability agenda which is the legislation, so how can our type of packaging, recycled packaging provide the retailers with the environmental performance they need? So five key areas of real opportunity for DS Smith in a very challenging market.

We are delivering well, as Adrian has said. We've seen growth in our overall business. All of our regions in terms of volumes are either stable or growing, so we don't have any heavy negatives in there, stable or growing across the business. But the areas that we've targeted, whether it's regionally in Central and Eastern Europe or in product ranges such as display, we are seeing very, very positive growth there as we expected, so therefore overall we've increased our share. I'll talk more about plastics later and how that supports the growth of corrugated packaging. As Adrian has outlined, we continue to invest, based on the response from our customer. It is customer led, it is customer demanded, and that's where we continue to put our capital and enjoy the growth.

So let's just look further beneath that performance for all stakeholders because we believe we're building a stronger business, a stronger business for all of our stakeholders to give confidence in the financial returns. So if you're an investor, you're seeing the dividend. But if you're an employee, what are you seeing? Well, we're seeing an improvement in our engagement scores. We're seeing a reducing staff turnover, not just because of the economic conditions but also in our most able staff, so engagement is improving. Our accident rate, just one of our measures, it's now down 22% on last year, a 70% reduction over three years. We have halved the rate of accidents in the businesses we have bought and we're now in the top quartile of performers and we'll drive it further.

If you're a customer, you have seen the underlying service improve. We've taken on SCA which had a much worse performance than old DS Smith and we're seeing the underlying performance improve. We've seen a 20% improvement in quality

and a real acceptance of our differentiated offering which I'll talk more about. On the environment we've seen an across the board improvement in CO2, landfill and water usage, but the engagement in the communities in which we're operating, those four new factories involve other factories closing, talking with the local communities, talking with the works councils, on top of all the SCA work and we're absolutely delighted with the degree of support that we continue to receive across the communities and regulators where we work.

So this differentiated offering, and it's more applicable today than it has ever been. The consumer will not accept price rises, so you have to optimise the whole supply chain. We have been reinforcing this. We've been continuing to market it. We feel we have a significant lead in the market and our customers are increasingly understanding it. It's looking at the total needs of our customer when we deliver, through their production lines, onto the lorry for distribution, into the regional distribution centres, into the store, back of store warehousing, on the shelf availability and then collecting the box. At every part of the cycle we believe there is significant opportunity to improve cost, improve carbon and improve sales.

We've been particularly working with some customers on the warehousing costs. A simple thing like R-Flute®, the growth of it is phenomenal. It doesn't mean anything for us, but the amount of cost it takes out of our customers is significant. We're now working with the line run speeds of our major customers. The average improvement in line run speed is over 50% of their cost is what we're getting. That's more than the benefits that we initially set out to achieve. With our on-shelf display improving sales density, particularly in the convenience and the hard discount sectors, and we've seen this take-up with more licensing into the Far East, with new customers and also an extension of our existing licencing into the US.

That's what I'm saying. What do our customers say? The proof of the pudding is what they're telling us, what they're prepared to say publicly. So here you have again Nestle, one of the world's leading companies, and they look at their supply chain very seriously. They rank it. They audit it. It's quite a significant process. They say, in Europe of any packaging supplier you're the best, not just this year but last year. In fact, we've increased our lead during the year. In our business in Central Europe and DACH they said, actually you're the best supplier of any supplier that we have – the number one supplier of over 13,000 suppliers they have built on the rankings that we say there. We're absolutely delighted to receive that. It gives us confidence that we're on the right path.

The right path, as I said, to continue growing our share. We've seen our volume growth at 2.2%. We've seen that against the corrugated market growth showing we have a growing market there

which is growing ahead of GDP of 0.9. The target areas, Central and Eastern Europe, DACH, Italy; markets that are either in growth themselves, such as Eastern Europe; countries that are new to us, places like Germany; or where traditionally we've had a very small share, in all those regions that we're targeting, that we're putting our capital expenditure, we've really seen some quite significant levels of growth. I'm going to give you some examples as to why, what's underlying that growth, not just on a regional basis but into the products.

So here's the first one on that technology led development. We all know about it. We all use it. It's a very exciting area. The technology is improving all the time. We anticipate this market will grow at about 10% per annum for many years to come. The UK is well advanced, but other European countries are catching up. So as we're the market leader in the UK, it gives us a very strong presence in which to roll out a similar model across Europe. The good news is when you buy online, everything comes in a box. Previously you just bought a product. Now it comes in a box. That in itself is good news, but what's increasingly important is the variety of product that's being delivered online. It's no longer just a book which is relatively simple to package; we're now into much more sophisticated products. That means sophistication of design, that means expertise, and with the rollout of our design centres, of our technology that we've talked about previously, we feel we have an extremely strong capability in that area.

But when you're talking to these customers it's the way they manage to reduce the bottlenecks in their supply chain, and the bottleneck is often around the packaging. In their warehouses they have to take the product from the shelf, then they have to package it. It's the packaging, the physical process that can often be the bottleneck. So we're working with some of your very largest, leading, solely online suppliers, not just from the packaging itself but on the automation of their factories. Of course we supply automated systems. We lead that market. They're very interested. We used to own approach which was all about the warehouse and the distribution of products, so we have a very strong presence there adding value to them.

That customer experience, when you receive the product, now if you look on some of these online portals you're able to have a choice of the sort of packaging you want. You're seeing us in action. If it's a present for somebody, you want a different type of packaging than if it's just for yourself. We're now able to offer that sort of flexibility. Here's a very good example that brings it all together; this is an example of a Danish postal service. It's wine in there. People are increasingly buying premium wines. It's one of the growth areas in what's actually a declining market in Europe. It's the premium sector. Stores can't stock it because of the cost, so it lends itself very well to an online presence, but you're going to have to send it through the post.

There are many jokes about splitting the atom by sending it first-class through the post. Thank you, Adrian. Thank you. But with this packaging, it has to be approved. So to send a bottle of wine through the Danish postal service you can only send it in packaging that's approved. We're the only approved packaging supplier there. If they want to sell wine in Denmark through the post, you've got to use something that's approved by the postal service. As the sophistication of products changes, that's the opportunity for us. Retail-ready. Retail-ready, our bedrock, our core strength.

Huge development in the UK where we lead the market. Huge opportunity as we see the major retailers increasingly adopt it. But the convenience and discount centres, we're seeing the growth in the discounters. Just in the UK it's assumed to grow by two-thirds over the coming five years. If we look at convenience, Sainsbury's is plus 17% year-on-year growth so we're seeing the development of these stores. Back with the increasing urbanisation of Europe, back with the increasing transport costs, we're seeing a continued growth here.

They have to maximise their sales density in the store. It's very limited space. The cost of replenishing their shelves not only in the physical cost but also in the disruption to the consumer, it absolutely lends itself to shelf retail-ready packaging. If you go into the hard discounters on your way home, you'll see by far the majority of their products are in shelf-ready packaging. The average in-store cost of a hard discounter is less than half the in-store cost of a major multiple. Less than half. You don't see people in the discounters stacking shelves; you see them wheel the product in on shelf-ready packaging. It's a phenomenal opportunity for us in a market that we lead.

We've talked about the display business. Why is display growing? Well, firstly, as the pressure on consumers' disposable income grows, they're more price sensitive. We're seeing a constant growth in the proportion of products built on promotions. A typical UK multiple grocer is now selling over 40% of their products on promotion. To promote it, it's about display; it's to draw the consumer's attention to that product. So when you go into retail, look at the display business there. If you're going to launch a new product you've got to grab the customer's attention. So display for promotions which is growing, for new products launching, we're seeing a growth in display. So that links back to Adrian's presentation about our new factories that we're building because, frankly, demand is just outstripping our capacity – an exciting and long-term trend.

I said I would turn to plastics. Why is that? We've been asked over the years, why do you have this business? Well, if you look at the perimeter of the corrugated box market, it's hugely underrepresented in the transportation of liquids for obvious

reasons. It's difficult for a cardboard box to hold water. But the thing about the cardboard box, it has a lower transportation cost than a bottle. It's got a greater branding opportunity as you can print the brand all over the box. If you've got a bottle, is it the front? It's not on the side. So the branding opportunity is greater and of course it's fully recyclable, so you just crush the box flat. Particularly with the decreasing apartment sizes throughout Europe and therefore less room to store your waste cardboard, its compressibility is increasingly important.

So we're seeing continued growth. We're seeing not just in Europe but in other parts of the world we have a presence, so in the US the demand has been absolutely phenomenal and we've just outstripped our capacity there so there's a new factory going down there. In Europe we have two new facilities being built which Adrian has talked about. We believe there's a long-term trend there. We're improving the cost base and the capacity. Returnable transit packaging, that's a much smaller part of plastics, but this where we pick up the old crates, beer crates, etc, on our mobile units. We crush them all down. We pelletize them and then we re-blow into a new crate. It's an environmentally based packaging solution and given our increase in marketing we're seeing a very good improvement there as well.

So, in summary, where are we? The summary of the year. There's been a strong set of financial results. Earnings up. Return on capital up. Market share up. Dividend up 25%. Built on improving the performance for our customer, our people and the environment. We believe we're starting to give the leadership our customers absolutely want and you've seen the feedback that the customers are giving us, not just in the share but in customers like Nestle. So, yes, the market is difficult. We expect it to be difficult. We remind people it's difficult. But given where we are, with the progress we've made, with our plans for the future, we're very excited about that, about our longer-term prospects. Thank you. That concludes our presentation, from Adrian and myself, and we're very happy to take any questions that anybody in the audience and I think we have some people on the telephones as well who may want to.

OP Ladies and gentlemen on the telephones, if you would like to ask a question please press star one on your telephone keypad. Thank you.

AMe Alexander Mees, JP Morgan
Volume grew through the course of the year or did it perhaps peak towards the middle of the year and then tail off and, if so, why? Secondly, where do you see net debt going over the course of 2015 and given you've got significant unused facilities at the moment, does that imply that you are actively seeking acquisitions during the course of the year?

MR If I take the first one and Adrian the 2.2. We're in FMCG and there are always a few changes. In the first half we started growing very nicely, finished the first half very well, continued into December and it's true in some parts of Europe the February and March, I hate to even say these words because it's the weather, some of our customers we just couldn't deliver to because they were flooded. So we saw then a slight sort of moderation at the start of the year. We're still growing in all our markets, but there's no doubt that some of the very heavy weather-related businesses, there was some impact and then as soon as that ended it started to improve so we finished the year very well. Of course the question is, if you didn't have the weather, but you do. We finished at 2.2 with a nice positive trend there, but these things just happen to be in some of our markets. It was short, it happened, it went away and we're back growing quite nicely. Adrian?

AM The financing thing you asked about, what we've tried to do is take you through, without giving a calculation, the way we think you can bridge to a number not dissimilar to ours. Clearly we're expecting strong cash flow again. We've set out where we'll be on capex, interest payments, tax payments, exceptional costs. I've hopefully alluded to the fact that we're putting an ambition back on the business again to drive more out of working capital. So as I sit here, and you can do the sums, in my head I'm not looking at an increase in net debt, far from it, but that's just how the maths will work out as you calculate it.

The missing link is probably the second part of what you've alluded to in terms of, yes, we have extended the maturity of our facilities. In fact, indeed we've increased them slightly and the question is, why would you do that? Well, first of all, managing liquidity, especially over a period of economic uncertainty, we think is paramount. We have to be sure that the business has got liquidity, number one. Two, a lot of those facilities are bank related so they can be drawn or undrawn, so it's independent of gearing, if you like. We do have a maturity, a small private placement maturity coming up in I think two years' time, August 2016, and that needs to be covered.

Then of course we are looking at, where we can, what M&A activity we need to drive the business in the areas we're not currently in or we're underrepresented in and that remains the case. We've looked through… there's no shortage of assets for sale at the moment. The issue for us is, what value can we generate through our ownership of those assets as opposed to a PE house buying them at a crazy multiple or not buying them at all and waiting to see what happens. So we're very much open for business there. We're looking at a lot of opportunities. We have looked at a lot of opportunities, but they have to be fitting within our financial criteria.

JJ Hi, Justin Jordan from Jeffries. Just a very quick question on volumes and pricing trends in calendar 14 year-to-date. Obviously

year-to-date we've seen softening OCC and testliner prices. You've been successful in increasing box prices and volume growth obviously in fiscal 14. Is it a more challenging environment in fiscal 15 to continue edging up box prices when customers can see your raw material prices falling?

MR The price of paper, we've said it many times, we'll say it again today: we have absolutely no idea really what it will be in six months' time. But the final consumer is under a lot of pressure so I say that when you have increasing paper costs it is not as simple as just, I've had a 5% increase in cost, therefore I've got to pass it on. It's up to us to mitigate that at every possible opportunity and if paper price is going up or going down, we are constantly seeking to reduce the amount of paper that is used in the packaging and, my goodness, are there opportunities.

So one of the reasons for our short paper position is it gives us that flexibility. So if I look at how the grades that we use, the design of the box, the amount of churn here is absolutely extraordinary. It's like it's of no other period. We've talked previously about the shift out of kraft and it's just accelerating. I think the last update we gave about 130,000 tonnes out of kraft in the last 12 months and it's just going on and on and on. So for us paper price is up and down. We remain fixed on, how can we delight the customer? How can we change the grades, improve the performance of the box using less raw material?

Now, when we come onto the coming year we'll be continuing to do that. We think there's opportunity and if we can do that, we can actually extend the perimeter of corrugated into some areas that are currently occupied by plastics. There's some real opportunities there to continue to grow and the background to that, you do have the ups and downs and some indices moving, but the ultimate trend is for us to reduce the amount of paper and increase the value that we add to our customers. That's really what's happening and I don't see that going away for the foreseeable future. Is there anything else, Adrian?

AM No, I think that's reasonable.

MR Yes.

JJ Just one quick follow-on. Obviously you've talked at length about weather in the last few months, but can you just share with us just what your volume growth was in Western Europe in the second half of the year?

MR So Western Europe? We've been growing. There's no region that we've been growing backwards. I'd say it's stable or growth. We need to… we'll just come back on that figure.

JJ Thank you.

AM You're specifically asking about the second half?

JJ Yes, I'm really just trying to get a feel for how significant France is, basically.

AM Yes, I can look at it.

BD Good morning, it's Barry Dixon from Davy. A couple of questions. Adrian, just in terms of the four new factories, just to get it clear, there's three on the plastic side and one on display? Can you maybe just give us a bit of colour around that in terms of what net new capacity that will add to the plastics division and also to the corrugated side? And presumably could you give us some indication of the cost of that and presumably it's included in the 150 to 160 of guidance on capex? The second question just in terms of paper prices, and I know Miles was just saying that none of us have any idea where it's going, do you get any sense that the industry is taking any downtime to try and alleviate the current pressure that we're seeing on recycled paper prices? We've seen a couple of players in the market announce downtime. Have you any sense, are others trying to do that? You also spoke previously about supply pressures from US kraftliner imports. Maybe you might just comment on that in terms of, has there been any change in that? Thank you.

AM Do you want to pick up the volume part on plastics? In terms of the new factories, you're absolutely right; there's two in Europe, one in the States. The costs of opening the plants, the capital cost of the plants are within the capital programme, both this year and next year. Individually they're material, but not enormous. The US plant will... I don't want to be too precise. No plant will be more than 20 million. They're less than that. In terms of how quickly they pay back, certainly with the US which is meeting a very rapid demand constraint we're looking at exceptionally good payback on that. In terms of in Europe on the plastics division, again, the costs of the actual factory is within the capex and not materially significant. In total for the group they're obviously significant investments, but in the division... did you ask about...?

BD Sorry, could you just clarify, this will be net new capacity, though, in the plastics division?

AM In plastics it's net new capacity in the States and it's a shift of capacity, it's a shift and increase of capacity in Europe. I'll have to back solve it at another time if you want the precision on that, but I can do that. But it's a shift in capacity from developed Europe into emerging Europe and a net increase as well and certainly a significant increase in efficiency. In display, we have an existing display business in the UK. This is in Germany and this is an entirely new facility close-by that will significantly again increase capacity there.

MR But just picking up, we bought SCA, huge underutilisation of the assets and we gave capex guidance. We continue to drive the utilisation of the SCA business. We've got a tremendous footprint and underutilisation and you're seeing the volume increases come through and you're seeing the capex guidance remaining unchanged. In some growth areas, such as plastics as one part of SCA display which is a long-term trend for us which again didn't come from there, we're seeing significant opportunity to invest in line with our previous guidance, no new net capex, as Adrian starts to allocate capital to our most effective areas. So we do see a significant improvement in our overall capacity.

I think display doubles our capacity on the continent in terms of where we are to where we're going, and on plastics in the US broadly, it's not quite doubled, it depends on the product mix, etc, it's got a slightly enhanced mix in there so it's about 70% and, as Adrian said, in Eastern Europe there's a big cost but there is a significant capacity increase. Again, there's a product mix issue in there, but it's around about the 50% level on the capacity, all in line with previous capex guidance – that means we're allocating capex to the best return areas.

You've asked about paper and downtime. Our suppliers do tell us when they're taking downtime. It does go up and down. There has been quite an erosion on testliner prices. If I had to call it, I think it will probably start to stabilise, but it's notoriously unreliable and I've no doubt if prices stay where they are, then some capacity will come out. I would expect that because I imagine some people are under a lot of pressure.

US kraft, let's just be absolutely clear on this: because we buy this in the market, it's an absolute commoditised product. There's no difference. You buy it anywhere, it's the same. You have a number of parts of the world that produce kraft paper and we are totally indiscriminate to where we buy it from. What's quite interesting, when you come out of Europe some suppliers are after very long-term supply contracts. They can set up the logistics and we're seeking to use that because we believe some of these other regions of the world away from Europe, putting it bluntly, the trees go very quickly, energy costs are on the floor, they have capacity so we want to tap into that market. So although we're reducing the amount of kraft, we're also changing the way we buy it and that's about just seeking the best cost base for our customers and we'll continue to do that. It moves up and down as to how much we take, but it's a position that we're very comfortable with and we'll continue to exploit.

BD Thank you.

OP Ladies and gentlemen on the telephones, as a reminder, if you would like to ask a question please press star one on your telephone keypad.

CO'G Catriona O'Grady from UBS
What volumes did you realise in Germany and Central and Eastern Europe, just in terms of putting that against the medium-term targets that you laid out last September. The second one around the restructuring in plastics, does that imply that you expect the margins to recover next year? I think, Adrian, you were saying starting to benefit from the end of next year. Thirdly, thinking more about your FMCG versus your industrials end market, have you seen the gap in terms of the profitability of those two sectors get less as customers in FMCG have been more willing to pay for the display products and the shelf-ready packaging? Thanks.

AM Let me take the second. Shall I do the second first because it's an easy one to answer, Catriona? Yes, in terms of plastics, you saw I think it was a 10-basis point erosion in margin year-on-year in plastics this year. Our analysis and our budget and our investment case is certainly for an improvement in margin next year, picking up further in the year after.

MR Absolutely. We're over the hump. In terms of the FMCG business, if we look at our product range, etc, we're obviously seeking to churn that to areas that we can have most value in. You've seen our overall return on sales increase, you've seen the return on capital improve and you've seen our market share gain. But there is quite a churn in there and I think as we develop our offering we understand more about the areas that we really can add value to and the areas that, frankly, become more commoditised. The average product life is about three years. You start very nicely and you can build the margins. You then go into a flat period and it then erodes. We're no different to most FMCG-ers so it's about culling the tail, and we're getting better.

In our capex numbers there's a significant investment in improving the structure of the group. When we're talking about acquisition, we don't just mean buy it and make a decent return. We mean integrate it with our staff, integrate it with our customers and integrate it with our supply chain, so putting in a lot of development of our systems to improve the understanding of our customer, product and region profitability. I expect the churn to increase and this is partly behind our guidance on future margins. We've taken the old SCA business and made 5.8. Now as a combined group 7.6 and I think in terms of future guidance people are expecting... their forecasts show further improvements in returns and we're quite comfortable with those, and a large part of that is that market intelligence about where we feel we're best able to add value to our customers and that has a direct correlation with margins against a tough backdrop, but it's no different for any company.

CO'G What about volumes in Germany and Central and Eastern Europe versus the targets?

MR The progress there has been very consistent with what we achieved in the first half from the year-to-date. There's been no particular change there. These are either new areas for us, so we have our customers saying, supply the same in those regions as you do elsewhere. The markets are either growing or a low presence, and we put a lot of capital behind that. We talk about new factories, but a lot of our investments in existing facilities are in those regions. So we used to have two what we call mega plants in Poland. We've now got a third and they've absolutely shoehorned in some quite considerable extra capacity now, so we've got a very nice network across Poland with some very, very significant investment in there just to cope with the increasing volumes that we're getting there, just to keep that service absolutely right because it's a very exciting area for us.

OP As a reminder, to ask a question on this call please press star one. Thank you.

HM Hugo Mills, Citi
Is it going to be very much economy led recovery and where can they go based on the margins?

MR Yes, so Western Europe, the big market in there is France and France is a very difficult market. For us, the whole market environment is very difficult. Our concern is that it's in deflation and the problem with deflation is if you're going to invest and we think of our customers, you're always going to get a better return if you delay that investment. It's quite a serious situation. We're in food and drink. People haven't stopped eating and drinking, so our volumes and the resilience of the business is very good, but ultimately there is an effect on that. It was assumed there would be one. So I think the margin opportunity there, we're still making good margins but I think the margin opportunity ultimately because that economic environment is less than it is elsewhere, because I don't think we're going to get the operational leverage coming through there that we can enjoy in other regions. Regions go up and down. We've got a platform of different regions in there, but there's no doubt that we are... whilst the business is stable and robust, etc, just the overall environment is, it's not a great place for an industry.

HM Secondly, just on the new investment, presumably returns on that would be well ahead of or certainly on the upper end of what you're looking for from a...?

MR Yes.

HF Hector Forsyth, Oriel

Securities. Just a couple of questions. The first one on the exceptionals. You're indicating I think 30 million of spend this year. Can you give us an indication of what that is and if you think that this is a feature of the business going forward?

AM No, I think, if it's okay, for a whole variety of reasons it would be better if we described that more fully at the half-year in terms of, it does involve looking at our whole footprint, how we're operating, particularly within the packaging business, and where we can drive further efficiencies through that. So it would be wrong of me to give too much colour now because there's a process to go through. Is it going to be a continued part of the business? From my perspective, everything is based on the returns they're going to generate and a pure investment case. As it stands, this is what we see the programme to be. We've gone through a process. We've looked at what we believe we can do, what returns that will generate into the future, and we're happy with the guidance we've given and we can certainly give more colour around that at the half-year. Miles, have you got anything?

MR No, we reconcile everything with SCA. What we spent, it's all in the appendix. We spent this amount, these are the benefits – they're all in the forecast or on your expectations, all in the actuals. We've got another amount here. It's absolutely discreet and you'll see that translate into our forward guidance, but beyond that we don't see anything else. It's got to make a return, but you're seeing it in the forecast. We always expected it, because when you integrate SCA... we always know there's going to be another opportunity. It's really understanding those opportunities and seeing what we can do and when and how that relates to future returns. We're very pleased with that. I think it's going to generate attractive returns going forward.

HF Okay, thank you. A slightly different tact, can you just talk us through how you're going to develop better your closed loop offering on mainland Europe?

MR Wonderful question. I can't believe I missed it off the presentation. So the closed loop in UK is absolutely outstanding. We are now collecting extensively in Eastern Europe where built on our business with Tesco they said, run it through all your other or the other stores across Europe. We've built on that with some other major retailers in that country as well. We've just completed a very nice acquisition in Italy which gives us a very strong presence up in, particularly in the northern part of Italy. We have established our businesses in France, secured with two major retailers there, so we're starting to see that grow. But the feedback from our customers is absolutely tremendous. It's absolutely what they want to see. So we talked to our big customers; they want to see that closed loop. They want to know that their packaging is picked up and re-used. It's time and time and time again. We've got a very nice footprint there. We collect from the retailers. We're unique in

that position and it's a major part of that differentiated offering and it's going to grow further. UK, France, now growing our position in Italy and we've got Eastern Europe set up as well.

AM Adding to that, we've been invited to look in Northern Europe and Scandinavia as well.

MR Absolutely.

AM Also, one retailer recently paid for us to do a piece of work specifically for them in an area of the world where we're not present, so I think it really is a unique offering we've got.

MR Yes, quite. Well, look, thanks. I'm conscious of everybody's time. Are there any questions on the telephones? No? That's great. Well, look, we've been here just over an hour and unless there are any other burning issues I think we should probably call that to a close. So, firstly, thank you, Adrian, and thank you everybody, for your time. We are here for a while afterwards if anyone has last-minute questions.