DS SMITH Q1 INTERIM MANAGEMENT STATEMENT

4 September 2012

Speaker key

OP Operator
MR Miles Roberts
AM Alexander Mees
RE Robert Eason
HF Hector Forsythe
MM Mike Murphy

MR Good morning and thank you for joining us today. I am Miles Roberts, the CEO of DS Smith, and I'm joined by Steve Dryden, our finance director. So this morning, ahead of our AGM, we're pleased to release our Q1 interim management statement. I would like to take a few minutes to run through the highlights of that statement, after which Steve and I would be delighted to take any questions you have. Before getting into the detail, I would like to say that we are pleased with the performance of DS Smith through Q1 and we're also very pleased with regards to the integration of SCA Packaging, on which we will be updating the market at our 100 day presentation in five weeks' time.

So in terms of trading and looking at the Group as a whole, trading has continued fully in line with our expectations, with good corrugated box volumes in the legacy DS Smith business slightly ahead of our GDP +1% target and we have seen particularly encouraging volume growth continuing in continental Europe. And yesterday we announced that RockTenn – the major US supplier of packaging – and DS Smith have entered into a strategic alliance, executing a licensing agreement that gives RockTenn the exclusive rights to manufacture and distribute our corrugated packaging designs and to distribute our packaging equipment in the United States of America.

Now, running through some of the highlights of the packaging business; as I'm sure you're aware, on 30 June DS Smith completed its acquisition of SCA Packaging as planned. Accordingly, net debt increased commensurately and SCA Packaging is consolidated in the accounts of DS Smith from this date. The integration work is proceeding slightly ahead of the planned schedule and we are pleased with the progress to date. We very much look forward to updating investors with more details at our scheduled presentation on 11th October.

And with regards to the outlook for the full year, we remain confident in the strength of the transformed DS Smith business model, with a good performance in the legacy DS Smith business, despite the on-going tough trading environment. SCA Packaging trading has been fully in line with our expectations, again, which reflected the difficult market conditions. We continue to expect to deliver a return on capital from the acquisition above our weighted cost of capital in this financial year. Our significantly enlarged geographic footprint has positioned us better to meet the demands of our pan-European customers and to deliver substantial value. Thank you. Steve and I would now welcome any questions any of you may have.

OP Thank you. Ladies and gentlemen, if you do wish to ask a question on this call please press *1 on your touchtone phone. We have a question from the line of Alexander Mees from JP Morgan; please go ahead, Alexander.

AM Good morning. Three questions for me, if I may. The first one relates to Continental Europe. Clearly some good growth happening there despite a poor economic backdrop. Can you just touch on whether that relates to market share gains and if it does, what underpins the market share gains and are you able to quantify them?

MR Well, as you know we've seen very consistent growth on Continental Europe for our business for many quarters now. At the full-year we put in quarter by quarter, it's never dropped below 3% like-for-like volume growth and that's continued. What we're finding is the focus on FMCG, it's a good category to focus in on. It's very resilient, so the underlying market is doing reasonably well. Secondly, we put a lot into product development and having the right assets to support our business and we've been very pleased with the take-up from our customers of that. And thirdly, getting the service and the quality right. It hasn't been right. A number of years ago we put a huge amount of effort and we've been rewarded with more business. Now, whether that's a market share gain or not, I'm not really too sure. What I know is we're growing and our relationships with our customers are good and we are investing in our business, and those are the reasons why we're growing.

AM Excellent. And just secondly, your comment that margins are moving up as you would expect with the operating leverage of the business, but presumably there has been some pressure from input cost, can you just give us some colour on those?

MR We saw input costs, and for us there's energy, starch, inks and obviously paper, and we buy most of our paper from our suppliers, and we had seen pretty consistent increases up until about December and then it started to flatten off and now we're seeing more material costs start to decline. Actually, we think at the moment they seem to be pretty stable. I wouldn't be surprised if they started to increase in the future. As you know, we have very short pricing agreements with our customers, typically about three months. So prices go up, we recover the cost. Prices come down, we hand them back.

And the reason for the increase in margin is, firstly, obviously where the raw materials go up or down we just pass that through, so we are making the same profit but obviously the turnover's lower because raw material costs have come down. This also is as we are continuing to improve our business, focusing on the right categories and driving efficiency in the organisation. We talked about the UK coming together, we talked about procurement, we talked about operational gearing, all of that's having the effect to drive margins and you see it in the return on capital. That's our primary measure – return on capital invested – and we're here to show our investors, good times, bad times, we add value every year in the cycle. Not on an average, every year, and that's what we're setting out to do.

AM And just finally on the announcement yesterday with regard to RockTenn and the agreement there, can you just give us some further colour on the implications of that, please?

MR Well, as we've been investing in product development we have a lot of patented designs. It's not just in the box, it's the way the box is made, it's how it's constructed, it's about the machines that are used for the end of our lines. This is one of the reasons our volumes have been very strong on the continent. And those big customers are global customers and they want that same technology in other regions of the world, and Rock Tenn have come to us and asked if they can license this. They've obviously worked with our customers, so those global customers can have the same solution no matter where they are in the world and that's what this means. For us it's a first. We're unaware of anybody else who does this sort of licensing across major markets of the world and it shows just how global our customers are becoming. And it also shows this is patented technology. People often ask us about, well it's just a cardboard box, where is the IP, where is the value? It's not just a box, it's the way it's constructed, it's the machines, it's the supply and this is showing the value that we're able to add to that. So we're absolutely delighted. We've got to work with them now to see how we can really grow that business and get it into the marketplace, but we are really encouraged by it.

AM Excellent, thank you, Miles.

OP Our next question comes from the line of Robert Eason from Goodbody Stockbrokers; please go ahead, Robert.

RE Hi, good morning everyone. Just in relation to input costs, you mentioned that you wouldn't be surprised if they go up in the next couple of months. Just in relation to that, I was just wondering what your comments are on the recent announcements for a €100 increase for container board prices and just your outlook for OCC prices as well. And just also in terms of your comments on volume, you've given us a bit of colour on mainland Europe, can you just give us a bit more colour on the UK and how volumes have trended over the last number of months?

MR The UK volumes have been… to be honest, they've been pretty flat, really. Slightly increasing but if it goes up 0.5% or 0.75% it's broadly flat and we aren't seeing any real change to that. The overall market is pretty stable and we are by far the largest supplier in the UK and we're trading in line with that market. When it comes to input costs we are seeing some increases. We use a lot of starch. Obviously starch comes from a variety of sources, corn is one of them, so we're seeing increases there. We're starting to see some energy costs start to go up. We do read about people announcing price of paper going up, etc. Frankly it is what it is. Our job is to recover that in the shortest period of time possible for our customers. But our outlook is for… it just feels like raw materials are going to start edging up. I don't think it'll be anything dramatic, just a steady increase. That's what we're planning for.

RE Just maybe two follow-on then, in terms of just, given your substantial position in the recovered paper market, OCC, what is your outlook there? And just going back to the RockTenn announcement yesterday, can you just give us any sense of the scale of the licensing agreement? For example, in relation to the product that this is on, what percentage of your Group sales does that represent? Just give us a sense of the scale.

MR Taking your first question with OCC. It's been increasing quite steadily, it's been reducing, it's stable. The outlook is, I think, fibre OCC is going to increase over the coming months. It does depend a lot on China. As you know, Europe and particularly the UK export a lot to China so it depends where they are. They can also source from the US against the sterling, dollar, euro exchange rate. But we do expect OCC to increase over the coming months. I don't think it will be dramatic but I think we'll see that kick up at a modest rate.

And in terms of RockTenn, some of our largest customers, where they can be a good couple of per cent of our turnover, so our turnovers are substantial so you're talking about a large business in Europe, those customers in the US, and the US market is, in terms of corrugated packaging is a very similar size to Europe. So we are potentially talking about very significant customers who want the technology in a very good economy in the US that's growing. Time will tell, but we're dealing with big customers here. We have substantial, substantial business with them in Europe and they have the same size of business in the US so let's see how it develops. But we really are quite excited about it. RockTenn has made a similar announcement. They're saying to the market, we have the DS Smith technology. That's what they announced in the US. We've now licensed it, we've got exclusive rights in the US and they are starting to market heavily. These guys are a fabulous company. They're putting a huge amount of effort behind it because they know the value this can give to our customers. So time will tell but we're excited about it.

RE Thank you very much.

OP Thank you. Our next question has come from the line of Hector Forsythe from Oriel; please go ahead, Hector.

HF Morning, guys. Just a couple of questions from me. I wonder whether you could say by segment i.e. industrial and FMCG how you're seeing volumes trending both across the UK and Continental Europe? And second question is, if you're able to at this stage just give us some colour on the customer reaction to the SCA deal and the realities of what they're offering you and if you can just say any response from them, any additional volumes, etc. I know you'll give a lot more detail on 11 October.

MR The growth that we've had in the Group, which has been very pleasing, has come from FMCG. That's where we have put a huge amount of focus. It's very resilient and it's growing, so that's where the growth comes from. As you know, about 25% of our business is industrial and that's broadly been flat/slightly increasing. If you split those by the UK to the continent most of our growth is in the continent, so it's virtually all FMCG in the continent. UK industrial has actually held up reasonably well. It's not that dissimilar from FMCG. Some of our customers are actually the UK car industry and that's been doing quite well. We've seen quite a reasonable demand there. Construction's still poor. Aviation seems to be doing reasonably well. So in summary, the growth comes from FMCG. Industrial is more flat. UK is broadly flat on both, so it's continental Europe FMCG which has really grown.

And with the customer reaction, we've created something that doesn't exist today. Our large customers are coming around more and more behind what they call power brands. They're coming much more around operational excellence, sites of operation for particular products supplying Europe, so increasingly they want the same packaging that runs through their lines in the same way. Customers like Proctor, they want our machines in their factories no matter where the factory is, so they have to have the same packaging. We've created something that just hasn't existed for a real, genuine pan-European supply, high quality assets with a huge focus on development behind the business. So as you can imagine, if you're a customer you're going to feel positive about it and they've been very positive. But positive sentiment is good, what we need is to really extract the value from that and we hope over the next year, 18 months, we're going to start to see the value of that come through. And again, we'll outline more on 11 October, but we're pleased with the reaction that we've had.

HF Fabulous. Looking forward to that presentation, then. Thank you.

OP Thank you. We currently have no further questions coming through so just another reminder, please press *1 if you would like to ask a question. And we have a question from the line of Mike Murphy from Numis Securities; please go ahead, Mike.

MM Morning, guys. Once again, can I just ask about the plastic packaging division, the performance of that in Q1, please?

MR Yes, plastics has been good, there's no question about it. It's been good. We've seen continued growth there, a huge amount of innovation. This is LP&D – liquid packaging and dispensing – this is the bag-in-box. We're pleased. Combination of improving operational performance, we've rationalised some facilities, just refocused on operational excellence, but new product developments coming through at the same time. But it's good, we're pleased. It's part of the reason that the corrugated is done well as well, driving the bag-in-box format. But yes, very pleased with that.

MM Thanks, Miles.

OP Thank you. Ladies and gentlemen, just one final reminder, please press *1 if you would like to ask a question. We've got no further questions coming through, I'll hand you back to your host to wrap up today's call.

MR Firstly, thank you again for your time this morning and for your interest in DS Smith. As I've said, trading has been fully in line with current expectations that reflect the difficult conditions. We're pleased with the progress with the SCA integration to date and will outline more on the 11 October, and we view the outlook for the remainder of the year with confidence. Thank you very much for your time.

OP Ladies and gentlemen, thank you for joining; you may now disconnect your line.