6 December 2018

DS Smith 2018/19 Half Year Results

Speaker Key:

MR	Miles Roberts
AM	Adrian Marsh
ALM	Alexander Mees
DO	David O’Brien
JJ	Justin Jordan
RC	Robert Chantry

MR Great. Well, firstly, welcome to our results announcement for the first six months of this financial year. Thank you very much for spending the time to come and join us. We very much appreciate it. Of course, we’re very pleased to talk about our results. We are very pleased.

In our results, I think there’ll be a number of really key themes here which we’ll continually come back to. Firstly, it’s around the strong fundamentals that underline our business. Why have we continued to keep growing, even in more uncertain times? So strong fundamentals to our business.

Secondly, we’re talking very much about the acquisitions that we’ve made and the substantial progress we’ve made there, but then also, around our future acquisition and our preparedness for that. And then lastly, we’ll be talking about the resilience of the business, but also the strength of the balance sheet of the group, how we see things going forwards.

00:01:15

So in terms of our half year results, we’re pleased. We’re pleased with those results. You’ve seen the headlines. It’s a very substantial improvement in really all of our metrics. But I think particularly, we’re pleased at how we have fully recovered all of the raw material in increasing input costs that we’ve incurred over the six months and indeed in the period leading up to that.

Our volume, we’ve grown well ahead of the market. And that is despite having fully recovered our input costs, the increasing input costs. So as a result of that good growth and a full recovery, our margins have increased by 120 basis points to 9.9% and we think they’re going to go further. The US has again performed very, very strongly. We’ll come back and talk about that. But very good returns and, I have to say, an excellent outlook.

And turning to the balance sheet, we’ve seen a good cash flow. We’ve seen our net debt to EBITDA fall to 2.1 times, getting closer to our medium-term objective of two times. And very importantly, we've now a new long-term financing facility that takes out any refinancing until five plus years.

00:02:44

And plastics, the strategic view is going very well and as a result of that, we've treated it as a discontinued business in these half year results. On Europac, our next acquisition, which we're very excited about, we expect this to complete around the end of the financial year, fully in line with our expectations and it's performing exactly as we expect it to.

And most importantly, half two has started well. A lot of momentum going into the second half and, I have to say, we're looking forward to it. But first of all, before I come back and build on those key themes, Adrian is going to take us through our half year results.

AM Thank you Miles. So good morning everyone. And as usual, I'm going to take you through our results for the half year. And unless otherwise explained, changes referred to are on a constant currency basis. I'll also principally be talking about the group on a continuing operations basis so that is excluding plastics, which is now on the balance sheet as held for sale and treated as discontinued.

We've again delivered on our targets with good volume growth, as previously indicated, back to more normal levels from the exceptionally strong growth of last year. The standout number, as highlighted at the pre-close, is return on sales. I'll be going through the bridge in a minute. But achieving such an improvement in a period when we were still very much in price recovery mode is a great achievement and testament to our robust business model.

00:04:41

Whilst on the subject of margin, you may remember that this is now stated on an IFRS 15 basis that requires certain cost sharing items such as energy to be treated as revenue rather than net cost, which has an overall effect in the half of increasing revenue while leaving profit unchanged. Whilst not material, it does have a small ten to 20 basis points difference. It has the same impact on prior years. So the 9.9% achieved this year is actually more like 10.1% in old money.

Return on capital has been steady period on period, but you'll be forgiven if you think that this looks like lower than the prior period. The reason it's reduced is that plastics has historically had a much higher return on capital than the group overall. Hence, the dilutive effect when it's taken out. We also have a full year effect of Interstate Resources in these numbers. However, despite both of these, we remain in the upper half of our target range.

Net debt to EBITDA is 0.8 times on a straight calculation basis. We are though in the somewhat unusual situation at the moment of holding cash for the Europac deal, which we raised in the summer, which will only be paid out in a few weeks' time, on completion.

00:06:01

So if we exclude the rights issue proceeds, we're at 2.1 times, which is still a decent improvement of 0.1 times since the year end, and we expect the full year to be on or under 2.3 times pre-disposals, which is again better than the 2.5 times we described when we announced the rights issue. Cash remains strong, as I'll describe in more detail on the cash bridge chart.

Summarising our financial headlines, all excluding plastics, revenue is up 16% and operating profit up 32%. I'll take you through the bridges for these key line items in a moment. The improvement has flowed through to earnings per share up 9% on a constant currency basis. The reason that the EPS growth is lower than profit is the rights issue in July, fairly obviously. Dividend per share is up 14%, reflecting decent growth despite the rights issue effect and is a strong statement of confidence that the board has in the group prospects.

Turning to the revenue bridge, this is our continuing operations, excluding plastics, as I've mentioned before. The adjustment for acquisitions is 247 million, as you can see, which is principally the four extra months of Interstate Resources and also a contribution from EcoPack, EcoPaper and Corrugated Container Corporation.

00:07:23

Volume from boxes was £48 million with a negative balance on other volume principally the impact of Chinese regulations on recycling flows. The increase from sales price mix is primarily driven from increases in box prices which has now recovered the paper price rises from previous periods. Overall, the result is a 6% organic rise in revenue.

Turning to EBITDA, the contribution from acquisitions is as I've described previously, and you can see the synergies coming through from the Interstate Resources acquisition, consistent with previous guidance. The volume contribution is a net of a positive from packaging, which had a similar drop through to previous periods, partially offset by a small decrease in other volumes, principally recycling, as I noted before.

As a number of analysts have asked, you can now see the full benefit of sales price and mix improvements coming through and the effects of the paper price rise is still impacting comparable period input cost, but absent the headwind of previous periods. We believe we've now fully recovered the historic price rises and current sales prices fully reflect this. The £141 million input costs is a net number which reflects all input cost, albeit paper is by a long way the most significant.

Margins, by regional segment, have all improved since the full year, with the strength of the margin, to some degree, reflecting the mix of business between packaging and paper in particular regions. The region with the least paper, Western Europe, has obviously had the toughest time recovering margins, although not particularly bad when you compare it to the comparable returns of the packaging assets we'll be acquiring in this region.

00:09:08

Whilst the US is the standout region, it has of course benefited from synergies coming through, as well as strong underlying trading and being long paper. As I've mentioned at the start, these figures are all on the new IFRS 15 basis, which for the group as a whole reduces reported margins by between ten and 20 basis points.

Plastics, as I've said, is now accounted for as discontinued as a result of the review process and the discussions with potential buyers, which we expect to conclude in this financial year. It's an excellent business with strong fundamentals. This particular period, its reported divisional profit has been impacted by a lag in the recovery of polymer pricing which is a dynamic well understood by those of you who follow plastics businesses.

The recovery of input prices is well underway, and the underlying business performs consistently well. Its profits have likewise, unsurprisingly, been impacted in the first half by separation activities which were required should the business be sold.

00:10:13

Exceptional operating costs were £29 million, excluding those related to Europac, which is line with the guidance previously given. This also excludes a significant non-cash item relating to future pension obligations for a certain population of the UK pension fund during the period 1990 to 1997. This is known as the guaranteed minimum pension equalisation, and follows a ruling which became effective on October 26th, and unfortunately for us, applied to any company with a reporting date after then.

This is quite clearly an educated estimate, given the limited amount of time we've had to assess the impact, and we've made an assumption in the midpoint of the range of potential exposure. We'll revise this over the next few months, but based on our preliminary advice, I don't foresee any significant change. And just to be clear, it's non-cash.

Of the £29 million charged this period, about half directly related to Interstate and other related acquisitions, and the remainder was an IT optimisation project that one could argue is, in itself, also resulting from integration requirements.

I've noted here how the costs are expected to play out over the remainder of the year. Excluding Europac costs and the pension equalisation charge, you should see these costs reduce such that our guidance for the full year operating cost, adjusting items, is now under £45 million or thereabouts, a reduction in our previous guidance of £53 million.

00:11:49

Europac exceptional costs are expected to come through in line with the guidance given at the time the deal was announced, with a total additional cost for integration of around €40 million, split across this year and next year. Some of that will be frontloaded for fairly obvious reasons, and there will also be the balance of costs relating to the transaction itself and I should also point out that there's around about £3 million relating to more business as usual type of restructuring that's been included in our reported EBITDA, i.e. we haven't adjusted for.

Cash flow has been good. Starting at the top line with EBITDA, working capital delivered an inflow over the period. Recognising the high degree of interest in this, I should note that in this period, our non-recourse receivables factoring balance fell slightly so you can be assured that this improvement in working capital was not a function of greater non-recourse factoring.

Our projects to improve underlying working capital are various, but focus around inventory reduction, reducing overdue debtors and rationalising our supply chain. The benefits from these initiatives are expected to continue through the second half, and also over the next financial year.

Capex is similar to the prior period in what is now a larger business, and I can confirm that the full year pre-Europac capex will be in line with our previous guidance of around £270.

00:13:14

The tax and interest cost is higher, period on period, principally due to the phasing of payments for the bond we issued in July 2017, which falls annually in July, and thus will be, if you like, a benefit in the second half of the year, and payment of tax in North America, following the Interstate acquisition, which was paid in the period before our acquisition last year. So that's a normal taxation cost. So that's what we would expect, going forward.

Having talked about this for a number of years now, and been one of the first companies to disclose, I thought it worth reminding everyone of the economic rationale and the way it gets treated by both ourselves and our lenders.

I realise that this subject of invoice discounting or sale of nonrecourse receivables receives a lot of interest, particularly in light of the recent collapse of a contracting company that may not have had either the same rationale or liquidity risk management as ourselves.

We're always reminded by our shareholders that they consider efficient balance sheet management as extremely important. Similarly, if we can economically anticipate our cash receipts, then we should. Many of our customers, such as the big FMCG groups, are of very high credit quality. So if we wish to receive their payments on, say, 15 days rather than the 90 or 120 days that we may have commercially agreed to, then we've got three choices.

00:14:44

Firstly, we can do nothing and wait for the payment to occur. Secondly, we can offer more attractive terms for early payment within our overall commercial terms. And thirdly, we can sell the receivable without recourse.

Given the quality of our customers and the development of this market for securitised receivables, it's often more economic to do this third option rather than the second option, which is what we have been doing. And to be clear, the subsequent impact on our cash flow is exactly the same as the second option.

I've also been asked a number of times why this isn't debt or isn't treated as debt, and my answer is always the same, because actually, it isn't debt, given it's a sale without recourse, and treated correctly and accounted for under IFRS. But most or even more importantly, it isn't treated as debt by our financing banks. Our financial covenants are exactly as we calculate them in our annual report.

The follow-up question to this is normally, but okay, what happens when these reverse? Then what if the market for these shut? And again, in my earlier example, what if they don't provide them to you any more specifically? To which my answer is that so long as the facility is committed, which ours is – for three years, as it happens – and the customers remain excellent quality credit, which they are, then simply, we don't consider that that will be an issue.

00:16:14

Those with long memories may remember problems in the past when companies sold receivables which either did have recourse or were only covered by short-term uncommitted facilities, typically commercial paper programmes, for which the market dried up completely during the credit crisis.

And I can assure you this is absolutely not the case with us. If our committed facilities cease to be available, then we have three years in which to modify customer commercial terms to deal with it.

The total cost of what we're currently doing on an annualised basis – excuse me – is approximately £7 million, and not get the same cash flow through early payment discount, we believe would cost us around about double that or an additional £8 million. So we're getting a P and L benefit of around about £8 million, and you can liken that to about ten basis points of margin.

Moving to the cash flow bridge, as mentioned before, it's skewed at the moment because of the rights issue proceeds. The other items are as previously described, with the £41 million in acquisition being the Corrugated Container Corporation business, bought in the US right at the start of the year. There've been no further acquisitions since June, and none are foreseen for the remainder of the year.

00:17:34

Our gearing, technically, sits at 0.8 times, based on our balance sheet, or 2.1 times, if you exclude the rights issue proceeds. Once we have completed Europac, there will be an additional circa £600 million of debt related to the balance of payment to the Europac shareholders and the ongoing debt of the business, which will bring us to a gearing at the balance sheet date, or our balance sheet date, of on or around 2.3 times, which is lower, as I said, than we previously guided.

We expect to further deleverage as we continue to generate cash flow. And in addition to this, there should be the net proceeds from the disposal of plastics, and the remedy disposals associated with the antitrust clearance for Europac. And you may remember at the time we announced, we talked about the potential requirement to dispose of two plants. Well, that's exactly what the requirement was in the end – one in Portugal, one in France – the collective of which is less than 1% of profits within the business case. So not material from a profitability perspective, but they will also generate cash flow.

Given these various asset disposals and taking into account the put option on Interstate, which I always think of as around about £200 million, even if it's actually slightly less at the moment, then you can see why we're very comfortable with our two times guidance.

00:19:02

Whilst I cannot comment on the likelihood of the put option ever getting exercised, I can note that the related shareholder fully participated in the recent rights issue and remain 5% owners of the group. Whilst the put is not included in our calculated leverage, as I said at the time of the rights issue, I do fully take it into account when we calculate liquidity.

Which leads me to advise you that we're delighted that our banking group, many of which are sat here today, have also expressed their commitment to our company by signing a new five-year, plus one, plus one, committed facility for £1.4 billion, which replaces an £800 million maturing facility plus our Europac bridge facility and gives us significant liquidity headroom without any assumption regarding asset disposals.

Whilst I've absolutely no doubt about the importance the UK stock market places on absolute leverage, my equal focus as Finance Director is always on liquidity and refinancing risk, particularly in times of increasing uncertainty, which is the reason why I'm extremely pleased to have secured the new facility now for the next five to seven years.

Here's the usual technical guidance slide. And the main point here is that it remains pretty much unchanged, with the exception of the adjusting items, which have changed from the full year in that our expectation for the full year is now lower on a like for like basis, albeit we do have this GMP pension adjustment which we related to the pre-1997 balance sheet, as I described before. And again, it's a noncash item.

00:20:45

If anyone has got any specific questions on the GMP adjustment, I'm happy to take them offline or in the Q and A. But you're going to see it with a number – pretty much every UK company. It relates to the so-called Barber ruling or Barber judgement to do with equalisation of guaranteed minimum pensions and it particularly applies to the period 1990 to 1997. But we can discuss that at length, I'm sure.

We have provided, and continue to provide, as much detail as required on adjusting items, and clarity as to when they will conclude. Our expectation is, next year, it will be a significantly lower figure, reflecting Europac integration, and nothing much else.

So looking at our track record, and again, I can't not stand here and be very pleased to show a continued upward trend and trajectory in earnings per share and dividend per share which, this period, is also contributing. We're very pleased with the performance. And with that, I'll now hand over to Miles who will take you, a little bit in more detail, about what's going on in the underlying business.

00:21:58

MR Great, thank you Adrian. You can see why we're pleased with the results. You can see, during the period, we have fully recovered the input costs, not just on paper but also on energy, on labour, on distribution.

There is some uncertainty, I think, in a lot of people's minds about the overall markets. However, we've shown that we've grown again, we've taken market share. The result of this are those price increases which have now averaged between 8% and 10% over the time that paper prices have gone up. We've ended the lag, which we've talked about. So we're now in a period where we're starting to over recover, which is pulling back on the lag we've seen previously.

And as said, the volume continues to grow. I have to say, when we look forward into the second half, we see continuing good, solid volume growth. But of course it would be, because we're based on FMCG, we're based on food and drink. We've seen our customers continue to consolidate their supply chain. We're seeing some really exciting moves in new innovation coming through. So we're pleased with the volume, and we have a very solid outlook for that. So we've got good underlying fundamentals to our business

And we've talked about the acquisitions. I'll come back to them later on. But in North America, we are very pleased with that, particularly in how we've been able to apply our commercial and our operational best practice into that business – a business thousands of miles away – and how we're able to generate real value for our shareholders and also for our customers on that basis. So we're pleased with the overall results. As I said, I'm sure you can see why.

00:24:17

Over the last few years, if I go back to 2010 – in fact, if you go back prior to that, the margins were low – I show here how our margin has developed over the period. I've also put on this graph the price of testliner.

And let's not forget, if you go back to the period January 2010, the economies were in a very difficult position. We had a big position particularly in France, in the UK as well, in Italy. You can see, during that period, we faced some really quite challenging economic conditions – general economic conditions.

Now, Adrian took you through how our earnings have gone in that period. I think it's important here to highlight how our return on sales has also developed as the price of paper has gone up and down. Now, during this period, we also made a number of significant acquisitions.

Many of you remember, if we go back to 2012, we bought the SCA business, a business where its margin, its return on sales was significantly below the 7.2% that DS Smith was making on its own. In fact, with the exception of North America, every single business we've bought has had a lower return on sales than DS Smith core business.

00:25:49

So during this period, we've had growing margins, bringing in businesses with lower margins and, as you can see, we've had a very variable paper price. If you go back to the last time paper prices fell, which isn't that long ago – it's about 18 months – you can see how the margin initially improved, and as we brought in some other businesses, it held steady, going up to 9.9% this time. So I think it's important when we look forward, we actually see further progression in the return on sales that DS Smith will make.

Now, we'll come back and outline more about that when we complete the Europac acquisition. But standing here today, our upper end of our range will certainly be improving when we come back and update all the guidance at the time of our full year results.

Then I wanted to return to North America because it's only a year since we've had this business. Just a year of ownership. And in that time, we are very pleased with the integration.

Many of you were at our capital markets day and you saw Jim Morgan, our President of the US business, talk about it, and the real excitement that's there about having a new entrant into the market with new ideas, with a different way of focusing on the customer.

00:27:20

I said earlier how we've taken our excellence in operations and in commercial and applied it to a business thousands of miles away. We are delighted with the customer reception. We are now signing up – we have signed up – and we have a good pipeline of opportunities, signing up customers on an American and a European basis because they want the same solution and they know they can only get that solution from DS Smith. Indeed, we highlight some of the customers there where we have now had those international, intercontinental deals.

You will have seen on Adrian's bridge of the profit, this business in this half year is making a return on the capital employed in excess of 11%. And that's in the second six months of owning it, we're above an 11% return on capital. Adrian has outlined the synergies. He had a figure there of £12 million.

If we look at the Interstate position within that and add on the first half of last year, we can see that it's making, in the first half, about $16 million of cost synergy. On a full year run rate, that's $32 million. One year into the acquisition, that's that operational excellence coming through. That's why we've revised the target for synergies of this deal, initially from $25 million, then to $30 million, to $35 million and currently, we're projecting to get at least $40 million of cost synergies from that business.

00:29:09

The outlook is very positive. We've acquired a small but very important business to us in Corrugated Container Corporation. We previously announced that. Again, we're very pleased with the increased capacity that's given us. Capacity is an issue for us there, such has been the demand on the business. We haven't been able to take in all the business that we were able to take into. We're not going to let our customers down, so we've had to defer some of it whilst we get Corrugated Container Corporation up and running and properly integrated.

And on the back of that, we've also announced a new greenfield in Indiana, positioned where many of our customers are. We're getting advance orders for that business. It's going to use a lot of the technology that we have in Europe. It's a very exciting move. I would have to say, the commercial opportunities are very attractive there.

If we turn to Europac, we talked about this at the half year. We are very excited by the opportunity. We set out a financial projection for that business of being above cost of capital in the first full year of ownership, and that's exactly where we see that business still performing today.

A lot of work has occurred in terms of planning for the integration. As you know, we've got a very experienced team here. The team that has integrated the US and many of our previous acquisitions, actually going back to Otor in France some years ago, it's the same team with the same processes, but more experienced and knowledgeable.

00:30:48

The planning has been excellent. We are ready for when this deal closes around the end of the year. The process to get here in terms of shareholder approval, in terms of the antitrust approval, in terms of now, in the CNMV offer period, has been exactly as we expected.

Adrian has outlined the remedy disposals, exactly in line with what we told shareholders. The profitability though is about 1% of the Europac's profits, so we're left with 99% of the profitability of that business after the merger review by the European Commission.

We can see our short paper position. We outlined this at the time of the full year when we talked about this proposed acquisition. We had 1.4 million tonnes short position last year. Obviously, the packaging has now grown by about another 150,000 tonnes by the time we'll close this deal. Europac brings in about a net 500,000 tonnes. So you can see there is still a very, very substantial short position in DS Smith.

That's a position we are very comfortable with, although we are taking the opportunity, as I said previously, to reassess our paper asset base – potentially being some more in, how we can reposition this. So we're excited. We're committed to the returns. The integration work is going well. And as I say, the inbound from a number of customers has been very positive as well.

00:32:29

We talk about the resilience of the business model. And again, this is what's really delivered those returns over many years, why we've been able to improve our profitability and dividend consistently over the last eight, nine years, despite some difficult economic conditions – because the fundamentals are that we're built on working for those big customers, that FMCG basis. The reason we focused on that is because of that predictability of demand.

We always know there's going to be some cyclicality. So how do we prepare ourselves? So in the good times, when these markets have been moving forward, we haven't focused on construction and other areas like that, which we know will come off; we've focused on building our position with these customers. We've grown our average share of the business from our big customers from 36% to 41%, and we brought in more of those customers.

So today, just under 80% of our business is what we call the FMCG in resilient categories. And that means those volumes have never gone down. People don't stop eating and drinking. And that is what the business is based on. That is why we maintain a positive outlook to the business. That's why we believe it's resilient, not just in the short, but in the long term as well.

We can build on that further, those customers, about the whole development of the solutions that they need. At the moment, we are extremely busy, making sure that Christmas is delivered, because most people are buying their Christmas presents in a box this year. And my goodness, are we busy. My goodness. Without us, there'll be no presents. I modestly say that.

00:34:31

And let’s just remind ourselves of those structural underpins for our company. We’ve got the e-commerce growth, we’ve got a huge change in the proliferation of retail channels. It’s happening not just in the UK but right across Europe; there’s more urbanisation, we’re getting more discount, more convenience stores being built. People are changing the way they’re shopping. Families are getting smaller, people are living alone or in smaller units more frequently.

That means they have more choice, that means they can decide what to buy, when to buy, really on that day. And that means a proliferation of packaging, people buying smaller quantities. That drives packaging volume. So we’re seeing good fundamental demand in that FMCG sector where 80% of our group is.

The increasing focus on sustainability. You heard in the last budget in the UK alone about how they want to put a tax or proposing to put a tax on packaging that uses less than 30% recycled paper. Well, in the UK, we only make recycled. 30%? Call it 50%, call it 80% – this is what we’re based on. So we’re very comfortable with that. And in fact, we’re going to see a lot more legislation coming out in Europe as well. We’re encouraging that. We think it’s a more sustainable way people can consume.

00:35:57

And we’re in pole position to capitalise. Our investment, our scale across Europe is simply unparalleled. Moving into the US, we’re very pleased with that reaction. We’re pleased with the reaction from the customers about the Europac move, with our investment into innovation – we outlined a lot of that at our capital markets day. It’s really coming through in our margins and our market share gains.

But for the group, what are we going to be focused on? Well, we’ve got to continue delivering from Interstate. We’re really looking forward to Europac. Cash generation, organic and inorganic cash generation, so we can see our debt coming back to our medium-term target, exactly as we’ve done in the past.

So the summary and the outlook for us. We’re pleased with the results. Top end margins, material growth, market share gains. We can see a material differentiation of our offering with customers, and that’s increasing. We can see a good, strong balance sheet, and happy with how we’re de-levering, particularly after the Europac acquisition. And that’s why we have a positive outlook with really good momentum into the second half of this year and, I have to say, beyond that as well. Thank you very much.

So we’re happy to take questions anybody may have, either Adrian or myself. We’ll just start at the front here with… do you want to say your name and where you’re from?

00:37:36

ALM Thank you Miles. It's Alex Mees from JP Morgan. Three questions please. Firstly, on margins, obviously a strong performance in the first half. You refer to an expectation that the margins will continue to improve from here. I just wonder if that's still your expectation, if you exclude Europac, which clearly has an effect on the mix. And secondly, just on margins, I wonder if you can just comment on the seasonality of margins, first half to second half. That's a rather long first question.

Question number two. Just after Europac, you're guiding to a lower level of gearing. I just wonder why that is, whether it's earnings driven or cash generation. Lower level of gearing, post-Europac. And finally, I wonder how you see the market for plastics assets as you look to potentially divest this. And also, if you were to sell paper assets – I think you alluded to having a rethink in terms of your asset base – whether you'd expect any further de-levering to come from that. Thank you.

AM Do you want me to take the second and you do the first three?

MR Do you want to do two and three and four? And I'll do one.

00:38:53

AM Margins, yes, we'll be expecting, obviously, as the run rate of cost price recovery and we work through, we would expect a small improvement in the second half. Two, no great seasonality. As you know now, Alex, the business has a distinct rhythm, so we have a good period in the autumn, as you'd expect, as you build up for Christmas. And then in the spring, with the food and drink companies, there's always a good performance then. So there's a fairly natural rhythm. And roughly now across Europe, it evens itself out.

On the UK, it always used to be very frontloaded, as a standalone country. But as the business has spread, it's much more balanced now. If nothing else changed, you'd expect a slightly better first and second half normally. But because we're still in this moving period, I'd expect a small improvement again, second half. I think I've answered your seasonality, hopefully.

In terms of leverage, it's two things. One is the underlying actions we're taking, as we said we would last year. Clearly, last year, the focus was about integrating Interstate, it was about driving volume, it was about starting and initiating the price recovery, and less pull was made on the lever of working capital. We've been quite open about that.

This year, we've got a large number of initiatives in place, going across the whole group, particularly around inventory, finished goods, spare parts for that matter, as we're trying to optimise how we manage our asset base, overdues – going hard across all of Europe on where they sit, and really focusing on working capital.

00:40:54

Supply chain as well. Again, every time you make an acquisition, you have an opportunity to manage through on that. And clearly, Europac will give us a bit of an opportunity there again. And the Europac business we're acquiring, I think generally, when you look at its numbers, it's slightly better than we thought it would've been at this period.

They also will have disposed of the Caradec business. I think they announced or that was described earlier in this week. Certainly, I saw something yesterday in a newspaper that was describing who had bought it, and there'll be proceeds of that in there.

So we're looking at the contribution to the 2.3x. It's the business in Europac has done well in the first half, and that's well publicised. Our business is doing well. We're calibrated on it, and we're managing cash flow. So I'm reasonably comfortable with that number. And then, do you want to do plastics or because I'm on a roll, I can tackle it?

MR Sure, you can carry on. You're on a roll.

00:41:55

AM So in terms of, it was a question as to how is the plastics process going. And yes, we've had a huge amount of interest, as you would expect. It's a primary carve-out from a major company, it's sweet-spot private equity, it's the sort of thing that people get very excited about.

And the process is to really start filtering what's excitement because there's just not much activity and people are desperate for anything, versus what are serious bids, serious players, serious prospects and what's the best home for the business, because in the end of the day, we still have a big obligation to make sure that the buyer is appropriate for it.

So we're really encouraged so far by the amount of interest. But you would expect that. It's the right size, it's the right sector, it's cash generative, it's got a good track record, it's scalable, you can see our roll-up strategy – there are a number of things that come into play to excite them. So we're quite happy about that.

You talked about, if I remember well, looking at the paper portfolio. Well, we always do. This is something we constantly look around. If at any point in time, there was something, yes, that would go to leverage for sure. Okay?

DO David O'Brien from Goodbody. A couple from me, please. Firstly, on volumes. And maybe a little bit unfair, given it's a fairly healthy number of over 3%, but there is a step-down from the run rate of 5% in last year which was pretty consistent throughout the period.

00:43:35

So could you give us an indication of where the step-down is coming from, be it by business segment or region or customer? And then you talk about good momentum into the second half. So are we expecting to go back up towards the 5% or a continuation of trend, please?

And secondly, just on the cost backdrop, there's a lot of talk about paper, but maybe Adrian, you could take us through what we should expect in terms of the other line items – transport, chemicals, energy and OCC – in the second half.

And finally, if we look at the 1.4 million tonnes that you're short, can you remind us what proportion of that is in Kraft liner at the moment? And remind us what percentage you're integrated. And given your comments around optimising the asset base, where is the optimum level of integration, as you see it, going forward?

MR I'll take the first and the third. Are you happy taking the second? So I'll take volumes and the short.

AM You do the volumes.

MR And you do the costs.

AM Yes. And then you can pick up paper if you want.

00:44:31

MR Okay. So with the volumes, 3.2%, it's been pretty consistent during the half year. It's been, as I say, pretty consistent. We have found, as I said earlier, in some places, basically we've been so busy, we've had a temporary pause. If we look in the US, we have to get these other assets in and integrate this new business, so there's no doubt we've held ourselves a little bit back there.

Of course, the primary thing is you always deliver to the customer what you said and when you said, and there are no prizes of taking on business where you're not absolutely confident about that. But that's all coming through. So if we look at the half year, it was pretty consistent. It is a step down from last year.

When we look at our FMCG business, it's performing pretty well in line. We did have a big boost last year as we took a number of new e-commerce contracts, we took a lot of share there. We absolutely lead this market across Europe. So this 3.2 is actually on last year's 5.2, so it's 8.4 in a period. So we don't feel that's too shabby at all. But there's more we can do to liberate some of this volume.

There's no doubt in some markets, we know we still have 20% of our business that's more exposed to some of those big capital equipment, etc., car production. We specifically limit ourselves for those categories. But there's no doubt, if you look into places like the UK, Germany and France, things like car production has undoubtedly been lower. Whilst our UK business actually grew quite well, we have seen again in construction and things like that, there has been a slowdown. So it's 20% of our business.

00:46:26

Now, that's in categories. When you look regionally, all of our regions are in growth. Some have grown more than others, though none give us particular cause for concern because people continue to consume, to eat and drink.

When you look at consumer expenditure on consumption items, this is what we try and link our business to. So if you go back over the last ten or 20 years, even back to the 2007/8/9/10s, if you look at consumer consumption expenditure, it is remarkably resilient. That's what we're pinning our sails against. People stop buying a new car, they may stop moving house, but they don't stop that day-to-day consumption.

And that's where 80% of our businesses are and what gives us that confidence to say, looking forward, we see ongoing good growth. Actually, against the market, we've done very well because we're far more focused on food and drink, so compared to market data, we have taken considerable share in that time and we're very pleased with that.

AM On the cost base, we never normally – and neither would you expect us to, I'm sure – give a breakdown of each item. But I think you can be reasonably confident to say that pretty much every cost is inflationary at the moment.

00:47:56

So if you look at energy, if you look at labour, if you look at transport, starch for that matter, they were in the first half, they will be the same in the second half. I'm not anticipating anything different. But to us, that's the cost of doing business. And what you need to have is measures in place to be able to deal with that.

So whether it's your historic capital investment around efficiency projects to give you an insulation against labour, if it's projects around energy, if it's procurement, we have a very sophisticated procurement function that themselves have what we think are reasonably achievable targets.

They always complain they're too stretched but they have a target of what we're expecting them to recover against prices. A lot of what we buy, commodity, a lot of what we buy, there are multiple sellers. It's not a consolidated supply chain, which is a benefit to us. OCC, for what it's worth, it's been broadly flat. The talk is – what we're seeing – is it's staying pretty flat.

What I can't say is what I know because I don't know anything. It depends what happens in global macro, what happens in China. But as it stands, our cost base, excluding anything under OCC, which is flat, is inflationary at the moment. There's no two ways about it. And we've got plans and steps in place, as you would expect, to constantly deal with that. But we do it every year. It's never not been inflationary. Well, one year, when energy came down, five years ago. That's about it.

00:49:39

MR Then our short position. So pull up the graph there that we've discussed at the time of the Europac deal. And it shows a substantial short position. And as I said, we're very comfortable with having a short. We think it's absolutely the right thing for our customers, and therefore, for our shareholders.

Looking at the 1.4 million tonnes, this is Europe only. You can probably add on the run rate, by the time Europac closes, it's going to be about another 200,000 tonnes. So we'll be at 1.55, 1.6 million on that same basis. The Europac business brings in a net – and of course, that's also been growing – 400,000 or 500,000 tonnes. So you can see basically, we end up with about a million tonnes short.

The Europac deal brings in about 400,000 of Kraft. We don't have any Kraft capacity ourselves. And the rest of it is in testliner. When we look at our relative shorts, we're obviously short in both. We're more short in Kraft than we are in test. But we're in short. And that can move around as we substitute.

But you could look at that it's going to be probably about 500,000 tonnes short in Kraft, and around 500,000 short in test, approximately. Going forward, we want to see that particularly in and around some markets around Central Europe where there's always new capacity coming on. We want to see ourselves maintaining a short position.

00:51:13

And therefore, as we said on the slide, we said it six months ago, we said it 18 months, we have actually divested, sold, closed a number of paper mills over the years. That is always an ongoing piece of work. And we see some more opportunities to improve our balance to produce the right returns for our shareholders, going forward. Not putting any timescale on it, but we constantly review this and there seem to be some good opportunities there.

DO Thank you.

MR Thank you.

JJ Hi. Justin Jordan from Exane. I've just got a few questions just regarding slide 17, the technical guidance. Sorry to be geeky for a second. Firstly, on depreciation, your prior guidance of 200 has come down to circa 185 to 190.

AM It's ex-Plastics, Justin.

JJ It's just Plastics, okay?

AM Yes.

JJ There's no change to underlying depreciation.

00:52:03

AM No. As we said, no, technical guidance is all ex-Plastics.

JJ Okay, thank you. But just in view of that then, why has the capex not come down as well?

AM Because there's not much capex in Plastics.

JJ Okay, great, thanks. If you put it that way. Thank you. Okay, so just moving to slide 14 then on factoring.

AM Yes.

JJ And thank you for providing additional disclosure here. Can you just explain? On note 16 of your annual report, you talk about reverse factoring, i.e. supply chain finance programme.

AM Yes.

JJ How much is the balance of that? I appreciate it's non-recourse also.

AM Well, the extent that our customers either sell our receivables or participate is not something I have any control over. So I don't actually follow it, Justin. If you look at our business model, so we've got a consolidated position.

00:52:59

We're a big buyer of paper, probably the biggest – well, certainly the biggest globally – buyer of paper. We've put everything through our global paper sourcing platform. We have a unique position. We're buying in a commoditised industry with a large number of suppliers. So with that, we take very good payment terms.

Now, whether someone in that wants to sell it, whether it wants to factor it, whether it wants to reverse factor it, upside down, whatever, is entirely up to them. All I can talk about, and I do, as you know, is what we do. And we sell receivables without recourse. I've described what it is and why we do it. What I can't talk about is what our customers will do.

JJ Okay, thank you. Just a point of clarification. The 550 million of factoring, clearly, it's non-recourse, it's off balance sheet, so that's clearly excluded from the denominator of the 13.9% return on capital employed you report?

AM Correct.

JJ Okay. So if I was to add it, the return on capital employed would fall by 160 basis points or so?

AM Well, if that's the maths you do.

00:54:04

AM If you add pension deficit, if you add anything that is not on the balance sheet onto the balance sheet, it will change the metric you're calculating your balance sheet on. Mathematically, you must be right.

JJ Okay, thank you.

MR And just on that, I think you're saying if it wasn't there, then would we negotiate that with our customers. So we don't see it coming back. It's…

AM I've said what we do. I can't be clearer than that. You can calc whatever, Justin, but the fact of the matter is, it isn't there, it's sold, and we don't take anything into account that we've sold.

JJ I appreciate the disclosure here. Thank you.

AM Okay.

MR Have we got time for one more question?

00:54:47

RC Hi. Rob Chantry at Berenberg. I just wondered if you'd give some thoughts on the US market, specifically regarding the position of the big guys, capacity coming into the market, whether that's been delayed. And also if you'd just give us some thoughts around that, on where you're winning, where you're taking share…

MR Yes.

RC What is working, and how that differs to the point at which you bought it. Thanks.

MR No, look, it's a great question, or great two questions. Just on the US market, you're right, there have been a number of announcements about some more capacity coming on and there have been a lot of concerns, I think, raised generally on a macro basis about what does this mean for the US market which is a high margin business.

When we look at the capacity that's been announced, quite a bit of it is actually for export out of the US, principally into China. Some of it is for the domestic market, but virtually all of that that's been announced is actually by integrated players. And what of course it doesn't say is what about the retirements of assets. And of course, recently, we've seen a number of announcements where those same integrated suppliers say, bring in that [?], but of course, we're now going to close down this other capacity.

00:55:59

The US market overall has moved from a position where packaging volumes, I think, have been pretty flat for a few years, whereas now, over the last few years, they've been increasing. In fact, even if you looked at all of the new capacity, that broadly just matches the forecast increase in demand because of sustainability, because of e-commerce, etc. In the US, about 19% of the market, of goods sold are on e-commerce, and that is increasing very rapidly.

So US market, concerns about supply, about new capacity coming on – we're saying we think, if you look at it, it matches the growth, but actually, a lot of it is for China, it doesn't take account of retirements, and there have been new announcements on retirements from those same companies. So our position is, and remains, that we do have some paper capacity there. I have to say we are very busy. Demand is good, it's strong, for the reasons that we've talked about. And going forwards, we see that very positively.

In terms of our position, as you know, we are a modest player on a national basis, but on the East Coast, particularly in the Southern East Coast, we're very pleased with the performance. The growth in our volumes, in our share is really around our innovation. So that's around shelf-ready packaging. We've had some super wins there where customers want new products, they're coming and talking to us. That is not a feature of the US market, but they know that we absolutely lead that market across Europe.

00:57:44

We've talked about the growth in e-commerce, and again, we're getting some really wonderful awards and new business coming through there. So we are very focused on the same sort of FMCG consumer expenditure, but using our technology, expanding the perimeter of the market, not just going head to head with some of those big American companies that are very good companies indeed. We're not trying to do that.

We're trying to expand the perimeter – new products, etc. – that takes corrugated packaging further. That's where our customers want us to be, that's where our shareholders want us to be. And now, frankly, you can see it in the results. Look at the increase in the margin that's coming through in that return on capital.

Look, I think we're at the end of our hour now, so I'm going to draw it to a close. But just to say to everybody, thank you very much for joining us today. We are around afterwards if there are more questions. We're pleased, and we look forward to the second half of the year. Thank you very much.

AM Thank you.

MR Thank you.

00:58:48