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DS Smith Plc

Interim Results for the Half Year to 27 October 2001

Reasonable start to the year in challenging conditions

- Group turnover up 3.3% at £711.9m (£689.2m)
- Profit before tax, exceptional items and amortisation of intangibles was £35.8m (£39.4m)
- Adjusted earnings per share of 7.7p (8.3p restated)
- Interim dividend unchanged at 2.8p per share
- Good performance from packaging operations despite poor UK market
- Office products impacted by lower sales in the UK and Ireland
- Tony Thorne appointed Group Chief Executive

Commenting on the half year results and outlook, Chairman Antony Hichens said:

“We have made a reasonable start to the year given the slowdown in the markets in which we operate. The packaging business has performed well in demanding trading conditions though the office products business made a disappointing start in the UK and Ireland.

“The recession that is gripping the world economy makes it extremely difficult to forecast trading conditions over the next few months so we are cautious about the outlook for the balance of this year. However, we have entered this downturn with strong market positions, an improving cost base and a healthy balance sheet. This is enabling us to make attractively priced bolt-on acquisitions whilst continuing the organic development of the Group.”

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DS SMITH Plc

Interim results for the financial half year to 27 October 2001

HIGHLIGHTS

The Group has made a reasonable start to the year given the slowdown that has occurred in our markets. The packaging business has performed well in demanding trading conditions, slightly exceeding the same period last year. By contrast the office products business made a disappointing start to the year in the UK and Ireland.

Group turnover for the half year to 27 October 2001 increased by 3.3% to £711.9 million from £689.2 million in the same period last year. Operating profit before amortisation of intangibles was £41.9 million compared to £45.0 million and Group operating margins declined to 5.9% from 6.5%.

Profit before tax, exceptional items and amortisation of intangibles was £35.8 million compared to £39.4 million for the same period of last year. The underlying effective tax rate was 30%. This compares to 31.7% for last year which, together with earnings per share and gearing, has been restated for the implementation of FRS19, the new standard on Deferred Tax. Earnings per share before exceptional items and amortisation of intangibles were 7.7p compared to 8.3p (restated) for the first half of last year.

Net borrowings rose to £255.0 million from £200.6 million at this time last year. Gearing increased to 55.6% from 43.3% (restated), and the interest cover remained strong at 7.0 times.

Expenditure on acquisitions in the first half amounted to £33.5 million including acquired debt. Capital expenditure increased slightly to £24.5 million for the first half year and is expected to amount to around £70 million for the full year.

INTERIM DIVIDEND

The Board announces an unchanged interim dividend of 2.8p. This dividend will be paid on 12 March 2002 to ordinary shareholders on the register at the close of business on 18 January 2002.

PACKAGING

Total sales for the packaging business increased by 2.5% to £445.6 million. Operating profit before amortisation of intangibles rose by 2.3% to £35.2 million and operating margins remained unchanged at 7.9% compared to the same period last year. The return on capital employed was 11.7 % compared with 12.3 %.

Corrugated and Paper

The corrugated and paper segment of Packaging saw a small fall in sales from £358.4 million to £351.7 million. Operating profit before amortisation of intangibles slightly reduced to £29.2 million from £29.9 million but operating margins remained unchanged at 8.3%.

European corrugated demand weakened as the year progressed, falling by 0.7% in the first nine months of 2001. Once again the UK market experienced much weaker demand, falling by 3.7% in the same period.

Waste paper prices fell during the first half of the calendar year before steadying during the third quarter. More recently demand from the Far East and low stocks in Europe have prompted some price increases. Corrugated case material (CCM) prices have also declined since January, in line with the waste paper price reductions. New CCM capacity coming on stream has not been disruptive as it was largely offset by closures and downtime taken by major producers. However, the recent weakening of demand across Europe may put further pressure on CCM margins. Corrugated box plants have been reasonably successful in holding their selling prices and have benefited from the fall in CCM prices during the year, although margins still remain inadequate.

DS Smith Packaging

Against the background of a poor UK market DS Smith Packaging produced a good performance. In addition to the benefit of falling CCM prices, profitability improved as a result of continued efficiency gains across the division and greater throughput in the conventional corrugated plants, especially at Bristol and Fordham.

The decline in UK manufacturing continued to impact the division adversely. The Tri-Wall heavy-duty business has been particularly affected by the downturn in the engineering sector and our packaging plants in Scotland have been badly hit by the closure of customers in the electronics market.

In September the division acquired, in a back to back deal with Mondi, 13 Danisco packaging units, based mainly in the south and west of the UK. These businesses, acquired well below the valuation levels of recent acquisitions in the industry, are already bringing benefits and the synergies resulting from integration will be significant after initial reorganisation costs. In particular, the Kettering sheet plant is a modern, well invested operation focussing on the production of lightweight speciality board, a fast growing segment of the market. This business will complement our existing Abbey sheetfeeding business to create a stronger force in this sector.

The returns in the UK market are unsatisfactory. Nevertheless, the progress made by the division in this challenging market is encouraging and should continue.

Kaysersberg Packaging

The Group's continental European corrugated division, Kaysersberg Packaging, experienced a slight fall in sales during the first half of the financial year but achieved a small improvement in profitability.

Corrugated demand in France has turned negative with overall demand 1% down for the first nine months of the calendar year and the situation in Germany is broadly similar. The main corrugated plants in France saw turnover fall in line with the market, although margins improved due to CCM price reductions. The Kaysersberg paper board mill experienced a difficult start to the financial year as selling prices suffered some erosion and market downtime was taken. The mill's new combined heat and power plant became operational and will help reduce both energy costs and greenhouse gas emissions.

In Italy, Toscana Ondulati continued to make excellent progress and the new factory being built to produce lightweight corrugated packaging is on course for start-up in the spring of next year. Our Polish operations have also performed well, recording stronger profits and continuing to gain from recent investment and production efficiencies. In Turkey our business made good operational improvements but fell into loss because of the difficult economic situation in that country.

The division's programme of performance improvement continues and should help the businesses weather the slowdown in their markets.

St Regis Paper

St Regis has performed better than expected during the first half of the financial year. Sales volumes have reduced slightly due to the slowdown in demand in the UK and continental Europe. Selling prices have also fallen during this period. However, lower waste paper prices, particularly during the early part of the financial year, have helped to maintain margins. The division also benefited from improving efficiencies, with Kemsley and Hollins paper mills making significant productivity gains.

The specialist mills have struggled for some time against overseas competitors but performance has slowly improved following some reorganisation, investment and product development. Progress should continue.

The UK packaging waste regulations imposed higher targets for waste recovery and recycling during the year. This resulted in higher PRN values which helped to support packaging waste collection when waste prices declined in the early part of the year. Severnside suffered a difficult start to the financial year due to this fall in waste paper prices. In the past couple of months prices have firmed as demand from overseas picked up, particularly from the Far East.

The outlook for the second half of the financial year is clouded by the risk that CCM prices may move down without a corresponding reduction in waste paper prices.

Plastics

Turnover in the plastics business increased by 23% to £93.9 million from £76.2 million in the first half of last year. Operating profit before amortisation of intangibles rose by 33% to £6.0 million compared with £4.5 million and operating margins increased to 6.4% from 5.9%.

DS Smith Plastics enjoyed a strong start to the financial year and has made good progress in most businesses. The division has kept tight control of costs and has seen some benefit from polymer price reductions.

Three small, but strategically significant, acquisitions have taken place to strengthen product ranges and extend geographic presence in certain markets. In May Carton Plastico, a small extruded plastics packaging company based in Madrid, was acquired which allows further development in the Iberian market. The liquid packaging business, operating under the Rapak name, grew strongly over the period. In November it further extended its market coverage with the acquisition of a 50% interest in AEP's liquid packaging business in Australia and New Zealand. Our liquid packaging operations are now better able to service major multinational customers, and the recent deal also secures access to valuable intellectual property. The division also recently acquired a small plastic pallet manufacturing business which will be integrated into the division's existing European reusable transit packaging operation.

The Kaisersberg extruded plastic product operation has suffered a downturn in sales resulting from the slowdown in the European manufacturing sector, but the Ducoplast heavy duty transit packaging business has been more robust with substantially increased sales during the period. The dispensing tap business also performed well in the half year while the DW Plastics crate business benefited from its operation in the Dominican Republic.

The outlook for the second half of the year is for further growth in profit, helped by lower polymer costs.

OFFICE PRODUCTS

Turnover in the office products segment for the first half of the financial year increased 4.6% to £266.3 million from £254.6 million. Operating profit reduced to £6.7 million from £10.6 million and operating margins were 2.5% compared with 4.2%. Return on capital employed fell to 7.5% from 13.3%.

Wholesaling

Spicers sales were £241.4 million for the half year, an increase of 5.6% on the same period last year. Operating profit fell from £10.3 million to £6.4 million. Operating margins declined to 2.7% from 4.5%.

Operating profit in the first half was expected to be lower than last year as a result of start-up costs in Germany and Spain and the cost of developing additional capacity in the UK and Ireland in anticipation of higher sales growth. The expected growth in the UK and Ireland did not materialise, causing a much greater fall in profitability than was forecast

As a result of a sharp slowdown since the summer, sales of the UK and Ireland businesses fell 1% and 4% respectively. The operations were not immediately able to adjust their cost base in line with the downturn. The businesses also experienced a much higher level of bad debts as dealer customers suffered in the deteriorating market conditions. The slowdown in the market and increased pressure on prices looks set to continue. The focus of attention in the UK and Ireland businesses now is to raise service levels, reduce costs and improve operational efficiencies.

Spicers France recorded a good performance for the half year with sales growth of 11%, despite the economic slowdown which has affected the French office products market. In October Spicers bought a competitor, Plein Ciel, which had been in administration. This is a significant acquisition, delivering a strong brand and the opportunity to grow sales to the Plein Ciel dealer network.

Sales growth in Spicers Germany remained strong at 28% for the first half, but is lower than previous rates of growth, mainly reflecting the weakening of the German economy. The second depot at Nuremberg has become fully operational and has alleviated capacity constraints on the Hanover warehouse.

In Spain the business is preparing for launch in spring of 2002. Building work on the first depot, in Barcelona, nears completion and a site is being sought in Madrid.

Although the office products market is challenging we expect the division to be on an improving trend in the second half.

Manufacturing

John Dickinson Stationery saw a small decline in sales, down 2.8% to £34.8 million from £35.8 million for the same period last year. Operating profit remained unchanged at £0.3m, giving slightly increased operating margins of 0.9%.

John Dickinson Stationery continues to operate in difficult markets. Envelope sales declined under sustained pressure from a high level of imports and severe price competition, though some success in growing branded product sales was achieved. The book and pad stationery business made some headway with an improving product mix. John Dickinson Ledbury and Spicer Hallfield produced reasonable performances though both suffered from the effects of a slowing UK economy.

Although the division is profitable it has far to go to raise margins to an acceptable level.

PEOPLE

Tony Thorne has been appointed Group Chief Executive with effect from today, succeeding Peter Williams. Tony joined the Group as Chief Operating Officer nearly a year ago. Peter Williams becomes Deputy Chairman and is expected to retire from the Board at the next AGM in September of 2002.

OUTLOOK

The recession that is gripping the world economy makes it extremely difficult to forecast trading conditions over the next few months so we are cautious about the outlook for the balance of this year. However, we have entered this downturn with strong market positions, an improving cost base and a healthy balance sheet. This is enabling us to make attractively priced bolt-on acquisitions whilst continuing the organic development of the Group.