

DS Smith Plc



10 December 2003

DS Smith Plc - 2003/04 Interim Results

DS Smith Plc (LSE:SMDS), the international packaging manufacturer and office products wholesaler, announces its results for the six months to 31 October 2003.

HIGHLIGHTS

Financial

- Turnover: £744.7m (first half 2002/03: £741.1m)
- Profit before tax and amortisation of intangibles: £39.3m (£44.8m)
- Return on average capital employed: 11.0% (12.7%)
- Earnings per share before amortisation of intangibles: 8.8p (10.1p)
- Cash inflow before dividends and acquisitions: £17.0m (inflow of £18.3m)
- Gearing: 44.2% (47.5%)
- Results after amortisation of intangibles: profit before tax £38.0m (£43.9m); earnings per share 8.4p (9.8p)

Operations

- A robust performance given the cyclical downturn in the paper market
- Further progress in Corrugated Packaging
- Spicers' profit improvement continues

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

“Market conditions remained difficult in the first half and, as expected, margins in our Paper business were significantly affected by the continuing cyclical downturn in the paper market. We produced a robust result across the Group and our focus on raising operational performance was reflected in further profit improvements in Corrugated Packaging and at Spicers.

“Although sales volumes are increasing in some areas of the Group, pricing remains under pressure. We are working on further ways to enhance our market positions and drive efficiencies. For the full year we anticipate delivering results broadly in line with expectations.”

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OVERVIEW

Market conditions remained difficult in the first half and, as expected, margins in our Paper business were significantly affected by the continuing cyclical downturn in the paper market. We produced a robust result across the Group and our focus on raising operational performance was reflected in further profit improvements in Corrugated Packaging and at Spicers.

Group turnover for the half year to 31 October 2003 was slightly ahead at £744.7 million (first half 2002/03: £741.1 million). Operating profit before amortisation of intangibles was £43.5 million (£48.6 million) and the operating margin was 5.8% (6.6%). Return on average capital employed for the six months was 11.0% (12.7%).

Profit before tax and amortisation of intangibles was £39.3 million (£44.8 million) and earnings per share before amortisation of intangibles were 8.8 pence (10.1 pence).

There was a cash inflow before dividends and acquisitions of £17.0 million (£18.3 million). Net borrowings were £215.8 million at the end of first half 2003/04 (£217.9 million) resulting in lower gearing of 44.2% (47.5%). Interest cover before amortisation of intangibles remained strong at 8.1 times.

INTERIM DIVIDEND

The Board announces an unchanged interim dividend of 2.8 pence per share which will be paid on 9 March 2004 to ordinary shareholders on the register at the close of business on 6 February 2004.

OPERATING REVIEW

Packaging

Total sales were £484.0 million (£475.2 million) and operating profit before amortisation of intangibles was £35.2 million (£39.2 million). Operating margin was 7.3% (8.2%) and return on average capital employed was 10.7% (12.6%).

Paper and Corrugated Packaging

Sales in the Paper and Corrugated Packaging segment were £376.4 million (£377.2 million). Operating profit before amortisation of intangibles was £27.7 million (£31.6 million) with lower profits in Paper being partly offset by higher profits in Corrugated Packaging. Operating margin was 7.4% (8.4%) while return on average capital employed was 10.7% (12.6%).

Paper

During the first half of the financial year there was pressure on the price of corrugated case materials (CCM) in both our UK and French paper operations. Margins were further squeezed by the fluctuating cost of our principal raw material, recovered paper and, specific to the UK, lower demand for Packaging Recovery Notes (PRNs). Government recycling

targets have a large influence on demand for PRNs and the recently announced future targets are expected to lead to some firming of the market during 2004.

Our UK paper business, St Regis, increased its production volumes through raised efficiency, which enabled it to maintain its substantial share of the domestic market and increase its exports, assisted by the euro strengthening against sterling. Towards the end of the first half we experienced increased energy and starch prices, and further adverse movements in recovered paper prices. These factors combined are contributing to continuing uncertainty in the outlook for CCM margins in the second half of the year.

A new warehouse at Kemsley mill, which will reduce the use of third party warehousing, has been commissioned. The Severnside collection and recycling operation continued to develop its collection infrastructure with the acquisition of a depot in Hull in May 2003.

Corrugated Packaging

Weak economic conditions, particularly in manufacturing, resulted in overall demand for corrugated board in our major markets remaining soft, with demand falling in the first nine months of calendar year 2003 by 1.2% in the UK and 1.6% in Europe as a whole*. Demand growth was stronger in Italy, Poland and Turkey.

Despite some price pressure, profit in our Corrugated Packaging operations continued to advance through targeting higher added value or growing market segments and through cost control.

In the UK, our sheet feeding operations suffered from heavy price pressure, although our recently acquired speciality sheet feeding plant performed well. Results from the conventional corrugated plants were mixed but the speciality, heavy duty and sheet plant segments made encouraging progress. A small acquisition of the northern UK corrugated businesses of Macfarlane Group Plc was completed on 3 November.

The French corrugated operations performed well through developing their business in higher added value products and good cost management. The Italian business maintained its growth, supported by the recent investment in its new lightweight corrugated factory, while in Poland, our developing positions in speciality products contributed to higher sales and profits. The Turkish business has made significant progress towards profitability through increased sales and cost reduction.

Plastic Packaging

DS Smith Plastics' turnover increased by 10% to £107.6 million. Operating profit before amortisation of intangibles was marginally lower at £7.5 million (£7.6 million) and operating margin was 7.0% (7.8%). Return on average capital employed was 10.5% (12.5%).

We made sales and profit progress in our two principal business sectors, liquid packaging and dispensing and returnable transit packaging, but the division's overall performance was held back by the results at two small operations. The first of these, our specialist coating business, suffered a reduction in exports to Asia and the Middle East during the first half of the financial year; these sales have begun to recover in recent months. The second is a new

* Source: European Federation of Corrugated Board Manufacturers

business, StePac, in which we have been investing and which specialises in modified atmosphere packaging for preserving the quality of fresh fruit and vegetables in transit.

In liquid packaging and dispensing, sales growth was maintained and profits were slightly ahead. There was some softening of markets due to economic conditions, which particularly affected sales of higher margin products including detergent taps in the USA.

Sales and profits in industrial returnable transit packaging advanced well assisted by continued growth and good cost management in extruded products. The injection moulded crate business benefited from strong demand from the brewing sector, driven by product innovation and new environmental regulations in Germany.

Office Products

Total Office Products sales were £260.7 million (£265.9 million) while operating profit before amortisation of intangibles was £8.3 million (£9.4 million). Operating margin was 3.2% (3.5%) and return on average capital employed was 12.6% (12.8%).

The office products market across Europe remains weak due to the effects of the economic slow-down on office activity; sales volumes continue to fall and customers are buying lower specification products than previously.

Office Products Wholesaling

Spicers' sales increased slightly to £244.4 million (£243.0 million) and operating profit before amortisation of intangibles advanced from £6.8 million to £7.2 million. Operating margin moved ahead from 2.8% to 2.9% and return on average capital employed progressed from 10.6% to 12.2%.

This result was achieved through the programme of operational initiatives commenced in early 2002. In the UK, Spicers continued to make progress through sales initiatives, further reductions in operating costs and maintaining high service levels. The French business, which was affected by the more recent downturn in its market, has cut costs and increased sales activity to stimulate demand. In Germany, customer confidence in our service capability is resulting in a good rate of sales growth although results have been affected by a limited number of bad debts; the business is making encouraging progress towards profitability. The Spanish operation, launched in April 2002, is achieving sales growth ahead of expectations. Preparation continues for entering the Italian market during 2004/05.

Office Products Manufacturing

John Dickinson's sales were £24.4 million (£32.2 million) and operating profit was £1.1 million (£2.6 million); the previous year's result included sales of £4.4 million and operating profit of £0.5 million from the Spicer Hallfield business which was sold in February 2003. Operating margin was 4.5% (8.1%) and return on average capital employed was 15.1% (28.1%).

Trading conditions were difficult in both branded products and envelopes with the latter business being additionally affected by continued intense competition from continental

Europe. This is being addressed through sales and marketing initiatives and further cost reduction in both business areas.

BOARD APPOINTMENTS

With effect from 9 December 2003, the Board has been further strengthened by the appointment of two additional Directors.

Jean-Paul Loison is appointed as an Executive Director of the Company and brings to the Board his extensive international expertise in the packaging industry. Jean-Paul, aged 61, is currently Divisional Chief Executive of the Kaysersberg Packaging division of DS Smith Plc with responsibility for the Group's continental European Paper and Corrugated Packaging operations. He joined Kaysersberg Packaging S.A. in 1970 and held various senior management positions before becoming Divisional Chief Executive in 1993 following its acquisition by DS Smith in the previous year.

Christopher J Bunker is appointed as a Non-executive Director of the Company. Christopher, aged 56, is currently Finance Director of the Water Division of RWE AG and was previously Group Finance Director of Thames Water Plc. Prior to that he was Group Finance Director of Tarmac Plc, Commercial Director of GKN Aerospace and Defence and Finance Director of Westland Group Plc. He is currently a Non-executive Director of John Mowlem Plc and Baltimore Technologies Plc. Christopher's breadth of financial experience in public companies will be a valuable addition to the Board.

OUTLOOK

Although sales volumes are increasing in some areas of the Group, pricing remains under pressure. We are working on further ways to enhance our market positions and drive efficiencies. For the full year we anticipate delivering results broadly in line with expectations.

Group Profit and Loss Account

	Note	Half year to 31 October 2003 (unaudited) £ m	Half year to 31 October 2002 (unaudited) £m	Year to 30 April 2003 £m
Turnover	2	744.7	741.1	1,479.0
Operating profit				
Before exceptional items and amortisation of intangibles	2	43.5	48.6	88.0
Amortisation of intangibles		(1.5)	(1.1)	(2.6)
Group operating profit		42.0	47.5	85.4
Share of profits of associated undertakings				
Before amortisation of intangibles		1.3	1.6	2.6
Amortisation of intangibles		0.2	0.2	0.4
		1.5	1.8	3.0
Total operating profit		43.5	49.3	88.4
Exceptional loss on sale of businesses		-	-	(8.5)
Profit on ordinary activities before interest		43.5	49.3	79.9
Net interest payable and other similar items		(5.5)	(5.4)	(10.9)
Profit on ordinary activities before taxation				
Before exceptional items and amortisation of intangibles		39.3	44.8	79.7
Exceptional loss on sale of businesses	3	-	-	(8.5)
Amortisation of intangibles		(1.3)	(0.9)	(2.2)
		38.0	43.9	69.0
Tax on profit on ordinary activities	4	(10.6)	(12.1)	(21.6)
Profit on ordinary activities after taxation		27.4	31.8	47.4
Minority interests - equity		(0.4)	(0.4)	(0.3)
Profit for the financial period		27.0	31.4	47.1
Dividends		(9.0)	(9.0)	(28.2)
Retained profit for the financial period		18.0	22.4	18.9
Earnings per share:				
Basic	5	8.4p	9.8p	14.7p
Diluted	5	8.4p	9.8p	14.6p
Adjusted	5	8.8p	10.1p	18.0p
Dividends per share		2.8p	2.8p	8.8p

The Group's results shown above are derived from continuing operations. There were no material acquisitions or discontinued operations in the previous year or the current half year.

Group Statement of Total Recognised Gains and Losses

	Half year to 31 October 2003 (unaudited) £ m	Half year to 31 October 2002 (unaudited) £m	Year to 30 April 2003 £m
Profit for the financial period	27.0	31.4	47.1
Exchange differences on foreign currency net investments	(4.9)	(2.5)	7.3
Total recognised gains and losses relating to the financial period	22.1	28.9	54.4

Group Reconciliation of Movements in Shareholders' Funds

	Half year to 31 October 2003 (unaudited) £ m	Half year to 31 October 2002 (unaudited) £m	Year to 30 April 2003 £m
Profit for the financial period	27.0	31.4	47.1
Dividends	(9.0)	(9.0)	(28.2)
Retained profit for the financial period	18.0	22.4	18.9
Exchange differences on foreign currency net investments	(4.9)	(2.5)	7.3
Goodwill previously written off	-	-	7.4
New share capital issued	1.7	-	0.4
Increase in shareholders' funds	14.8	19.9	34.0
Opening shareholders' funds	472.9	438.9	438.9
Closing shareholders' funds	487.7	458.8	472.9

The difference between reported and historical cost profits for the periods reported above is not material.

Group Balance Sheet

	As at 31 October 2003 (unaudited) £ m	As at 31 October 2002 (unaudited) £m	As at 30 April 2003 £m
Fixed assets			
Intangible assets	51.7	47.5	49.0
Tangible assets	541.9	546.7	560.9
Investments	29.5	28.5	29.0
	623.1	622.7	638.9
Current assets			
Stocks	145.2	148.5	155.2
Debtors	346.3	336.3	334.3
Short term investments	25.2	11.7	26.7
Cash at bank and in hand	52.2	45.8	27.7
	568.9	542.3	543.9
Creditors: amounts falling due within one year			
Trade and other creditors	(313.9)	(336.1)	(355.9)
Borrowings	(24.3)	(24.0)	(142.7)
Net current assets	230.7	182.2	45.3
Total assets less current liabilities	853.8	804.9	684.2
Creditors: amounts falling due after more than one year			
Borrowings	(268.9)	(251.4)	(114.0)
Other	(4.4)	(1.9)	(2.7)
Provisions for liabilities and charges	(87.0)	(86.0)	(87.9)
	493.5	465.6	479.6
Minority interests – equity	(5.8)	(6.8)	(6.7)
Net assets	487.7	458.8	472.9
Capital and reserves			
Called up share capital	32.3	32.1	32.2
Share premium account	190.5	188.7	188.9
Revaluation reserve	8.8	8.9	8.8
Profit and loss account	256.1	229.1	243.0
Shareholders' funds - equity	487.7	458.8	472.9
Gearing (net debt expressed as a percentage of shareholders' funds)	44.2%	47.5%	42.8%

Group Cash Flow Statement

	Note	Half year to 31 October 2003 (unaudited) £ m	Half year to 31 October 2002 (unaudited) £m	Year to 30 April 2003 £m
Net cash inflow from operating activities	6	59.7	64.7	142.0
Returns on investments and servicing of finance		(5.6)	(5.6)	(7.5)
Taxation		(11.5)	(7.2)	(15.1)
Capital expenditure and investments				
Purchase of tangible fixed assets		(27.5)	(34.2)	(63.4)
Sale of tangible fixed assets		1.5	1.4	4.2
Purchase of holding company shares		(1.0)	(0.9)	(0.8)
Purchase of fixed asset investments		-	(0.1)	(0.1)
Sale of fixed asset investments		1.4	0.2	0.6
Net cash outflow from capital expenditure and investments		(25.6)	(33.6)	(59.5)
Cash inflow before dividends and acquisitions		17.0	18.3	59.9
Acquisitions and disposals		(14.8)	(17.3)	(16.1)
Equity dividends paid		(19.2)	(19.1)	(28.2)
Net cash (outflow)/inflow before use of liquid resources and financing		(17.0)	(18.1)	15.6
Management of liquid resources		0.2	4.6	(8.4)
Issue of ordinary shares		1.7	-	0.3
Financing - net increase/(decrease) in debt		74.6	44.0	(29.9)
Increase/(decrease) in cash in the period		59.5	30.5	(22.4)
Reconciliation of net cash flow to movement in net debt				
Increase/(decrease) in cash in the period		59.5	30.5	(22.4)
(Increase)/decrease in debt financing		(74.6)	(44.0)	29.9
(Decrease)/increase in liquid resources		(0.2)	(4.6)	8.4
Increase in net debt resulting from cash flows		(15.3)	(18.1)	15.9
Net debt acquired with subsidiary undertakings		-	(2.0)	(2.0)
Exchange differences		1.8	(1.9)	(20.3)
Increase in net debt in the period		(13.5)	(22.0)	(6.4)
Opening net debt		(202.3)	(195.9)	(195.9)
Closing net debt		(215.8)	(217.9)	(202.3)

Notes to the Accounts

1 Basis of preparation

The interim financial information, which is unaudited, has been prepared using the same policies as those adopted in the accounts for the financial year ended 30 April 2003. Those accounts have been reported on by the company's auditors and delivered to the Registrar of Companies. The report of the auditors was unqualified and did not contain an adverse statement under section 237(2) or (3) of the Companies Act 1985.

2 Analysis of Group turnover, profit and capital employed

		Half year to 31 October 2003 (unaudited) £ m	Half year to 31 October 2002 (unaudited) £m	Year to 30 April 2003 £m
Turnover				
Packaging:	Paper & Corrugated Packaging	376.4	377.2	747.0
	Plastic Packaging	107.6	98.0	195.0
		484.0	475.2	942.0
Office Products:	Wholesaling	244.4	243.0	495.6
	Manufacturing	24.4	32.2	59.7
	Intra-segment sales	(8.1)	(9.3)	(18.3)
		260.7	265.9	537.0
		744.7	741.1	1,479.0
By origin:	United Kingdom	415.6	440.2	865.5
	Rest of World	329.1	300.9	613.5
		744.7	741.1	1,479.0
Operating profit (see a) below)				
Packaging:	Paper & Corrugated Packaging	27.7	31.6	53.1
	Plastic Packaging	7.5	7.6	14.7
		35.2	39.2	67.8
Office Products:	Wholesaling	7.2	6.8	16.2
	Manufacturing	1.1	2.6	4.0
		8.3	9.4	20.2
		43.5	48.6	88.0
By origin:	United Kingdom	27.6	33.9	59.7
	Rest of World	15.9	14.7	28.3
		43.5	48.6	88.0
Capital employed (see b) below)				
Packaging:	Paper & Corrugated Packaging	507.5	495.4	500.6
	Plastic Packaging	139.3	128.0	136.0
		646.8	623.4	636.6
Office Products:	Wholesaling	118.3	123.7	122.3
	Manufacturing	14.1	18.8	13.8
		132.4	142.5	136.1
		779.2	765.9	772.7
By origin:	United Kingdom	485.3	478.1	456.9
	Rest of World	293.9	287.8	315.8
		779.2	765.9	772.7

2 Analysis of Group turnover, profit and capital employed (continued)

		Half year to 31 October 2003 (unaudited)	Half year to 31 October 2002 (unaudited)	Year to 30 April 2003
Return on Sales				
Packaging:	Paper & Corrugated Packaging	7.4%	8.4%	7.1%
	Plastic Packaging	7.0%	7.8%	7.5%
		7.3%	8.2%	7.2%
Office Products:	Wholesaling	2.9%	2.8%	3.3%
	Manufacturing	4.5%	8.1%	6.7%
		3.2%	3.5%	3.8%
		5.8%	6.6%	5.9%
By origin:	United Kingdom	6.6%	7.7%	6.9%
	Rest of World	4.8%	4.9%	4.6%
		5.8%	6.6%	5.9%
Return on average capital employed (see c) below)				
Packaging:	Paper & Corrugated Packaging	10.7%	12.6%	10.6%
	Plastic Packaging	10.5%	12.5%	11.5%
		10.7%	12.6%	10.7%
Office Products:	Wholesaling	12.2%	10.6%	12.7%
	Manufacturing	15.1%	28.1%	23.1%
		12.6 %	12.8%	14.0%
		11.0%	12.7%	11.3%
By origin:	United Kingdom	11.4%	14.0%	12.4%
	Rest of World	10.3%	10.4%	9.7%
		11.0%	12.7%	11.3%

a) Operating profit is stated before exceptional items and amortisation of intangibles.

b) Capital employed excludes fixed asset investments, net borrowings, deferred consideration due in respect of acquisitions, corporation tax, dividends payable and minority interests.

c) Return on average capital employed for the half year is calculated as twice the operating profit divided by the average capital employed including the intangible assets on the balance sheet.

3 Exceptional items

The loss on sale of businesses last year included £7.4m of goodwill previously written off to reserves.

4 Taxation

Tax on profits before exceptional items and amortisation of intangibles has been charged at an effective rate of 27.0% (half year to 31 October 2002: 27.0%; year to 30 April 2003: 27.1%), being the expected full year effective rate.

The tax charge for the period consists of UK taxation of £4.2m (half year to 31 October 2002: £5.8m; year to 30 April 2003: £9.0m) and overseas taxation of £6.4m (half year to 31 October 2002: £6.3m; year to 30 April 2003: £12.6m).

5 Earnings per share

The basic earnings per share have been calculated on the profit for the period of £27.0m (half year to 31 October 2002: £31.4m; year to 30 April 2003: £47.1m) and on 321.1m (half year to 31 October 2002: 320.3m; year to 30 April 2003: 320.3m) ordinary shares, being the weighted average in issue and fully paid during the period.

The adjusted earnings per share excludes the effect of exceptional items and amortisation of intangibles and has been calculated on the adjusted profit for the period of £28.3m (half year to 31 October 2002: £32.3m; year to 30 April 2003: £57.8m).

6 Reconciliation of operating profit to net cash inflow from operating activities

	Half year to 31 October 2003 (unaudited) £ m	Half year to 31 October 2002 (unaudited) £m	Year to 30 April 2003 £m
Operating profit before exceptional items and amortisation of intangibles	43.5	48.6	88.0
Depreciation	31.7	30.8	62.2
Profit on sale of tangible fixed assets	(0.3)	-	(0.4)
Working capital	(14.8)	(11.8)	(6.0)
Increase/(decrease) in provisions	(0.3)	(3.2)	(3.3)
Other non cash operating items	(0.1)	0.3	1.5
Net cash inflow from operating activities	59.7	64.7	142.0

7 Analysis of net debt (unaudited)

	At 30 April 2003 £m	Acquired £m	Cash flow £m	Exchange differences £m	At 31 October 2003 £ m
Cash at bank and in hand	27.7	-	26.0	(1.5)	52.2
Overdrafts	(39.8)	-	33.5	0.1	(6.2)
	(12.1)	-	59.5	(1.4)	46.0
Debt due after one year	(110.1)	-	(160.0)	4.2	(265.9)
Debt due within one year	(101.9)	-	84.9	0.2	(16.8)
Finance leases	(4.9)	-	0.5	0.1	(4.3)
	(216.9)	-	(74.6)	4.5	(287.0)
Short term investments	26.7	-	(0.2)	(1.3)	25.2
Total	(202.3)	-	(15.3)	1.8	(215.8)