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PACKAGING

PAPER AND CORRUGATED MARKET OVERVIEW

THE CORRUGATED PACKAGING MARKET

The European market for corrugated packaging in 2008 is estimated to have been approximately €23 billion, equivalent to circa 22 million tonnes or 40 billion square metres¹, of which the UK market is estimated to be 9%. Demand for corrugated packaging is principally influenced by overall economic activity and manufacturing output.

In the calendar year 2008, the European market for corrugated packaging, measured in square metres, declined by 2.8%². Demand in western Europe fell by 3.3% and within this the UK market fell by 3.5%. Demand in eastern and central Europe continued to be relatively stronger but only grew by 0.1%. Owing to cost and environmental pressures, there is a continuing emphasis in most markets on reducing the average weight of packaging. As a result, European demand when measured by weight declined by 3.6% and the UK market, which is at the forefront of the 'lightweighting' trend, fell by 4.6%. Across Europe, demand deteriorated as the year progressed and this trend continued in the early months of 2009.

Usage of corrugated packaging (boxes) for the fast-moving consumer goods (FMCG) sector, which accounts for approximately two-thirds of the corrugated market, has been affected by the slow-down in retail demand but has remained significantly stronger than that for industrial market

sectors. Demand from the FMCG sector continues to benefit from the trend towards the use of retail-ready packaging (RRP), which can be readily converted from its initial role as a protective transit pack into a box or tray that can be placed on display in the retail store. RRP benefits retailers by reducing the manual work involved in loading goods onto store shelves and reducing the amount of damage to goods in store, while enabling products to be presented more attractively. RRP requires more sophisticated packaging manufacturing capabilities for cutting, printing and gluing the corrugated board to form the more complicated box structures. The increased proportion of these higher value-added boxes, often requiring multi-passes within the production process, has contributed to capacity utilisation across the corrugated industry remaining higher than would be indicated by the overall level of demand.

Usage of corrugated packaging for the home delivery of products continues to grow in association with the growth of purchasing through the internet. In contrast, the usage of boxes in most industrial manufacturing sectors has been severely affected by the sharp downturn in industrial activity throughout Europe. Demand from the automotive, construction and chemical industries has been particularly weak.

Within the overall weaker market for boxes there is a continuing strong trend towards the greater use of lighter-weight corrugated packaging. This trend is being driven not only by the continuing pressure through the supply chain to reduce the cost of packaging but also the increased attention being given to the quantity and type of packaging being used in order to reduce the amount of waste going to landfill. Corrugated packaging is fully recyclable and the trend towards use of lighter-weight boxes has been enabled by the increasing availability of high-quality lightweight recycled corrugated case material (CCM) with good strength characteristics. This lightweight CCM allows box manufacturers to produce packaging with high performance characteristics while reducing the weight of material used.

Supply of corrugated board and boxes is generally relatively local to the point of production, with a typical operational radius of approximately 150 miles, owing to customers' service requirements and the proportionately high transport costs for a low-density product. Pricing and margins in corrugated packaging are strongly influenced by developments in the price of CCM, the paper that is the principal component in corrugated packaging, and which typically accounts for around 50% of the cost of a box.

¹ Source: European Federation of Corrugated Board Manufacturers/DS Smith estimates

² Source: European Federation of Corrugated Board Manufacturers

EXPANDING OUR RECYCLING SERVICES

STRENGTH TODAY

20 times

We collect, each year, sufficient waste paper for recycling to fill the bowl of Wembley Stadium circa 20 times.

ACTIONS FOR TOMORROW

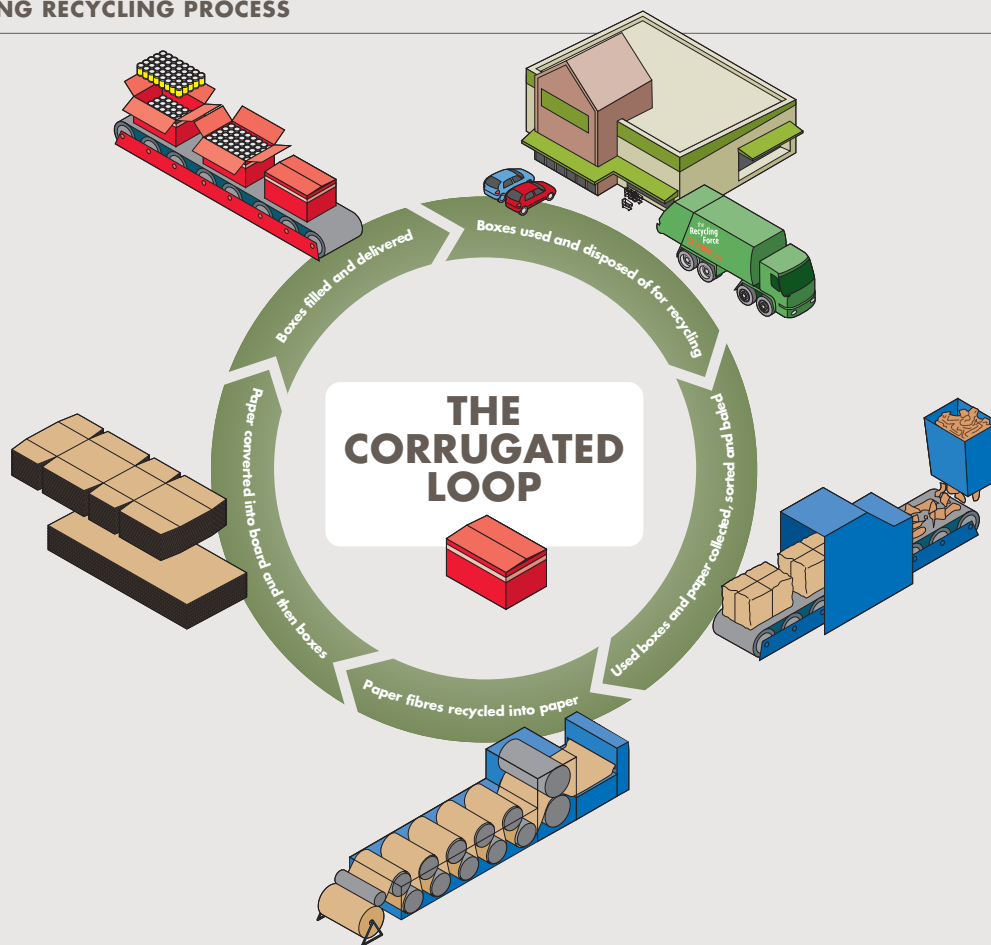


We have developed Severnside Recycling into a significant asset for the Group. In addition to being a major collector of waste paper for recycling, it is now one of the UK's largest collectors of plastic waste for recycling. From its headquarters in South Wales, it co-ordinates the collection of waste from circa 12,500 business locations and provides a range of waste management services.

THE CORRUGATED PACKAGING RECYCLING PROCESS

DS Smith's operations play a significant role in the first three stages of the corrugated packaging recycling process. The fibres in corrugated boxes can be back on the shelf in-store within 14 days of disposal; their re-use minimises waste disposal to landfill. In the UK, over 80% of corrugated packaging is recycled.

Corrugated boxes protect products, reduce product wastage, enable more efficient and lower-cost handling and transportation and are increasingly used to provide strong visual display in-store. Approximately two-thirds are used for food, beverages and other fast-moving consumer goods.



THE CORRUGATED CASE MATERIAL MARKET

Whereas boxes are generally sold locally, CCM is sold on a pan-European basis and pricing is therefore affected by pan-European supply and demand. The total demand for CCM in Europe (including eastern and central Europe but not Russia) in 2008 was circa 25 million tonnes. The market for CCM in Europe is dependent upon European demand for corrugated packaging, as the imports and exports of unfilled boxes are negligible. Approximately 80% of the CCM used in Europe is made from recycled fibre, with the balance principally comprising kraftliner, which is made from virgin wood pulp.

The lower demand for boxes has resulted in reduced demand for CCM. However, within the overall CCM market there is strong demand for high-quality, lightweight CCM to produce lighter-weight packaging. The growth in the usage of lightweight CCM continues to be limited by the available supply of lightweight paper as the majority of the existing CCM machines are unable to manufacture lightweight papers cost-effectively or to an acceptable quality. This increased demand for high-quality lightweight CCM is resulting in the addition of new CCM capacity capable of producing lightweight paper. In January 2009, the Group started production of its 'K-light' lightweight CCM product at Kemsley. Other European producers plan to commence production of lightweight CCM on new machines located in Poland, Hungary and Germany during the



CCM reels are shipped from the paper mill to a box plant for conversion into corrugated board.



Corrugated board is cut to the required size before its final conversion into a box.

second half of 2009 and in 2010. This new capacity, which is expected to be started in 2009 and 2010, will produce circa 1.5 million tonnes per annum when it is fully operational. It is anticipated that the production from the new machines will principally be targeted at satisfying the rapidly growing European demand for lightweight paper.

During 2008 and 2009, a number of closures of older recycled CCM machines, representing circa 0.8 million tonnes of capacity, have been announced and implemented across the industry. Despite these closures it is estimated that there is currently an oversupply of some three to four million tonnes of CCM in Europe as a result of the current lower demand for boxes.

CCM AND BOX PRICES

The reduced demand for corrugated packaging during 2008 resulted in an increase in European industry CCM stocks and this, coupled with the developing oversupply position, led to a progressive weakening of the price of recycled CCM. In continental Europe recycled CCM prices fell by approximately 50%³ between December 2007 and April 2009. Recycled CCM prices in the UK, which were supported to some extent by the weakness of sterling, fell by approximately 30% over the same period. The combination of weaker demand and lower CCM prices has resulted in some reduction in box prices. This reduction has been more marked in continental Europe than in the UK.

WASTE PAPER

Waste paper, the principal raw material for recycled CCM, is a globally traded commodity. The price of old corrugated containers (OCC), the principal grade of waste paper used for producing CCM fell sharply in autumn 2008 as a result of substantially reduced demand from Asia. The price of OCC has firmed in recent months as a result of some recovery in purchasing from Asia and the lower level of availability in Europe, which is due to the lower overall level of economic activity. In the UK, the value of Packaging Recovery Notes (PRNs), which are issued as evidence that packaging has been reprocessed in compliance with the UK Packaging Waste Regulations, has remained at a low level.

UK PAPER AND CORRUGATED PACKAGING

Results were affected by lower demand and a sharp fall in the price of CCM.

	2008/09	2007/08
Revenue – £m	785.8	753.2
Adjusted operating profit – £m*	36.5	68.5
Adjusted EBITDA – £m*	73.2	100.4
Segment key performance indicators:		
Revenue growth – %	4.3%	9.6%
Adjusted return on sales – %*	4.6%	9.1%
Adjusted EBITDA margin – %*	9.3%	13.3%
Adjusted return on average capital employed – %*	6.7%	14.3%

* before exceptional items of £18.2 million (2007/08: £nil)

2008/09 PERFORMANCE

Results in the UK Paper and Corrugated Packaging segment were adversely affected by lower demand and a sharp fall in the price of CCM. Our corrugated box business performed well despite a lower demand for boxes but this was not sufficient to offset the weaker results in our paper business. Revenue advanced by 4.3% to £785.8 million; on a like-for-like basis, excluding New Thames Mill, acquired in February 2008, revenue declined by 4.4%. Adjusted operating profit was significantly lower at £36.5 million (2007/08: £68.5 million).

Our waste collection business, Severnside Recycling, performed satisfactorily despite the effects of large swings in the price of waste material during the year and lower sales volumes. The amount of waste available for collection was lower due to the reduced levels of activity at retailers and other businesses. The dislocation in the market for waste caused by the sharply reduced demand from Asia resulted in Severnside acquiring a number of significant new customers, who recognised the benefits of Severnside's expertise and infrastructure for waste collection and recycling. The Group's reprocessing capability at its paper mills and the Group's own requirement for waste paper were increased during the year by the start-up of the converted paper machine at Kemsley which produces lightweight CCM. In addition to fulfilling its primary role of securing the required quantities of fibre for our UK paper mills, Severnside developed further its value-added waste management services in response to growing demand, which is being stimulated by government action to reduce the amount of waste going to landfill. During the course of the year, Severnside and our UK box business, DS Smith Packaging, have further strengthened their marketing collaboration for our 'cradle-to-cradle' environmental capability. Customers are increasingly recognising the benefits of the Group's expertise in the design of waste-minimising packaging, the manufacture of fully recyclable boxes and waste recycling and disposal services.

St Regis, our UK paper business, was affected by significantly lower sales volume and a squeeze on its margins due to the fall in the price of CCM and continuing high input costs. These factors increasingly affected results during the second half of the year. In addition to the lower demand for CCM as a result of reduced box demand, plasterboard liner sales were severely affected by the slow-down in the construction industry. Production at the mills was adjusted in recognition of the reduced level of demand.

³ Source: RISI, Inc.



The new stock preparation plant was a major part of the investment to modify New Thames Mill at Kemsley.



Production of lightweight CCM at New Thames Mill began on schedule in January 2009.

We have adjusted capacity levels and costs in our corrugated operations to reflect the reduced demand and changes in product mix.

As we enter 2009/10, the recent trends in both demand and pricing across the UK Paper and Corrugated Packaging segment have been adverse and energy and waste paper input costs are exerting further pressure on our margins. We have taken action to reduce costs and raise operational performance and are focused on maximising the opportunities presented by our strong market positions.

In January 2009, production of lightweight CCM commenced on schedule on the recently acquired and modified paper machine at Kemsley, which has an initial capacity of 260,000 tonnes per annum. The quality of the 'K-light' product being produced is exceeding our high expectations and there is strong demand for this lightweight paper despite the generally weak demand for CCM as a whole. Although prices currently being obtained for the product are below those anticipated when the project was initiated, this investment has, we believe, materially strengthened the long-term competitiveness of our UK Paper and Corrugated Packaging business. It has established us as a leader in high-quality lighter-weight packaging and given us a significant capability as well as an increased share of this growth market segment.

As a result of the lower overall demand for CCM, we closed, with effect from 1 May 2009, the PM1 machine at Kemsley, which was the Group's oldest paper machine and had a capacity of 75,000 tonnes per annum.

DS Smith Packaging, our UK box business, achieved a good result, maintaining its share in a weaker overall market. Prices began to come under pressure during the second half of the year. We benefited from our expanded and strengthened position in the FMCG sector of the market and particularly from our focus on RRP, which continues to increase its share of the market. We are continuing to develop our innovative supply chain support service, as part of which we work with customers to produce packaging solutions that will reduce customers' transportation and handling costs. In our sheet feeding operations, which supply corrugated sheet to box converters, we have retained our market share and have had a positive response to the use of our 'K-light' material.

LEADING THE WAY IN LIGHTWEIGHT CCM

STRENGTH TODAY

5m miles

St Regis, the UK's leading supplier of recycled paper, produces circa 5 million miles of paper each year.

ACTIONS FOR TOMORROW



Our investment at Kemsley to produce lightweight CCM makes St Regis the first and only significant UK supplier of this type of paper. Lightweight CCM is in strong demand and Kemsley's product is acknowledged by customers as being of a very high quality. The investment project was highly cost-effective and was completed on time despite its very tight schedule.

**CONTINENTAL EUROPEAN
 CORRUGATED PACKAGING**

We achieved a strong result despite weak demand across our markets.

	2008/09	2007/08
Revenue – £m	363.4	346.0
Adjusted operating profit – £m*	30.4	20.3
Adjusted EBITDA – £m*	45.8	33.9
Segment key performance indicators:		
Revenue growth – %	5.0%	12.3%
Adjusted return on sales – %*	8.4%	5.9%
Adjusted EBITDA margin – %*	12.6%	9.8%
Adjusted return on average capital employed – %*	15.2%	10.9%

* before exceptional items of £24.7 million (2007/08: £nil)

2008/09 PERFORMANCE

The Continental European Corrugated Packaging segment achieved a strong result despite weak demand across its markets. Revenue increased by 5% to £363.4 million (2007/08: £346.0 million). This segment, which is a substantial net buyer of paper, benefited from our previous actions to raise prices, the fall in the price of CCM and good cost control. Together these factors enabled us to offset the effects of lower sales volumes. Operating profit increased by 50% to £30.4 million. Excluding the effects of foreign exchange translation, revenue was £40.5 million lower than 2007/08. Operating profit, excluding the effects of foreign exchange was £3.3 million higher than in the prior year.

In our established markets, the French paper business, which focuses on supplying speciality products, maintained its profits despite substantially lower sales volume. Our French corrugated packaging business made good progress, assisted by better margins and operational improvements at the main facilities. Our particularly strong market position in heavy-duty packaging for the industrial sector in France was severely affected by the sharply lower level of activity in its customers' industries. The effects of this



DS Smith Kaysersberg has invested to increase its capabilities for supplying boxes to the FMCG sector.



Retail-ready packaging is supplied to major international food manufacturers.

were partly offset by the benefits of our actions and investment aimed at increasing our business in the FMCG sector. Based on its strong market positions in the FMCG sector, our Italian business performed well in a worsening trading environment.

In our developing markets, the Polish business achieved a further strong advance, gaining share in a broadly static market. We are benefiting from the investments we have made over a number of years and our focus on developing sales of higher value-added products. Our small converting businesses in the Czech Republic and Slovakia, aimed principally at the automotive industry in central Europe, experienced especially tough trading conditions. Results at our business in Turkey, which focuses on the brown and white goods and automotive sectors were also depressed by the international economic slow-down. We have extended our programme aimed at lowering costs and improving performance and we are taking an impairment charge against this business. Operating results at our Ukrainian associate business, Rubezhansk, which is reported under associates, were affected by weaker sales volume and margin pressure. Although the business remains profitable and cash generative, we have fully impaired the value of our investment in it because of its exposure to a large US dollar denominated loan.

In 2009/10, we expect margins to come under increased pressure while sales volumes remain subdued. Our priorities are to maintain good levels of profitability in our three principal markets, France, Italy and Poland. We will continue to develop the Polish business and concentrate on supplying the higher value-added product sectors in all our markets.

INVESTING FOR GROWTH

STRENGTH TODAY

250m

DS Smith Polska produces over 250 million boxes a year.

ACTIONS FOR TOMORROW



We have grown our business in Poland by circa 125% over the last five years. Our plant at Kutno is one of the most advanced in Europe and achieves very high efficiency levels. Recent investment in Poland has been heavily focused on further developing our capabilities to supply higher value-added products for the FMCG sector.

PLASTIC PACKAGING

Results were lower in both of our major sectors.

	2008/09	2007/08
Revenue – £m	236.9	223.4
Adjusted operating profit – £m*	7.0	10.7
Adjusted EBITDA – £m*	19.2	21.2
Segment key performance indicators:		
Revenue growth – %	6.0%	10.7%
Adjusted return on sales – %*	3.0%	4.8%
Adjusted EBITDA margin – %*	8.1%	9.5%
Adjusted return on average capital employed – %*	5.3%	8.4%

* before an exceptional charge of £4.0 million (2007/08: £1.9 million)

MARKET OVERVIEW

Returnable transit packaging (RTP) products are mostly used within the retail, automotive, electronics and beverage sectors. Demand is heavily influenced by industry sector activity levels. RTP is often a capital purchase for our customers, being driven by particular projects, hence annual demand can be uneven. The European market for RTP, which is estimated to be approximately €1 billion, is fragmented into many product sub-sectors and has a large number of suppliers. In western Europe, the markets we serve are estimated to have declined in 2008 by 15% as a result of the slow-down in industrial and retail activity. The previous trend towards the use of multi-trip, reusable packaging on cost and environmental grounds has reduced in recent years, although there remain many market sectors that are well suited to returnable systems. This slow-down in demand has been partly a result of the fluctuations in polymer costs and partly a result of the general decline in economic activity.

The global market for liquid packaging and dispensing (LP&D) products is estimated to be approximately £400 million. The principal uses of bag-in-box packaging are for wine, agricultural produce (such as fruit juice and dairy products) and food service applications such as carbonated soft-drink concentrate (for the hotel and restaurant industries). The market for dispensing products (principally taps), other than for bag-in-box systems, is fragmented across a wide range of applications. DS Smith Plastics is a major supplier to the wine and liquid detergent sector; the latter has grown strongly in recent years in the USA and has more recently started to grow in Europe.

The recent volatility of polymer prices has contributed additional uncertainty into our markets over the last year. During the first half of calendar year 2008, polymer prices rose substantially as a result of the high oil price, reaching a peak in August 2008. They then fell sharply during the autumn and early winter months before firming again during the first half of 2009. This volatility contributed to the uncertainty of demand during this period as it exacerbated the tendency of customers to defer ordering products, particularly in the RTP sector.

2008/09 PERFORMANCE

DS Smith Plastics' revenue increased by 6% to £236.9 million, including the positive effect of foreign exchange translation. Results were lower in both of our major sectors and consequently overall adjusted operating profit fell by 34.6% to £7.0 million. The effects of foreign exchange translation improved revenue and operating profit by £33.9 million and £3.1 million respectively compared with 2007/08.

Revenue in RTP, which accounted for 43% of the segment revenue, was 6.0% lower due to weak and variable demand from almost all its main customer sectors. Sales to the construction and automotive sectors fell sharply and our beverage crate business was significantly affected by the deferral by our customers of anticipated crate replacement programmes.

In LP&D, revenue, which accounted for 45% of the segment, grew by 16.2%. Our USA operations maintained their good performance, partly due to the development of new market sectors for bag-in-box packaging. Our European operations continued to be affected by competitive pressures, particularly in the wine sector. The restructuring of our operations in Germany was completed in April 2009 and further restructuring of our tap and bag operations in the UK is being implemented.

We are seeking to mitigate the effects of the ongoing weak demand, especially in RTP, through our restructuring actions and productivity improvements.



Returnable transit packaging is designed to meet the needs of customers' logistics systems.



Bag-in-box packaging is being used for an expanding range of products, including fruit juices.

OFFICE PRODUCTS WHOLESALING

Profit was flat, assisted by a good performance in continental Europe.

	2008/09	2007/08
Revenue – £m	720.5	644.9
Adjusted operating profit – £m*	20.1	20.1
Adjusted EBITDA – £m*	25.7	26.1
Key performance indicators:		
Revenue growth – %	11.7%	13.3%
Adjusted return on sales – %*	2.8%	3.1%
Adjusted EBITDA margin – %*	3.6%	4.0%
Adjusted return on average capital employed – %*	15.2%	15.1%

* before an exceptional charge of £3.7 million (2007/08: £nil)

MARKET OVERVIEW

The office products markets of the UK, France and Germany, in which Spicers currently has approximately 85% of its sales, are estimated to be worth approximately £5 billion, €6 billion and €7 billion respectively, at manufacturers' selling prices. The demand for office products is principally influenced by the level of economic activity. The value of the markets in which Spicers operates fell in 2008, with the traditional stationery sector declining significantly although the electronic office supplies (EOS) sector continued to show modest growth⁴. The value of the market is being held back by price deflation caused by intense competition between suppliers and the trend for consumers to buy lower specification or own-branded products. EOS, which is a growing sector of the market, accounts for approximately 50% of the total office products market. It is especially price-competitive on the high-volume EOS products.

The relative shares of the various supply channels to the end-user market differ by country. Spicers principally supplies office products dealers and resellers. In the countries in which Spicers operates, this channel accounts, on average, for approximately 35% of the total office products market. The share of the market held by dealers has been relatively stable in recent years. Office products dealers primarily sell to small and medium-sized organisations, generally offer a high standard of service to their customers and source most of their products either from wholesalers or direct from manufacturers.

2008/09 PERFORMANCE

Office Products Wholesaling – Spicers – showed an overall sales growth, which was magnified by the translation benefits of the strong euro. Despite the adverse impact of the economic environment on the demand for office products, revenue increased by 11.7% to £720.5 million (2007/08: £644.9 million). Adjusted operating profit was flat at £20.1 million, due to a fall in profit in the UK and Ireland while profits in continental Europe as a whole increased slightly, assisted by the strength of the euro. The effects of foreign exchange translation improved revenue by £57.9 million and operating profit by £3.1 million compared with 2007/08.

In the UK, which accounts for approximately half of our office products wholesaling revenue, we grew sales. However, this growth masks a significant decline in traditional office products, offset by a large growth in lower margin EOS. Despite our actions to reduce the cost to sales ratio, the fall-off in traditional product sales, combined with the effects of a highly

competitive market situation, put substantial pressure on profits. Action has been taken to improve the sales mix and to raise efficiency levels further, with the aim of reversing this downward profit trend.

In continental Europe, our well-established businesses in France and the Benelux region performed solidly despite their revenue being affected by the decline in the overall market; our Benelux operations were additionally impacted by a change in government policy in Flanders regarding the supply of stationery to younger school children. Spicers Germany continued its development, reporting good revenue growth, assisted by further improvement in its service levels. Our Italian operation once again showed good overall growth, consolidating its position as a significant supplier in this market and reporting its first full year of profit. Spicers Spain produced a creditable result in light of the severity of the national economic slow-down in this country, which affected its overall revenue despite growing its EOS sales.

George Adams, who was appointed to the role of Chief Executive of Spicers in June 2009, brings with him a wealth of relevant business experience both in the UK and continental Europe as well as a good understanding of the Spicers business.

We expect the current year to be testing, especially in the UK market. Throughout 2009/10, our priorities at Spicers are to maintain our good overall performance in continental Europe while re-establishing profit improvement in the UK. We will focus on improving our overall sales levels, primarily in traditional office products, and on tight cost control. We believe that Spicers is well placed to take advantage of improved economic conditions when they arrive, due to its strong market positions and its thorough understanding of supply chain management.



Customers' orders are picked and despatched for same-day or for next-day overnight delivery.



Spicers' distribution centres process orders for circa 700,000 line-items per week.

⁴ Source: DS Smith estimates based on national data

SPICERS' BUSINESS MODEL

SPICERS

Supplies trade customers – dealers and resellers – with:

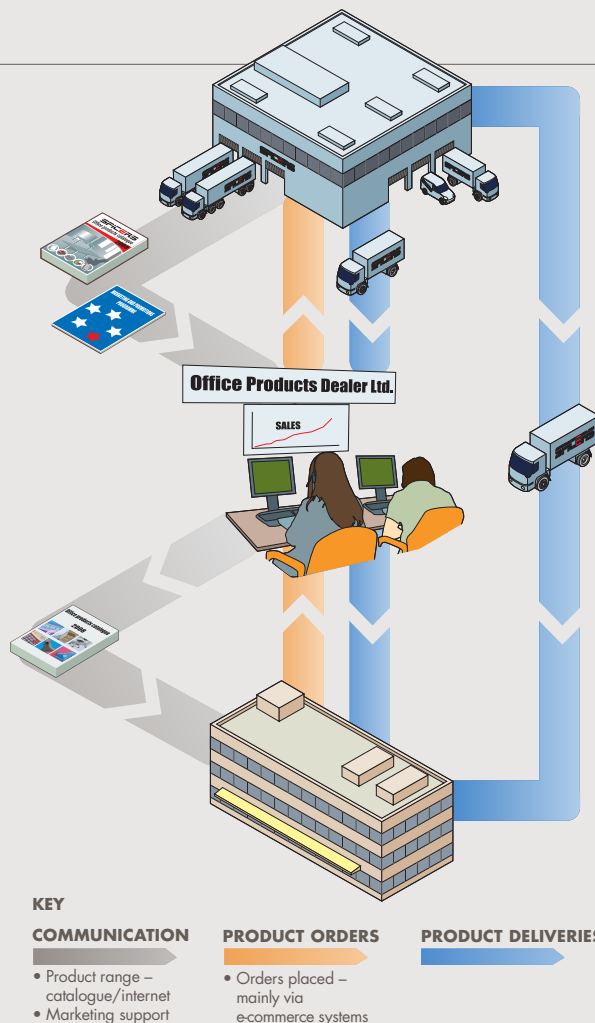
- Everything for the office, except computers – up to 22,000 product lines across Europe, branded and own-label
- Marketing support – catalogues/promotions
- Business development support
- E-commerce systems
- Fast service – same/next-day delivery
- Fulfilment service – orders delivered to dealers or direct to end-users

DEALERS & RESELLERS

- Sell to end-users
- Some hold stock
- Some are stockless and use Spicers as their fulfilment provider
- Source products from Spicers; may also buy from manufacturers

OFFICE END-USERS

- Offices of all sizes – from one person to large businesses – buy their office products from dealers
- Dealers also sell to other organisations such as schools and sometimes sell directly to consumers
- End-users can buy from the dealer customers of Spicers not only traditional stationery and electronic office supplies but also office furniture, janitorial supplies and office catering and vending provisions



ADDING VALUE FOR OUR DEALERS

STRENGTH TODAY

22,000

Spicers supplies up to 22,000 office product lines to some 12,500 dealers across Europe.

ACTIONS FOR TOMORROW



Spicers continually develops new ways to support its customers. It provides its dealers with marketing material such as promotional catalogues and brochures. Its innovative e-commerce systems enable ever faster and more efficient communication between Spicers, its customers and the end-users. Increasingly, Spicers provides a complete fulfilment service, delivering direct to end-users.