



Our ongoing focus on cash management resulted in strong cash generation.

OVERVIEW

The Group has achieved a robust financial performance in challenging trading conditions. The cash flow performance in the year demonstrates the Group's ability to generate cash despite significant capital investment and restructuring programmes. In August 2008, we successfully refinanced a syndicated loan facility at market-competitive rates.

TRADING RESULTS

The Group's trading results for the year to 30 April 2009 are summarised in Table 1.

The major drivers of the 2008/09 results were: lower volumes across the Packaging activity as a whole due to the weak economic environment; decreases in CCM selling prices in the UK Paper and Corrugated Packaging segment; and continuing strong competition combined with lower demand in the UK business of the Office Products Wholesaling segment. The improvement in margins in our continental European packaging operations together with the effects of the depreciation of sterling against both the euro and US dollar offset some of the decline.

Revenue for the financial year ended 30 April 2009 increased by 7.1% over the prior year; it was 17.0% higher in the first half of the year and 2.0% lower in the second half. Excluding the effects of the acquisition, in February 2008, of New Thames Mill within UK Paper and Corrugated Packaging, revenue was up 3.5%. If, in addition, the effect of movements in foreign exchange rates is excluded, revenue was down 4.5% on 2007/08.

Adjusted Group operating profit (excluding exceptional items) in 2008/09 was £94.0 million (2007/08: £119.6 million). The decrease in adjusted Group operating profit resulted from declines in UK Paper and Corrugated Packaging and Plastic Packaging of £32.0 million and £3.7 million respectively, which were partially offset by an increase in Continental European Corrugated Packaging of £10.1 million. Adjusted operating profit in Office Products Wholesaling was flat. Group adjusted operating profit in the first half of the year was £54.4 million (2007/08 H1: £60.4 million) and in the second half was £39.6 million (2007/08 H2: £59.2 million). The Group's adjusted return on sales was 4.5% (2007/08: 6.1%).

The Group's adjusted return on capital employed (which is defined as the adjusted operating profit divided by the average capital employed) decreased from 12.9% in 2007/08 to 9.3% in 2008/09, below the Group's estimated pre-tax cost of capital of 11.8%. The decline in the Group's return on capital employed reflected lower returns in 2008/09 across UK Paper and Corrugated Packaging, Plastic Packaging and Office Products Wholesaling, which were partially offset by a better return in Continental European Corrugated Packaging.

EXCEPTIONAL ITEMS

The Group recorded net exceptional charges before tax of £55.7 million during the year (2007/08: £1.9 million). A total of £50.6 million was recorded against operating profits which included £18.1 million in respect of the impairment of the carrying value of the Group's Ukrainian associate and £5.0 million in respect of our Turkish business, as well as £0.5 million against an investment in Italy. The balance of £27.0 million related to the restructuring costs and provisions as part of the Group's previously announced action programme. Restructuring costs of £18.2 million were incurred in UK Paper and Corrugated Packaging, £1.6 million in Continental European Corrugated Packaging, £3.5 million in Plastic Packaging and £3.7 million in Office Products Wholesaling. The restructuring costs comprise redundancy and other cash costs of £25.1 million and a balance of £1.9 million of non-cash items, principally impairments of tangible fixed assets. The cash return on this expenditure is expected to be £26.0 million in 2009/10 (2008/09: £nil) and this will help to underpin the Group's performance in the current year. Operating profit after exceptional items was £43.4 million (2007/08: £117.7 million).

TABLE 1 – TRADING RESULTS SUMMARY

| | First half | | Second half | | Full-year | |
|--|----------------|---------|----------------|---------|----------------|---------|
| | 2008/09 | 2007/08 | 2008/09 | 2007/08 | 2008/09 | 2007/08 |
| Revenue – £m | 1,102.8 | 942.7 | 1,003.8 | 1,024.8 | 2,106.6 | 1,967.5 |
| Adjusted operating profit – £m* | 54.4 | 60.4 | 39.6 | 59.2 | 94.0 | 119.6 |
| Adjusted return on sales – %* | 4.9% | 6.4% | 3.9% | 5.8% | 4.5% | 6.1% |
| Adjusted return on average capital employed – %* | 10.8% | 13.6% | 7.7% | 12.3% | 9.3% | 12.9% |

* before exceptional items

INTEREST, TAX AND EARNINGS PER SHARE

Net interest expense increased from £20.8 million in 2007/08 to £23.6 million in 2008/09, mainly reflecting higher interest rates following the refinancing completed in August and increased average net debt. Employment benefit net finance income, which is a non-cash item, was £1.5 million (2007/08: £8.8 million), reflecting a higher opening deficit on the defined benefit schemes. For 2009/10, given the higher discount rates used, higher opening deficit and reduced return on assets, it is anticipated that there will be an increase in the employment benefit finance charge to circa £11 million.

The Group's adjusted share of the non-exceptional after-tax profits of Rubezhansk, the Group's associate paper and packaging company in Ukraine was £0.6 million, down from £3.4 million in 2007/08. The Group has reported an exceptional loss of £5.1 million as the Group's share of the after-tax net loss at Rubezhansk incurred in the second half of 2008/09, principally as a result of foreign exchange losses incurred on Rubezhansk's US\$87 million loan, following the significant decline in the Ukrainian Hryvnia against the US dollar. Exchange rate movements have resulted in Rubezhansk breaching its banking covenants. Consequently, due to the uncertainty of the financial position of Rubezhansk, the Group has fully impaired the carrying value of its investment in Rubezhansk. This impairment of £18.1 million has been charged to operating profit as an exceptional charge. The net cash cost of this investment has been less than £5 million. Having reduced the carrying value of the investment to zero the Group has no further exposure to potential future losses at Rubezhansk. There is no recourse to the Group for the loan held by Rubezhansk.

Adjusted profit before tax was £72.5 million (2007/08: £111.0 million). Profit before tax after exceptional items was £16.8 million (2007/08: £109.1 million).

The Group's effective tax rate, excluding exceptional items and associates, at 31.4%, was higher than last year's rate of 29.4% as a result of a shift in the mix of profits towards the higher tax rate jurisdictions in continental Europe. The tax charge on exceptional items of £5.4 million comprises an exceptional charge of £13.3 million in respect of UK taxation following the announcement of the cessation of industrial building allowances, partially offset by tax allowances of £7.9 million for restructuring costs.

Adjusted basic earnings per share were 12.6 pence (2007/08: 19.9 pence). Basic losses per share were 3.0 pence (2007/08: earnings 19.6 pence).

DIVIDEND

The proposed final dividend is 1.8 pence (2007/08: 6.2 pence), giving a total dividend for the year of 4.4 pence (2007/08: 8.8 pence). Dividend cover before exceptional items was 2.9 times in 2008/09 (2007/08: 2.3 times). After exceptional items the dividend was not covered (2007/08: cover 2.2 times).

TABLE 2 – CASH FLOW

| | 2008/09 £m | 2007/08 £m |
|---|---------------|---------------|
| Operating profit before exceptional items | 94.0 | 119.6 |
| Depreciation and amortisation | 69.9 | 62.0 |
| Adjusted EBITDA | 163.9 | 181.6 |
| Working capital movement | 30.8 | 13.2 |
| Other | (11.1) | (9.2) |
| Cash generated from operations¹ | 183.6 | 185.6 |
| Capital expenditure payments | (87.4) | (66.5) |
| Sales of assets | 7.7 | 9.3 |
| Tax paid | (21.0) | (27.8) |
| Net interest paid | (23.0) | (16.8) |
| Dividends | - | 1.0 |
| Free cash flow | 59.9 | 84.8 |
| Exceptional cash costs | (17.2) | (5.8) |
| Dividends | (34.4) | (33.7) |
| Dividends paid to minority shareholders | (1.9) | - |
| Net acquisitions | (1.2) | (87.2) |
| Net cash flow | 5.2 | (41.9) |
| Shares issued | - | 0.2 |
| Purchase of own shares | (0.2) | (2.0) |
| Net debt acquired | (0.2) | (1.3) |
| Non-cash movements | (44.5) | (25.6) |
| Net debt movement | (39.7) | (70.6) |

¹ before exceptional cash items

CASH FLOW

The Group generated free cash flow of £59.9 million (2007/08: £84.8 million). Adjusted EBITDA fell by £17.7 million to £163.9 million, however, a strong focus on working capital resulted in a cash inflow of £30.8 million (2007/08: £13.2 million). Cash generated from operations (before exceptional items) was £2.0 million below the prior year at £183.6 million.

Net capital expenditure payments after disposals were £79.7 million (2007/08: £57.2 million), the most significant expenditure being the investment to convert the paper machine at New Thames Mill. The interest paid increased in line with the income statement charge after excluding last year's non-cash charge relating to an increase in the fair value of put options held by minority, non-continuing shareholders in a subsidiary of the Group.

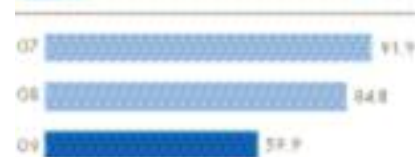
ADJUSTED OPERATING PROFIT £million



ADJUSTED RETURN ON SALES %



FREE CASH FLOW* £million



* before exceptional items

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Tax payments were £21.0 million (2007/08: £27.8 million) and were reduced by the lower adjusted trading profit described above. Cash dividend cover, defined as free cash flow divided by dividends paid/declared for the year, was 1.7 times, down from 2.5 times in 2007/08.

The cash outflow in respect of exceptional restructuring costs was £17.2 million (including cash outflows related to exceptional charges made in 2007/08), compared with a cash outflow from restructuring costs of £5.8 million in 2007/08.

The net cash outflow on acquisitions and disposals was £1.2 million (2007/08: £87.2 million) principally accounted for by the acquisition of a small recycling business in north west England.

In respect of pension payments, the agreed annual contributions into the UK Group Pension Scheme were £15.6 million in 2008/09 (2007/08: £14.6 million).

Overall, the Group generated cash of £5.2 million after funding additional capital expenditure and restructuring costs.

FINANCIAL POSITION

Shareholders' funds totalled £458.0 million at 30 April 2009, down from £601.7 million at 30 April 2008, principally due to the increase in the net liability to the Group Pension Scheme and the impairment of the carrying value of the Group's associate in Ukraine. Net assets per share were 116.7 pence (30 April 2008: 153.9 pence). The loss attributable to the shareholders of DS Smith Plc was £11.8 million and dividends of £34.4 million were paid during the year. In addition, after-tax actuarial losses of £88.5 million on the Group's defined benefit pension schemes were debited to reserves through the Statement of Recognised Income and Expense. Other items recognised directly in equity, relate to currency translation of £0.7 million and movements in cash flow hedges of £10.3 million.

The Group has committed facilities to 2012 of £535 million. The closing net debt was £291.5 million, £39.7 million higher than at the start of the year, reflecting the net cash inflow during the year of £5.2 million and non-cash movements, principally exchange differences and related fair-value movements, of £44.5 million.

Gearing, defined as net debt as a percentage of net assets, was 63.9% (30 April 2008: 41.8%); the movement reflected the increase in borrowing from the net cash outflow for the year which was proportionally greater than the increase in shareholders' funds. Adjusted Interest Cover (as defined in the loan agreements) was 4.5 times, compared with 7.6 times last year, the lower cover reflected the lower adjusted operating profit combined with the increased interest charge. The ratio of net debt to EBITDA (before exceptional items) was 1.8 times (2007/08: 1.4 times).

The Group's banking covenants for the syndicated loan and the private placements specify an Adjusted Interest Cover not less than 3.0 times, a maximum ratio of net debt to EBITDA of 3.25 times and net assets to be in excess of £360 million. The covenant calculations exclude from the income statement exceptional items and the net interest income/charge arising from the defined benefit pension schemes. The calculation of net assets excludes the net asset or liability arising from the defined benefit pension schemes. As at 30 April 2009, the most important covenant is the Adjusted Interest Cover and this had an Adjusted Profit headroom of £34.6 million (2007/08: £78.9 million).

ENERGY COSTS

The high level of energy costs continued to be a significant factor for the Group in 2008/09. The Group's total costs for gas, electricity and diesel fuel increased from circa £91 million in 2007/08 to circa £114 million in 2008/09. After adjusting for the effect of the acquisition of New Thames Mill in February 2008 this represents an underlying increase of circa £5 million. The Group continued with its strategy of hedging the energy costs with suppliers and financial institutions, the purpose of which is to reduce the volatility of energy costs and provide the Group with a degree of certainty over energy costs.

Approximately 40% of the Group's energy costs, principally related to our largest energy-consuming facilities, are incurred under supply contracts in which our energy costs tend to lag the trends in market prices.

CAPITAL STRUCTURE AND TREASURY MANAGEMENT

The Group funds its operations from the following sources of cash: operating cash flow, borrowing, shareholders' equity and disposals of peripheral businesses, where appropriate. The Group's objective is to achieve a capital structure that results in an appropriate cost of capital whilst providing flexibility in immediate and medium-term funding so as to accommodate material investments or acquisitions. The Group also aims to maintain a strong balance sheet and to provide continuity of financing by having a range of maturities and borrowing from a variety of sources.

The Group's overall treasury objectives are to ensure sufficient funds are available for the Group to carry out its strategy and to manage financial risks. The Group's treasury strategy is controlled through the Treasury Committee, which meets regularly and includes the Group Chief Executive, the Group Finance Director, Group Financial Controller and the Group Treasurer. The Group Treasury function operates in accordance with policies and procedures approved by the Board and controlled by the Group Treasurer. The function arranges funding for the Group, provides a service to operations and implements strategies for interest rate, foreign exchange and energy exposure management.

ADJUSTED INTEREST COVER



The Group's main borrowing facilities comprise: private placements, of US\$105.0 million due in 2012 and £25.0 million also due 2012; a private placement of US\$105 million due 2014 and US\$95 million due 2016. Additionally, the Group has a syndicated revolving credit facility of £287.5 million, which expires in 2013 and a bilateral facility of £50.0 million expiring in 2010. At 30 April 2009, the Group's committed borrowing facilities were £625.9 million. The total gross borrowing drawn under all these facilities at the year-end were £346.1 million. At 30 April 2009, the Group's borrowing facilities had a weighted-average maturity of four years and one month.

The major treasury risks to which the Group is exposed relate to movements in interest and foreign exchange rates and market prices for energy. The overall objective of the Treasury function is to control these exposures whilst striking an appropriate balance between mitigating risks and controlling costs. Financial instruments, including derivatives, may be used in implementing hedging strategies but the speculative use of financial instruments, including derivatives, is not permitted.

The Group manages the risks associated with its purchases of energy in the UK through its Energy Procurement Group, which operates under the oversight of the Treasury Committee. UK purchases of energy represent the significant majority of the Group's overall energy costs.

The Treasury Committee regularly reviews the Group's exposure to interest rates and considers whether to borrow on fixed or floating terms. The Group has a current policy of mainly borrowing at floating rates, which the Treasury Committee believes provides better value over the medium term. Fixed-rate borrowing, taking into account the effect of related swaps, comprised 35% of total borrowing at 30 April 2009 (30 April 2008: 16%).

The Group has a net investment in major overseas subsidiary companies' foreign currency assets and liabilities, in particular those whose functional currency is the euro or the United States dollar. The Group's policy is to hedge a large part of the resulting exposure to movements in foreign currency rates, by means of debt in the same currency, to a level determined by the Treasury Committee. The overseas net assets hedged through euro borrowing increased from 85% at 30 April 2008 to 89% at 30 April 2009 as a proportion of the Group's euro net investment.

The Group's foreign currency debt may be put in place either in the currency itself or through the use of cross-currency swaps on differently denominated borrowing. The Group applies hedge accounting under IAS 39 to its hedges of its net investment of foreign currency subsidiaries and records exchange differences arising on the net investments and the related foreign currency borrowing directly in equity. In addition, the Group's operations make product sales and purchases of raw materials in foreign currencies; here, cash flow hedges are taken out to reduce the risk associated with these transactions.

IMPAIRMENT

When applying IAS 36, 'Impairment of Assets', the Group compares the carrying amounts of goodwill and intangible assets with the higher of their net realisable value and their value-in-use to determine whether an impairment exists. The value-in-use is calculated by discounting the future cash flows expected to be generated by the assets or group of assets being tested for impairment. At the year-end, a series of tests were undertaken to determine whether there had been any impairment to the balance sheet carrying values of goodwill and other intangible assets. The key assumptions behind the calculations can be found in note 10 to the financial statements.

In summary, the test indicated that, despite the weak markets currently being experienced, the value of discounted future cash flow meant it remained appropriate not to write off any of the goodwill previously acquired by the Group. The tests for impairments did indicate that due to the uncertain state of the corrugated box market in Turkey it was appropriate to make an impairment of £5.0 million against the plant and equipment of Çopikas, the Group's subsidiary in Turkey.

Approximately 73% of the carrying value of the Group's goodwill is allocated to UK Paper and Corrugated Packaging.

Whilst the Board considers that its assumptions are realistic, it is possible impairment would be identified if any of the key assumptions were changed significantly. The net book value of goodwill and other intangibles at 30 April 2009 were £222.0 million (30 April 2008: £215.2 million).

As noted above, the Board has reviewed the carrying value of the Group's Ukrainian associate, Rubezhansk, and has determined that due to the financial position of Rubezhansk it is prudent to impair fully the carrying value of this investment.

Note 10 to the financial statements sets out additional information regarding the Group's annual impairment exercise including the details of the carrying value headroom for the key cash-generating units that hold goodwill.

PENSIONS

IAS 19, 'Employee Benefits', requires the Group to make assumptions including, but not limited to, future asset returns, rates of inflation, discount rates and current and future life expectancies. The use of different assumptions could have a material effect on the accounting values of the relevant assets and liabilities, which in turn could result in a change to the cost of such liabilities as recognised in the income statement over time. The assumptions involved are subject to periodic review.

The Group operates one defined benefit pension scheme in the UK and has some small, overseas arrangements. The aggregate gross assets of the schemes at 30 April 2009 were £555.3 million and the gross liabilities at

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30 April 2009, calculated under IAS 19, were £746.6 million, resulting in the recognition of a gross balance sheet deficit of £191.3 million (30 April 2008: £75.9 million), a net deficit of £138.0 million (30 April 2008: £54.5 million) after the establishment of a deferred tax asset of £53.3 million (30 April 2008: £21.4 million). The increase in the gross balance sheet deficit of £115.4 million was principally due to a reduction in asset values of £166.5 million resulting from the decline in global equity prices during the year.

In order to control the future costs and financial obligations of these schemes, the Group's UK defined benefit pension scheme is closed to new members. The current service cost in 2008/09, amounted to £9.7 million compared with £8.3 million in 2007/08. The Group's agreed annual cash contributions to the main UK scheme were £15.6 million (2007/08: £14.6 million). A triennial valuation of the scheme was carried out as at 30 April 2007.

Note 24 to the financial statements sets out additional information regarding the Group's pension and other post-retirement benefits.



STEVE DRYDEN

Group Finance Director

The Group has a rigorous procedure for understanding and managing its significant risks.

The Group faces various risks, both internal and external, which could have a material effect on its performance. The Group's exposure to individual risks is limited and diversified by the fact that it has several distinct types of activity, with 30 business sectors operating from over 100 sites in 18 different countries, and it sells to a broad range of customers. Details of the limited dependence of each of our segments on any one customer are provided in the Description of the Group on pages 12 and 13. The main commercial and other risks that are specific to a business segment are described within the narrative on that segment. The principal Group-wide key risks and uncertainties, as perceived in the light of present knowledge, and the way they are managed, are described below. There are further references to the risks faced by the Group in the Financial Review on pages 22 to 26, in the Corporate Governance section on pages 38 to 40 and in the Notes to the Accounts on pages 58 to 100. The Group seeks to mitigate its insurable risks through an insurance programme that covers property and liability risks where it is relevant and cost-effective to do so.

CHANGES IN THE DEMAND FOR, OR PRICING OF, THE GROUP'S PRODUCTS AND SERVICES AS A RESULT OF GENERAL ECONOMIC CONDITIONS OR MARKET-SPECIFIC FACTORS

The profitability of the Group's businesses is sensitive to the volume and mix of sales and to product pricing. Demand across the Group's markets has weakened and become less predictable as a result of the global economic downturn. This has, in turn, contributed to a fall in prices in some of the Group's markets. In the present circumstances, management has reduced visibility for forecasting the Group's levels of activity and margins. Trading conditions may prove to be very different from those that are currently expected. In these circumstances the Group's businesses are monitoring sales and pricing trends in their markets especially closely. The businesses all have programmes in place aimed at maximising sales and managing margins in the context of the evolving situation in their specific markets.

For our paper-based packaging products, a 5% reduction in the current level of overall demand across Europe could have the potential to reduce future operating profits by approximately £14 million. However, the actual impact would depend upon the specific impact of the reduction on individual products and markets and upon the outcome of the actions that management would take to mitigate the effects of such a change in demand.

With specific regard to our UK Paper business, based on an annual production of approximately 1 million tonnes, if the selling price of paper moved by £10 per tonne, the Group's operating profit would be impacted by circa £10 million, all other factors being equal. The actual impact would initially be partially mitigated by a corresponding reduction in the paper costs within our corrugated packaging operations.

In respect of our Office Products Wholesaling business, a 1% reduction in the overall margin achieved for office products would reduce Group operating profits by circa £7 million.

Further information on the changes and trends in demand and pricing relevant to our business segments is provided within the market commentaries in the Operating Review on pages 14 to 21.

VOLATILITY OF PRICING AND AVAILABILITY OF GLOBALLY TRADED RAW MATERIALS

In 2008/09, the Group purchased approximately £93 million of waste paper and approximately £110 million of polymers and films as the principal raw materials in its Paper and Plastic Packaging businesses, respectively. These products are globally traded and subject to variations in supply and demand which result in volatility in their pricing. The Group endeavours to recover any raw material cost increases through good material usage programmes and through price rises. Approximately one-third of the Group's corrugated and plastic packaging customer contracts include arrangements to link selling prices to an index of raw material prices. The achievement of price increases for the majority of our Packaging business is substantially determined by the state of supply and demand in the relevant market at any time. Due to the variety of contractual arrangements with customers, margins may be squeezed for a period of time until price increases are achieved to recover input cost increases. In the present trading environment it is likely to prove more difficult to recover input cost increases through price rises.

The Group's Severnside Recycling business collects and trades waste paper to ensure a continuous cost-competitive supply to the Group's paper mills. It achieves this through long-term contracts with major suppliers of waste paper and the collection of waste from smaller suppliers through its network of collection depots. Based on the Group's purchases of waste paper of approximately £93 million, a £10 per tonne increase in waste paper prices would reduce Group operating profits by £8 million. However, as noted above, the actual impact on future profitability would depend upon the extent to which finished goods prices are linked to input prices.

Of the Group's total polymer and film purchases, polycarbonate, polypropylene and high density polyethylene are the principal polymers used, with the remainder comprising a large number of different polymers and films. The Group has developed a good level of expertise in polymer purchasing and uses a number of suppliers to ensure it is purchasing at competitive prices.

VOLATILE AND INCREASING ENERGY PRICES

The Group's exposure to energy costs is described on page 24 and is being managed in a number of ways. The Group is looking to maximise in-house energy generation from its combined heat and power (CHP) plants in the UK and France, thereby taking advantage of the greater efficiency of the CHP process. It is also investigating the potential for the use of renewable or low-carbon energy sources, including refuse-derived fuel. The Group continues to undertake a wide range of energy-saving projects aimed at increasing its energy efficiency and reducing its energy usage. In 2008/09, the Group reduced its energy usage by 10% compared with 2007/08, principally due to lower activity levels across the Group.

The regulatory developments in the energy market are monitored and the Group collaborates, when appropriate, with other higher energy users in the paper and other industry sectors to influence government on energy policy and the operation of energy markets. The Group maintains a centralised energy-purchasing approach in the UK and France, which enables it to obtain economies of scale in buying and to apply specialist expertise. Given the sensitivity of the Group's financial results to energy prices, the impact of energy costs are managed through the use of long-term supply contracts (which reduce the volatility of price movements) and the application of hedging techniques. The Group transacts hedging instruments with a number of counterparties and monitors its overall reliance and exposure against each counterparty.

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RISK MANAGEMENT CONTINUED

A US\$10 per barrel increase in global oil prices would reduce Group operating profits by circa £3 million and a 10 pence per therm increase in UK gas prices would reduce Group operating profits by circa £3 million.

MOVEMENTS IN FOREIGN EXCHANGE RATES AND INTEREST RATES

These risks and the way in which they are managed through the Group's Treasury Committee and its subsidiary committees or groups are described on pages 24 and 25.

In terms of the effects of currency translation, the principal conversion rates which affect the Group's reported financial performance are sterling to the euro and sterling to the US dollar. An increase in sterling's value against the euro by 10 cents would decrease operating profits by around £3 million, principally due to the impact on the translation of profits in the Group's euro denominated operations. This impact would be partially offset at a profit before tax level by a reduction in interest costs of circa £1 million due to translation of interest costs on the Group's euro debt. Similarly, a 10 cents increase in the value of sterling against the US dollar would reduce reported operating profits by around £0.3 million and reduce interest costs by circa £0.1 million.

An overall one percentage increase in interest rates across the debt held by the Group would increase interest costs by £1.8 million. However, as noted on page 25, we currently have 35% of our debt placed at fixed interest rates.

THE FUNDING POSITION OF THE GROUP'S UK DEFINED BENEFIT PENSION SCHEME

The funding of the Group's UK defined benefit scheme is sensitive to a number of key factors: the value of the assets, of which 63% is invested in equities and 37% in bonds, gilts and cash; the discount rate, based on the yield on high quality corporate bonds, which is used to calculate the scheme's liabilities; and the expected mortality rate of the scheme's members. The funding position of the scheme has deteriorated during 2008/09 as described on page 26. The Group faces the risk that this funding position may deteriorate further over time. The Group and the scheme's trustee have sought to mitigate this risk through the scheme's investment strategy and through having increased the contributions made to the scheme by both the members and the Group. The regulatory environment for pension schemes and their trustees has changed in recent years, in particular with the Pensions Act 2004: the presence of a deficit in a scheme may now oblige the trustee or possibly the Pensions Regulator to seek some further funding of the scheme in the event of a significant corporate action or perceived decline in the Group's financial covenant. The sensitivity of the funding position to the key assumptions is detailed in note 24.

THE CONTINUING AVAILABILITY OF BORROWING FACILITIES, INCLUDING COMPLIANCE WITH BORROWING COVENANTS

The Group's borrowing facilities and their management through the Treasury Committee are described on pages 24 and 25. The Group has committed facilities of £625.9 million (2007/08: £506.0 million) and, as at 30 April 2009, £346.1 million was drawn against these facilities. The facilities are provided by a range of banks that typically have a credit rating of BBB+ or greater. The Group is required as a condition of its

borrowing facilities to remain within certain covenants. These are detailed in the Financial Review on pages 24 and 25. In the event that a breach of covenant occurs, borrowing under the facility becomes repayable on demand.

The Group has cash deposit, borrowing and transactional relationships with a range of institutions. The counterparty risk is carefully monitored to ensure that the risk of an individual counterparty failure would not curtail the Group's ability to manage foreign exchange, energy or impinge significantly on its borrowing facilities. Cash deposits are held with institutions of credit rating AA or greater.

CUSTOMER CREDIT RISK

Although the Group has a broad base of customers, the financial failure of one or more of the Group's key customers may have a material impact on the results in a particular segment and result in a significant loss of future business. Given the current environment we are closely monitoring credit risk across our customer base. The potential effect of the failure of any particular Group customer is limited as no single customer represents more than 2% of the Group's revenue.

THE EFFECTIVENESS OF THE GROUP'S ACTION PROGRAMME FOCUSED ON COST REDUCTION AND CASH GENERATION

In the light of the challenging trading conditions, the Group has implemented an action programme which is described in more detail in the Chief Executive's Review on pages 7 to 9. If trading conditions were to worsen significantly from the currently expected level, this programme may prove not to be sufficient and it may be necessary to reduce the Group's cost base further, thus incurring additional restructuring costs. In these circumstances the Group's results could be adversely affected.

SERIOUS BREACHES OF THE LAW OR OTHER REGULATIONS

The Group's Key Corporate Values, which are described in more detail in the Corporate Responsibility Review on page 30 and are available in full at www.dssmith.uk.com/pages/Policies.asp on the Group's website, require all employees to comply with all relevant laws and regulations in the countries in which they operate. The Group recognises the risk that substantial fines, or other penalties, may be imposed for non-compliance with laws and regulations relating to competition, environmental, health and safety or other matters, and has control mechanisms, ongoing programmes and systems, and special initiatives in place for monitoring compliance. It also carries out training programmes for employees and has systems in place to share expertise and best practice on these matters. The Group has a Workplace Malpractice Policy, and a process for employees to report any suspected wrongdoing in confidence, that is in place across its international operations where such reporting is permitted by law.

INCREASING COSTS IN THE MEDIUM TERM RELATED TO CLIMATE CHANGE AND CARBON DIOXIDE (CO₂) EMISSIONS

As a result of its substantial energy usage, the Group is likely, in the medium term, to be increasingly subject to regulation and taxation of its CO₂ emissions. The details of this and the actions being taken to reduce the Group's future energy usage and CO₂ emissions are described in the Corporate Responsibility Review on page 35 and in the statement of the Group's strategy for managing its energy costs on page 24.

PRODUCT LIABILITY

The Group's packaging products, many of which are supplied into the food and beverage industries, may give rise to potentially substantial product liability claims in the event of a failure of the packaging to perform its function when in use or from contamination of the product by its packaging. The potential for such claims is reduced by the fact that the majority of the Group's packaging is used as secondary, or transit, packaging and does not come into direct contact with the products it ultimately protects. The Group takes all reasonable steps to ensure the safety and adequate performance levels of its packaging through design, manufacturing control processes, technical testing and other means while having appropriate product liability insurances in place. It also looks to minimise its product liability risk through its relevant terms and conditions of trading.

OTHER SOCIAL AND ENVIRONMENTAL MATTERS

The Group's management of other social and environmental risks is described in the Corporate Responsibility Review on pages 30 to 35.