Full year 2021 results

3 March 2022

Transcript

Presenters

Andrew King, Group CEO

Mike Powell, Group CFO

Q&A Participants

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Justin Jordan, Exane BNP Paribas

Wade Napier, Avior

Brian Morgan, RMB Morgan Stanley

James Twyman, Prescient Securities

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Andrew King, Group CEO

Good morning all, and welcome to the Mondi 2021 results presentation. I am Andrew King, your Group CEO, and I am joined by Mike Powell, our Group CFO. I will be providing you some highlights for the year before passing on to Mike for an overview of both the financial and operating performance. I will then be coming back to update you on both our strategic positioning and, more importantly, some of the exciting growth opportunities we do see for the business going forward. After that, Mike and I will be delighted to take your questions.

However, before we go into the review of the prior year, I would like to share some thoughts on what is obviously a fast-escalating situation in the Ukraine. The events unfolding in the Ukraine are tragic, and the impact extends well beyond national borders. Our thoughts are with those directly affected, and we are actively doing what we can for our much-valued colleagues at our paper bag plant in Lviv in west Ukraine, where production is currently suspended, as well as our regional sales team located in the capital, Kyiv. We also have a number of Ukrainian nationals working in our plants in bordering European countries, so this humanitarian crisis is deeply personal for many Mondi employees. We are contributing to the humanitarian effort, both at a Group level with financial assistance to the World Food Programme, where we have an existing relationship, and also through many local initiatives. While we may all wish for peace and stability, attempting to predict the medium-to-long-term impact on both our business and the situation more broadly remains extremely volatile and is, of course, complete guesswork.

I remind you that we have four operations in Russia that represent around 12% of the Group's revenue by location of production and have, on average, contributed around 20% to Group EBITDA over the last three years. This includes our high-margin, cost-competitive, integrated paper mill in Syktyvkar in the Komi Republic and three packaging converting businesses. All are currently operational. At present, we do continue to operate in all these locations where it is both safe and clearly within the law to do so. We are actively assessing the implications on our business of the Russian sanctions and, of course, the related international responses, but, as I have already said and as I am sure you will appreciate, this is a fast-moving and very fluid, complex situation. I know that you will have many questions, but there is not much more we can say today. We will, of course, update the market as required as developments unfold.

If I then look back at 2021, I think it can be summarised as a year of strong delivery, accelerating growth and ongoing progress on our sustainability journey. Our integrated position, the agility of our people and the proactive collaboration across the supply chain insured we were able to deliver strongly for all our customers. We achieved good volume growth across all key segments of our business. I am particularly pleased with the strong gains we continue to make in our growing packaging segments and also the recovery in volumes we have seen in our Uncoated Fine Paper business, aided by solid market share gains. We saw meaningful price momentum across the Group, driven by significantly improved supply-demand fundamentals and positive mix effects. Importantly, as we will cover in more detail later in the presentation, we were able to fully compensate for the significant cost inflation that we have seen and has really become a feature of the operating environment.

We also continue to invest for the future. A highlight of the year was the successful delivery on a number of our key capex projects, bringing increased capacity in strongly growing markets, cost improvements and, of course, also, sustainability benefits. Importantly, and this is a feature of what we will discuss a bit later, the growing markets we serve and the unique positioning we have within these markets provide opportunity for further growth. Supported by our ambitious capex programmes, we currently have a pipeline of expansionary projects already approved or under advanced evaluation amounting to about €1 billion. As I say, I will come on to provide more detail on this later. We are confident that the cash generation of the business can support both this investment programme and also returns to shareholders, with the annual dividend up 8%.

Sustainability clearly remains centre to our strategy. We have a great track record in this regard and are rightly recognised as a leader in the field, but, clearly, there is much more to be done. In the year, we made great progress in embedding our MAP2030 programme, the action plan for the next decade. Very excitingly, around the sustainability agenda, we have identified significant opportunities to develop our unique portfolio of sustainable packaging solutions. I will come back to some of the recent examples of innovation in the space again later in the presentation. We really do see great opportunity to continue growing in this area, and we are supporting it with meaningful investment. I will now hand over to Mike to take us through both the financial and operating highlights before coming back to talk to you about the strategy.

Mike Powell, Group CFO

Thank you, Andrew. Morning, everybody. Let me take you through the numbers for the year ended 31 December 2021. I will start with the Group, and then I will dive into the business units. We delivered a strong financial performance in 2021. All key metrics were up year-on-year. EBITDA of just over €1.5 billion was up €150 million against 2020, with the second half up around 30%. All of this gives the Board confidence to propose a final dividend up 10%.

I will take you through the key components of the 2021 EBITDA growth, which, as you can see, is mainly driven by higher selling prices outpacing costs alongside some good volume increases. We drove volume growth in Corrugated Packaging and Flexible Packaging on the back of our portfolio of innovative and sustainable packaging solutions. Our attention to quality and service for our customers and the reliability of our integrated value chain continue to win through. Uncoated fine paper volumes also increased with our customers recognising the stability of a long-term supplier and the sustained quality of our products alongside consistent service as others exit this market.

Selling prices were up across the entire business, most significantly in Corrugated Packaging. I will talk a little bit more about selling prices in more detail as I come to the business units. However, let me deal with costs generically on this slide as it is pretty widespread and saves me repeating it four times in each business unit. We saw large cost increases, in particular energy, resins, paper for recycling and transport costs. On energy, our pulp and paper mills generate most of their energy needs internally from biomass, accounting for around 65% of our fuel sources. This mitigates the impact of a significant surge in external fuel costs. Energy costs gradually increased during the first half from the very low levels in 2020 before rising sharply at the end of Q3 as a result of the significant European gas and electricity price increases. The year-on-year increase in energy was about €160 million. Resin and paper for recycling costs increased sharply in the first half and have remained stable at those high levels. The year-on-year increases were around €160 million and €120 million respectively. We are currently seeing cost pressures continuing to rise, particularly wood, chemicals and, of course, energy costs. That said, we do expect to be able to pass these into the markets. The rest of the cost base was well managed, though that was subject to higher maintenance costs due to the longer planned shuts, additional resources to service the extra demand for our products and general inflation applying to most other costs. Currency movements had a net negative impact, mainly already reported in the first half of the year, as a result of the weaker US dollar, coupled with losses on translation from a weaker Russian rouble and Turkish lira relative to the euro.

Turning to the strong cash characteristics of the business now. On the left-hand side, you see last year's closing net debt followed, in green, by the EBITDA of €1.5 billion that we delivered in FY21. Working capital increased on the back of strong revenue growth in the year and some inflow timing of Q4 in the prior year. Absolute working capital as a percentage of revenue was 12.8% in line with our expected range and guidance of 12% to 14%. We have leading market positions in good markets, and we continue to consistently invest behind their potential to deliver value accretive growth.

Our capital expenditure for the period was €573 million. That equates to about 140% of depreciation, and, as you know, we completed the acquisition of Olmuksan, which is delivering well. With net debt of €1,763 million, that leaves us 1.2 times levered at the end of the year, with good strength for us to continue to have optionality. Andrew will cover some of that later in the presentation. In June 2021, we entered into a €750 million revolving credit facility. This is a Sustainability-Linked Loan matching funding strategy with the core business strategy. At the end of the year, the Group had a strong liquidity position of around €1.3 billion. Credit ratings remain unchanged and debt maturity is in good shape, with nothing material due in the short term.

To wrap up the Group part, we can report good numbers, continued opportunities and a strong financial position.

After the year, in mid-February, we agreed to sell our Personal Care Components (PCC) business to Nitto Denko for an enterprise value of €615 million. This simplifies our portfolio and enables us to focus on core packaging and paper businesses and to pursue our strategic priority to grow in sustainable packaging. We expect completion of this in the second half of 2022. A decision regarding the use of the net cash proceeds from the sale of PCC will be taken upon completion. The remaining portion of Engineered Materials, Functional Paper and Films, will be merged into our Flexible Packaging business unit, and this will strengthen integration along the kraft paper value chain, fostering innovation in functional papers.

I just wanted to also take this opportunity to remind you about our disciplined approach to capital allocation. This remains unchanged. Organically, we are focused on growing in packaging through selective capital investment opportunities. Our track record of execution here speaks for itself. We have a strong pipeline of capital investment projects to further capture that growth. Again, Andrew will cover those later. Supporting payments of dividends to shareholders remains important to us, and we are pleased to recommend an increase in the final dividend, up 10%, and we continue to evaluate growth opportunities through selective M&A.
To summarise, we can invest organically, deliver dividends and seize appropriate opportunities in M&A, as well as repatriate cash if surplus. All these decisions on free cashflow are made within the core premise of maintaining our strong and stable financial position and solid investment-grade credit metrics, and you have seen that we have a strong balance sheet.

Let me dive quickly a little deeper business by business. Starting with Corrugated Packaging, this business continues to deliver industry-leading margins and returns. Sales volumes were up in the year, and selling prices were significantly higher, with the effect coming through strongly in the second half. Our capital investment programme and acquisitions completed in the year further contributed to Corrugated Packaging's performance. While 2020 was very much a story of eCommerce demand, in 2021, we saw strong demand across all end uses, particularly eCommerce and FMCG. Pleasingly, containerboard sales volumes were up on the prior year, supported by our broad, high-quality product portfolio. Corrugated solutions volumes grew 13% organically. This was made possible by our backward integration to paper at a time of paper shortages. Ongoing investment in our converting network and our sharp focus on innovative products and services of the highest quality. We implemented price increases across all containerboard grades, leading to higher average selling prices year-on-year, and we were successful in passing on higher input costs through to box prices.

Now, turning to Flexible Packaging. The business achieved good volume growth and successfully implemented price increases to recover significantly higher input cost prices. We saw strong volume growth in end uses, particularly in paper-based shopping and eCommerce bags, as well as consumer applications such as food and pet food, where we have leading market positions. There was also good demand for building materials and from the construction sector during the period.
Kraft paper sales volumes were significantly up on the prior year, notably in our range of speciality kraft papers, where sales volumes have almost doubled over the last three years, benefitting from increasing customer demand for paper-based, sustainable packaging. Paper bags sales volumes were up 9%, with growth across all regions supported by growing demand in new applications. For example, our recyclable, lightweight and flexible MailerBAG for eCommerce now accounts for 3% of our total paper bag volumes.

Prices in the kraft paper value chain were modestly up year-on-year. On the back of continued strong order books and tight market conditions, we have implemented price increases across our range of kraft papers and paper bags at the start of 2022 that reflect prevailing spot prices. Prices today are some 20% to 25% higher than the average for that of 2021.

To remind you, Engineered Materials represents less than 5% of the Group's revenues. Its performance stabilised in 2021. We saw a good recovery in industrial and specialised end uses in Functional Paper and Films, and we completed the restructuring work in Personal Care Components that we initiated at the end of 2020. This business also implemented significant price increases.

In Uncoated Fine Paper, underlying trading performance improved significantly over the course of the year with higher volumes and prices offsetting input costs, particularly energy and transport. EBITDA comparability with 2020 was impacted by a €34 million lower forestry fair value movement in the year and the impact of longer planned maintenance shuts in 2021, with a €30 million effect. If you add those numbers together, the €64 million effect was mainly a second-half effect, and, therefore, you can see clearly from the chart the underlying progress that was made in this business.

Our sales volumes grew 11% in the period. Customers do value us as a supplier of choice while capacity leaves the market due to our excellent customer service, superior cost competitiveness and our financial stability. We have increased our market share in all the key markets where we operate. In Europe, we estimate market demand increased 6% to 7% in the year, showing a good recovery, while our sales volumes in this region grew some 14%. On the back of improving demand and increasing costs, we implemented a series of price increases, most notably in the second half of the year and also earlier in this current year. European benchmark prices today are 20% to 22% higher than the 2021 average.

Let me summarise. We are really pleased with our strong financial performance. Our results have been driven by growing volumes and implementing price increases, which more than offset higher costs. We have successfully executed strategic investments, and the agreed PCC disposal gives us further focus. The Group has a robust balance sheet, providing strategic flexibility to invest and grow in our expanding packaging markets where we have leadership positions. With that, let me hand you back to Andrew, and he will talk about the longer-term strategic view. Thank you.

Andrew King

Thanks very much, Mike. As I said earlier, I would like to come back now to the strategic positioning of the Group and, most importantly, the growth opportunities we see for the business going forward. I will remind you of our track record, how we see the markets developing going forward and why we have the ability to keep winning in these markets and, in turn, how that supports our accelerated investment program. If I step back first, I remind you of the credentials we have for profitable, long-term, value accretive growth. You can see from this slide that we have a great track record of delivery. Over the past decade, we have successfully grown the business on all key profit metrics while, at the same time, driving improved returns on capital. We have done this by systematically investing in our cost advantaged assets and seizing acquisition opportunities at the right value, balancing investment for growth with supporting returns to our shareholders. This has, of course, been facilitated by the very strong cash generation of the business, allowing us to grow without recourse to external funds.

As a consequence of this disciplined capital allocation, coupled with our rigorous and relentless focus on driving operational performance, we have built an industry-leading, integrated, cost advantaged platform. Importantly, also, our early embrace of sustainability has guided and focused our product development and operations over many years. This has insured that as demand for sustainable solutions has increased, our ability to anticipate and respond to customers and the end-user needs have kept us ahead of the game.

Our leadership in sustainability is widely recognised and valued by our customers. Here, you can see I highlight a selection of external benchmarks. I believe I can safely say that no other group in our sector ranks consistently so highly across all these well-regarded rating systems. Of course, as mentioned earlier, we are far from done on our sustainability journey. We are taking the necessary action for the future, guided by our Mondi Action Plan 2030, which is now very much embedded in the business. More recently, you would have seen this includes a commitment to Net-Zero by 2050 with science-based targets to limit global warming below the 1.5°C threshold. Clearly, the urgency around climate change has not diminished as a consequence of the recent crisis in Ukraine.

Our leading market positions that focus on sustainability, the cost advantaged assets that we enjoy and, of course, our culture of continuous improvement have allowed us to consistently deliver strong growth in our key packaging segments, as illustrated on this slide. You will see that this growth has accelerated in the past year, driven in large part by the rapid increase in demand for new sustainable packaging solutions. At the same time, as Mike already talked to you about, the demand for the more traditional products has also recovered following the slowdown during the height of the COVID pandemic.

The security of supply we can offer, given our wide production footprint and our vertical integration, coupled with our focus on innovation, service and quality, has driven growth ahead of the markets in all key segments. Very importantly, the packaging markets we serve do continue to grow. While estimates obviously vary significantly, we do expect to see good, strong structural growth in our two core packaging markets of corrugated and flexibles, underpinned by those key growth drivers of sustainability and eCommerce.

Going to those briefly, looking at the eCommerce-led growth, we do see the rate of growth in demand for eCommerce packaging slowing relative to the very high levels seen in the last few years, mainly as COVID restrictions are lifted and consumers are tending to spend more money on services. However, we still expect to see a clear positive trend, and absolute demand growth will still be material, particularly now that eCommerce is working off a much higher base.

On sustainability, it is very clear that the trend for more sustainable packaging is here to stay. All key stakeholders, from end-customers through our FMCG and other customers to NGOs and regulators, are demanding change. We are seeing a clear acceleration of this trend and are very well placed to capitalise on it, with our unique platform, offering paper where possible and plastic where useful. I will come back again to some of the latest innovation we are seeing in this area in the presentation. Supporting all of this, we have an ambitious expansionary capital investment programme. We have a pipeline of projects already approved or under advanced evaluation amounting to around €1 billion, which we expect will deliver mid-teen returns when in full operation. On this slide, you will see we detail a number of these key projects. Very compelling to me is that the investments are spread across our range of packaging businesses both in terms of product and geography and upstream and downstream, meaning we are not placing undue reliance on any single market or asset. In round terms, we are investing around 50% in each of Corrugated and Flexibles, while the upstream-downstream split is around 60-40.

In Corrugated, we are building on our containerboard capacity by investing in brownfield expansion, in our Kuopio and Świecie mills while we have underway around €185 million in expansion projects across our network of corrugated plants serving the fast-growing markets of Central and Eastern Europe and Turkey. In Flexible Packaging, we are currently in advanced evaluation of a new 200,000 tonne per annum kraft paper machine at one of our cost advantaged locations to serve the growing kraft paper market. Here, we have a clear market-leadership position with very strong vertical integration with our paper bags business.

Similarly, many of the new applications we are seeing for paper-based solutions to displace other forms of less sustainable packaging solutions are using kraft paper products as their base. Linked to this, we see exciting opportunities to grow our functional papers offering to meet our customers' growing demand for innovative, sustainable packaging with the necessary barrier properties, again, using kraft paper as the base. In our Flexibles converting businesses, we continue to expand our leading global paper bag network while also investing to expand our capacity and cement our leading position in the fast-growing European pet food packaging market. With this pipeline of expansion projects, coupled with our ongoing stay-in-business needs, we would expect capital expenditure to be in the region of €700 million to €800 million in 2022 rising to €900 million to €1 billion in 2023. As you can see, this represents a manageable acceleration of our ongoing capital investment programme supporting the growth opportunities that we continue to see in our packaging businesses.

Coming back now then to our innovation focus, I would like to take you through a few recent examples of innovation in sustainable packaging and our three Rs principle of replace, reduce or recycle, using paper where possible and plastic when useful. Here, you will see two fantastic examples of how we are leveraging our unique platform and our capabilities in papermaking, coating and converting to replace unnecessary plastics with recyclable paper-based packaging for Iceland and Les Crudettes. We have developed these solutions to run on our customers' existing packaging lines, avoiding, as a consequence, additional costs. It is important that they provide the same shelf life, preventing food waste, which is also critical for sustainable societies, and in taking action against climate change.

We continue to innovate with customers to develop eCommerce solutions that are easy for the consumer to recycle and enable our consumers businesses to grow. You will see there our fantastically named BCoolBox is on the left-hand side of this slide. It has specially designed internal insulating panels, keeping meals refrigerated for over 24 hours. I would encourage you then to try Tyme Foods, whose ability to expand deliveries beyond the city centres with standard transport, of course, now, without the need for expensive refrigerator trucks. Our customised insert for the ship-in-own-container solution on the right-hand side, as you will see, of the slide, eliminates the need for additional packaging, fits through a letterbox while protecting a product, and it is Amazon Certified Frustration Free packaging.

Clearly, if our paper-based solutions cannot do the job, we believe recyclable flexible packaging is the most resource-efficient alternative due to both its barrier properties and high material efficiency. We help our customers reach their recyclability targets by developing mono-material packaging solutions that are, again, fit for a circular economy. You will see the pouch on the left for Henkel uses 70% less plastic than a rigid bottle and can be a refill for the dispensing container at home, supporting a consumer reuse model. On the right-hand side of the slide, you can see our lightweight, high-barrier solution for a German consumer brand. WalletPack replaces non-recyclable multi-material packaging while reducing plastic by 40%. It is easy to open and reclose and, again, very importantly, prevents food wastage.

Let me then finish by reminding you of the key takeaways. We continue to deliver strongly, evidenced by that strong performance in 2021 across all key financial and sustainability metrics. The strong growth we see in our markets, coupled with our proven ability to win in these markets, opens up further growth opportunities for the business, and we are putting more money behind it. With our accelerated investment programme, including that pipeline of €1 billion in projects, we are delivering strong growth in packaging which is sustainable by design. While we are fully aware of the recent significantly heightened geopolitical and macroeconomic risks, we have the capacity to both manage and finance this investment programme, and we are convinced it is the right thing for the long-term benefit of our stakeholders. With that, I thank you very much and I am happy to turn over to questions and let Mike facilitate.

Questions and Answers

Cole Hathorn, Jefferies

It is Cole Hathorn from Jefferies. Thank you very much for taking the question. Andrew, I would like to focus on the longer-term strategic investments first of all. You talked about 2% to 4% packaging growth. If I went back to 2015 levels, am I right in assuming that this is better growth into the future than in the past due to the structural drivers you talk about and particularly Flexible Packaging? I would like to focus on that. You talk about a potential kraft paper machine and then on the converting side. How would you frame your position in sack and kraft paper and how you are winning in that converting? I think you are the market leader with more than 30% sack kraft capacity and then on the converting side as well. Is this investment so that you get more than your share of paper growth and then, on the converting side, more than your fair share of converting growth as well? Thank you.

Andrew King

Thank you very much, Cole. I think the short answer is yes. We do see an acceleration in the growth in these markets, particularly, as you say, in the flexibles space. I think, historically, particularly in the sack kraft business, you would have seen this was a very low-growth industry focused around traditional industrial applications, cement, building materials and the like. Clearly, we have seen a change in that dynamic over the last few years. As I highlighted in the presentation, a lot of the kraft paper offering goes into a number of these flexible solutions, which are increasingly being used to displace less sustainable packaging solutions. We cite a couple of examples there, but there are numerous such examples from the stretch wrap that is replacing a plastic alternative to, for example, things like the MailerBAG, which is now being used in applications, so displacing plastic wrap in eCommerce. Similarly, kraft paper is being used directly in wrapping eCommerce solutions. I can go on regarding things like that. A simple example is that packaging solution for salad, and things like that simply did not exist two or three years ago. One can often talk about anecdotal evidence of innovation and things. These are really making a big difference now. We highlight, for example, the MailerBAG being 3% of our volume now in paper bags. It was nothing two years ago, so it just illustrates that it is starting to really move the needle, and we are really seeing a huge number of different applications coming for those speciality kraft paper applications, as we see, but also the traditional sack kraft. With all of that in mind, the market is extremely tight. I believe it will continue to be. Obviously, there are always the normal ebbs and flows, but these strong structural drivers are not going away, so, yes, we are very confident when referring to that market growth of 2% to 4%. We think that is the market. We think we can do more than our fair share of that. How do we do that? Certainly on the converting businesses, we continue to invest behind the growth of those businesses. As you would have seen, we have highlighted, for example, our new plant in Colombia. We are doing another one in Morocco as well. We are investing also behind increased capacity in our existing facilities, and we have the biggest global network of paper bag plants of anyone by some distance, so I think that, in itself, puts us in a very strong position.

Again, I come back to the unique platform we have, and, again, I know this is an easy statement to make, but I think it is demonstrably the case that we have the deep knowledge on the kraft paper making. We are the biggest producer of kraft paper grades in the world. We have deep knowledge in what we call the coating applications, making functional barrier properties for that paper where you need additional functionality, and we have the deep knowledge and customer intimacy on the converting, both from our consumer flexibles and our traditional bags businesses. Really, it is about bringing that to bear and giving that offering to our customers. We are very excited by a lot of these opportunities, and, again, we are putting money behind it to make sure we stay ahead of the market on this.

Lars Kjellberg, Credit Suisse

Good morning. Thank you for taking my question. I just need to still ask about Russia. Of course, we are seeing quite a few companies simply pulling down trade lines and exiting Russia for all sorts of reasons. How do you think about Russia in the context of what is going on? I know this is maybe an incredibly unfair and difficult question to respond to, but please provide some colour on that. I have a slightly simpler question. I suppose you, of course, had very strong pricing momentum at exceeding cost in 2021. How should you make us think about that relationship in 2022, especially then considering the big step up you are seeing in kraft paper? In the annual contracts, of course, and uncoated fine, you are seeing strong momentum, and, if you could share some thoughts specifically on that business in terms of the competitive environment considering your cost base is really outstanding versus some of your peers. Those would be my questions. Thank you.

Andrew King

Thank you very much, Lars. As I said in my opening remarks, the situation in Russia is clearly rapidly evolving, highly complex and extremely fluid. We are addressing that on an active basis, actively monitoring the situation and actively reacting to the situation, but, as I said, if we have any further updates to provide, we will provide them as the situation unfolds.

On the issue of price versus cost, it is the perennial debate. Clearly, the cost base is rising, and I think that is not new news to anyone. Everyone who is talking in the industry will be telling you that, and not just our industry but across the industries, but I think, very importantly, as you rightly point out, we have seen good pricing momentum. Why is that? Clearly, the supply-demand balance across our paper offerings has been very strong or very supportive of late. We have seen good price momentum on the containerboard grades. Coming into the start of this year, clearly, pricing is well above where it was, on average, for last year. Similarly, on the kraft paper side, as you rightly point out, because we have some more contractual business in kraft paper, it takes a bit more time for the pricing to come through, but that has come through, as we expected, on the annual business going into 2022. We highlight that the pricing right now is well above the averages for 2021, so, certainly, as we start the new year, we have seen good pricing. Price levels are well-elevated from what they were in 2021, albeit the cost base, clearly, continues to rise.
The biggest imponderable on the cost base right now, as everyone would testify to, is the energy situation. We can talk more about that, but, obviously, it is highly volatile. The good news for us is, as you well know, even though it is an important input cost, and will continue to be so, and of course, you have seen prices rise fivefold for gas in Europe and even beyond that now. It will always impact, but we are also structurally well positioned because we have a lot of own-energy production because, by definition, if you are more of a virgin paper producer, you produce more of your own

energy. As you know, we have been investing heavily for that energy efficiency over a number of years now, and I think that places us in good stead as well, so the cost base, although clearly impacted by the input cost pressures we see, is possibly less so than you might see if we were not so backward-integrated into own-energy production. Yes, as we sit today, pricing is strong, albeit there is still a lot of pressure on the cost base.

Justin Jordan, Exane BNP Paribas

Good morning. I am Justin Jordan from BNP Exane. I have three separate questions. Firstly, sorry, I need to ask a little bit more on Russia. Can you just remind us, firstly, geographically, where you are in Syktyvkar? From memory, you have been there for several decades through periods of economic and political uncertainty. What are the actual products that you make and sell in Russia? Secondly, back to, I suppose, the core business, as it were, can you talk us through the increased capex guidance that you are giving on slide 13 and 14? Within the guidance of 2023 capex, does that explicitly include a decision on the sack kraft additional mill? Is that baked into the guidance as it were, or is that additional potential beyond that?

Thirdly, clearly, you are in the process of realising €615 million from the PCC disposal, which is a fantastic result. Can you talk us through how the Board can think about allocating those proceeds? It gives, clearly, a very strong position to the Group. Refresh our thinking on how we should be thinking about capital allocation going forward.

Mike Powell

Sure. Thanks, Justin. Let me take questions two and three first, and then Andrew can come back. In terms of the capital, the cash capex flows that Andrew talked about do assume that we deploy that expansionary €1 billion of capital to help how that flows out. These are rough numbers because it will change, but I would think of that €1 billion flowing out in cash terms as about €250 million in 2022, about €450 million in 2023 and then the balance flowing out in the years thereafter if that helps.

Okay. You mentioned the sale of the PCC business. I would quite like to complete the deal and get the cash in. You would expect me to say that. Listen, you know how we think of capital. I have been through it again this morning. That has not changed. We will continue to look at that, and we will clearly look at that once the deal is complete.

Andrew King

Yes. Justin, on the Russian situation, Syktyvkar is 1,200-odd kilometres northeast of Moscow, if my geography is correct. It is high and cold. The products out of Syktyvkar in particular are about 550,000 tonnes of uncoated fine paper, 330,000-odd tonnes of white-top products, white-top containerboard, 200,000 tonnes of newsprint and some dry pulp, which is sold into the outside markets. That is the product mix there.

Wade Napier, Avior

Good morning, everyone. It is Wade Napier from Avior Capital. I have a couple of questions, specific on the kraft investment, the 200,000 tonne mill that you are assessing there. Could you just give us a little bit of colour as to the size of the market within Europe or globally? I want to understand what 200,000 looks like relatively. Then, maybe, post-investment, what will your split between commoditised industrial bags versus speciality paper look like? Which mills are you specifically looking at making that investment? I am trying to think where you have excess pulp capacity to accommodate that. I assume you are going to remain integrated vertically post that investment. Then, secondly, just on FX, you recorded an impact of about €60 million this year. Obviously, the rouble has blown out of it. At spot prices, how should we think about that impacting the Group in 2022? Thank you very much.

Mike Powell

Thanks, Wade. Just to cover off the FX, if you sat here today and worked out the rouble and other currencies, we are probably looking at something around a €70 million hit. Most of that is clearly rouble denominated. That is fairly volatile as you have seen.

Andrew King

Yes. Then, just coming back onto the kraft paper machine that we are looking at, to put it in context, we produce about 1.2 million tonnes of kraft paper grades. In round terms, it is about 900,000 tonnes of sack kraft and 300,000 tonnes of what we call specialities, with the specialities growing rapidly. Now, in certain facilities, we have the capability to move between the speciality and the sack kraft, so, as the different markets develop, we are able to manoeuvre between them, and that is a real strength of ours because we have a portfolio of assets within kraft paper, which, again, makes us unique in the market. The concept here is about 200,000 tonnes of incremental sack kraft capacity, but that does allow us in some of our other facilities to look at increasing the speciality component, so I would think, in rough terms, we would look at about, on a full incremental basis, probably half of it being sack kraft and the other half being, essentially, specialities as we develop into those speciality markets. That is because, as I said earlier, a lot of these speciality kraft papers are what is being used in these consumer applications, and that is obviously where we see a lot of growth, but we are seeing a lot of growth also in the traditional sack kraft applications.

We have an extremely strong downstream presence, as you well know. That is growing rapidly. You saw the growth rates of last year, and we continue to see growth, so we can forward-integrate, frankly, most of this tonnage, but we also have an outside market that we see big opportunities for selling into. Yes, it is a strongly growing segment for us. We are the best positioned to deliver into that segment. In terms of overall market size, the addressable global market is always hard to define because there are a number of kraft paper grades that are separately defined, but I would say it is an 8 million tonne market if you take the total kraft paper segment, so we are certainly confident that this is paper that is much needed in this growing market and can be easily absorbed.

In terms of mills, finally, we are looking across our mill network. We have, again, the luxury of a lot of low-cost operations that have low-cost pulp production and also the capability for expansion, so we are assessing that. The good news is we have options around that and we are refining all that. As soon as we have that refined, we will be making a final decision on it.

Brian Morgan, RMB Morgan Stanley

Thank you very much, guys. Sorry. I am going to beat this one a little bit more on the kraft paper. Would you expect it to be a virgin or recycled feedstock or a combination of both? Then, also, could you chat to us on the margins? Obviously, do not give us numbers, because you won't, but just help us to frame our thoughts. Is the speciality a materially higher margin than the commodity sack kraft side of things? That is one question on kraft paper. The second one is on energy costs. Can you give us a number for 2021? I cannot see it in the release anywhere on total energy costs and what you would expect that to be in 2022 if you were to mark spot for the rest of the year.

Mike Powell

Yes, sure. Brian, again, let me take the energy question first. The energy costs in 2021 were around €500 million. It depends what hour you look at the forward spot, but, to try to be helpful, I think you could probably add on €250 million or €300 million to that. Again, I would just balance that with what we have also said, which is, of course, the selling price environment, so, of course, if that passes through, we still remain confident of passing those costs through, either through price increases already established, or if the market takes further cost increases then I am sure the market prices will also move across the industry to adjust.

Andrew King

Yes, Brian. On the kraft paper and the feedstock, again, we have the luxury as a business of having a great portfolio here, so we do have some kraft paper grades that do have some recycled content. For example, our EcoVantage product, which, I remind you, is the product we invested in at the beginning of this year with that expansion in our Štětí machine to be producing a product for particularly the paper bag, the retail bag, market. That is sold out because, clearly, there is huge demand for that, driven by both regulation and, of course, consumer preferences. That does have some recycled content, but, typically, with kraft papers, our real strength is in the strength of our paper, which is driven by virgin pulp utilisation, so the higher-strength kraft paper offerings, typically, are largely virgin-pulp-based, and that is where we see our real strengths. Where you see a lot of these applications, for example, with that stretch wrap product and things, what you really need is high-strength properties, and that is what the market is looking for, for these types of applications, and we think we are extremely well positioned. The long and the short of it is this new capacity would be virgin-based, but we also have some capacity across the Group that does have some recycled content as required for different applications.

In terms of the margins, it is a gross generalisation to say speciality is better than sack kraft because it depends a lot on the configuration of the assets that you are using and the markets that you serve. We believe all our kraft paper offering is nicely profitable.

James Twyman, Prescient Securities

Thank you very much. I have three questions. The first one is on wood costs. It sounds as though it was low single-digit increases last year. Could you give some idea about whether it is similar again? In terms of the presentation, it sounded like it may be picking up a little bit. Secondly, in the engineered plastic products business, could you talk about what you actually have left there? It is still quite a decent-sized business. Why do you think that those businesses are going to be core to the Group in future when they obviously were not part of the Flexibles business when you did change the divisional structure before? The final one is, if you do not mind, on Russia. There are some companies that have said that they are going to stop supplying paper, chemicals and other products to Russia. Just based on the facts as we see them now, in terms of what companies have said, going forward, to you, can you continue operating under that scenario? Obviously, things will change in the future, but just based on what we have seen so far. Thank you.

Mike Powell

Thanks, James. Yes, let me comment on wood. Yes, wood prices were fairly benign and flat last year. They have increased through very back end of last year and into early this year, so we would expect wood to increase, particularly around the Central Europe and Eastern Europe area, so we are expecting increased wood prices there. I think, as to the scale of that, time will tell, but I do not think they will be low single-digit. They will be higher than that. Clearly, forecasting that forward becomes quite difficult, but, again, in terms of our ability to pass those through, we remain pretty confident on that, but we will see increased wood prices, we believe.

Andrew King

Yes, James. On the issue of what is left after the disposal of PCC, what is left is a very important business for us, which is our Functional Paper and Films business. It was in a different business unit to Flexibles, but that does not mean that there is not significant interaction and integration benefits between the two. Frankly, it fits more logically as part of the Flexibles value chain because, effectively, what they do is use a lot of the kraft paper grades, which they then coat with different applications to provide additional barrier protection properties, which then, in turn, can be used either in our consumer packaging applications or a number of other industrial applications and the like. When we talk about leveraging that unique platform, I see this as a core part of that because this is really the interlinkage between the paper businesses and the converting businesses providing that extra barrier functionality, which allows us to make a number of those products that we showed earlier. I think there are a lot of exciting opportunities around this because, where you see the need to replace plastic by paper solutions, invariably, you need to add barrier properties to that paper. That is exactly what this business does, and we are looking to put more money behind it.

I mentioned in the presentation that we are looking to invest further in that functional paper and films area to deliver more of these functional barrier papers, so I think there are a lot of exciting opportunities that that business brings for us. It fits very well in our flexibles offering, and we are looking to increase the integration of that business into our overall flexibles offering. Finally, on Russia, we are operational as we sit today. We are not unaware of all the complexities around all of that, but, as of today, we are fully operational.

Sean Ungerer, Chronux

Good morning, guys. Thank you for the time. I have a couple of questions, and please excuse me with the first one as it is perhaps a bit silly. In terms of the PCC disposal, barring formalities, can we confirm that that is pretty much going to 100% take place in H2 and hence receive the proceeds on that basis? It is quite a nice hefty capex and obviously quite encouraging in terms of your plans for the next two years. In your capex assumptions, what have your assumptions been around Russia in formulating that? Obviously, the balance sheet, at the moment, is very strong. If you get the proceeds, it is going to be even stronger, and you can pretty much assume, if you had zero cashflow out of Russia, the balance sheet would be fine, so I would be interested to hear if you can give us any insights on that.
Going back to Russia, just from an operational perspective, obviously, at the moment, you have enough raw materials etc, but, in terms of actually making cash payments, receiving cash and exporting at the moment, could you comment around that? That it from my side. Thanks.

Mike Powell

Sure. Thanks, Sean. On PCC, the deal is subject to normal customary closing conditions. We will work through those, and, as I say, we expect to close that in the second half of 2022.

Andrew King

Yes. On the question around capex and the Russian assumptions, firstly, obviously, this €1 billion of capex pipeline, as you will see, is spread geographically. None of it incorporates our Russian position, but, in terms of funding requirements, we believe we are well funded as a group and we have the capacity and it is the right thing to be doing to continue to support long-term growth of the business. In terms of the Russian exports, again, I can only reiterate what I said earlier. It is a fluid situation and we continue to operate as of today.

Mike Powell

Okay. Thank you very much. It is great to be physically back with everybody and meet people. If we have not been able to get to your question, apologies for that, but Clara, myself and Andrew are available, as ever, to take your questions. Thanks very much for this morning and your support.

ENDS