Half year 2022 results

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Transcript

Presenters

Andrew King, Group CEO

Mike Powell, Group CFO

Q&A Participants

Joffrey Bellicha Meller, Bank of America

Lars Kjellberg, Credit Suisse

Cole Hathorn, Jefferies

James Twyman, Prescient Securities

Justin Jordan, Exane BNP Paribas

David O'Brien, Goodbody

Andrew King, Group CEO

Good morning all, and welcome from my side to the Mondi 2022 half year results presentation. I'm going to provide some highlights of the half year before passing on to Mike for an overview of our financial performance. I'll then take you through an overview of the operating performance before finishing with an update on our strategic positioning. After that, Mike and I look forward to taking your questions.

The first half can be summarised as one in which we delivered very strongly across the business, while accelerating delivery on our growth ambitions in sustainable packaging. Importantly, we enjoy a strong financial position, providing the strategic flexibility to fully leverage the exciting growth opportunities available to the Group. This was achieved against a very challenging backdrop and is testament to the strength of our operating model, the resilience of the markets in which we operate, and our people, who I must once again thank for their commitment, agility, endurance and, frankly, sheer tenacity through these turbulent times.

The world continues to adjust to the effects of the pandemic, evidenced by ongoing major supply chain challenges, volatile demand and significant inflationary pressures. This has of course been exacerbated by the war in Ukraine and various knock-on impacts, not least on our people who live and work in the region, but also, of course, on the cost and availability of key inputs in our European operations, such as energy and wood.

On Ukraine, I would like to once again express our concern for the ongoing war in the country and the far-reaching humanitarian impact. We sincerely hope for a peaceful resolution.

In response to the war, you will recall that we announced on 4 May that we are looking to divest all our interests in Russia. As mentioned at the time, it is a complex process undertaken in a fast-moving political and regulatory environment. I can confirm that the process is well underway, and we will keep the market updated on all major developments. You'll note that we have classified the Russian assets as discontinued operations held for sale in the half-year accounts. Unless indicated otherwise, our commentary in the rest of the presentation will focus on our continuing operations. Mike will provide more detail, but a key message is that even without the contribution from our Russian operations, the group is in a robust financial position.

We also continue to make good progress in investing for future growth, focused very much on the structurally growing, sustainable packaging markets that we serve. I'll provide some more detail later in the presentation, but suffice to say that we are on track in executing on the €1 billion of expansionary projects we have in the pipeline. Excitingly, we also see continued opportunity to develop innovative new solutions centred around our customers' demands for more sustainable packaging solutions. Again, I'll come back to some of our recent successes later in the presentation. I'll now hand over to Mike to take us through the financial performance in some more detail. Over to you, Mike.

Mike Powell, Group CFO

Thanks Andrew and morning everybody. I'm delighted to take you through the Group results for the first half of 2022. Those that have had a chance to look at the release will have noticed the changes in our accounts, reflecting our business decisions, separating out Russia, and showing the sale of the Personal Care Components business. Let me start with the total group, including Russia, and that's really simulating the old basis, if you like, but not numbers that you'll see in the primary accounts, and then I'll walk you through the changes.

As Andrew has said, strong numbers under any metric, with EBITDA up 65% to €1.17 billion, and that increase flowing through into material increases in EPS and return on capital employed. This slide is continuing operations, so now excluding Russia, and matching the numbers in the release, which you can see reflects our strong performance in the first half. Underlying EBITDA is up 66% at €942 million, with material increases in EPS and return on capital employed, and clearly gives us a strong platform for growth going forward, and, as you'll see later, a balance sheet at less than 1x levered.

The next two slides are a little techy, I'm afraid, but I do want to take you through the accounting changes before I come back to the business performance. Let's take Russia first. As you know, the Board made the decision to exit Russia on 4 May, and as a consequence the accounting reflects that. For the income statement and cash flow we've separated Russia into discontinued operations. The continuing group is imaginatively therefore called continuing operations. Not only do we separate continuing and discontinued for the current accounting period, but we also do it for the prior period, and hence we restate those prior year numbers. The balance sheet shows Russia in two lines, assets held for sale and liabilities held for sale. However, under the accounting standards you do not restate the balance sheet for previous periods.

Let me then come onto Personal Care Components. You will remember within the Engineered Materials business unit there were two business segments, being PCC – the Personal Care Components business – and the Functional Paper and Films business. Following the sale of PCC on 30 June, we've moved the Functional Paper and Films business into Flexible Packaging. PCC is shown separate as a disposed business, and the Engineered Materials division therefore no longer exists, leaving us with our three business units of Corrugated Packaging, Flexible Packaging and Uncoated Fine Paper.

Those are lots of words but let me try to turn that with some real numbers. The top row, which you won't see in the accounts just released, is as if we had done the reporting on the old basis. Row two moves the Functional Paper and Films business from the Engineered Materials column into the Flexible Packaging column, and you can see the €35 million moving. On this row you also see the balance, being Personal Care Components EBITDA of €1 million moved into a disposed operation, meaning that Engineered Materials no longer exists.

The next row moves Russia out of Corrugated Packaging, Flexible Packaging and Uncoated Fine Paper into discontinued operations held for sale. As we have previously stated, about two-thirds of the Russian business's EBITDA was in UFP, and one-third in Corrugated Packaging. That leaves the underlying EBITDA of Corrugated Packaging at €375 million, Flexible Packaging at €416 million, and Uncoated Fine Paper at €171 million. Those business units, along with the disposed PCC business and corporate costs, add to the €942 million in the accounts. The only other thing to note on the bottom right of the slide, is that now Russia is a discontinued operation. Under the accounting standards, discontinued operations only get shown as a one-liner in the income statement, so you don't actually see the EBITDA of €228 million, but you will see it post-tax as €148 million as a one-liner at the bottom of the income statement.

That's enough about the accounting transitions. Everything I'm going to talk about from here on in relates to continuing operations only, and I'm really pleased that we're showing margin expansion and delivering strong results. Let me walk you through this EBITDA bridge from last year's €566 million to the €942 million, and that's a 66% increase in the first half. Andrew will give you more colour by business unit in a minute, but it's pretty evident we've increased prices in a timely manner in all of our business units across all products, and these increases more than offset costs.

Input costs continue to be significantly up across the board, and supply chain disruptions continue to be a challenge. Wood markets tightened, impacting both costs and availability, driven by increased demand for firewood as an alternative source to fossil fuels, and reduced supply due to less calamity wood on the market and the impact of sanctions on Russian and Belarusian timber.

Energy costs remain volatile. A reminder that our pulp and paper mills generate most of their energy needs internally. Biomass sources now account for 80% of the fuels used in this process, and we therefore only have approximately 10% of our fuel consumption as natural gas, meaning we're structurally hedged to a large extent. That said, we are of course seeing increased energy costs, and we're passing those on.

In terms of energy availability, some of our operations, particularly in Central Europe, are reliant on continued gas supply, and we continue to actively monitor the supply situation, whilst of course investing to diversify our fuel sources, drive self-sufficiency further, and energy efficiency. We do expect continued inflationary pressures on our cost base in the second half, mainly due to the higher wood and energy costs in Central and Eastern Europe, along with higher transportation and chemical costs. There's also no real evidence of supply chains returning to normal until next year.

Whilst underlying volumes were slightly up, we did have our Merebank, South African facility flooded due to the unprecedented rainfall at the end of the first quarter, and hence, along with the declines in the PCC business, you see the volume number here at €33 million down. The only other thing to point out on this chart – it's great to see the Olmuksan acquisition continuing to deliver ahead of expectations, with some super work by the team in Turkey.

Let me move to the strong cash characteristics of the business. On the left-hand side in purple you see the restated opening net debt of around €1.7 billion, and on the right-hand side in green the closing net debt of €1.2 billion. You can see how we made the progress, with the strong cash earnings of the business we've talked about, being the €942 million, and the usual seasonal working capital increase of approximately €400 million. Absolute working capital as a percentage of revenue was 14.5%. That's actually down on last year's 15% at the same time, and I'd expect the second half to come in a bit better than that, in line with our usual guidance of 12% to 14% of revenue.

We continue to invest in our leading market positions in sustainable packaging to deliver value accretive growth, and our capital expenditure during the period was approximately €250 million. For the full year, I'd expect capital expenditure of €500 million to €600 million, above our depreciation of €400 million, and that's testament to our continued investment in the business. Finance and tax cash costs were generally in line, though with the increased interest rate environment, finance costs did increase, mainly driven by interest rates in the Czech Republic and Poland, where we have seen material increase in interest rates. For the full year, we expect net finance costs to be in the region of €140 million. With the PCC sale netting €646 million, we ended the period with €1.2 billion of net debt and 0.8x levered. We have around €1.6 billion of liquidity, and no material short-term debt maturities.

Our capital allocation framework and discipline has not changed. We acknowledge that we have a strong balance sheet – as I said, 0.8x levered going into the second half – and we will continue to follow the long-established framework. You're aware we're investing over €1 billion of capital into organically growing our packaging businesses, with a great track record of execution. You've seen the dividend policy of two to three times cover being applied consistently, and at half year, we followed our normal mechanical process, being a third of last year's total dividend, representing an increase of 8%. M&A opportunities in line with core strategy continue to be evaluated. Opportunities may well increase if more tricky economic climates lie ahead, and, as ever, if we believe we should distribute capital back to shareholders we will do so on a timely basis.

So let me wrap up. We have financial strength and strategic optionality, whilst continuing to deliver results and supporting our customers with sustainable packaging and paper solutions. With that, let me hand back to you, Andrew.

Andrew King

Many thanks, Mike. I'll provide some detail on the business units before going on to some comments on our strategic positioning. If we go first to Corrugated, we've clearly delivered very strongly, with EBITDA up 72% on the back of these significantly higher prices and volume gains, which more than compensated for the rising cost base. I was particularly pleased to see the solid contribution from Mondi Olmuksan, as mentioned by Mike, which we acquired in May 2021. While Turkey clearly remains a volatile market, we firmly believe in the strong structural dynamics underpinning growth.

Volume growth in the containerboard business was supported by the ramp-up of production from our kraft top white machine in Slovakia, and in the downstream Corrugated Solutions business, we have seen somewhat softer demand in Central Europe and particularly Turkey, when compared to the very strong volume growth of the prior year. While our eCommerce volumes continue to show good growth, we have seen lower demand in other end uses impacted by the macroeconomic slowdown, and our customer logistics and supply chain challenges.

Pricing has been very strong across all product categories, with the containerboard price increases successfully passed on through box prices. Pricing going into the second half is stable, supported by a sharply higher and steeper cost curve. Even though selling prices are at all-time highs, it is clear that industry margins do not reflect the same due to the material change to the cost curve. We remain very much excited by the structural growth drivers of eCommerce and sustainability, and are working hard to develop innovative solutions for our customers.

In Flexible Packaging we also delivered a very good performance, achieving very strong price increases and good volume growth, which more than offset a sharply rising cost base. We saw volume growth across all major categories, supported by very strong innovation in new products centred around sustainable packaging, coupled also with growth in eCommerce applications. We remain excited by the number of new demand sources we are seeing for our products as we leverage our unique platform, under the mantra of 'paper when possible, plastic where useful'.

Significant price increases were implemented across our paper value chain during the period on the back of the very tight markets, the most recent of which was implemented early in the second half. In Uncoated Fine Paper, we saw a very good recovery in performance after a difficult 2021, on strong pricing momentum coupled with an improving operating performance. In Europe, with solid demand, the capacity reductions we have seen in the market and cost support, we have been able to successfully implement a series of price increases across all grades.

While we continue to plan for long-term structural decline in demand, as a group we are benefiting from being a supplier of choice as other players leave the industry. It should be noted that our European Uncoated Fine Paper operations are particularly exposed to the current tightness in wood markets and the ongoing pressure on gas prices mentioned earlier by Mike.

In South Africa we successfully completed the commissioning of the rebuilt recovery boiler at Richards Bay. We saw the mill down for the whole of Q4 2021 and also into the early part of 2022. The half was, though, affected by major flooding at our Merebank mill in April, affecting production for most of the second quarter. The team there has done a fantastic job in getting things up and running again, and we're currently ramping up deliveries.

If I then go on to how we are delivering on our strategy and positioning the business for further sustainable value accretive growth, I'd like to first just look at some of the key strategic initiatives undertaken during the period. Our focus for growth remains on delivering sustainable packaging solutions for our customers. We continue to see a real demand for innovative packaging solutions that support their environmental goals.

While there's naturally some talk that people's priorities are changing when faced by things such as the heightened energy security risks and the sharply escalating cost of living, I'm a firm believer that the drive for more sustainable packaging solutions is a long-term trend that is here to stay. We continue to invest in our unique platform to support growth in sustainable packaging and to drive innovation in support of our customers' needs.

We're very pleased to have completed the sale of our PCC business at the end of June. This is an important strategic step for us, as it sharpens the focus of the Group on our core packaging and paper offerings. At the same time, as mentioned by Mike, we moved our Functional Paper and Films business into Flexible Packaging, aligning our organisational structure with the value chain, and facilitating optimisation of our unique platform in flexibles. I remind you we enjoy full integration from paper through functional papers and into converted flexible packaging. Many of the exciting new innovations we are seeing in sustainable packaging are coming from this platform.

We see our two packaging verticals of Corrugated and Flexibles as offering very exciting opportunities for growth. We will continue to actively pursue such opportunities, both organically and potentially inorganically, in these segments. In Uncoated Fine Paper post the divestment of Russia, we will be focused in two regional markets, Central Europe and South Africa, where we have both very strong assets and leading market positions. As indicated before, most of the assets underpinning our Uncoated Fine Paper business are also mixed use, in that they produce products in strongly growing segments, for example containerboard and pulp in our Richards Bay mill in South Africa, and containerboard and kraft paper at Ružomberok in Slovakia. We continue to optimise these key assets, with the current focus being the ongoing ramp up of our containerboard capacity with the new machine in Ružomberok, and the continuing modernisation programme at Richards Bay. As you can see on the slide, excluding Russia, around 82% of our earnings come from our structurally growing packaging segments, and around 18% from Uncoated Fine Paper.

Something we are naturally very proud of is our longstanding focus and leadership in sustainability, which is widely recognised and valued by both our customers and other stakeholders. We've highlighted on this slide a selection of the leading external ratings benchmarks, where we are consistently rated amongst the best in our sector and beyond. Of course, more importantly, 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 well embedded in the business. I remind you that this framework is centred around the three key areas where we believe we can have the most impact: circular driven solutions, created by empowered people, taking action on climate.

I'll now take you through some examples of how we are helping our customers transition to more sustainable packaging. Here you'll see a fantastic example of the versatility of corrugated packaging. I showed you last year how it can be used to protect boilers, and now we have a 100% recyclable solution for a leading global TV producer. It replaces polystyrene inserts, maintaining the same high-protection capabilities and saving space. Not only does it deliver transport efficiency, our solution also replaces around two tonnes of polystyrene per annum only for this customer for this particular application.

Here you see some fantastic examples of how we're leveraging our unique platform and our capabilities in paper making, coating and conversion to replace unnecessary plastic with recyclable paper-based packaging. We have developed these solutions together with our packing machinery suppliers, which means that while volumes are still small today, once a customer switches from existing machinery to this one, it will drive long-term demand for our paper products.

On the left you'll see a recycled coated paper for eCommerce applications, which enables the retailer to automate packaging to fit the size of the item being shipped. The solution has excellent runnability, and protects against water vapour and moisture, while also using resources efficiently and being 100% recyclable. On the right you'll see a 100% paper-based, 100% Mondi product replacing shrink film in the packaging of PET bottles. The top clip is a corrugated solution. The banderole – or sleeve – is made of our super-strong tear-resistant paper. The solution has a 50% lower carbon footprint than the plastic alternative, and we're working with other beverage customers on similar paper-based packaging.

Finally, our fit-for-purpose recyclable flexible packaging. On the left you see an innovation from Essity and Dow to increase post-consumer recycled plastic and add bio-based polymers. This contributes to a more circular economy, where plastic can be given a new life and recycled into new solutions. On the right of the slide you'll see our fully recyclable retort pouch, which replaces complex structures, often including aluminium. With this excellent barrier providing a long shelf life, the circular solution again helps to prevent food waste. We are very proud to have been recognised with a Swiss Packaging Institute Innovation Award for this product.

As already mentioned, we continue to invest behind the growth we see in sustainable packaging. We highlighted earlier this year that we have an expansionary capital investment pipeline of over €1 billion. I emphasise that this programme is unaffected by events in Russia. None of the identified growth projects were located in Russia, and similarly we have the financial and management capacity to continue pursuing this exciting growth programme. Furthermore, the markets that we serve and the asset base we can leverage allows us to explore further opportunities for value accretive growth.

To remind you of the major projects currently in progress, in Corrugated we have a strong mix of projects in our upstream businesses, with around €220 million allocated to the expansion of containerboard capacity at our low-cost operations in Poland and Finland, and downstream, with €185 million being invested in expanding our corrugated capabilities across a number of sites. All are progressing according to plan.

In Flexibles we are working on investments covering all aspects of our business. In upstream kraft paper, we are in advanced evaluation of a new circa €350 million, 200,000 tonne kraft paper machine at our low-cost mill in Štětí, which is our flagship operation in kraft paper. Here we have a clear market leadership position, with very strong vertical integration with our paper bags business. Furthermore, many of the new applications we are seeing – and we illustrated some of those earlier – are for paper-based solutions to displace other forms of less sustainable packaging using these kraft paper products. We expect to be in a position to make a final decision on this project during the second half of the year.

Importantly, we also continue to expand our downstream offering, with ongoing investment in our leading global paper bags network, expansion of our capacity in pet food packaging, where we enjoy a market leadership position, and growing our offering in functional barrier papers, which is a key area of growth, addressing the need for fully recyclable, paper-based packaging with appropriate barrier properties to replace plastic alternatives.

Let me finish, then, by reminding you of our key takeaways. We continue to deliver strongly across all businesses, evidenced by the significant margin expansion and EBITDA growth achieved in the first half. We remain focused on the structurally growing sustainable packaging markets that we serve, leveraging our unique platform with an ambitious pipeline of growth projects. Finally, we have the financial flexibility and depth of knowledge and experience to support this growth agenda. With that summary, I'll hand you back to Mike to start the Q&A.

Questions and Answers

Mike Powell

Thanks, Andrew. I can see we have the first question from Joffrey from Bank of America.

Joffrey Bellicha Meller, Bank of America

Morning everyone. Thanks for taking my question. The first question I have is on the use of proceeds from the PCC divestment. How is your thought process developing there? I think some of the investors were expecting some form of announcement after the divestment or at the moment of the H1 earnings. Are you waiting for the Russian divestment to happen before announcing anything?

Mike Powell

Thanks Joffrey. Joffrey, I've covered the capital allocation framework, which has been longstanding. As I've said in the past, we don't follow event-driven things. We follow our long-established capital framework. That's pretty clear. We've got the order in which we think, which is if we've got opportunities to deploy capital into the organic business we'll do so, and we're doing so. Andrew has just talked about that, and clearly, we continue to look at further opportunities in our core markets there.

We've talked about the dividend and the good increase there, and getting good cover on the dividend, and then I've talked about M&A opportunities. Those may increase as the economic climate changes. We've always said if we have surplus capital, we will not sit on it, and therefore I think you should expect us to follow that framework. I think if you look back in time where we've had surplus capital, there's good evidence that that's returned. I think at the moment we clearly are continuing to look at that framework and the opportunities that the business presents for the markets that we have. Do you have any further questions, Joffrey, or was that your only question?

Joffrey Bellicha Meller

No, I have a few more. Could you just remind us what is the share of sales from the Group towards Germany, and update us on your energy costs? I remember at the full-year results you were giving us a new number for energy cost year-on-year increases. Do you have any update there?

Mike Powell

In terms of energy, we can separate energy out, for sure. I think at the beginning of the year I said it would be about €800 million. Who knows where the energy price will go? On today's spot prices, could that be up to €950 million, €1 billion? For sure.

I think the important thing to think, as we do for energy, is firstly the self-sufficiency that we have, which I've covered in terms of the 80% biomass and that we're only exposed, probably, for about 10% on natural gas. Being at the right point on the cost curve's really important, because of course, given where we are in the lower quartiles, if you're in the lower quartiles you are better placed.

The last point I'd make on energy, as you think about it, is it clearly doesn't exist just on its own as a cost. We've managed to pass that on to the customers and work with our customers, and therefore there's a sales price effect. I know you try to isolate energy as an individual cost, but there's a number of things that surround it.

Andrew King

Joffrey, on your question on Germany I assume that's linked into this energy question. You can see disclosed in our segmental reporting that I think Germany accounted for about 10% of our revenue by location of production in the first half. If I recall, that includes particularly the Gronau asset that we sold as part of the PCC business, so you'll naturally see that go down. That was the single biggest production site we had in Germany. We do have some other converting operations in Germany. No paper mills in Germany, but off the top of my head I don't know what the turnover will go down to in Germany, excluding the PCC business, which obviously you have to do going forward, but it'll be materially lower, I expect, because Germany was the major hub of production for our PCC business, which, as you know, we disposed of at the half year.

Lars Kjellberg, Credit Suisse

On cost inflation and pricing, as you mentioned, there's been meaningful pricing increases. Going forward, as things seems to be stabilising a bit – containerboard prices, you had a price increase in kraft, I guess, and uncoated, we'll see what happens – but how do you see this going forward? Clearly you've been very successful in passing on those costs to price. On demand trends it would be interesting to hear what you are seeing. You talked about some slowing in box volumes in particular in certain markets such as Turkey, but also on the kraft paper side, the more industrial part of it.

If we can comment a bit on the structural growth drivers that you have in your business that, as you said, Andrew, you're excited about, how should we view that as an offset to some of these cyclical potential negatives, i.e. where do you see structural growth as a driver for your business in terms of a percent in volumes or however you want to frame it?

Andrew King

Thanks, Lars. I think any predictions of the future at the moment are somewhat fraught. I think we're all speculating on how the macroeconomic situation will evolve.

Clearly, we're in a somewhat – well, not unprecedented, but we're in a phase of the world which we forgot about. When we're seeing a lot of inflation we're obviously seeing a rising interest rate environment and the knock-on effects on consumer confidence and the like. I think it's extremely difficult to predict, and we state that – these are not just words, but the macroeconomic uncertainty mixed with the geopolitical uncertainties makes any views of the future very, very difficult.

As we said, on the pricing front, clearly we go into the second half with good pricing levels. Clearly they're above the average for the first half, but it's just by virtue of the fact that we've got a sequence of price increases through the first half. In that kraft paper business, as you know, you have a lot of business which is done semi-annually or some still annually, and so it was important at the half-year with the price increases there, which came through strongly.

On the fine paper side there's also been a series of price increases. As I mentioned in my commentary, I think it is important to note that while prices are at all-time highs, so is the cost curve more generally. As we know, the cost curve for all products has risen, and I believe it's also steepened, because clearly the more unintegrated producers – the ones who don't produce their own energy in particular – have seen an exponential rise in their cost base. I think that's what's playing out right now, so even though we're seeing a slightly softer demand environment across the piece, pricing is holding up simply because the top end of the cost curve cannot afford price reductions. We're seeing that play out, as you well know, with all these closures and the like in containerboard, or the recycled grades in particular, who are most exposed to the energy. I suspect that will play out in other areas as well.

We are in the fortunate position, as you know – as Mike alluded to earlier – of being significantly self-sufficient in energy. It doesn't mean it doesn't hurt when the energy price goes up, because even with 10% of our energy coming from gas, it's still going up, and the related electricity prices are also going up. It does impact in absolute terms, but clearly not as much as it might impact others. I think there is a lot of cost support at the top end of the cost curve for pricing even in a softer demand environment, which one could expect in a recessionary environment, if that is indeed what plays out.

But as you rightly say, in terms of the structural drivers, clearly we are – and continue to see – the eCommerce effect. We mentioned that our Corrugated business volumes are down on a like-for-like basis. They were up in absolute terms because of the Olmuksan acquisition, and frankly I think that also slightly muddies things a bit, because it's dangerous to look at these things in total isolation even though one does it for analytical purposes, but you don't run the business in that sense, because we've owned it for a year now.

Where we've seen end-use applications moving, eCommerce remains growing, which is good, clearly not at the same rate it was growing. The FMCG applications have come off to some extent, but are somewhat defensive. I think on the industrial side a lot of it's to do with supply chain issues with our customers who are struggling, but generally speaking, it's still a defensive sector, per se. More importantly, I think there are – as you rightly point out – additional applications being developed on the whole sustainability front as well. We showed you a great example there where we're displacing polystyrene. There's numerous such examples. It's very difficult to put a number on this, but on a through-cycle basis that's worth at least one percentage point, I would say, on growth relative to what it would be otherwise.

I think more excitingly for me as well is in the flexibles sector, where eCommerce is a nascent trend. It was later to the eCommerce effects. We're now using more and more MailerBAGs, which are displacing other forms of eCommerce packaging, mainly plastic wrap and the like. You saw where we are developing with our customers, where you can put – effectively fill eCommerce products on an in-line basis, which means that the packaging is more customised to the product, which is clearly addressing one of the major frustrations of customers of eCommerce businesses, which is that the packaging's always too big for the product. A lot of our flexible packaging offering actually addresses that very well, so we're very excited about that.

The whole sustainability trend more generally – we alluded to some of the examples there – still remains a very key driver here. One has to assume in the very short term if people are more worried about cost of living then you might see a slowdown at the lower end of the market, because people are fixating more on cost than on sustainability, which is unfortunate, but I think it's a natural occurrence in a downturn. But, at the same time, I believe those structural trends around sustainability are very entrenched, and if anything, at the high end of the market your customers will differentiate with their packaging around the sustainability topic, and certainly we see no reduction in the lack of urgency amongst our customers to drive for more sustainable packaging. Again, I think that's worth at least one to two percentage points of growth on top of the growth without those new structural drivers that we see.

Yeah, we are very clear that those structural drivers are here to stay. In the short term if there's some sort of cyclical downturn because of recessionary outcomes in macro, of course that affects things in terms of overall slowdown, but it's certainly not going to impact the structural drivers we see. A longwinded answer, but I think very important in the context of the current market.

Lars Kjellberg

Just one clarification point. I appreciate the cost support you have, of course, for pricing, but my question was really about the incremental. Do you see prices following higher costs into H2? That was really my question.

Andrew King

Yeah, I think that's extremely difficult to speculate on right now. We've just got a series of price increases into the beginning of the second half, so I think it's too soon to say where next.

Cole Hathorn, Jefferies

Just following up on the energy position here, can I just get a better understanding? You've pulled out 10% of your energy needs from gas, so I'm just trying to understand how your different divisions will operate. I imagine your packaging businesses are predominantly biomass, and if worst comes to worst they would continue to be able to operate and it would more likely be your Uncoated Fine Paper business that's exposed to gas, as you pulled out, so just some colour on how you're managing the business in case there's a worst-case scenario.

Secondly, on order books and what you're seeing on the demand front by division, I'm just trying to understand how your order books have shifted in Corrugated Packaging as well as your Flexible Packaging business.

Finally, on Russia you've given a lot of new disclosure that everyone's digging through at the moment, but classifying it as held for sale there's a certain level of expectation that it'll be sold within 12 months. Should we read this as you're in a better position than we thought at the beginning of the year to be able to classify it as held for sale?

Mike Powell

Thanks, Cole. Why don't I start with your last point on Russia, and then I'll pass over to Andrew, who can build on it and move on to other questions. In terms of Russia, the accounting regulations are – you have to follow a certain set of rules. One of those is that you believe that the business can be sold in the next 12 months. That's clearly what we believe today. Why do we believe that? As you read the accounts and have more time to read the accounts you'll see we've included a lot of disclosure in note 16. There has been a lot of interest in the business. We have always said it's a good asset. There's been a lot of interest. There's been a number of indicative offers at the balance sheet date, and we continue to run the process.

Clearly, we are running a process in a Russian environment and, as Andrew has said, Russia is at war with Ukraine, so that process does require regulatory approval, and therefore our belief today is that we can sell this asset. There's been a lot of interest, but clearly it will require regulatory approval and therefore it is more uncertain than a normal process. That's our belief today, absolutely.

Andrew King

Just coming onto the other two questions, the issue of which of our businesses are more or less exposed to gas, you're right in the sense that Uncoated Fine Paper – well, to be clear, European fine paper – the number that we quoted around 10% of our energy needs coming from gas is obviously all in. That includes, for example, South Africa, where obviously the gas situation is a slightly different dynamic to the European gas situation, but taken in the round it's 10%.

Clearly within that, the European fine paper assets, as I think I mentioned in my presentation, is probably the most exposed to gas, because Neusiedler is an unintegrated facility, as you know, so that doesn't produce its own energy. It buys largely gas to make the energy there. And then Ružomberok in Slovakia, although it's integrated it does require external energy inputs, and so hence is exposed to it as well. But the other central European mills also use some gas, fairly limited amounts, because that's the benefit of being an integrated operation where you produce a lot of your own biomass energy. Obviously, by contrast, for example, the Scandinavian operations are not affected at all. Yes, I think you're right in saying that the business most impacted in the short term by the gas situation would be our European fine paper assets.

In terms of the order situation and the demand picture more broadly, clearly it's difficult to generalise because obviously every business is different. That is the benefit we have of being exposed to a number of different businesses, and clearly they all have different dynamics attached to them. I mentioned the Corrugated downstream business. The volumes were off in the first half, but, again, I stress that we are a regional business there so one cannot extrapolate that to a pan-European effect. It was because, as I say, Turkey's numbers were off, off an extremely strong performance last year on the volume side. Importantly, we made more money this year than we did last year in Corrugated, and that's what's most important.

On the Flexibles side, bags saw good volume growth in the first half. It remains very robust. Clearly there are pockets that are stronger than others, but on the balance it still remains good. We'll have to watch how the European building materials industry gets impacted if the cost of living issues become more paramount then of course that can impact it, but again, we've got a broad portfolio and a broad exposure there both geographically and product wise, so it remains in good shape.

Yeah, in Uncoated Fine Paper the order situation is good. Clearly, while we believe in the ongoing structural decline in that market, and you're seeing it return to what I'd call the normal, I suppose, 1% to 2% per annum type of decline in the European market as a whole, as I mentioned, I think we've been gaining share because there has been a lot of supply side contraction, both permanent, and also these soft conversions, where people have taken capacity out of fine paper. As a supplier of choice we've enjoyed the benefit there, and we continue to do so. Then South Africa is a different market; we're ramping production back up again as a consequence of the floods, and the order situation is extremely strong. It's about making sure we can produce into that order situation. I hope that gives you a feel for it.

James Twyman, Prescient Securities

Thank you for taking my question and the additional disclosure as well. My questions are, firstly, most recycled containerboard producers are taking downtime and trying to raise prices. I think you've got about 500,000 tonnes of that. Could you talk around whether you're thinking of taking downtime, and also whether you're also looking to raise prices?

Secondly, working capital. Of that €400 million of outflow, how much would you say is a permanent factor due to higher raw material costs, and how much might be a seasonal factor?

And then finally, regarding Russia, you haven't written it down, which implies that you have some level of confidence in getting regulatory approval for a possible disposal. I think the general consensus would be that is highly unlikely, so I'd be very interested to know what your reason for confidence is in that.

Mike Powell

Thanks. Let me take the working capital and go back to Russia. The working capital, James, I would see mostly as seasonal. As I said, I'd expect some of that to come back. Clearly there's higher prices, but there's obviously higher costs, and therefore your payables also carry some bigger weight. There's a little bit in terms of that, but it's mostly seasonal supply chains are still a bit messy, so there's bits stuck where they're not supposed to be in all types of working capital for everybody, but I think that will come back.

In terms of Russia, I've been very clear and the disclosures are clear. We have a lot of interest in this asset. We clearly need to agree with a counterparty and then go for regulatory approval. There are a number of companies that have been through regulatory approval, but it's an unknown path, so – but it is a path that we have said we will go down. The board's been pretty clear about its exit from Russia, and therefore we believe that holding it as an asset held for sale at the value of the net assets today is appropriate. Clearly, if it wasn't, we'd have done something different. Might that change? For sure. As I've said, it's not a well-trodden path, but with all the evidence we have, both at the balance sheet date and at the time of signing the accounts last night, that's the information we have, hence we presented it that way.

Andrew King

James, on your question on the recycled containerboard downtime, the simple answer is we will produce for our customers provided we can make a profit on the production. We are confident right now we are profitable throughout our operations there. We enjoy a very low-cost position, as you know, and so we will produce, as I say, as long as we can make a profit on every tonne that we produce.

Justin Jordan, Exane BNP Paribas

Good morning. I've got three questions. Firstly, on Russia, thank you so much for the increased disclosure from clearly describing it as a discontinued. I just want to clarify, sorry, there was a little bit of an echo when you were responding to Cole's earlier question. For it to be described as a discontinued business in accounting terms, what is the expectation of a timeline for a divestment from here? Was that six to 12 months that you said earlier, or can you just clarify what that was, please?

Secondly, just on your updated capex, and I appreciate this is the continuing operations capex of €500 million to €600 million for 2022, I just want to double check that excludes any potential decision on Štětí. And then in the prior capex guidance that you've given – or expectation, shall we say – back on 3 March, the midpoint was some €200 million-odd higher in 2023 over 2022. Is that still a very broad-brush guidance that you would think about? A higher capex in 2023 on 2022, and that presumably would include a positive decision on the Štětí expansion?

Thirdly, I've got one slightly geeky question. Just on the PCC disposal, is there any tax leakage we should expect on the positive profit on disposal proceeds?

Mike Powell

Thank you, Justin. All good questions. Let me take all of them. Hopefully you can hear me with no echo. The Russian asset held for sale, you have to have a live marketed process and believe you can dispose of the business within 12 months. On PCC, if you look at the accounts in the line you see a €246 million gain. There's a €5 million tax leakage, so it's minor, so almost nothing. There's nothing further to come in terms of cash tax, other than those numbers I've just quoted.

On the capex, whilst the number has changed in terms of the guidance from the old number of guidance, the main difference is Russia. As you know, we've stopped all strategic projects in Russia, so if you take the old guidance, take off Russia and take off PCC, then there's a little bit of timing, which isn't anything different. Other than that, as Andrew has said, there is absolutely no change to our strategic deployment of capital, and all the projects remain on track. It's really timing of cash flows, PCC and Russia that bridges you from the number we gave at the beginning of the year to the continuing operations, and no change to our business.

On Štětí, the number for Štětí is included in the guidance that we've given you for 2023 in the release.

David O'Brien, Goodbody

Morning. Three questions, please. Firstly, on Corrugated you've flagged the investment of €185 million over the next couple of years. Can you give us a sense of what level of capacity that will bring into the system? Could you give us an update on, post stripping Russia out, what is your net long containerboard position now in the Corrugated division for containerboard? You did call out the benefits of vertical integration. How should we think about vertical integration in that business going forward, given that investment that you mentioned?

Secondly, on Uncoated Fine Paper, we've touched on some of the pressures on the non-integrated guys. How do you expect the capacity picture to evolve there over the next year or so, given that there's still pressure? Do you see a risk that maybe there are assets finding a way into the containerboard space in due course?

Finally, you've touched on the cost of living crisis, which is pretty broad-based. How are you offsetting that for your staff? What type of labour and cost inflation should we be expecting into the second half and beyond?

Andrew King

I count that as four, but we'll still take them, David. Firstly on the capex and the capacity expansions in Corrugated, it's always extremely difficult and I think somewhat dangerous to try and quantify a capacity expansion in Corrugated, because obviously it's investing firstly across the network of plants, and it'll be debottlenecking a certain line, and it'll be including in certain places more actual Corrugated capacity and the like. We don't quote it, not because we're trying to be not transparent, but just because it's fairly meaningless in a sense. I think what's important to note is that it's spread across eight or nine different plants geographically and in terms of the market segments that it serves.

Obviously quite a lot of it is invested behind the ongoing growth in eCommerce. We are very well positioned to serve the eCommerce customers, particularly in Central Europe, and we've developed extremely strong relationships there with the key eCommerce customers. I think we're also doing a great job on the innovation front there. Importantly, as well, we can offer them opportunities also on the bag side, and we are working on very much a coordinated basis. This is in some ways new to us, because it used to be that corrugated and bags would have operated fairly separately, but for example on the eCommerce side, it's a combined offering, which is very exciting for us.

In terms of the net long/short position, clearly Russia was 300,000 tonnes of containerboard, so, simplistically, knock 300,000 tonnes off our current production. Having said that, obviously we've been ramping up in Ružomberok as well at the same time, although some of that's in the half-year numbers. Where does that leave us? Obviously that product from Russia was a virgin product, as you know. We've always been long virgin containerboard. We've always been very comfortable with that, because all of those products are niche in themselves, from the white top product that we make in Russia. Also, in South Africa, it's essentially the same product which we sell into Europe, so we're selling more. We have the opportunity to sell more out of South Africa. Similarly, the product in Slovakia is a white top product with a recycled content as well, and then we've got the semi-chem products and the pure virgin, so we're long and we remain long in the virgin products.

We're actually short of recycled production. We make around 500,000 tonnes and consume closer to a million tonnes of the recycled product, so we're net short there. Again, you have to look regionally. We're short in Turkey. We're more balanced in Central Europe, albeit because of the growth we've seen there have become more short, and that's something we're looking at. In our view, long virgin products, which are niche products, is fine. In terms of our recycled-to-integration levels, being more balanced, particularly – and what I mean by balanced is physically integrated – so being able to ensure you can supply into your own box plant network is important, and we're looking at further opportunities to make sure that we are more balanced in that regard. It's an opportunity for us going forward.

You asked a question about conversions from fine paper into containerboard. Clearly that is always an opportunity for certain players, and we'll possibly see more of that over time. Obviously in the near term the discussion is more whether the existing containerboard producers can make money, and as you can see, there's also some closures. I think there was one closure being announced recently, and potentially more on the horizon, frankly, if margins at the top of the cost curve are where they are. I suspect there might be some more conversions over time. Similarly, that tightens up our fine paper market for us, which is no bad thing.

On the labour inflation question, inflation more generally is a big issue. Clearly labour needs to be recognised in all of that, and we are clearly, like everyone else, trying to understand the ramifications of the current inflationary effects, how much is transitory and how much is permanent. Clearly, we're going to reflect that in how we think about our wage structures and salary reviews. We are determined to always be competitive in the respective markets in which we operate. That's something we've always done and we'll continue to do so, so we'll need to understand it in the context of the market environment as it evolves.

Mike Powell

David, thank you. I'd like to wrap up just thanking everybody for their interest, and if there's any further follow-up questions or questions we didn't get to, we will come straight back to you. Thanks very much for your interest continuing.

ENDS