Q3 2022 results

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Transcript

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Q&A Participants

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Andrew King, Group CEO

Good morning, everyone, and thank you for joining the call this morning to discuss our trading update. I'm Andrew King, your Group CEO, and with me is Mike Powell, Group CFO. I'll start with a brief summary of this morning's announcements before we will take any of your questions.

I'm pleased to report that we delivered a very strong performance in Q3 with underlying EBITDA from continuing operations at €450 million, up 55% compared to the prior year period. This was on the back of higher average selling prices and overall volume growth, more than offset by the significant cost pressures. We're able to mitigate the impact of the significantly higher European gas and electricity costs in particular as most of our pulp and paper mills generate the majority of their energy needs internally.

Importantly, our €1 billion expansionary capital investment programme is progressing well, and we expect these projects to deliver mid-teen returns when in full operation. Within that portfolio of projects, we are pleased to have recently approved the investment in a new 210,000 tonne per annum kraft paper machine at our flagship Štětí mill in the Czech Republic for an estimated €400 million investment – start-up expected in 2025 with full production ramped up by 2027.

In August, we agreed to acquire the Duino mill near Trieste in Italy. We plan to convert the existing lightweight coated mechanical paper machine into a high-quality cost-competitive recycled containerboard machine with an annual capacity of around 420,000 tonnes. This converted machine would be expected to start up in 2025.

If I then turn briefly to the outlook, while significant geopolitical and macroeconomic uncertainties do remain and we anticipate continued inflationary pressures on our cost base as we enter the fourth quarter, we are confident that the group will continue to demonstrate its resilience and deliver a year of good progress. We remain well placed to deliver sustainably into the future, underpinned by our integrated, cost-advantaged asset base, our culture of continuous improvement, our portfolio of sustainable packaging solutions, and the strategic flexibility offered by our unique platform for growth, strong cash generation, and financial position.

With that, I thank you, and Mike and I would be happy to take questions.

<u>Questions and Answers</u>

Lars Kjellberg, Credit Suisse

Good morning, and thanks for taking my questions. I just wanted to try to understand a bit the sequential moves and the various components. We can obviously see pricing. You called out wood costs and energy costs, and, as far as I recall, you haven't hedged your energy costs, so I suppose that's a direct hit, but the one question that is somewhat more opaque is the wood cost development in your wood catchment area and, as you already called out at the half-year point, availability. And I've seen some comments from Mayr-Melnhof for example, they even talked about suspension of production because of wood supply issues.

So if you can elaborate a bit on the sequential moving parts for that €32 million drop in EBITDA versus the prior quarter given the strong price environment, and also how we should view the various components – cost, price, and volumes – heading into Q4. Those were my questions. Thank you.

Andrew King

Lars, it's Andrew here. That seems to be a very generalised question, so I think we could unpick it into a couple of things.

Firstly, the wood cost progression, which Mike can follow – more generally, the progression on earnings is all about a rising cost base more generally, and wood and energy being the two most specific of those. And, as you rightly say, energy is not hedged, so what you see is what you get on our energy bill. We are effectively structurally hedged, so, even though you've seen a massive increase in natural gas and electricity, and all the related energy costs in Europe, clearly, our bill has gone up as a consequence of that, but not as much as you might have expected, simply because we have a lot of our own energy generation.

So on a sequential basis, there's a high increase in variable costs, clearly offset to a large extent by increasing sales prices because we entered the quarter with higher prices, and in particular in things like kraft paper, as we flagged at the half-year, we implemented further price increases going into the third quarter, and we've got overall volume growth, albeit it's mixed in different segments. So that's the overall picture. In terms of the wood cost story, maybe Mike can give you a bit more colour on that.

Mike Powell, Group CFO

Yeah, listen, we're talking about deltas. It's a good quarter and a good year-on-year increase, but the wood – probably, at half-year, our wood costs were half-year on half-year up about 40%, probably. Energy obviously was a lot more than that, and we've flagged both. Wood costs continue to inflate, as Andrew has said, so we see wood being used for other sources of energy, of course, in some parts of Eastern Europe in particular.

But wood costs continue to inflate through the quarter, and, as Andrew said, the real quarter – despite it being very strong, you do see that delta because we entered the quarter at very high prices, and they've relatively been flat through the quarter, but costs have inflated, and, therefore, if you want to look at the downside on the quarter-on-quarter, it's very simple on that basis.

Andrew King

I was going to add on the availability issue, wood resources in Central Europe are particularly tight. I think it's particularly in the hardwood segment because hardwood is an alternative energy source, so it is really linked to this whole energy game because, in a number of Central European countries, you're finding households and the like are burning hardwood as a fuel source instead of gas, so people have the alternative to switch between the two.

So, clearly, with these ultra-high gas prices, and of course concerns around security of gas, people have been switching to burning wood in their homes, so that has been a different demand source which has arisen. Of course, it's extremely difficult to predict how that might continue because, of course, gas prices actually seem to be coming down in the spot market, and maybe there's a sense that, actually, the availability issue isn't as chronic as people might have expected. And so you could easily see that switch back over time, but, undoubtedly, at the moment, that is causing pressure, particularly in that Central European wood.

We've been managing that – the wood and energy situation. We've also taken some modest downtime in certain of our mills, particularly in the fine paper mills – so Slovakia and Austria – in order to effectively balance off the high wood cost and availability issues with the demand picture. So there has been some modest downtime that we've taken as a consequence of wood availability, and simply the energy pricing – particularly relevant to Austria because, as you know, we have an unintegrated facility there which consumes a lot of energy.

Lars Kjellberg

So, on those comments, I suppose, unhedged energy – somewhat softer energy prices, at least for now. Wood continues to rise, so how should we think about cost inflation and your ability to offset that by pricing? I guess it seems as if containerboard prices are, broadly speaking, stable. Fine paper – stable-ish, or slightly up, and kraft paper – I guess we'll find out. But is that an area where – you called out still strong demand trends, or at least resilient demand trends, in kraft. Does that continue to see that positive price progression? That was my final question, thank you.

Andrew King

I think, firstly, on the cost side – and, of course, all of these things are linked. I guess it depends which day of the week you ask me because we're seeing, as I'm sure you guys also track the spot gas prices in Europe, they're all over the place. More recently, they have come down, actually, in the last few days. So, clearly, in our case, that gives immediate relief because we don't hedge, and particularly, for example, the unintegrated. Obviously, more generally, it gives relief to those players who are more exposed, I suppose, to the external price of energy.

And, of course, if one looks at the recycled containerboard cost curve – and this links into pricing, I suppose, because you're seeing some cost relief actually taking place just at the moment because energy prices have come off to some extent. As you well know, PFR prices have come off to some extent, and I guess that the cost pressure that existed officially a few weeks ago is probably alleviated to some extent. And that, in turn, is clearly feeding through to the fact that, generally speaking, the price increase that the recycled containerboard industry were talking about not that long ago has dissipated, but it's dissipated because it was premised on cost inflation, which seems to have modified a bit.

But, as I'm sure you can all appreciate, this is a highly volatile world, and one simply doesn't know from one day to the next what the spot price of energy and PFR and the like might be. Related to that is also the whole issue of the capacity that was taken out on a temporary basis as an industry over the summer months. It seems like some of that is coming back as people have got confident and their cost base is being mitigated to some extent. And, of course, that'll have an impact on the supply/demand balance going into the back end of the year.

Lars Kjellberg

And on the kraft paper question around pricing.

Andrew King

Kraft paper, as I've mentioned, we got a meaningful increase at the half-year that's held very well. We've had a very good quarter in our kraft paper and more generally in our flexibles business going into the final quarter. Obviously, bags has a seasonally weaker quarter normally, and I stress it's seasonal because the height of the construction period, particularly in Europe, is obviously through the summer months in Europe, and so, generally, seasonally, you'd expect a weaker quarter. And, of course, we also take a lot of our kraft paper downtime – the maintenance shuts and stuff – in Q4.

So quarter-on-quarter is always dangerous to look at because there's always a seasonal impact, and as a consequence, that's the way we time our shuts as well into Q4. So Q4's normally a slower quarter than Q3 for seasonal reasons, not necessarily calling on the cycle.

Lars Kjellberg

I get that, but the kraft paper price – that was more what I was referring to – if that continues that momentum.

Andrew King

The kraft paper price is holding steady, yes.

Lars Kjellberg

Okay. Thank you.

Mike Powell

Thanks, Lars.

Cole Hathorn, Jefferies

Morning. Thank you very much for taking my question. Just following up on the demand question Lars raised, is there any commentary you can give on what you're seeing in some of your end markets – the construction end markets for the paper bag side, as well as your general, your retail etc, just so we can get an understanding of how that's developing on the sack and kraft or flexible packaging business. And then, similarly on the corrugated, any kind of demand commentary you can provide?

And then the second question is on the Russia disposal. Could you just clarify the process from here? Hopefully we get the Russian approvals for the transaction to come through, but what would be the process from Mondi's side once you've got those Russian approvals? Would it effectively be, once the Russian approval's in space, then you do the shareholder meeting, and then ultimately complete and get the cash? It's just to understand the sequence of events. Thank you.

Mike Powell

Cole, thanks for your questions. Let me start with the second one, and I'll let Andrew take the first. So, yeah, just a reminder – so the approvals that the buyer has to deliver are twofold. One is on antitrust, and the second one is to get approval from the sub-commission. And with that approval for the agreed SPA that we have with them is the agreement on the funds being delivered to an account of our choice in a currency.

Once those approvals have been cleared, there is, because it is a class 1 transaction, we need to have a shareholder meeting, which we would call, and then, once that has been done, then we can close the transaction, and then, of course, the funds will flow. And then, just as a reminder, we have committed that the net cleared funds would be repatriated to shareholders as soon as we practically can. I hope that answers that one for you, Cole.

Cole Hathorn

Thanks, Mike. Just for clarification, so you would get the funds in – I would consider it like an escrow account until the shareholders approve, and then it would flow out. There wouldn't be risks of…

Mike Powell

No, I think the timings may well interact with each other, so we'll work through that, but we would need to have the shareholder approval before we can close the deal.

Andrew King

And, on the demand question, so, on the flexible side, as I reiterate, we had a strong quarter in Q3 with very resilient demand across frankly most end uses. I remind you, in terms of our mix, we have 400,000 tonnes of speciality kraft papers, and then 900,000 to a million – somewhere around there – tonnes of sack kraft. On the speciality kraft papers, clearly, a lot of that goes into retail applications from that rebuilt machine of producing the paper bags for retail, and then a lot of it also goes into things like food service, and some into industrial applications.

I think the retail paper bags is probably a bit softer right now. I think simply footfall in retail shops is probably a bit lower, and you see a bit of that coming through at the moment – not terrible, but it's certainly a bit softer. And food service, these type of things – extremely resilient – if anything, quite strong. And industrial – a bit softer, maybe, as we look forward, but it's certainly not particularly concerning or anything like that. So, when you ask the detail of our end uses, you can hear it's a mixed picture, and you really do have to look at the individual end use applications.

On the sack kraft side, as you know, a lot of it goes into building materials. In Europe, that's the building materials for DIY applications and things, non-bulk delivery, and that, whereas, in what we call our overseas markets, the export markets from Europe, a lot of that is into cement and the like. The export markets are holding up very well, very resilient. Europe feels a little bit softer, but certainly no real concern around that, but just a bit softer than it has been in what was extremely strong markets for the last couple of years.

On the corrugated side, likewise, I always remind everyone that we are very much a regional business in corrugated solutions, and we distinguish here between corrugated solutions volumes and our containerboard volumes. Our containerboard volumes held up very well and continue to do well. We are a low-cost producer delivered into the markets that we serve, so we do extremely well there. On the corrugated solution side, we are a regional market in north-eastern Europe and Turkey. Obviously, every one period can be a bit different, particularly in the likes of Turkey where it is volatile, so it's more of a regional difference rather than that kind of end use difference.

In terms of end uses, as you would expect, the food and beverage and those sort of things are pretty resilient. eCommerce continues to be good, but there are signs that it's slowing down. Industrial is mixed because, again, I think it would be dangerous to generalise. It's more of a regional differences there than anything else. So I hope that that helps.

Justin Jordan, Exane BNP Paribas

Thank you. Good morning, Mike and Andrew. Just two quick questions, if I may. Just firstly, following up, Andrew, on, I suppose, your comments on the outlook for flexibles, can you just remind us, you've got, clearly, a number of, I suppose, annual and semi-annual fixed-price contracts, which I believe, typically, you're renegotiating in Q4 of the year. Given the index price moves we've seen and the comments you've made regarding further price increases achieved around H1 and into Q3, I assume we should be expecting price increases on those annual contracts post renegotiation, or is that now in question given the slight softness in demand that you're commenting on?

And then, secondly, I just want to clarify something on Russia. I appreciate it's a very complicated situation, but I just want to clarify that the Board's intention is ultimately 100% of whatever net proceeds are received will be distributed to shareholders. Is that still the Board's intention on the Russian disposal? Thank you.

Andrew King

Okay, I'll take that easy one first. Yes, that's the intention. So, as we stated – and it remains the intention on the dividend story.

On the question of flexibles – and you're talking specifically about sack kraft paper – it is the one that has a lot of annual pricing, well, some annual price contracts. I mean, it is less than it used to be. More and more of that business is going to either semi-annual, or, if not, floating pricing. So the annual contract negotiations aren't quite as big a deal as they would have historically been, but, nonetheless, they still are important, and it is still the next pricing event, I would say. But, on the speciality kraft paper, it's much more fluid, and it encompasses a number of different subgrades that you would be pricing at different times on a different basis.

But, going into the annual price negotiations, we haven't started those, simply put, so I think it would be extremely premature to be able to prophesise what might happen. I think it's incumbent on us to be talking to our customers first before we tell you what might be happening. So I think we're going to be going into those negotiations. I mean, clearly, there's a general increase in costs, and that is self-evident for everyone to see, and the markets remain resilient, but we need to have those discussions with our customers.

David O'Brien, Goodbody

Good morning, guys. Thanks for taking my questions. Just three quick ones, please. Mike, you were good enough to give us a steer around energy costs at the interim stage. I think you said you might be looking at up to €950 million for the year. I just wonder if you could give us an update in where you see that. It's quite volatile. And, secondly, just on the move into Italy with the Duino mill, I guess, how should we think about the opportunity to build a more substantial Western European corrugated business over the medium term when you see it moving into paper assets into the likes of Italy?

And, finally, just on the capex projects, what kind of EBITDA contribution are you expecting for 2022, and do you have an early steer on maybe what the contribution for '23 could be, please?

Mike Powell

Yeah, let me take energy. I mean, it's not a bad number, more by luck than judgment given the volatility of the markets, but I think it's still probably a good guide for the full-year number. In terms of EBITDA on projects, I think we said it would be about €60 million for this year, and I think we've probably – certainly on some calls – talked about €50 million next year. I think, this year, it's obviously a bit softer just because some of the projects are suffering from the availability of the wood.

There's nothing fundamentally changed with the quality of the projects. They're more affected by some short-term dynamics around that wood availability that Andrew has talked about. So a bit early to call next year, but there's nothing other than good in terms of the timing of the projects, and, fundamentally, the long-term nature and deliverability of the capex execution and projects there, David.

Andrew King

Good, and just on the – call it 'Italy ambitions', I think, more broadly, our corrugated value chain being containerboard and corrugated, we have an extremely strong platform there. We have a fantastic platform on the upstream containerboard side with extremely cost-competitive production well located to serve our growing markets around us and a strong network of converting plants. In the recycled containerboard space, our belief has always been strong physical integration is an important facet of that business by contrast to the virgin grades, where you can be an open market player and sell into a broader market, which we do. But, on the recycled side, we believe strong forward integration is important.

The Duino mill, as we stressed when announcing it, it offers us the ability to backward integrate our Turkish containerboard requirements. We are short of recycled containerboard in Turkey, and this – if you look on a map, where this mill is located is right next to a port which has got very good access into our Turkish network, so we are able to supply very cost effectively, we believe, from this mill into Turkey when it's up and running. But obviously, it also opens up avenues for us to be supplying into the regional market where the mill is located.

And we like our corrugated business. We have every intention to continue to grow our corrugated business, and, if this throws up opportunities for us to develop further in that region, then, of course, we will look at those. But, first and foremost, the priority is to firstly complete on the transaction, and, secondly, to get on with the conversion, and that immediately gives us the benefit of integration into our Turkish corrugated network.

James Twyman, Prescient Securities

Yeah, thank you very much. I've got three questions. Firstly, could you give us the maintenance cost number for Q3? And secondly, there seems to be a bit of kraftliner price weakness at the moment, so I'm just wondering in terms of your view on whether this is a trend or whether you're attempting to reverse the weakness that we're seeing. And then, thirdly, just your opinion on how much downtime has been happening in the industry, mainly on the recycled side, but what's your view on what percentage of the industry may have been down, and maybe what you're seeing at the moment? That would be great. Thank you very much.

Mike Powell

Thanks, James. James, maintenance is about €30 million, I'd probably expect the same in Q4.

Andrew King

And then, onto the much easier question of what's happening with kraftliner prices next. Firstly, kraftliner prices are currently stable. Clearly, every market, and I know everyone looks at RISI and different markets and things like that, we'll have to see how that develops.

Clearly, there are and this, I guess, comes linked into your other question around the downtime, and, as I said earlier, a lot of capacity was taken down through those summer months. We would estimate it was probably something like 15% to 20% of European recycled containerboard capacity which was idled for some period of time.

Obviously, we don't have total transparency on that either. We can also just read the same things that you probably do, but that would be our estimate. So it was a meaningful short-term reduction in capacity. Clearly, it's extremely expensive to take that downtime because you've got a fixed cost base and no revenue, essentially, while you're doing it, so it typically doesn't last very long.

As I said earlier, I suppose some of that capacity has been incentivised to come back on because of the lower PFR prices, which are ironically as a consequence of those downtime being taken because, obviously, demand for PFR is then reduced, and so, hence, the price has come down sharply. I mean, the price of PFR is probably down over €100 a tonne over the last month or so, so, clearly, that has given the higher cost recycled containerboard producers some cost relief.

And, at the same time, and more recently to that, even, energy prices or gas prices have also been coming down to some extent. Again, who knows where the next move is on that. But, at the moment, they're coming down. So I think that's what's given the relief to the high end of the cost curve to allow them to come back into the market. Clearly, if coming back into the market increases supply, and one would have to assume that that's going to make it very difficult to get further price increases at the least, and then we'll have to understand whether that gives rise to some of these guys giving some of the cost relief they've seen back to their customers. It's early days, and that we will have to see. And, of course, the kraftliner prices ultimately are – have a link to the recycled containerboard prices, and we'll have to see how that then plays out.

So I'm afraid I can't give you any more definitive answer than that because I simply don't know because these are big moving parts that one will have to continue to watch. And so, yes, I think that answers both the pricing and downtime questions you had.

Sean Ungerer, Chronux Research

Good morning, Andrew and Mike. Thanks for your time. Just to hop on the unbleached sack kraft price increases, just to confirm, so, post the H1 results, there was a bit of a price increase that went through in your spot business. Let me just confirm that, please.

And, secondly, the non-cash gain in the uncoated wood-free business – if you just comment around that, please.

And then, lastly, I'm assuming the commentary around the cost control initiative is the usual Mondi stay in business – how you guys practise, or is there any specific cost-savings programmes that you guys have introduced? Thanks.

Andrew King

I'll take, certainly, the paper price question. I think your phrase was, 'a bit of a price increase'. I would suggest it was a bit more than a bit. I mean, it was a meaningful price increase at the half-year, and, yes, it was fully implemented, and it's been in place throughout the quarter. But, to be clear, that's on the sack kraft business. The speciality kraft paper business has a number of other different levers, and there's also been various movements in there. But, obviously, the primary half-year increase was on the sack kraft side.

Maybe just touching on that cost control question, yes, I mean, we are not believers in grand statements of cost reduction processes. We believe we should always be working on our cost base. Clearly, in these times, you redouble your efforts because every efficiency gain you can make when input costs are on the rise, as they are, just gives you even more of a payback. So it's the imperative around driving efficiencies, driving productivity and the like are just that much more enhanced.

But it's not about some grand restructuring programme, which typically, frankly, you kid yourself that you're actually delivering on these things. But we believe in constantly driving our cost structures, driving our efficiencies and the like, and that puts us in good stead, and we'll continue to look at that. Obviously, we also have some capital expenditure programmes, which also facilitate cost optimisation, particularly around this whole energy situation.

As you know, we've invested a lot of money over a long time not because we foresaw the current energy crisis in Europe, but just because it was good business even at lower energy prices. Clearly it makes those returns on those investments even better now with the current spot energy, and we think there are other things we can do on the energy side which will enhance our cost effectiveness, so we'll continue to look at those and exploit those.

Mike Powell

In terms of the non-cash forestry fair value gain in Q2, it was probably around €20 million, and, therefore, sequentially in Q3, it's about €30-35 million. That really reflects, obviously, the increased costs of wood. The value of the trees are worth more, and, therefore, you'd expect a slightly higher gain. And, sat here today, we'd probably expect about the same number in Q4.

Daniel Isaacs, 36ONE Asset Management

Thank you very much. Thanks for this call, guys. I just wanted to ask – it's probably difficult to give more insight on, but just wondering – I mean, we've seen a couple of deals from other companies from Russia being confirmed and paid out, etc. I mean, is there any feeling from the guys on the ground there of what's happening with the process? Is it because the deal size is relatively large that it's usual for it to take to take a bit longer to get confirmed or anything like that?

Andrew King

Thanks for the question, Daniel. I really think we're in the realms of total speculation here, so I think it'd be wrong for me to comment on any of that. As you know, this is a process where the buyer seeks approval. That process is underway, and I think it would be wrong for me to speculate on exactly how that unfolds simply because there is no formal timetable that the authorities are under around us, and we need to see out how it unfolds. So I'm sure you'd understand if I would avoid any speculative commentary on it.

Daniel Isaacs

Yeah, sure. No, I was just curious if there's any maybe deal size guidance from any department on timing or anything like that, but it doesn't sound like it. It sounds like it's all done just up to a certain someone to make a decision.

Andrew King

Yes. There is no categorisation by deal size, if that's your question.

Daniel Isaacs

Right, right, okay. Thank you.

Mike Powell

Thanks, Daniel.

Saul Casadio, M&G Investments

Yes, hi. Thanks for taking my questions. It's just a clarification on your energy bill because you clarify your fuel mix, but also, I want to understand a little bit more about your electricity bill because that is also, especially in Europe, linked to gas prices. So I wanted to understand if that 10% of gas exposure also includes the electricity bill with some estimates, or you're treating electricity differently, and I'm trying to better understand the link to gas of that one, considering I'm not an expert in utility bills.

Andrew King

Sure. We give that indication because that's the pulp and paper mills where the vast bulk of the energy consumption takes place. We do procure electricity as well. We are largely self-sufficient in electricity, so I think we produce about 80-odd percent of our electricity needs from our own energy sources. So there's biomass fuels, gas, coal, all the other energy sources.

So you're correct in that electricity costs are also going up, so, when Mike gave that indication – in rough terms, I think we've spent €450 million on all our energy input costs last year, so that includes electricity. It includes coal, gas, the biomass that we buy in specifically to convert into energy, all of those different sources, but clearly inclusive of electricity purchases. And that bill has basically doubled year on year, and that clearly incorporates the effect on the electricity bill of higher input gas and the like.

But by far the biggest component of our energy, as I say, is made from our own biomass plus biomass energy that we buy in, and that counts for about 80% of our total fuel usage, but it's probably, call it 75% of our total energy usage including electricity. So the electricity component is – yes, it's relevant, but it's not a significant portion of our total either spend or consumption. And then, as I said, roughly speaking, of our fuel requirements, gas is 10% of that order of magnitude.

Saul Casadio

Okay. Okay, that's helpful, but, just to follow up if I can, of that €400 million roughly energy bill, what is the electricity component just of that bill, not the consumption in general, but just what you buy?

Andrew King

I don't have that number off the top of my head, but it would be a smallish component of that because of that bill – it's everything from the biomass that we purchase rather than the one that comes in through the recovery boiler plus coal, light fuel, oil, gas obviously – all manner of mix of that. So the electricity component – as I say, I can't – I'm looking at Mike, and he doesn't have it off the top of his head, but it's not a huge component. But, of course, it's also been rising exponentially relative to other input costs.

But I think, very importantly for us, of that total energy usage, we have a significant portion of it through biomass energy, and through our own biomass energy generation, and that gives us the natural hedge. And, as we've stressed before, we don't hedge our energy input costs, so what you see is what you get, which is also a good thing when prices come off. You'll see it immediately in our numbers as well. And right now, energy costs are coming off.

Cole Hathorn

Morning. Thanks for taking the follow-up. It's a bit of a longer-term question, but you've mentioned wood cost and availability rising through Central Eastern Europe. If we think about that from a strategic perspective and where your mills are located, we're always worried about new supply coming on stream mostly, on the recycled side, but, on the virgin side, does this argue that the availability to put in a new virgin mill or conversion machine is more challenging? Ultimately, what I'm trying to get to is, is your asset base in Central Eastern Europe well placed because new capacity addition is going to be more challenging because of wood availability? Thank you.

Andrew King

Yeah, thanks, Cole. I mean, I think we've always said one of the reasons we like our – call it 'significant virgin-based paper production' is because we think a) there are higher barriers to entry, and, secondly, it's typically a steeper cost curve. And, if you're well positioned on that cost curve, you can do extremely well on a through-cycle basis. I think we've proved over the years that that premise has held true.

And you're right in the sense that the current situation, because it's really driven by the Ukrainian crisis, this whole thing, for two reasons. One is obviously the Russian wood basket is effectively now off limits to European producers. We didn't ever rely particularly on a lot of imports from – well, hardly any imports of wood from Russia and/or Belarus, but it was serving some supply into Europe.

And, of course, then, related to that is the whole energy crisis and the fact that, as I say, wood is being used as an energy source. So those things combined is what's made the markets particularly tight at the moment, but there's always been the structural challenge of accessing the competitive, low-cost fibre resources to make virgin product.

We are very well placed because we are the incumbent producers in the particular regions in which we operate, and hence the reason you also see a lot of our expansionary capex in this area, is around the incremental capacity expansions that we can achieve at those cost advantaged operations that we have. So I'll remind you we're spending just under €100 million in Świecie, in Poland, to produce another 50,000-odd tonnes of integrated pulp and paper production, and we know that will be highly cost competitive. This new machine in Štětí that we mentioned here is diverting, essentially, 100,000 tonnes of pulp that we have on the dryer at the moment into our paper machine, and then we can squeeze out another 100,000 tonnes of pulp out of the existing pulp operations with modifications. In this way, this is where the capex goes to produce then 200,000 tonnes of fully integrated low-cost kraft paper.

But these things, I agree with you, it's not easy for others to replicate. In fact, it's virtually impossible. So I think that does create a strong structural advantage, which we've had – we've always said we've had, and we continue to build out on an incremental basis. At the same time, we have a fantastic downstream business as well, which also gives us a real strength because, as you know, in kraft paper we are by far the biggest consumer of kraft paper as well, with our extensive bag network which is a global business, and that gives us a real, strong integration strength as well.

So yes, I mean we firmly believe that all of these structural advantages are here to stay, and if anything, compounded by recent events. Remembering also that kraft paper – one of the big competitors is based in Russia, and obviously cannot now serve into Europe. In fact, the most recent sanctions have explicitly stated that these products are sanctioned for export from Russia into Europe, so all of these factors coming specifically to this new paper machine of ours, we see as a significant advantage that we enjoy, and will continue to leverage.

So I think that's a very good basis on which to end this call. So, again, thank you everyone for your attention. Obviously, Mike and myself are here if there are any follow-on questions that you may have, but, otherwise, have a very good day, and I'll pass you back to the operator.

ENDS