Half-year 2021 results

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Transcript

Mike Powell (Group CFO)

Good morning and welcome to Mondi's half-year 2021 results presentation. I am Mike Powell, the Group CFO, and I am joined today by Andrew King, the Group CEO. Before I hand over to Andrew, at the end of today's presentation there will be an opportunity to ask any questions that you may have. With that, I will hand over to Andrew.

Andrew King (Group CEO)

Thanks, Mike. Good morning to all of you, and thank you for joining us. Against the backdrop of a patchy economic recovery we continue to deliver strongly as a business, and, importantly, position ourselves for sustainable growth well into the future. I am going to provide some of the highlights of the first half before passing back to Mike for an overview of the financial performance. I will then go into some more detail on the business unit performance and our trading environment, before finishing with a short overview of progress on our various key strategic initiatives. After that, of course, Mike and I look forward to taking your questions.

Last year was characterised by significant volatility in the markets that we serve, from panic buying of some of our products to significant declines in others as whole end-use segments were shut down at the height of the national lockdowns. By contrast, in the first half of this year we have seen a general recovery in demand across most of our segments, in some cases to such an extent that it has caused significant tightness in supply chains. This has also resulted in strong cost inflation, which has affected a number of our key inputs.

Against this backdrop I am very pleased by the performance we delivered in the first half. We have strong sales volume growth across most key markets, rising prices and effective cost control. This has established real momentum in the business from the lows of the second half of last year, which is reflected in the strong sequential progression. Importantly, through all his volatility we have not lost sight of the future. Our philosophy of investing through the cycle continues to hold us in good stead. In the period, we made good progress through the completion of the Olmuksan acquisition in Turkey, delivering on our capital investment programme and approving further expansion investments in our fast-growing corrugated business.

Similarly, sustainability remains at the centre of our strategy and I am delighted by the progress we have made in embedding our Mondi Action Plan 2030 since its launch earlier this year. I am particularly pleased with the progress we have made in developing our new, innovative, sustainable products for our customers, by leveraging that unique platform of ours based on our principle of paper where possible and plastic when useful. I will come back to highlight a few of these examples later.

As I said, I will now hand over to Mike to take us through the financial performance in a bit more detail. Mike, over to you.

Mike Powell

Thanks, Andrew. Let me take you through the numbers for the first half of the year. On slide 7, you can see the key metrics of the income statement and return on capital employed. We delivered a strong performance in the half-year, up sequentially on all key profitability metrics. Revenue was up 5% on the prior year, with strong volume growth in packaging and uncoated fine paper, all underpinned by our broad range of innovative, sustainable packaging solutions. Average prices were higher year-on-year and sequentially, and Andrew will cover this in a bit more detail later. As you can see, underlying EBITDA of €709 million was up 15% sequentially, and there is good momentum as we go into the second half.

Looking now at the main drivers for the year-on-year underlying EBITDA movement, on slide 8, here you can see, as I previously mentioned, we saw strong volume growth in our packaging and paper businesses, further supported by a positive contribution from previously completed investment projects. Selling prices were higher across the business, and in particular in the corrugated packaging value chain. I am also encouraged that pricing at the end of the first half was higher than the average in the period, with further price increases being implemented in the third quarter. Input costs were up, with significantly higher paper for recycling, resins, energy and transport costs. It is worth noting paper for recycling and resin costs, which made up a large part of the movement that you see, stabilised towards the end of the first half, but at those elevated levels. Fixed cost inflationary pressures were mitigated by our ongoing cost reduction initiatives.

Currency movements had a net negative effect on our results, most notably due to the negative impact on certain of our export-orientated businesses of a weaker US dollar, coupled with the translation losses from a weaker Russian rouble and Turkish lira relative to the euro. If currencies stay where they are today for the rest of the year we would expect a limited impact in the second half. Additionally, the non-cash forestry fair value gain was €11 million lower than the prior year. Based on current market conditions we expect it to be lower in the second half than in the first. Overall, we ended the period with underlying EBITDA of €709 million, which included an impact of planned maintenance shut costs €40 million higher than the prior period, which, as you know, is partly captured in volumes and partly in costs on the waterfall chart that you see.

Turning to the movement in net debt, you can see the continued strong cash characteristics of the business. On the left hand side, you can see the EBITDA that I have just talked to and then the seasonal investment in working capital. We continue to invest in the business through the cycle, supporting value-accretive growth, and our capital expenditure for the period was nearly €300 million. That equates to about

140% of depreciation. We expect capital expenditure for the full year of between €600 million to €700 million, and we continue to further evaluate capital investment projects for growth in the packaging markets where we operate. During the period, we also completed the acquisition of a 90% interest in Olmuksan, strengthening our position in the fast-growing Turkish corrugated market. We paid tax of €80 million and interest of €60 million, giving rise to the €140 million that you see. We are also pleased to have paid the 2020 final dividend, resulting in cash repatriated to shareholders of just over €200 million. We ended the period with net debt of €2 billion, retaining financial strength in the balance sheet, which you can see on slide 10, with a net debt to EBITDA ratio of 1.5 times at the end of the period.
In June, we entered into a new €750 million five-year revolving multicurrency credit facility agreement to refinance the existing €750 million facility that was due to mature in July 2022. The new RCF incorporates key sustainability targets linked to our MAP2030 framework, aligning our funding with our sustainability goals. The facility has no financial covenant, which I believe further reflects external stakeholder views of the strength of our business through cycle. At the end of the period the Group had a strong liquidity position, providing strategic flexibility of around €1 billion.

Lastly, to our technical guidance, I will not go through all of these, as I have already touched on many of them on the preceding slides and they are largely unchanged. Our capital expenditure projects continue to deliver, and we continue to expect a €50 million incremental EBITDA contribution in 2021 as we ramp up our machine conversion at Štětí and the new Ružomberok kraft top white machine, together with a number of projects across our converting plant network. We now expect the impact of planned maintenance shuts to be around €150 million for the year, with around a third already incurred in the first half and two-thirds expected in the second half, mainly as a result of extended project-related shut at Richards Bay as part of the mill's ongoing modernisation.

With that, let me hand back over to Andrew to take you through the operational and strategic review.

Andrew King

Thanks, Mike. As I said, I will now look in more detail at the four business units, starting with our Corrugated Packaging.

We delivered another strong performance in corrugated, and are seeing ongoing good momentum in the business, supported, as we have always said, by the strong structural demand drivers of eCommerce and sustainability. As you will see, EBITDA was flat year-on-year. If you do adjust for the timing of the maintenance shuts, we are seeing an upturn in the underlying profitability. Particularly pleasing is the ongoing, very strong demand we are seeing across our product range. In containerboard we are capacity constrained, with this demand typically benefitting us more through price in the short term, while in corrugated solutions we achieved significant 15% growth in volumes.

Last year was very much a story of eCommerce-led growth offsetting the weakness in industrial and other applications. This year, by contrast, while eCommerce does continue to grow we are also seeing significant recovery in other end-use segments. This growth is of course further supported by our backward integration at a time of paper shortages, together with the ongoing investment program in our converting network, and the focus on delivering innovative products and services of the highest quality. You will know that containerboard prices rose sharply through the period, and on the back of the very tight ongoing market situation we are currently implementing further price increases in the third quarter. At the same time, we of course have seen a rise in input costs, most notably in paper for recycling, energy and transport. We look to mitigate these cost pressures wherever possible through our tight cost control.

Finally, we were obviously delighted to welcome the Olmuksan team to Mondi in May, significantly strengthening our position in the fast-growing Turkish corrugated market.

Moving on, our flexibles continue to deliver strongly. As you can see, year-on-year underlying EBITDA was down, but, again, we saw a strong sequential improvement as pricing and volumes recovered from the lows seen towards the back end of last year. Encouragingly, we are seeing a very strong demand picture across our product range, again, driven by consumer, building materials and eCommerce applications. In paper bags this translated into an 11% growth in volumes, with all regions seeing good growth.

Consumer flexibles was working against a very strong comparable period, highly impacted by significant stocking of consumer goods at the time of the initial Covid lockdowns. It nevertheless delivered another good performance, illustrating again the resilience of this business to changes in the business cycle. High demand, coupled with supply constraints, is continuing to drive sharp increases in spot kraft paper prices. As we have previously noted, though, the impact on our profitability is somewhat delayed due to the annual contract nature of much of our business in both sack kraft and paper bags. We would expect to see the full effect of these increases come through next year as contract business is repriced to fully reflect the prevailing spot prices.

In Engineered Materials it was pleasing to see the strong demand recovery in functional papers and films across a range of industrial and specialised end uses. Similarly, we have made good progress in stabilising and realigning the portfolio of personal care components in response to what is declining volumes in a mature product. We also continue to develop opportunities to leverage our coating technologies to develop new, sustainable packaging alternatives to replace plastics. I will come back to a few examples of some of these great products we have developed by leveraging this knowledge.

In Uncoated Fine Paper it has been very encouraging to see a very strong recovery in demand for most of our fine paper products, following a very weak second quarter of 2020. While overall industry demand is not back to pre-crisis levels – and we certainly subscribe to the view that there has been some permanent decline in demand – our business is currently seeing a good order situation across all operations, supported by clear market share gains. If I look at this by way of example, in Europe we estimate that overall demand was up around 6%, while our volumes were up around 20%. These market share gains reflect the fact that our customers value the strength and stability of a committed long-term supplier, offering a broad product range, excellent customer service, cost-competitiveness and financial stability. I will come back later in the presentation to recap on some of the strategic positioning of our fine paper business.

On the back of demand recovery and the ongoing squeeze on non-integrated producers from rising pulp prices, we are now starting to see upward momentum in uncoated fine paper prices following the price erosion seen over the course of the last year. We have implemented price increases in the second quarter, with further to come in the third quarter. EBITDA comparability with the first half of the last year is impacted by the €11 million lower forestry fair value gain noted by Mike and the timing of the maintenance shuts. Stripping out these effects, we would be up year-on-year.

If I look into H2, while we are encouraged by the upward momentum in pricing and demand, we should of course note the long extended shut at our Richards Bay operations as part of that comprehensive mill modernisation programme. As you all know, we also suspended operations in South Africa in July during a period of civil unrest, in order to protect our people and assets. I am very pleased to report that we are back in full operation, with no damage done to our production sites.

If I move then on to our strategy, I will take you first to our strategic framework, which you will all be familiar with. I believe we have made good progress during the period on all aspects of our framework, but in the time available I would like to just provide some detail on three, namely sustainability, investing in assets with cost advantage, and partnering with customers for innovation.

Earlier this year, we launched our Mondi Action Plan 2030, centring our sustainability efforts on circular-driven solutions, created by empowered people, taking action on climate. Each of these focus areas is underpinned by clear commitments and targets. I am excited by the progress we are making in embedding this action plan into the organisation. We are well underway in developing detailed roadmaps to ensure delivery on our commitments. We are clearly showing tangible progress in a number of areas, off an already strong track record.

Coming onto this, this slide clearly evidences that track record. We highlight here the progress made over many years, including in safety, greenhouse gas emissions, fibre sourcing and waste-to-landfill, all achievements that we as a group can be rightly proud of. Of course, this provide a great platform for further progress over the next 10 years.

Coming then to another important facet of our strategy, what we call investing in cost advantage assets to support the structurally attractive markets that we operate in. I want to first remind you of how we think about growth in our respective business units. We continue to see excellent growth opportunities across our range of packaging businesses, which currently contribute around 75% of group earnings. We have supported this growth with meaningful investment; over €1.7 billion above depreciation has been invested in these businesses over the past five years. Importantly, we continue to progress further growth projects in all our packaging segments, and we certainly see plenty more opportunities to come in the future.
In Uncoated Fine Paper our strategy is to invest at a level that retains our highly competitive positioning in our chosen regional markets. On Engineered Materials, we look to develop specific niche positions where we believe we have a competitive advantage. In total we have invested around €1.9 billion above depreciation over the past five years, of which around 90% has been directed to that fast-growing packaging segments.

The key element of the Group's success over many years has been the ability to leverage that cost-advantaged pulp and paper production footprint. This of course continues to be a core part of our strategy. We currently have projects totalling more than €750 million in various phases of development, from recently approved for development through to full ramp-up. These projects will bring highly cost-competitive new capacity, efficiency gains and environmental benefits. We will continue to investigate further such opportunities where we see that confluence of customer requirements, the right asset configuration and other technical parameters in the mills.

As already mentioned, we are seeing strong structural growth in all the packaging markets that we serve. This gives us great optionality to invest behind this growth, where we believe we have strong competitive advantage. We have been systematically investing in our converting platform for a number of years now, with the aim of enhancing our product and service offering, expanding our geographic reach, and improving efficiencies and costs. As you will know, we recently approved further investments in our European corrugated and bags network to support the rapid growth in eCommerce business, while we continue to develop our geographic reach in bags, consolidating what is our global leading position. Again, I believe we have further exciting options for growth in these segments, both on the organic and inorganic side.

As I mentioned earlier, I just want to come back briefly to our positioning in Uncoated Fine Paper, which is our main non-packaging exposure. I mentioned earlier that our strategy is to maintain our competitive positioning in our chosen markets. I remind you that we are market leader with cost-advantaged production in our three core markets of Europe, with clearly a strong bias towards central and eastern Europe, CIS and southern Africa. We continue to gain share in each of these regions, as customers value that security of supply, product range and superior customer service that we are able to offer.

We also have the option to leverage our integrated asset base to grow in packaging. As you know, our uncoated fine paper production is largely centred around our highly cost-advantaged operations in Slovakia, Russia and South Africa, all of which already produce a combination of products, and where we have further options to produce more packaging products. This all results in a very strong cash-generative business, with a privileged asset base, and that optionality to grow our packaging offering.

Finally then, I just want to touch on another key value driver, which is partnering with customers for innovation. Mondi does indeed have a unique platform, offering paper where possible and plastic when useful. I certainly believe this allows us to be a real single source of truth for our customers in their journey towards more sustainable packaging. We bring this together in what we call our EcoSolutions approach, where we seek to drive sustainable packaging through our three R's of replace, reduce and recycle. I am very pleased to report that the momentum really is picking up, and we have seen some great examples of recent product developments spanning a range of capabilities that are really gaining significant traction with our customers.

Coming on to a few of those, I will start with Advantage StretchWrap, which is a great example of how Mondi can partner along the value chain, contributing its deep paper knowledge to deliver sustainable packaging solutions. This brown kraft paper, which we make in our mill in Dynäs in Sweden, has outstanding stretch, puncture resistance and high-tensile strength, which makes it ideally suited to replace plastic shrink film in pallet wrapping. It is made of renewable, responsibly sourced fibre and is recyclable almost anywhere in the world. One customer has already installed this packaging solution. We have more than ten trials ongoing and a fantastic level of interest across the market. If you think about it, the majority of European pallets are shrink-wrapped or wrapped in shrink film. We estimate that for every 1% of pallets in Europe where Advantage StretchWrap replaces shrink film, we could save more than 10,000 tonnes of plastic.

I have spoken to you about MailerBAG before, which is a highly recyclable, high-quality kraft paper bag designed for eCommerce, which complements our portfolio of innovative, corrugated-based solutions. It is easy to open and reclose for product returns, and due to its flexible nature, offers protection without transporting excess air. As a consequence, it saves space in storage and in transit. We are investing to upscale production across six countries, and by the end of 2021 we will be able to produce around 350 million bags per annum.

Moving on to a corrugated example, I have a fantastic example of innovation and the versatility of our corrugated packaging developed by our team in Turkey. This 100% corrugated solution eliminates the need for protective polystyrene while packing and transporting boilers, which each weighs around 34 kilograms. It is a fully recyclable solution which also delivers transport optimisation benefits. We are of course excited by the multiple applications this solution could be used for.

Moving on, here I have an example of a functional barrier paper structure which can replace complex unrecyclable packaging. This product eliminates aluminium and reduces the amount of plastic required. It is 85% paper-based, and recyclable in its home market. Additionally, it can be used in our customer's existing packing lines, which is really important from an efficiency perspective. Our team collaborated with Unilever for more than 18 months to develop this solution. Of course, we are working today on similar projects with FMCGs and retailers in food, pet food, and homecare applications.

Last but by no means least is our fit for purpose recyclable flexible plastic packaging. Flexible plastic packaging extends shelf life and prevents food waste. The efficiency of this material relative to other substrates you can see is illustrated on this slide. What we are now working towards is making that flexible plastic packaging fully recyclable. In the last few years we have developed a number of mono-material recyclable structures, and here I include a couple of recent innovations, being our BarrierPack or Flexzibox Recyclable for pet food packaging and numerous other food applications, and then you look at the EnvelopeForm, which is a high-barrier film solution, in this case for cheese packaging.

Finally then, just to round off, a reminder of our first half highlights. I firmly believe we delivered a strong performance in the first half and, importantly, we see good momentum going into the second half, with strong demand and rising prices across our product grades. Importantly, we continue to invest through the cycle to leverage our platform, and sustainability has always been and remains central to our strategy as we pursue our purpose of contributing to a better world by making innovative, sustainable packaging paper solutions. Thanks very much; with that summary I will hand you back over to Mike and we can take your Q&As.

Questions and Answers

Cole Hathorn, Jefferies

Morning Andrew, morning Mike; thanks very much for taking my question. The first one is on the growth opportunities here. You are calling out very attractive paper bag growth over the years and box growth ahead of the years. Could you just give a little bit more on how you are expanding and investing in your converting facilities? I know you have been doing it over the years, but it hasn't come out in those big capex announcements like your paper machines. That is the first question.

The second question is, following up on the StretchWrap that Andrew called out, that opportunity there seems very big. Even if you get, say, 5% of the market, I imagine the demand for paper would be even more than the plastic, considering its higher waste. That is over 100,000 tonnes, just 5% of the market. That is almost a new machine for you guys. How are you thinking about the market and when would we start to see that actively being used? Thank you.

Andrew King

Thanks, Cole. I mean, as you rightly say, typically when we talk about capex the focus is invariably on the big upstream capex projects, simply because that is the more capital-intensive side of the business; the big new paper machine investments and the like are clearly where the majority of the capex will continue to be attracted. But as you rightly say, we are seeing extremely strong growth in our converting operations, and of course that follows an ability to serve those markets through the investment projects we have been doing over a number of years. We have been investing above depreciation consistently for a few years now in the corrugated business and in the bag side, and obviously also supplementing that on occasion with inorganic investments. Most recently we obviously expanded our offering in Egypt with an acquisition in bags. More recently obviously we have done greenfield investments in Colombia, which we started up successfully earlier this year, and we are looking at further investments in North Africa on the bag side.

It is an ongoing journey. Individually each capex isn't huge in the great scheme of things, but of course, collectively, it does add up, so we will continue to invest in that. Clearly you have more flexibility on your capacity in converting. It is easier to add new capacity, but it is very much dependent on the market development. We are always cognisant of investing behind the market, making sure we are serving the markets that we want to serve and that we are best able to serve, given our attributes and, clearly, what our customers are looking for. We certainly see further opportunity for expansion there. We mentioned in the literature how we have approved further investment in our corrugated network recently to continue the ability to expand, particularly with our eCommerce customers, but of course there are other customers which are growing strongly as well. So, it is an ongoing journey, and we will continue to look for those expansion and investment opportunities.

Just on the StretchWrap, yes, I agree with you. It is a big opportunity. As we tried to illustrate there, 1% of that pallet StretchWrap market could be 10,000 tonnes of plastic. That is more like 15,000 or 20,000 tonnes of paper, because it is a heavier basis weight, obviously, on the paper side. It is always difficult to extrapolate these things, because clearly there is also a function of being capacity constrained in the near term in terms of the ability to serve that market. We are already serving it through the production in Dynäs. Does it provide opportunity? In the first place it obviously provides a better mix effect into our business, which is immediately beneficial for us. Can we look to invest further behind it? Clearly there must be expansion potential across our kraft paper network, not only because of StretchWrap, but because of a number of other applications that we are finding for our speciality kraft papers. We see a very exciting future for that, and we are certainly looking at investment opportunities behind that growth.

Mike Powell

Does that answer your questions, Cole?

Cole Hathorn

Yes, thank you. Just one follow-up on that. The opportunities in the kraft paper segment and sack kraft are clearly encouraging, but what does your position as the number one paper producer and converting network provide you versus competitors to take advantage of these opportunities that arise?

Andrew King

Clearly it is a very powerful position. For one thing, no one can match our geographic reach in bags. I think last year was a classic example, where there was a real push towards shortening people's supply chains. People did not want to rely on big, long supply chains because the risks were very clear, and so those of us who have the geographic reach to be able to produce locally is an extremely powerful position. I think what is also critical is that real, deep knowhow in terms of both paper-making and bag-making, which we can really bring to bear in those propositions to our customers, so we can really inform them on the journey that they are taking towards those sustainable products in terms of what we can do from a technical perspective, both in paper-making and the converting. That is an extremely powerful position. Of course, we have that established asset base on the upstream side which allows us the opportunity to look for further expansions of a brownfield nature, which I think are invariably more value accretive than if you are looking at a potential greenfield investment.

Mikael Doepel, UBS

Good morning Mike and Andrew. I have two questions, if I may. Firstly, on the Uncoated Fine Paper business, as you point to, we see quite nice recovery in the volumes there, and you continue to outperform the market. The pricing is starting to improve as well. Still, if you look at this business from a historical perspective, if you look at average EBITDA, for example, for 2018 to 2019, you did generate around €475 million for a margin of 26%, and last year we are down to €266 million for a margin of around 18%. Now, it is of course recovering from that, maybe towards €300 million or so, but it is still quite far away from the levels you generated a few years back. My question is what would it take to get back to those levels? Is it realistic to assume that you can get back to those levels, or is it, as Andrew said previously, an element of permanent demand destruction that keeps you from getting back there? That would be my first question, if you could talk a bit about the path towards recovering the earnings in that business.

The second question would be on the sack kraft paper markets, and in particular the pricing there. If you could just shed some light on how we should think about the flow through on your volumes, on the price increase that we have seen. If you look at the RISI statistics, for example, there has been quite meaningful increases, especially on the brown sack kraft papers, with 2% to 10% increases, pricing up about 20% now year-on-year on a spot basis. I was wondering if you could talk a bit about how that is going to flow through to your numbers in the second half of this year into 2022.

Andrew King

Thanks very much, Mikael. Firstly, on the Uncoated Fine Paper side, as I said in the presentation, I firmly believe what has happened over the last 18 months is that there has been some acceleration in that structural decline in demand. We always typically planned previously for a 1% to 2% per annum structural decline, and of course that will ebb and flow depending on economic cycles and the like. Clearly what we saw last year was a much more profound drop, but a lot of that was temporary in nature when people were just closed down; we have seen a strong recovery of that, but we still remain at levels, in terms of the industry dynamic, well below pre-crisis levels. I am certainly a believer that we are not going to see a recovery in overall demand to pre-crisis levels.

Clearly, for us, we do benefit from the fact that, as the long-term, stable supplier – and we will continue to be that long-term, stable supplier – we are seeing customers coming to us because they value that, and we will continue to be that supply into the market. That is benefitting us in terms of market share gains, hence the volume recovery we have seen this last year. But if I look at the industry structure more broadly and industry margins, one has to assume that if you have that type of structural decline in demand you have to see a supply-side response. Now, the good news is we are seeing that supply-side response. You all know the announcement from Stora Enso a few months ago. That capacity has not yet gone out of the market, but we understand they will be closing in Q3, Q4, I believe, so that will have an impact, but we have to see the supply side fully respond to the structural decline in demand before you can get a material structural change, should I say, in the overall margins. But, notwithstanding that, we are seeing good volume growth in our business. We are seeing a recovery in profitability. Recognising that profitability is still good, but certainly it can continue to get better.

When can it get back to pre-crisis levels? I think you have to see more capacity closures and I certainly believe that that is not just a wish without foundation. There is still a lot of capacity, even with the modest price increases we are seeing at the market who are under deep pressure. As you know, with pulp prices having gone up, unintegrated players in particular are feeling squeezed. I suspect there probably will be more closures, but I think you have to see that happen before you can see that sort of structural change in the margins in our business. Notwithstanding that, we are seeing good recovery.

On the sack kraft, on the pricing side, yes, it is always complicated, clearly, because, unlike the containerboard side, for example, we do have a lot of fixed-price contract business in the paper side and also in the bag side. Our rough rule of thumb on that is a third, a third, a third. In other words, a third of our business is annual contract business, a third is what we would call semi-annual contract business and a third is floating price. That is whether you sell a tonne of kraft paper as a bag or into the market directly.

What happened this year was we saw pricing come off through the course of last year – the spot price, that is – and then the annual contract business was priced off that relatively low spot pricing. It was only subsequent to that, into the backend of Q1 this year, that we started to see a rise in the spot pricing. That, as you rightly say, has moved up quite sharply now, but now it will take some time to feed through in terms of our pricing mix because of that lag effect created by the annual contract business. I hope that is clear.

Mike Powell

Ok Mikael? Thanks for your questions.

Lars Kjellberg, Credit Suisse

Good morning. I just want to focus a bit on cost inflation. Clearly you broadly matched your sales price increases in H1. I suppose part of that is actually a function of higher maintenance cost on a year-on-year basis, but how should we think about the underlying cost inflation as we are heading to H2 and the sales price component? Of course, you are talking about higher exit rates and incremental price movements, essentially across your portfolio. Is it fair to assume you are going to see prices outpacing costs? Certainly on the back of your comment you may have stabilised inflation towards the end of the first half.

I also want to talk a bit about your flexible packaging offering, especially the resin side. Andrew, you talked about reducing where possible, and that sustainability debate. Is that one where you see equally strong momentum in that sustainability trade in comparison to your easier wins, in a way, on the fibre-based packaging?

Mike Powell

Thank you, Lars. So let me start with the input costs. If I split the input costs down, Lars, if I take OCC at Q1, the OCC costs were rapidly escalating at that point, and we saw that continue through the period. OCC costs were about €100 a tonne higher through the period, and we use about 1.5 million tonnes on an annualised basis. That differential of €100 per tonne actually plays into the second half as well. I think that €100 per tonne is a good number for the year. Whilst they have stabilised to some point, you will still see the H2 on H2 impact. Indeed, because the exit rate of it was higher than the average for the first half, you will see some of that inflation still play through H2 on H1.

On resins, which was the other callout at Q1, that has played out. You have seen the indexes for resins up 50% at times from the low point and, again, we saw resin inflation. Those have stabilised as we exit the period, and therefore into H2 you'll get the same averaging effect. The one thing I would remind you on resins, of course, is that does get passed through. There is a delay as we pass that through in some cases, but there is a pass through mechanism in a large part of the business on the resin side.

Energy and transport is well documented. Those have increased, and energy costs and transport continue to increase. I think on the rest of our cost base, Lars, I would probably couch it at, that we are probably at 3% to 5% second half over first half on other inflationary costs. Wage inflation: again, whilst it is a large topic, clearly in the Americas and availability of labour, we are not yet seeing that in the larger part of our business at this point, but clearly we keep an eye on wage inflation.

Andrew King

Just on that question of the sustainability trends in the resin-based flexibles, as you referred to them, the answer is the momentum is strong across the piece. The consumer flexibles area is probably where the greatest level of innovation opportunity sits. Some of those examples we presented are really taking our substrate knowledge in paper, combining it with our substrate knowledge in coating applications and the like, and then in turn leveraging our understanding and knowledge of the customer that we have in our consumer flexible areas to really develop all of these sustainable solutions, be it the functional paper side of things or the fully recyclable plastics opportunities. This is a huge discussion, as you could imagine, with all our customers, those primary packaging customers of ours in consumer flexibles.

There is a huge amount of opportunity there. We are putting a lot of effort behind it. We have a natural advantage over others, simply because we know all about both paper and the resin opportunities and what they are capable of, and we are bringing those together. I must say I am very excited by this. It is something that a year or two ago was talked about and understood that it was coming, but now we really feel it. It has got a lot of momentum. I am sure if you go to the supermarket these days you will notice if you buy everything from snack bars to Smarties in their packets you will find them in paper-based solutions. It is paper-based solutions made by our consumer packaging business. It is not made by the traditional paper bag producers. Yeah, there is a lot of opportunity there and that momentum is only just starting.

Lars Kjellberg

Just on Olmuksan, can you say anything about your financial contribution of that business and your thoughts on any potential synergies, integration efforts or benefits that you talked about when you announced the deal?

Andrew King

Yeah, it is certainly going very much according to our plan on the acquisition side. We are delighted with the team at Olmuksan. Obviously we are happy to have acquired it at a time when the market is also conducive. Sometimes you get lucky on that side of things. The team has joined us and we are in the throes of the integration process, respecting the fact that it is obviously also a listed company, and you can see the numbers as reported. Yes, we are delighted with the acquisition and it really gives us a very strong position in what is a fast-growing corrugated market in Turkey.

Wade Napier, Avior

Morning Mike, morning Andrew. A couple of questions from me. I want to understand the strategy with regards to the corrugated packaging and the converting side of things. There seems to be more emphasis on it now relative to the larger upstream projects. In this business, as I understand, it is largely a regional corrugated play, so I am just trying to understand what Mondi's competitive advantage is in this business relative to your other converting business, i.e. the paper bags business, where you have a global footprint. Andrew did speak about how the group benefits from that global footprint. How is this now different to corrugated, where you are really a regional player?

Further to the corrugated growth that you are seeing, 15% in the first half, what sort of cadence should we expect in the second half, considering that the benefits of the industrial packaging side of things is probably going to start exiting the base? Can you give us a little bit of a flavour of what you are seeing so far in the second half of the year?

Andrew King

Thanks Wade. With regards to the corrugated strategy, firstly we have always had a good corrugated business and it continues to get better; maybe we are just talking about it a bit more. We are delighted with the performance of that business, as you can see from the volume growth and the underlying profitability growth that that underpins. Clearly we are a regional player in corrugated, but an extremely strong regional player, so we really operate in three key regions: Poland, which, as you could imagine, is a fast-growing market inherently, and we are a leading player in that market, clearly backed up also by our extremely strong backward integration position; central eastern Europe, which really comprises southern Germany into Czech Republic and Austria, with also a very strong regional presence there. We have quite a lot of what we call a heavy-duty business there, selling into automotive and the like. It is an extremely strong position in what is effectively a niche market within corrugated. Then we have our Turkish presence, which, as I just said with Olmuksan, has cemented our position as a clear leader in that market, and we are delighted with what is a high-growth market.

There is no mutually exclusive strategy in regard to corrugated. We certainly believe being a very strong player in our selected regions does not give us any disadvantage relative to other players who might have a broader regional, global or pan-European strategy because there is a lot of very strong regional business that you can go after in corrugated. The corrugated market is a very different dynamic to the bags market. On a global basis bags has a relatively small niche market. The sack kraft global market is probably a four or five million tonne market. As you well know, corrugated or containerboard in Europe is a 30-odd million tonne market, so it is a very different dynamic. I do not think one can equate the two, but clearly we have good scale in the markets that we serve in corrugated, and I think that has manifested in that very strong growth that we see in that market, and, more importantly, the very strong returns we are getting out of that business.

We are delighted with that business. We will continue to grow it. We certainly see opportunity for further growth, both organically and hopefully inorganically, if the opportunities arise. Of course, we also have opportunity to backfill that with containerboard if the circumstances allow, but always on the basis that the containerboard itself needs to be a very strong, low-cost production, because we certainly firmly believe that that is always going to be a key value driver.

On the H2 growth rates, we are only early into H2, but the simple message is the markets remain very strong here and we continue to grow. The simple problem that everyone has, frankly, is access to paper, even as an integrated player. Our corrugated guys are crying out for more paper right now. If anything, the market as a whole is capacity constrained, but we continue to see very good growth rates in corrugated. As I mentioned, eCommerce continues to be a very important driver, but we have also seen a recovery in what I would call the traditional uses of corrugated as well, and those two factors combined mean that the market continues to be very strong.

Mike Powell

Does that answer your questions Wade?

Wade Napier

Thanks Andrew, thanks Mike.

David O'Brien, Goodbody

Thanks for taking my questions. Just a couple from me, please. Firstly, on sustainability and as that team has evolved over the last number of years, can you share with us what you think the proportion of your packaging business in total is now directed specifically into sustainable products? What has the penetration been within your own business? As part of that evolution, how have the pricing discussions with those type of products differed from more traditional packaging solutions? Is there any difference between fibre-based or coated applications?

Secondly, you have just talked about the tightness we are still seeing in containerboard across Europe. Do you guys still see upward pressure on pricing there, or how should we think about that nearer-term?

Andrew King

Firstly, David, on the question of how much of the portfolio is with sustainable products, it is always an extremely difficult thing to measure, because just to define what is sustainable is very difficult. I always think also with sustainability more generally you have to have a combination of solutions; it is not any one solution. If you define it as simply fully recyclable products, for example, then around 80% of our portfolio is fully recyclable. The component that is not is, of course, things in the Engineered Materials space, the personal care component areas, and some of the multi-laminates flexibles offerings. Of course, in themselves, for example, that flexibles offering uses a whole lot less raw material than the alternative solutions, be it metal cans or glass or the like, so they still offer a big sustainability advantage. What we are obviously pushing from an innovation perspective is making sure all of those things can then be fully recyclable as well. That is where a lot of the development is taking place, and we are making very good strides in that regard, which is in itself exciting.

On the pricing side of things, clearly a lot of the solutions – call them the incumbent solutions – are there for a reason, in that they offer functionality at a very attractive price point. A lot of the sustainable solutions have typically been more expensive than the existing solution, but frankly that is no longer really a discussion with our customers. They are seeking those sustainable solutions. As you know, they have made a lot of commitments themselves, the big FMCG customers in particular, around pushing the sustainability agenda, and clearly they need our help in that regard. Even if these products are costing more than the incumbent product, they are certainly wanting them because they see them as a competitive advantage now. You can sell that as a value proposition to their customers in turn, so we are not seeing that as an inhibitor at all, and clearly where we can get ahead of the game in terms of our innovation.

As I say, I cannot reiterate enough that, with the platform we have, we have that ability to get ahead of others in terms of our ability to innovate with those, combining the different substrates or the paper technology with the knowhow in our primary retail packaging. There are great opportunities, and we are seeing that. Hopefully some of those examples illustrated in the presentation bear that out. I apologise; I did not get the last question. If you could maybe just repeat that, David?

David O'Brien

Yes. You have commented on how tight containerboard markets remain. Do we still see upward pressure on pricing there?

Andrew King

Yes. I cannot stress enough that markets remain very tight. I think there are some price increase initiatives at the moment in the market. I have every confidence that they will go through. I think the market is sufficiently tight. The problem challenge, frankly, is availability of paper. I think everyone is maxed out on paper production, all the producers, and there is a scramble for volume. This is not a stocking thing or anything like that. There is no stock in the system. It is underlying demand which is driving this.

Mike Powell

If I move to a question from the webcast, it is from James Twyman at Prescient. Andrew, James is asking if you could talk around whether you are seeing the same positive developments in terms of demand in Russia as you are seeing in Europe?

Andrew King

Thanks for the question, James. I think in Russia clearly our main exposure is on the uncoated fine paper side. We do obviously also sell some containerboard and newsprint into Russia. The short answer is yes, we are seeing a strong pickup in volumes in our Russian business if you look at the year-on-year comparator. The short answer is yes.

Mike Powell

James has a second question as well, Andrew, around the idea of capex for 2022. Let me take that one. I think it is a bit early to call 2022. I think you can assume, James, we invest through cycle. Clearly we will take note of where markets are, but I think we will need to get a little closer to 2022 and understand the world, but you should assume that our strategy remains unchanged. Andrew has outlined it very nicely today. We will come back to that guidance for 2022 later.

Sean Ungerer, Chronux Research

Good morning and thank you for the questions. Just in terms of going back to your sack kraft pricing, is it fair to assume that H2 should have a baseload of 67% of the price increase filtering through, and then by Q1 next year the full amount? My second question is on the interpretation of the potential upside into packaging. Is that a switch from uncoated wood-free or is that an addition to the capacity that could potentially be added down the line? My third question: your net-long pulp position has been reduced from 350,000 tonnes to 250,000. Is that on the back of a much stronger uncoated wood-free performance than expected? The last question: in terms of corrugated, when do you see the scenario easing up?

Andrew King

Sean, you are too quick for us. I will take the questions I caught there. On the sack kraft question, in rough terms, yes. I say 'in rough terms' because we always have to heavily caveat that guidance because it is a rough rule of thumb. But yes, we will certainly see into the second half some positive effect of the price increases we are seeing in the spot markets now, and then the full effect will come through in next year. It is of that order of magnitude, yes. I am maybe even slightly understating how much one would expect to come through the new year. All, of course, predicated on the fact that the current market conditions prevail at the time of those key price negotiations into the new year, which is obviously still six months away.
I did not quite get the second question on the issue of the pulp positioning at 250 versus 350. Yes, it is a function of a couple of things, the most important being one of the reasons why our pulp long position is reducing is because, if you recall, the new paper machine in Slovakia utilises some of the pulp that we were putting on a pulp dryer, and so that forward integrates the pulp. The good news on that front is that, a) we are ramping up faster than we had anticipated at the time of estimating that 350,000 tonne long position, and b) we are using more of the pulp. In other words, we are selling the higher-grade product than we thought; we took a more cautious view in our planning around the mix effect of the new machine, i.e. we thought we would produce more of the more recycled product and less of the product using the virgin pulp. The fact is the market is wanting the higher-grade product, and we are delighted to serve that because obviously it is a better margin for us, so we

are producing more of that. So both from a technical perspective and a market perspective we are driving more usage of that pulp for making our kraft paper.
On the other side of things we obviously had some production disruptions. You would have known we had a fire at our Frantschach mill, and fortunately we were able to get back to full production of kraft paper, which, as you can imagine, we are prioritising. There is a pulp dryer there which we are not able to fully utilise until such time as we fully repair the damage done by the fire, which will be in the third quarter of this year. For those reasons we adjusted the expectation for the full pulp outlook.

Mike Powell

Sean, I know you had a fourth question which neither of us captured, and whether we have answered your first three, so back to you. Just remind us of your fourth question and anything we have not covered.

Sean Ungerer

Okay, excellent. There were actually two more. The first one that we skipped was in terms of the uncoated wood-free asset base. You obviously alluded to further optionality in terms of packaging. Is that a switch out to lower uncoated wood-free capacity down the line, or was that in addition of paper packaging? Maybe I have missed the boat; if you could just let me know on that. Just lastly, obviously the containerboard story is very tight at the moment. Stocks across the supply chain are pretty tight, and that does not seem to be easing any time soon, especially on the kraftliner side. As Andrew phrased it, when do you think this cry for paper is going to stop? Is that a H1 story next year? Are you able to give any colour on that?

Andrew King

Firstly, on the optionality around that uncoated fine paper production base, I remind you of the fact that when we talk about our uncoated fine paper production base the key assets there is Richards Bay in South Africa, which makes market pulp and containerboard. It is not even a fine paper asset, to be honest. Clearly some of that pulp goes into making fine paper down the road in Merebank, largely for the domestic market, and that is a very profitable business for us. Clearly that does provide optionality in due course. The focus right now is we have this extended shut later this year and we are modernising that mill, and we will stabilise that operation and make sure that it reaches its full production potential, which gives us the additional output.

In Slovakia we have already invested in PM19, the new containerboard machine, and certainly in the near term the focus is optimising that and ramping that up to full capacity, which gives us more output there. In Russia, which is the other big contributor to our uncoated fine paper profitability, clearly we see it is a really multifaceted mill, producing uncoated fine paper, producing white top containerboard, and producing pulp, a lot of softwood pulp, also, for softwood applications. Clearly that gives us a lot of levers to pull. I believe there is opportunity on both sides, both in terms of expanding these operations for more packaging, not necessarily converting uncoated fine paper. At the same time there is also optionality to convert some of the uncoated fine paper if the markets do not require that fine paper, but the simple message right now is they do require it and we are selling it very profitably into their home markets. So the options are both conversions and/or expansions, but we continue to assess both, and obviously also a function of how the market looks.

The issue of when does this current tightness in containerboard alleviate, I do not think anyone can really answer that. I think the only thing I can say is we cannot see it at the moment. Clearly our order situation is extremely strong. We simply cannot fulfil everyone's needs. We are not seeing any softness or insight at the moment. I think one gets into the realms of prophesising if anyone really knew when that might happen. All I would say is we certainly believe in the strong structural growth in this market, and clearly it has been exacerbated in the short term by the rebound effect following the Covid unlock. I think the eCommerce effect is not going to go away, and the underlying structural drivers of both eCommerce and sustainability are very much intact, so that continues. I cannot see that alleviating at all.

On the supply side, there is some new supply coming on over time. This new supply has been coming on this year, but it has been very quickly absorbed into the market with limited effect on just how tight these markets are. I certainly do not see it any time soon.

Mike Powell

I will move to the last question, which is a webcast question from Ross at JP Morgan, and it is really around, 'Can you give some comment and colour around the downstream volume growth by segment? What are the drivers, for example, eCommerce, consumer, industrial, and how has that evolved sequentially?'

Andrew King

Sure. I think the main message here is, if I look at the box business, last year was very much a story of very strong eCommerce growth, for all the obvious reasons. Everyone was locked away at home, so firstly you could not go and buy things from bricks and mortar shops, and secondly your discretionary income could not be spent on services and holidays and the like, and that undoubtedly had a big impact on the eCommerce side from a positive perspective, but from a negative perspective, clearly a lot of industrial applications, other forms of retail, etc, were negatively impacted. Net net, the industry as a whole was probably up 2% or 3% in Europe last year, which is actually a very strong performance when you consider the economic backdrop at the time.

This year you have seen a continuation of that strong eCommerce demand, not quite as rampant as it was last year, but nonetheless still very good, and off a higher base than it was last year, simply because of the rapid growth over the last couple of years. On top of that, you have seen a recovery in, as I said earlier, the more traditional uses, everything from industrial things to the consumer durables and the like, and these have all come back quite strongly. That collectively has led to very strong overall market growth. I am delighted that we are taking more than our share of that because of our very strong offering and being able to grow faster. As I say, it is really a combination of eCommerce plus all these other things coming through.

That is particularly on the box side. On the bag side, again, we are seeing the traditional uses, be it cement – I am sure those of you who maybe follow the cement industry will have seen the cement producers are coming back very strongly – and clearly as customers of or as a supplier to them we are seeing the benefits of that, particularly across the Middle East, North Africa, these sort of regions, which are very cement-exposed. From our perspective you are seeing that recovery there. In Europe it is all about people building their houses and things, and there is a lot of that going on. I am sure people have followed the house builders and things; they are doing extremely well at the moment, and we are suppliers to that, so those traditional uses are coming through.

What is also very exciting for me is the fact that you are seeing new demand sources. I mentioned the eCommerce bags in the presentation. Those are growing very strongly and we are seeing real volume coming through there, and all those other consumer applications as well. For a while you just saw sugar and flour and these sort of things in paper bags, but more and more other applications are going back to paper and you are starting to see that reflected in our bag volumes as well. It is an exciting story, both in terms of a cyclical recovery of the traditional uses, plus a lot of these new uses driven by the sustainability agenda.

Mike Powell

Okay. Thanks, Andrew. We have no more questions. I would just like to thank you all for your time, your interest and obviously your questions this morning. Thanks very much.

ENDS