Q3 2021 results

7 October 2021

Transcript

Andrew King (Group CEO)

Good morning. I am Andrew King, Group CEO of Mondi. With me today is Mike Powell, our Group CFO. I would like to briefly summarise this morning's announcement before taking any of your questions.

Mondi delivered a very strong performance in Q3, with higher average prices across the business and strong volume growth delivered on a year-on-year basis, against a backdrop of what is sharply high input costs. Underlying EBITDA for the third quarter was €388 million, up 27% on the comparable prior year period, and up 9% sequentially.

Throughout this period of high demand, we of course remain very focused on ensuring the security of supply and high-quality service to our customers. Our growth is underpinned by our leading packaging portfolio, and we continue to develop innovative and sustainable packing solutions to help our customers achieve their environmental goals.

Going into costs in particular in a bit more detail, input costs were significantly higher in the quarter, both year-on-year and sequentially. If we compare to Q2, we saw higher energy, resins, transport and chemical costs. Paper for recycling, which is obviously a big input, was mostly stable, although this did increase towards the end of the quarter. Energy costs, which is highly topical in Europe, did increase through the period and rose sharply at the end of the quarter, on the back of material increases in electricity and gas prices. We expect them to remain at these elevated levels, at least in the fourth quarter.

Looking at our investments and how we have delivered value-accretive growth, our major capital investment projects are progressing well. With these investments we do capture opportunities in our growing packaging markets, we strengthen our cost competitiveness and deliver sustainability benefits. We also have expansionary projects underway at a number of our converting operations, which allow us to grow with our customers, enhance our product and service offering, and improve efficiencies and converting costs.

We are obviously very excited by the possibilities offered by our high-quality asset base, supported by the strong structural growth trends in the markets we serve, including eCommerce and the demand for more sustainable packaging, and we look to continue to evaluate further organic development opportunities in our packaging businesses.

Finally from my side, moving onto the outlook, demand remains strong and we are implementing price increases across the business that will support the recovery of the ongoing inflationary pressures. While in the short term the fourth quarter will be impacted by recent input cost increases alongside the planned maintenance and project-related shuts, the Group remains well-placed to deliver sustainably into the future, supported by our leading offering of sustainable packaging solutions, our integrated cost-advantaged asset base, and of course our culture of continuous improvement.

With that, Mike and I are very happy to take your questions.

Questions & Answers

Lars Kjellberg, Credit Suisse

Just a couple of questions, very quickly. You have highlighted that demand continues to be strong. Could you give us any colour for the various business lines, broadly speaking, on how the order books have developed into Q4 versus Q3? Also, on the cost side, if you can give us any sequential or year-on-year quantification of the cost pressures you saw and what you're looking for into Q4?

Andrew King

Very good, Lars. Thanks very much. I will take the first question on demand and then Mike can handle the second question on the costs. On the demand picture, as we say in the commentary, it remains really strong. When I look at our order situation across the piece, we certainly do not see any weakness across the order situation, or any signs thereof. As you well know, following the commentary on the sector, typically we have seen a very strong demand picture for some time now and, as I say, that certainly does not show any signs to me of relenting. When you look at it business-by-business on the corrugated side, our volumes were very strong again in Q3. Comps are starting to get a little bit harder now, but nonetheless still in an absolute sense, sequentially, very strong. That is really underpinned by, as we well know, the eCommerce effect. It continues to be very strong, but of course we are also seeing ongoing strength across pretty much all end users now, and that is really what is driving this. Again, the sustainability structural driver should not be underestimated here. We are also seeing a number of examples where we are simply using more corrugated solutions, which might have historically not been in corrugated. That all goes well.

Obviously we have been saying that ultimately this is not a 10% compound growth business as we saw in industry growth numbers for the first half of the year. It will slow down over time from that, but I still believe it will continue to grow structurally at healthy levels.

In terms of the flexibles business, again, our bag-order situation remains very robust. Clearly, we are going into a seasonally slower period. Q4 is always slower than the summer months because of the slowdown in European construction. However, if I look at it versus this time last year, we have remained extremely strong. We again see it pretty much across the piece and more geographically for us in Europe, across the Middle East and North Africa, into the Americas, a healthy order situation and demand picture.

Then, finally, uncoated fine paper, again, a decent order situation. Obviously there is a different paradigm around uncoated fine paper, where we saw a structural decline taking place pre-COVID and then the accelerated decline in COVID. Clearly, it has recovered from the lows of last year quite healthily and our order situation remains good in those products. In a lot of ways, as well, it is more of the same from what we were talking about a couple of months ago when we released half-year results. Maybe Mike could also talk about the costs, which have changed to some extent.

Mike Powell (Group CFO)

Yes. Lars, thank you for your question. Just to cover the broad range of costs, though I am sure you really want me to talk about energy. Transport remains tight and continues both availability and costs. Resins are probably stable at a high level. Wood prices are nudging upwards. PFR actually remains relatively high and, again, I would describe it as nudging upwards slightly. Those, as Andrew has just alluded to, are a bit more of the same, with a little bit more.

The major change has been energy, which is getting a lot of press coverage as well. Just to give you Mondi's overview, Mondi generates from its pulp and paper mills about two thirds. About 70% of our energy needs are actually biomass generated from the process. About 70% of our energy is biomass. Of the remainder, we have clearly gas in Russia. That is obviously not affected by the recent increases, which really therefore, in Mondi terms, bring us back to our central European asset base, and that is really gas and electric. Clearly, you have seen the gas indexes have moved fivefold in the last little while. Clearly, that does have an impact.

To scale it, I would say Q4 versus Q3, it depends where the prices also end up, but to try to put some numbers around it, it is probably €30 to €40 million, if we sat here today the Q4 versus Q3 impact. Clearly, we need to continue to manage energy.

We do not really manage the business by the quarter, as I have always said, Lars, and therefore it comes back to the strength of the business model and how the industry prices that through. Those are the sort of impacts that we are dealing with on a Q4 basis, and clearly it will depend how high those prices stay and for how long, and then the impact in terms of selling prices into next year. Does that help?

Lars Kjellberg

It does, thank you. Can I have one quick follow up, just on the sustainable packaging and the pipeline that you commented on, Andrew? Are you seeing any wins or is it just a pipeline that is building? I figure the market has been so tight you cannot really take on incremental business, so how should we think about that?

Andrew King

Yes, Lars, incremental business on the containerboard side is more difficult, because, as you say, we are capacity constrained, so you typically see that reflected in price. The same applies effectively to the kraft paper on the flexibles side, where we are also seeing a big benefit of the structural driver on sustainability. Clearly, where you have the ability to be a bit more and you can adjust in terms of a volume perspective is in the converting operations.

No, it is not just the pipeline, it is for real. We are selling more product both in the corrugated side and probably even more so on the speciality kraft and flexibles areas, where we are seeing the ability to displace other forms of less sustainable packaging. We quoted at the half-year some examples around that. In the corrugated space, for example, we are using less and less polystyrene inside the box in order to support fridges and other consumer non-durables and things like that, because you can use corrugated there. Similarly, in the flexible space, everything from industrial applications, for example that stretch-wrap product we are now making and successfully commissioned with a customer and have a lot of demand for, through to the consumer applications where you are using more and more paper-based products, displacing different forms of substrate, which is very exciting, and also our recyclable plastic solutions as well, which are clearly in high demand because that is also a huge environmental benefit if you can drive the sustainability or recyclability of those products, it is not just a pipe dream, to use your phrase, but it is real and it is happening. However, I agree with you that in the short term on the paper side it is a bit frustrating, because one is obviously capacity constrained to some extent, but it is obviously also reflected in the price, which is positive.

Lars Kjellberg

Thank you.

Brian Morgan, Morgan Stanley

Just a point of clarification if I may. Your energy costs in the past have been €400 million a year. Just to clarify, I assume that relates to the one third that you buy externally in electricity and gas. Is that right?

Mike Powell

In rough numbers – and again rough gives you the guide – last year the total energy bill, including biomass, gas, electric and other forms, was about €320 million to €330 million. This year I would guess it would be about €500 million, but that includes all forms. You need to remember that 2020 was a light-volume year, so those are absolute numbers that hit the income statement. Obviously 2019 costs were somewhat higher because the volumes were higher. If that answers your question, those are the absolute year-on-year numbers we are dealing with.

Brian Morgan

That is perfect, thank you. Then can we just touch on chemicals? I do not know if I missed this in your commentary, as I am writing pretty furiously, but in terms of the Q-on-Q change in chemical costs, is it a smaller quantum than the energy change?

Mike Powell

Yes.

Brian Morgan

Okay, so it is not quite as inflationary as energy.

Mike Powell

Correct.

Brian Morgan

That is fine, thank you.

Andrew King

I would go so far as to say, Brian, it is not nearly as big a deal as energy. In terms of increments, that energy cost that Mike outlined is by far the most significant. Paper for recycling, which is a story which is well-documented, is obviously another cost that has been going up year-on-year but has stabilised more generally. Remember also that the energy number Mike quotes also has volume effect in there as well, because obviously 2020 was a lower-volume year than 2021. So there is some volume effect there, but obviously there is a lot of price effect. Simply put, if you see European gas prices go up fivefold, that does have an impact, even on a business like ours, which is more insulated than a lot from these type of things, because we produce a lot of our own energy because the big integrated virgin production, as you well know, is our own biomass energy generation largely, and of course also to the extent we buy gas in Russia, which is not impacted by the current dynamics. As I say, any business that is exposed to a fivefold increase in a single cost item like that is an impact, but we are in a relatively strong position on that front. One must not forget, as we keep saying, that the pricing environment remains very strong for our products.

Brian Morgan

That is great. Thank you very much.

Mikael Doepel, UBS

Coming back to the volumes commentary, have you experienced any logistical constraints there? We are hearing some of the commerce companies voicing some bottlenecks in deliveries. I am just wondering if that is something you are feeling and whether it is having an impact on your volumes.

Andrew King

To be honest, there are logistics issues and we have seen it particularly in the cost of logistics. Again, it is well known that seaborne containers, etc, have also gone up materially in price. Logistics, certainly through the height of the COVID period – and I do not want to suggest the COVID period is over, but through the height of all the lockdown restrictions, etc – last year was a major issue for everyone, I believe. However, I certainly believe that has alleviated. We have well-established logistics chains. Obviously, we have a very wide network of plants, and particularly, for example, in the bags business where we are the local producer, as it were, we have a distinct advantage there. I would not want to suggest that logistics is not an ongoing challenge for everyone, but I do not see it as a particular bottleneck at this stage. Whether it is a bottleneck for certain of our customers or not is harder to determine. We certainly have worked very hard to make sure we get inbound and outbound logistics working, and our guys have done a great job in making sure that has happened.

Mikael Doepel

That is very clear. Secondly, on the corrugated box pricing in particular, I am wondering what magnitude of progression you are seeing on the pricing there. If you think about Q3, for example, compared to Q2, can you elaborate on that a bit?

Andrew King

We always say there is a three to six-month lag on box prices going through on the back of paper prices. In some ways the good thing about big paper price increases is that the box makers have no choice but to get the box prices up. If anything, that allows you to do it a bit quicker than you would typically on average. That is what is playing out. The box price development is typically following the containerboard price development, if anything slightly quicker than maybe you would traditionally believe, simply because of the magnitude of these paper price increases and the fact that the box makers simply have to get the pass through. Again, our business has done extremely well in this regard. Our corrugated solutions business, as we call it, has done a great job in making sure we retain our margins in that business, in the face of, obviously, for them, very strong, sharp cost increases on the containerboard side, obviously net net for the Group a clear positive, because of the long position we have there. Of course, they continue to work hard on that because, as you well know, containerboard prices have continued to rise.

Mikael Doepel

That is clear. Finally on fine papers, you alluded to the strong or decent order situation there. I am wondering if you still see a year-on-year improvement in volumes there, heading into Q4, and also if you see further price recovery heading into Q4.

Andrew King

Yes, certainly relative to last year we are well above. The industry more broadly is, and, as we said at the half-year, we have certainly outperformed the industry and we continue to do so, as our customers value that security of supply, that commitment to continuing to deliver both in terms of service and quality of product. That has ensured a good order situation. Clearly we are well above last year as an industry, but at the same time still below what I call 'pre-crisis levels'. As I said before, I do not believe demand in the sector is going to recover to pre-crisis levels, but, at the same time, the good news is obviously we have seen some supply side response as well, which is also very important in this context. That has also helped tighten up the order situation. At the same time, as we have said already, the costs have been going up. Clearly for unintegrated producers, the pulp prices are another input cost. It is less impactful for us, obviously, but certain of our production is also unintegrated. In addition to that, now we have this energy pressure on, again, the unintegrated producers primarily. We are in the market for price increases because the cost base has gone up there as well.

Mikael Doepel

That is very clear. Thank you very much.

David O'Brien, Goodbody

Good morning, everybody. Thanks for taking my questions. Three from me, please. We have focused a lot on the negatives in terms of cost. I guess, on pricing, could you give us some quantification of what the positive impact has been on pricing overall, either into Q3 or what you are expecting into Q4. As an add-on to that, we often think about OCC, wood or pulp as a driver for price increases or conversations with customers. Typically, how have price increases around energy been received by your customer base?

Secondly, you have talked about capacity constraints. How do you think about your own capacity situation on a three to five-year view, while recognising you are just ramping up a couple of machines at the moment?

Finally, you guys have talked about, 'paper where possible, plastic where useful,' which is a reasonably unique facet of the Mondi Group and its sustainability agenda. How has that helped with the wins you are seeing at the moment, in terms of that offering and beginning to pivot between both?

Andrew King

I hope I have all that. On the pricing, I am not going to give you absolute numbers because obviously one has to always look at these things in the round, but very clearly we continue to see pricing benefits. Q3 average pricing was sequentially up on Q2 across the piece, pretty much, as we saw the full effect of the Q2 price increases coming through. As you well know – you have seen the industry commentary, numbers and all of that sort of thing – we continue to get price increases through the Q3 and into Q4, so I remain confident on a sequential basis that the Q4 pricing will be on average higher than Q3. Obviously, at the same time, as we have made clear, the cost basis is also going to be higher in Q4 than Q3. In short, pretty much across the piece without exception, we are seeing positive pricing momentum. It obviously varies to some degree by segment, but also by grade within those segments, as you well know. The brown grades typically in containerboard have been moving faster than the white top and semi chem, largely because that has always been more volatile, and it went down further than the others and is now going up faster. Across the piece we are seeing price increases there. It is the same on sack kraft. Sack kraft, as we always say, in terms of the mix effect and how it affects our received price, there is always a bit of a delay there, both on the way up and on the way down, because of the contract nature of that business. There is a spot price, but then there is also the average price achieved, which takes longer to come through. We are very clear on that. We cannot reprice our whole book whenever the spot price moves in sack kraft; it takes a bit of time. However, we remain confident that, as those contracts come up for renewal, they will be repriced to higher price levels.

Then on fine paper, as I mentioned already, we have had modest price increases. I firmly believe that there is every motivation to push further price increases on the back of what are increasing costs. I guess that alludes to your second question. Particularly in the fine paper space where there is still a lot of unintegrated capacity, which is very exposed to energy prices and the pulp price, it is a discussion we are having with our customers right now around that.

On the question of capacity expansion, we continue to look. Obviously we have a number of projects both in commissioning and in the pipeline which will continue to incrementally add volume. If we tot up what we currently are optimising and/or have in the pipeline, it is around 8% capacity expansion in our upstream businesses. Obviously we are continuing to optimise PM19 in Slovakia, which is obviously ideal coming into what is a very strong demand market, and we optimised it in two ways. We are obviously incrementally every month getting more volume out of that mill and also optimising the product mix into what you would call the higher-value kraft top products as opposed to pure unbleached recycled containerboard. That is an ongoing optimisation. We have gone a long way this year, but we will go much further next year as well.

Then we have also been optimising that new expansion in Štětí, and that is going exceptionally well. I remind you, we are producing more paper for the retail paper bag market. There is exceptionally strong demand for that, and we pretty much sold out on that product and are producing as much as we can.

We have ongoing de-bottlenecking in the likes of Syktyvkar, which obviously every tonne is very valuable. It is, by definition, a low-cost production and we are modernising our Richards Bay facility, which will also give us stability and improve production output there.

We continue to explore other opportunities, because we do have that privileged low-cost asset base, in conjunction with strongly growing markets that we serve. That clearly lends itself to onward investment, so we are proactively looking at the next options around that and I am very confident we will come up with some good ways to spend our shareholders' money to make sure we can continue to develop and grow into these structurally growing markets that we serve.

On the last question on the paper/plastics discussion, I keep talking about our unique platform. Genuinely we have a unique platform there in that we have deep knowledge of particularly kraft paper making. We have knowledge of what we call functional papers, where we add functionality to the paper by doing a small layer of coating and the likes. A lot of the current developments and thinking is how you use such a small layer of resin that you can make it fully recyclable, and yet still have additional functionality that paper does not have. We have a lot of capability here. Of course, we also have all the converting knowledge both in the full paper-based solutions, where we are biggest globally, and also in other substrates, on conversion, be it resin, aluminium, etc. That serves an extremely demanding consumer products group, where we are producing the primary packaging for them that you see on the supermarket shelf. We are seeing every day examples where we can bring all of those capabilities together to offer them the best solution, as you say, under the banner of 'paper where possible, plastic when useful.' I think that does encapsulate how we think about it.

As I said in my opening remarks, driving further paper-based solutions is obviously immediately beneficial from an environmental perspective, because it is widely recyclable already as a solution. Also, one should not forget that, for certain applications, you need something thicker. You simply do not have the barrier properties with paper. In those solutions, the trick is making it with less raw material and making that raw material, and the product, fully recyclable. We are doing a lot of work in that regard. We have a lot of great solutions there and we will have more solutions around that. We are doing a lot of work in terms of making sure we bring the full capability of the group to bear for our customers' benefit in driving those value propositions for them. We have made great strides in that, but there is a lot more to come in that area. As I said in answer to Lars' comment, this is not just waving around and showing the odd anecdotal innovation example. This is now becoming real and it is really making a difference. We are seeing real volume pick up and real machine time taken up. Paper machines are big beasts that produce a lot of volume, and you need volume business. These solutions are really generating good volume opportunities and good pricing opportunities for us. We remain very excited by it. We have lots more to come from that area.

David O'Brien

That is great. Thanks a lot, guys. Take care.

Mike Powell

Thanks, David.

Justin Jordan, Exane BNP Paribas

Good morning, everyone. I have two separate questions. Firstly, thank you for all the detail on energy and transport. Just moving on to more positive aspects of pricing, you have clearly achieved substantial price increases across many of your product areas in Q3, given the 9% sequential increase in EBITDA, and well done on that. Just thinking about 2022, specifically within flexible packaging, clearly you have a number of semi-annual and fixed annual price contacts with some of your major global industrial customers. Does the strong demand and pricing environment that you are seeing give you greater confidence in achieving material price increases on those annual contracts for 2022?

Secondly, on a completely unrelated area, I am assuming given this assessment ramp-up to date in Ružomberok and Štětí, you are very comfortable with the prior guidance of €50 million additional EBITDA in 2021 from capital projects. Then, to take a step back and think about the strong demand environment that you are seeing, does that potentially accelerate some of the Board's thinking on further capital investments? I am thinking in the context of Mondi having spent €1.9 billion net investment on capital projects and bolt-on M&A in the last five years, and clearly in general they have been phenomenally successful. Given the strong demand environment you are seeing, does that make you, if anything, accelerate future plans into potential future capital investments going forward in 2022 to 2025?

Mike Powell

Justin, let me take the second one first and then we will pass over to Andrew. Yes, on the €50 million projects, the only reason that would be less is because of the energy that we discussed, which you described as bad news. The cost pressure is obviously on that project. What I would reiterate is that the projects have ramped up exactly as we expected, but clearly the costs in the short term may well affect that number, just because the costs have moved so quickly in the short term. The projects are in great shape ramping up and will provide us great platforms into 2022 and beyond, which probably leads nicely onto you, Andrew.

Andrew King

Yes, the first question is an easy one to answer. Yes, we believe that the current environment is conducive to upward repricing of whatever contracts are coming due as we head into the new year. I certainly see no reason at this stage. One does not want to ever be too presumptuous around these things, because obviously it is always a question of circumstances at the time, but it is very clear that these markets remain very strong. Our order situation remains extremely tight. We continue to struggle, frankly, to meet all the demand that we see out there. I am talking specifically about the sack kraft and kraft paper segments. In addition to the traditional industrial applications having been very strong, the likes of the cement market, etc, remaining very strong, and building materials in Europe remaining very strong, you are seeing these other demand sources come out. The eCommerce growth in bags is coming through very strongly, which is great. In addition, the consumer-related applications for paper bags is coming through, and in the kraft paper space all the speciality segments are growing really well, and we continue to see new uses which are displacing other forms of packaging. All of these things say to me that the order situation is extremely strong and there is certainly no reason to believe that as those contracts come due we should not be able to reprice them upwards.

Probably linked to your final question on the capex front, we see a real demand for the products we make. One should always make sure to unpick the difference between the cyclical effects and the structural effects, because it is the structural stuff you want to invest behind. However, very clearly there we do see good, strong, structural growth for all the reasons I have just articulated in these markets. As I said earlier, our asset base lends itself to further investments focused very much on the things we have always held dear to us, which is high-quality, low-cost production that we can expand.

Yes, we are actively looking at that and one also should not forget that the downstream converting businesses also lend themselves to onward growth. Growth does not come for free, but, as we demonstrated more recently, the value of the investments we have been making systematically in those businesses over the years is coming through with the strong growth we have seen right now. We are prepared to continue to support the growth in those businesses. We have a fantastic flexibles converting platform, and I see ongoing opportunities to incrementally expand that both through expansion of existing production, or just through brownfield expansion, but also selectively on either greenfield and clearly on the M&A front where we sequentially buy things. There are certainly more opportunities to come, and all these new sources of demand are very exciting for that business.

Likewise, in the corrugated space we have a fantastic platform, central and eastern European focused, with obviously also a very strong position in corrugated in Turkey. We are seeing really strong demand, particularly obviously from the eCommerce sector, but from a number of other sectors. Again, that lends itself to our ability to continue to invest and grow behind that. I am very excited by the potential there, and I certainly see the ability to support that growth with capex. As always, it is dependent on making sure it drives the returns for us, because it is value-accretive growth, which I always stress is most critical for us, which is what we fixate on.

Justin Jordan

Thank you, Andrew and Mike.

Cole Hathorn, Jefferies

Good morning. Thank you for taking my question. I just wanted to follow up on Lars' and Justin's question around the demand environment and the strong order situation. You have talked quite positively about trying to price up and having pricing power to offset the cost inflation, but I am wondering what the broader market is thinking, particularly in containerboard. There are a lot of recycled containerboard players that are smaller, may not have any hedging in place and do have much higher energy costs. How do you think they are going to deal with this cost environment? Is it going to be a situation of them really pushing price, because demand is good, to offset this cost inflation, or are some of these players effectively taking some downtime because they cannot operate at the current price levels, which I suppose will end up tightening the market?

Andrew King

Cole, I have no idea what our competitors are thinking. As you can imagine, we do not talk to them. Yes, your observation that there must be cost pressures on standalone recycled containerboard because, by definition, they do not have biomass energy, you buy typically off the grid normally, or you might have some sort of boiler system, and some of it would be gas. Some people might have some multi-fuel boiler capacity, I guess. Generally, if your question is whether the cost curve for containerboard is steepening as a consequence of this, because the recycled producers are seeing incrementally stronger cost pressures, the answer is yes. Exactly what people are then thinking as to how they are going to mitigate that pressure, it is impossible for me to speculate.

What I see, obviously, in our business, is we are obviously always working on our cost base anyway. We are in the fortunate position of having a lot of biomass energy generation as Mike's already alluded to. At the same time there are good fundamental reasons, simply from the tightness of these markets in supply and demand terms, as to why prices have been going up. To me, that is what is most important here, that we have strong demand, and yes there is incremental supply, but the fact is these markets remain very tight, and hence we have been able to achieve good price increases here. However, as I say, what others are thinking or doing, I cannot speculate on.

Cole Hathorn

Thanks for the colour. Then just a quick clarification; I just did not quite hear it. On the flexible plastic packaging business, have you recovered the impact from the higher resin prices by the end of the third quarter, or is there still a little bit of recovery to go there on the polymers and the various resin inputs?

Andrew King

It is largely through. We have always said in that business we are in the fortunate situation that a lot of the business is driven off a formula, so you effectively get an automatic pass through with a delay of sorts. It normally takes about a quarter for that to wash through. Obviously there is some business which is not formula-led, and obviously we have some business where there might be some resin comping, as it were, which is not material to the overall offering, which is in a way more difficult to pass through. By and large it has passed through. That resin story, even if it goes up in absolute terms, is not as big a drag on our margins, simply because there is a lot of pricing mechanism and frankly no converter can take price risk on resin prices.

Cole Hathorn

Thank you very much.

Sean Ungerer, Chronux Research

Good morning, Andrew and Mike. Thanks for the questions. Just going back to corrugated, obviously you have alluded, and everyone knows the market has been pretty tight. I guess, on the 12 to 18-month view, barring any major macro shocks, what could you see alleviating the tightness in the market, or do you see this as business as usual for the next 12 months?

Andrew King

Thanks, Sean. It is difficult to predict next week, let alone in 18 months. If you look at it longer term, as I keep reiterating, there are good, strong structural growth drivers here. This eCommerce thing is not going to go away, and every dollar spent through an eCommerce channel just uses more packaging more broadly than through a traditional bricks and mortar channel. I firmly believe we are not going to see a reversal in the business that has gone online, as it were. Similarly, as I said, the sustainability trends are only really gathering momentum, if anything. That is a firm driver behind ongoing good, strong growth in demand.

That said, as I said at the half-year and I will reiterate, the first half of this year the industry as a whole grew volumes at 10%. That, to my mind, is not sustainable. It was obviously exacerbated by the fact that you saw both the ongoing very-strong eCommerce picture, in addition to recovery playing out in a lot of the traditional sectors as well.

Over time, what will happen is the growth in eCommerce demand has to slow down. It will still be growing; it just cannot be growing at the rates we have seen. Clearly, through the pandemic, eCommerce had an open goal in the sense that everything else was closed and people were spending all their money on buying things off the internet. Clearly, as the world opens up and people can spend their money on other things, like travel and entertainment and the like, that will have an impact. You are starting to see that, anecdotally, if you look at the commentary out of the eCommerce producers, or the companies, that that rate of growth has to slow down, albeit it is not going to reverse, in my view. That will, over time, cause a slowdown from the current very strong rates of growth we are seeing in corrugated. As I say, I emphasise that I firmly believe the structural trends are frankly stronger than they would have been two or three years ago, in terms of the way we see things.

In my view, that is the way it is probably going to unfold over the next 12 to 18 months. It is always difficult to predict an end. Of course, there is always going to be a macroeconomic overlay on all of this, albeit in 2020 there was a mass decoupling of corrugated demand from the macro. We saw the macro indicators go backwards, and yet even in 2020 corrugated demand grew. Clearly it would subdue the rate of growth we are currently seeing if you saw a macroeconomic slowdown of some sort. I still think it remains a very robust picture as we look forward.

Sean Ungerer

Thank you. The corrugated volume growth printed in H1 was up 18% year-on-year. Is that similar to Q3 or has Q3 outperformed that?

Andrew King

The thing with year-on-year numbers is they can be a bit misleading, because it depends on what the comp is. Obviously the comp is getting harder in H2, but the volume growth remains very good. You just have to always be wary of the comp.

Sean Ungerer

Switching over to the uncoated woodfree business, I know there was a bit of commentary about it earlier, but I know at the last update call when I asked about it you were still seeing the need for further capacity rationalisation. Linking to that, obviously there has been a couple of percentage point price increases going through, and probably a bit more before the end of the year. Could you comment on how you are thinking about that in terms of cost push versus supply/demand balance in Europe specifically, and any read-through for North America.

Andrew King

I would not know about a read-through for North America. If you look at Europe, there is very little trade flow between the two. There is a bit of volume from Europe which typically goes into North America, but not vice versa. I would say it remains the case that there still needs to be capacity rationalisation in this market. What has happened recently with this cost inflation is the cost curve has moved up, and that puts the marginal players, and has steepened even further in my view, because the unintegrated producers who dominate the high end of the cost curve are the most exposed to this energy story, and obviously pulp as well. So that must have put even more pressure at the top end of the cost curve. We have seen strong structural decline in demand over the last year. It has new recovered, which is encouraging, and we bear more than our fair share. We have done well in terms of gaining share in that context. I can only think there is a lot of capacity which is under enormous pressure right now. Yes, I plainly believe there should be more capacity flows. We have seen a recent big move with Stora Enso's capacity now coming out of the markets, having been announced earlier this year. I would suspect there needs to be more to come.

Sean Ungerer

Just a follow up for Mike. The commentary around the energy cost – and maybe I misheard you. I heard that FY20 was at the €300 million mark, versus a normal range of €400 million, but I am looking here at what was reported under variable costs, and I have energy of around €452 million for FY20. The jump from €452 million to €500 million does not then seem as aggressive.

Mike Powell

Sorry, I lost you. Can you just repeat the question?

Sean Ungerer

Earlier on the call when you were speaking about energy costs, you said the usual run-rate is about €400 million per annum, but with the bill in FY20 closer to the €330 million mark, but obviously you said that does include biomass. I am just tying that into what was reported under variable costs in FY20 of about €452 million.

Mike Powell

Firstly, I do not recognise the €452 million. What I am trying to get over is the absolute numbers in FY20 for energy, biomass, gas, electric in the main, and a few other fuels, was about the €320 million mark. That number in FY20, of course, was quite a low number because volumes were somewhat lower in FY20 because of the world. The FY19 number would have been nearer the €400 million mark. This year's number will be nearer the €500 million mark. Whilst there is a year-on-year delta of about let us call it €180 million – though we have not finished the year yet – that delta needs to be taken into consideration with the stronger volumes that we are making as well. That was the point I was making, that, if you like, on a normalised year, call it €100 million.

However, I would reiterate, we often in the past have talked about the PFR, we have talked about resins, and now we are talking about energy. As Andrew says, I am sure next week we will be talking about something else. The strength of our business model and the structural drivers that Andrew has talked about leave us in good shape. Sure, there are Q-on-Q impacts. We have to get on and manage those, frankly, and make sure our customers get our products and our employees are great at servicing that. It is our job to path through that, and we have some good drivers to do that.

Sean Ungerer

Thanks, guys.

James Twyman, Prescient

I have three questions. Hopefully they are quick. First, the maintenance costs were obviously pretty high this year. Could you give an idea of what you think the costs would be next year, assuming next year is more of a normal year?

Secondly, you sell a lot of pulp to Asia. I think it is around 200,000 tonnes. Prices have clearly weakened there, but they have not weakened in the rest of the world. What are you seeing there in terms of that market? Are things stabilising there? Are maybe things improving a little bit?

Thirdly, your white top products and your semi chem products are less cyclical than the brown papers, but it is even more extreme this year than normal. The white top kraftliner price is pretty much the same as normal kraftliner now, which is extraordinary. I am just interested to know why you are seeing the gap closing quite as much as it is.

Mike Powell

Let me take the first one. Yes, I would expect next year on maintenance to be lower and back down to more normal levels, if you like. Hopefully that answers your first question. Then on the second and third questions…

Andrew King

Yes, we sell some pulp into Asia, but we are a small player in that market. I would not say we have any particularly great insight. The pulp pricing is generally stabilised, having risen, as you know, extremely sharply over the last number of months. Clearly China is generally slowing down to some extent, but beyond that I do not have much wisdom to add in terms of the Asian markets.

On the white top kraftliner story, yes, there has been a narrowing of the gap. It is not quite the same price; it still trades at a premium to unbleached kraftliner. White top kraftliner is a niche product which is used for certain very specific applications. As with everything, when prices of things are going up and your customers are looking at ways to mitigate those costs, sometimes you buy down, as it were. I expect there is an element of that, with people trying to substitute a more expensive product for a slightly cheaper product, albeit that slightly cheaper product is getting increasingly expensive in itself. It is safe to say we still make a lot of money out of that white top product, and we will continue to do so, and I suspect it will remain less volatile through the cycle. There are fewer producers, and it is very discrete, niche markets that are served.

I suppose on the margin, where people try and use something cheaper, that is probably what is happening right now. However, it is not to say there is not a very strong picture for the white top market. It is just probably you have not seen quite the rate of increase of prices, and it is always a sequencing thing as well. From one quarter to the next, the relationship can change. I would not read more into it than that.

James Twyman

Broadly you are saying you are seeing in those markets strong order books like you are in the rest of the business.

Andrew King

Yes, absolutely.

James Twyman

Thank you very much.

Andrew King

Thank you very much, everyone, for your interest, as always. As always, we are available on the end of the phone if any further clarification or comments or questions are required. Again, thank you very much and enjoy your day.

ENDS