

# Financial Review



**“The Group achieved a strong financial performance despite economic conditions.”**

## OVERVIEW

The Group has achieved a strong financial performance despite challenging trading conditions. A combination of early action taken to control costs and relentless focus on managing the business through the tough economic conditions led to our matching the level of operating profit achieved in 2008/09. Free cash flow was higher than in 2008/09 due to the planned reduction in capital expenditure and the additional benefits of asset disposals and lower interest payments.

## TRADING RESULTS

The Group's trading results for the year to 30 April 2010 are summarised in Table 1.

The major drivers of the 2009/10 results were: lower prices across the Packaging activity as a whole due to the weak economic environment; a recovery in CCM selling prices during the second half of the year in the UK Paper and Corrugated Packaging segment; a significant turnaround in our Plastic Packaging segment and a resilient performance from the Office Products Wholesaling segment.

Revenue for the financial year ended 30 April 2010 decreased by 1.7% compared with the prior year; it was 7.7% lower in the first half of the year but 4.9% higher in the second half. Excluding the effect of movements in foreign exchange rates, revenue was down 3.6% on 2008/09.

Adjusted Group operating profit (excluding exceptional items) in 2009/10 matched the 2008/09 figure of £94.0 million. UK Paper and Corrugated Packaging was marginally down, at £35.4 million, whilst Continental European Corrugated Packaging declined by £7.5 million to £22.9 million. The performance in these two segments was offset by strong performance in

Plastic Packaging which increased operating profits by £8.5 million to £15.5 million and Office Products Wholesaling which was £0.1 million ahead of last year at £20.2 million. The Group's adjusted return on sales was maintained at 4.5%.

The Group's adjusted pre-tax return on capital employed (which is defined as the adjusted operating profit divided by the average capital employed) increased from 9.3% in 2008/09 to 9.7% in 2009/10, although this remains below the Group's estimated pre-tax cost of capital of 11.8%. The increase in the Group's return on capital employed reflected higher returns in 2009/10 in both Plastic Packaging and Office Products Wholesaling, which were partially offset by lower returns in UK Paper and Corrugated Packaging and Continental European Corrugated Packaging. The pre-tax cost of capital for each segment varies between 11.1% for Plastic Packaging and 13.4% for Office Products Wholesaling.

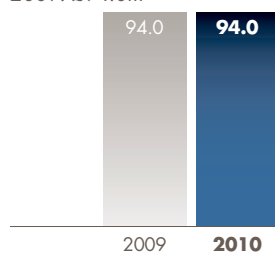
## EXCEPTIONAL ITEMS

The Group recorded net exceptional charges before tax of £13.3 million during the year (2008/09: £55.7 million). A total of £13.3 million was recorded against operating profits, of which £2.7 million were restructuring costs. Impairments included the impairment of the carrying value of intangible assets within UK Paper and Corrugated Packaging of £4.3 million. In anticipation of the disposal of the Group's business in Turkey, which was announced in May 2010, the assets of the business were impaired by £5.9 million. A further £0.4 million was recorded against exceptional costs in respect of Demes Logistics (which was sold in January 2010) and the anticipated disposal of a small UK corrugated packaging business, which occurred after the year end. Operating profit after exceptional items was £80.7 million (2008/09: £43.4 million).

### Adjusted operating profit (£million)

**£94.0m**

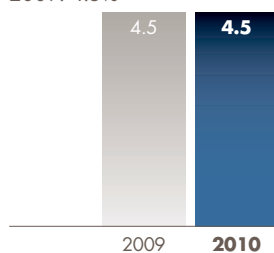
2009: £94.0m



### Adjusted return on sales (%)

**4.5%**

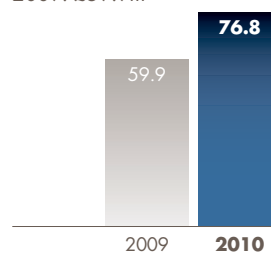
2009: 4.5%



### Free cash flow (£million)

**£76.8m**

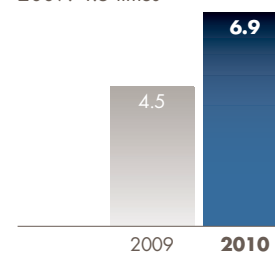
2009: £59.9m



### Adjusted interest cover (Times)

**6.9 times**

2009: 4.5 times



**INTEREST, TAX AND EARNINGS PER SHARE**

Net interest expense decreased from £23.6 million in 2008/09 to £14.4 million in 2009/10, mainly reflecting lower interest rates and lower average net debt. The employment benefit net finance charge, which is a non-cash item, was £11.5 million (2008/09: £1.5 million income), reflecting a higher opening deficit on the defined benefit schemes. For 2010/11, given the lower discount rates used and higher return on assets, it is anticipated that there will be a decrease in the employment benefit finance charge to circa £8.0 million.

In 2008/09 the Group took the decision to fully impair its investment in Rubezhansk, the Group's associate business in Ukraine. Consequently, the Group has not recorded any income in respect of profits achieved by the business due to the continuing uncertainty of the outcome of the negotiations between Rubezhansk and lenders regarding the restructuring of Rubezhansk's US\$87 million loan. There is no recourse to the Group for the loan held by Rubezhansk.

Adjusted profit before tax was £68.3 million (2008/09: £72.5 million). Profit before tax after exceptional items was £55.0 million (2008/09: £16.8 million).

The Group's effective tax rate, excluding exceptional items and associates, at 26.1%, was lower than the previous year's rate of 31.4% mainly as a result of the recognition of prior year foreign currency losses which only became recognisable under IFRS when the tax return is submitted. A tax credit on exceptional items of £0.9 million resulted from tax allowances for restructuring costs.

Adjusted basic earnings per share were 12.9 pence (2008/09: 12.6 pence). Basic earnings per share were 9.7 pence (2008/09: losses per share 3.0 pence).

**TABLE 2 – CASH FLOW**

	2009/10 £m	2008/09 £m
<b>Operating profit before exceptional items</b>	<b>94.0</b>	94.0
Depreciation and amortisation	<b>72.0</b>	69.9
<b>Adjusted EBITDA</b>	<b>166.0</b>	163.9
Working capital movement	<b>(2.4)</b>	30.8
Other	<b>(9.7)</b>	(11.1)
<b>Cash generated from operations</b>	<b>153.9</b>	183.6
Capital expenditure payments	<b>(52.6)</b>	(87.4)
Sales of assets	<b>13.0</b>	7.7
Tax paid	<b>(21.3)</b>	(21.0)
Net interest paid	<b>(16.2)</b>	(23.0)
<b>Free cash flow<sup>1</sup></b>	<b>76.8</b>	59.9
Exceptional cash costs	<b>(18.4)</b>	(17.2)
Dividends	<b>(12.9)</b>	(34.4)
Dividends paid to minority shareholders	<b>-</b>	(1.9)
Net acquisitions	<b>(1.0)</b>	(1.2)
<b>Net cash flow</b>	<b>44.5</b>	5.2
Purchase of own shares	<b>-</b>	(0.2)
Net debt acquired	<b>(0.9)</b>	(0.2)
Non-cash movements	<b>8.4</b>	(44.5)
<b>Net debt movement</b>	<b>52.0</b>	(39.7)

<sup>1</sup> before net acquisitions/(disposals) of equity in subsidiaries, exceptional cash costs and dividends

**DIVIDEND**

The proposed final dividend is 3.1 pence (2008/09: 1.8 pence), giving a total dividend for the year of 4.6 pence (2008/09: 4.4 pence). Dividend cover before exceptional items was 2.8 times in 2009/10 (2008/09: 2.9 times). After exceptional items the dividend was covered 2.1 times (2008/09: not covered).

**CASH FLOW**

The Group generated free cash flow of £76.8 million (2008/09: £59.9 million). Adjusted EBITDA rose by £2.1 million to £166.0 million. Despite the increase in paper and box prices towards the end of the year, our tight control of working capital resulted in a working capital cash outflow of just £2.4 million (2008/09: inflow of £30.8 million). Cash generated from operations (before exceptional items) was £153.9 million (2008/09: £183.6 million).

**TABLE 1 – TRADING RESULTS SUMMARY**

	First half		Second half		Full-year	
	2009/10	2008/09	2009/10	2008/09	2009/10	2008/09
Revenue – £m	<b>1,018.0</b>	1,102.8	<b>1,052.6</b>	1,003.8	<b>2,070.6</b>	2,106.6
Adjusted operating profit – £m*	<b>48.5</b>	54.4	<b>45.5</b>	39.6	<b>94.0</b>	94.0
Adjusted return on sales – %*	<b>4.8%</b>	4.9%	<b>4.3%</b>	3.9%	<b>4.5%</b>	4.5%
Adjusted return on average capital employed – %*	<b>9.9%</b>	10.8%	<b>9.4%</b>	7.7%	<b>9.7%</b>	9.3%

\* before exceptional items

Capital expenditure payments after disposals were £52.6 million (2008/09: £87.4 million). The interest paid decreased in line with the income statement charge.

Proceeds from sales of assets and investments of £13.0 million were principally accounted for by the sale of the Demes Logistics assets, together with the disposal of surplus property assets.

Tax payments were £21.3 million (2008/09: £21.0 million). Cash dividend cover, defined as free cash flow divided by dividends paid/declared for the year, was 6.0 times, up from 1.7 times in 2008/09.

The cash outflow in respect of exceptional restructuring costs was £18.4 million (including cash outflows related to exceptional charges made in 2008/09), compared with a cash outflow from restructuring costs of £17.2 million in 2008/09.

The net cash outflow on acquisitions was £1.0 million (2008/09: £1.2 million).

In respect of pension payments, the agreed annual contributions into the UK Group Pension Scheme were £15.6 million in 2009/10 (2008/09: £15.6 million).

Overall, the Group generated cash of £44.5 million (2008/09: £ 5.2 million) after funding additional capital expenditure and restructuring costs.

## FINANCIAL POSITION

Shareholders' funds totalled £474.8 million at 30 April 2010, up from £458.0 million at 30 April 2009, principally due to lower borrowings. Net assets per share were 121.0 pence (30 April 2009: 116.7 pence). The profit attributable to the shareholders of DS Smith Plc was £37.9 million (2008/09: £11.8 million loss) and dividends of £12.9 million (2008/09: £34.4 million) were paid during the year. In addition, after-tax actuarial losses of £7.0 million on the Group's defined benefit pension schemes were debited to reserves through the Consolidated Statement of Comprehensive Income. Other items recognised directly in equity, relate to currency translation gain of £5.5 million and movements in cash flow hedges of £(10.1) million.

The Group has committed facilities to November 2012 of £530 million. The closing net debt was £239.5 million, which was £52.0 million lower than at the start of the year, reflecting the net cash inflow during the year of £44.5 million and non-cash movements, principally exchange differences and related fair value movements, of £8.4 million.

Gearing, defined as net debt as a percentage of net assets, was 50.6% (30 April 2009: 63.9%); the movement reflected the reduction in borrowings from the net cash inflow. Adjusted Interest Cover (as defined in the loan agreements) was 6.9 times, compared with 4.5 times last year. The higher cover reflected the higher adjusted operating profit combined with lower interest charge. The ratio of net debt to EBITDA (before exceptional items) was 1.4 times (2008/09: 1.8 times).

The Group's banking covenants for the syndicated loan and the private placements specify an Adjusted Interest Cover not less than 3.0 times, a maximum ratio of net debt to EBITDA of 3.25 times and net assets to be in excess of £360 million. The covenant calculations exclude from the income statement exceptional items and the net interest income/charge arising from the defined benefit pension schemes. The calculation of net assets excludes the net asset or liability arising from the defined benefit pension schemes. As at 30 April 2010, the most important covenant is the Adjusted Interest Cover and this had an Adjusted Profit headroom of £56.6 million (2008/09: £34.6 million).

## ENERGY COSTS

The high level of energy costs continued to be a significant factor for the Group in 2009/10. The Group's total costs for gas, electricity and diesel fuel fell from circa £114 million in 2008/09 to circa £109 million in 2009/10. The Group continued with its strategy of hedging energy costs with suppliers and financial institutions, the purpose of which is to reduce the volatility of energy costs and provide the Group with a degree of certainty over future energy costs.

## CAPITAL STRUCTURE AND TREASURY MANAGEMENT

The Group funds its operations from the following sources of cash: operating cash flow, borrowing, shareholders' equity and disposals of peripheral businesses, where appropriate. The Group's objective is to achieve a capital structure that results in an appropriate cost of capital whilst providing flexibility in immediate and medium-term funding so as to accommodate material investments or acquisitions. The Group also aims to maintain a strong balance sheet and to provide continuity of financing by having a range of maturities and borrowing from a variety of sources.

The Group's overall treasury objectives are to ensure sufficient funds are available for the Group to carry out its strategy and to manage financial risks. The Group's treasury strategy is controlled through the Treasury Committee, which meets regularly and includes the Group Chief Executive, the Group Finance Director, Group Financial Controller and the Group Treasurer. The Group Treasury function operates in accordance with policies and procedures approved by the Board and controlled by the Group Treasurer. The function arranges funding for the Group, provides a service to operations and implements strategies for interest rate, foreign exchange and energy exposure management.

The Group's main borrowing facilities are shown in Table 3. At 30 April 2010, the Group's committed borrowing facilities, excluding the bilateral facility, were £566.5 million. The total gross borrowing drawn under all these facilities at the year end were £255.5 million. At 30 April 2010, the Group's borrowing facilities had a weighted-average maturity of three years and four months.

**TABLE 3 – BORROWING FACILITIES**

Facility	Committed funds million	Maturity
Private placement	US\$105.0	2012
Private placement	£25.0	2012
Private placement	US\$105.0	2014
Private placement	US\$95.0	2016
Syndicated revolving credit facility	£287.5	2013

The major treasury risks to which the Group is exposed relate to movements in interest and foreign exchange rates and market prices for energy. The overall objective of the Treasury function is to control these exposures whilst striking an appropriate balance between mitigating risks and controlling costs. Financial instruments, including derivatives, may be used in implementing hedging strategies but the speculative use of financial instruments, including derivatives, is not permitted.

The Group manages the risks associated with its purchases of energy in the UK through its Energy Procurement Group, which operates under the oversight of the Treasury Committee. UK purchases of energy represent the significant majority of the Group's overall energy costs.

The Treasury Committee regularly reviews the Group's exposure to interest rates and considers whether to borrow on fixed or floating terms. The Group has a current policy of mainly borrowing at floating rates, which the Treasury Committee believes provides better value over the medium-term. Fixed-rate borrowing, taking into account the effect of related swaps, comprised 44% of total borrowing at 30 April 2010 (30 April 2009: 35%).

The Group has a net investment in major overseas subsidiary companies' foreign currency assets and liabilities, in particular those whose functional currency is the euro or the US dollar. The Group's policy is to hedge a large part of the resulting exposure to movements in foreign currency rates, by means of debt in the same currency, to a level determined by the Treasury Committee. The overseas net assets hedged through euro borrowing decreased from 89% at 30 April 2009 to 76% at 30 April 2010 as a proportion of the Group's euro net investment.

The Group's foreign currency debt may be put in place either in the currency itself or through the use of cross-currency swaps on differently denominated borrowing. The Group applies hedge accounting under IAS 39, 'Financial Instruments: Recognition and Measurement', to its hedges of its net investment of foreign currency subsidiaries and records exchange differences arising on the net investments and the related foreign currency borrowing directly in equity. In addition, the Group's operations make product sales and purchases of raw materials in foreign currencies; here, cash flow hedges are taken out to reduce the risk associated with these transactions.

#### IMPAIRMENT

When applying IAS 36, 'Impairment of Assets', the Group compares the carrying amounts of goodwill and intangible assets with the higher of their net realisable value and their value in use to determine whether an impairment exists. The value in use is calculated by discounting the future cash flows expected to be generated by the assets or group of assets being tested for impairment. At the year end a series of tests were undertaken to determine whether there had been any impairment to the balance sheet carrying values of goodwill and other intangible assets. The key assumptions behind the calculations can be found in note 10 to the financial statements.

In summary, the tests indicated that the goodwill and other intangible assets of certain small packaging businesses within UK Paper and Corrugated Packaging required impairment by £4.3 million.

On 28 May 2010, the Group announced the intention to sell its business in Turkey. Consequently, the assets and liabilities of this business have been reclassified to assets and liabilities held for sale. An impairment of £5.9 million has been made to reflect the estimated value of the business.

Whilst the Board considers that its assumptions are realistic, it is possible impairment would be identified if any of the key assumptions were changed significantly. The net book value of goodwill and other intangibles at 30 April 2010 was £221.2 million (30 April 2009: £222.0 million).

Approximately 71% of the carrying value of the Group's goodwill is allocated to UK Paper and Corrugated Packaging.

Note 10 to the financial statements sets out additional information regarding the Group's annual impairment exercise including the details of the carrying value headroom for the key cash-generating units that hold goodwill, together with sensitivity analysis.

#### PENSIONS

IAS 19, 'Employee Benefits', requires the Group to make assumptions including, but not limited to, future asset returns, rates of inflation, discount rates and current and future life expectancies. The use of different assumptions could have a material effect on the accounting values of the relevant assets and liabilities, which in turn could result in a change to the cost of such liabilities as recognised in the income statement over time.

The assumptions involved are subject to periodic review.

The Group operates one defined benefit pension scheme in the UK and has some small overseas arrangements. The aggregate gross assets of the schemes at 30 April 2010 were £689.1 million and the gross liabilities at 30 April 2010, calculated under IAS 19, were £892.2 million, resulting in the recognition of a gross balance sheet deficit of £203.1 million (30 April 2009:

£191.3 million), a net deficit of £146.1 million (30 April 2009: £138.0 million) after the establishment of a deferred tax asset of £57.0 million (30 April 2009: £53.3 million). The increase in the gross balance sheet deficit of £11.8 million was principally due to an increase in liabilities of £145.6 million due to a lower discount rate and an increase in the inflation assumption. The increase in liabilities was partially offset by an increase in asset values of £133.8 million resulting from the appreciation in global equity prices during the year.

In order to control the future costs and financial obligations of these schemes, the Group's UK defined benefit pension scheme is closed to new members. The current service cost in 2009/10, amounted to £6.7 million compared with £9.7 million in 2008/09. The Group's agreed annual cash contributions to the main UK scheme were £15.6 million (2008/09: £15.6 million). A triennial valuation of the main UK scheme was carried out as at 30 April 2007 and the scheme actuaries have commenced work on the valuation as at 30 April 2010. The Group anticipates that it will have concluded discussions with the trustees of the main UK scheme on the outcome of the 2010 valuation by the end of the 2010/11 financial year.

Note 25 to the financial statements sets out additional information regarding the Group's pension and post-retirement benefits.



**STEVE DRYDEN**  
Group Finance Director

## The Group has maintained rigorous procedures for understanding and managing its significant risks.

The Group faces various risks, both internal and external, which could have a material effect on its performance. The Group's exposure to individual risks is limited and diversified by the fact that it has several distinct types of activity, with 30 business sectors operating from over 100 sites in 16 different countries, and it sells to a broad range of customers. Details of the limited dependence of each of our segments on any one customer are provided in the Description of the Group on pages 20 and 21. The main commercial and other risks that are specific to a business segment are described within the narrative on that segment. The principal Group-wide key risks and uncertainties, as perceived in the light of present knowledge, and the way they are managed, are described below. There are further references to the risks faced by the Group in the Financial Review on pages 28 to 31, in the Corporate Governance section on pages 42 to 45 and in the Notes to the Consolidated Financial Statements on pages 65 to 105. The Group seeks to mitigate its insurable risks through an insurance programme that covers property and liability risks where it is relevant and cost-effective to do so.

### CHANGES IN THE DEMAND FOR, OR PRICING OF, THE GROUP'S PRODUCTS AND SERVICES AS A RESULT OF GENERAL ECONOMIC CONDITIONS OR MARKET-SPECIFIC FACTORS

The profitability of the Group's businesses is sensitive to the volume and mix of sales and to product pricing. Demand across the Group's markets has weakened and become less predictable as a result of the global economic downturn. This has, in turn, contributed to a fall in prices in some of the Group's markets. In the present circumstances, management has reduced visibility for forecasting the Group's levels of activity and margins. Trading conditions may prove to be very different from those that are currently expected. In these circumstances the Group's businesses are monitoring sales and pricing trends in their markets especially closely. The businesses all have programmes in place aimed at maximising sales and managing margins in the context of the evolving situation in their specific markets.

For our paper-based packaging products, a 5% reduction in the current level of overall demand across Europe could have the potential to reduce future operating profits by approximately £15 million. However, the actual impact would depend upon the specific effect of the reduction on individual products and markets and upon the outcome of the actions that management would

take to mitigate the effects of such a change in demand.

With specific regard to our UK Paper business, based on an annual production of approximately 1 million tonnes, if the selling price of paper moved by £10 per tonne, the Group's operating profit would be impacted by circa £10 million, all other factors being equal. The actual impact would initially be partially mitigated by a corresponding change in the paper costs within our corrugated packaging operations. The UK paper business has experienced the most volatility with respect to its performance.

In respect of our Office Products Wholesaling business, a 1% reduction in the overall margin achieved for office products would reduce Group operating profits by circa £7 million.

Further information on the changes and trends in demand and pricing relevant to our business segments is provided within the market commentaries in the Operating Review on pages 22 to 27.

### VOLATILITY OF PRICING AND AVAILABILITY OF GLOBALLY TRADED RAW MATERIALS

In 2009/10, the Group purchased approximately £112 million of waste paper and approximately £101 million of polymers and films as the principal raw materials in its Paper and Plastic Packaging businesses, respectively. These products are globally traded and subject to variations in supply and demand which result in volatility in their pricing. The Group endeavours to recover any raw material cost increases through good material usage programmes and through price rises. Approximately one-third of the Group's corrugated and plastic packaging customer contracts include arrangements to link selling prices to an index of raw material prices. The achievement of price increases for the majority of our Packaging business is substantially determined by the state of supply and demand in the relevant market at any time. Due to the variety of contractual arrangements with customers, margins may be squeezed for a period of time until price increases are achieved to recover input cost increases. In the present trading environment it is likely to prove more difficult to recover input cost increases through price rises.

The Group's Severnside Recycling business collects and trades waste paper to ensure a continuous cost-competitive supply to the Group's paper mills. It achieves this through long-term contracts with major suppliers of waste paper and the collection of waste from smaller suppliers through its network

of collection depots. Based on the Group's purchases of waste paper of approximately £112 million, a £10 per tonne increase in waste paper prices would reduce Group operating profit by £9 million. However, as noted above, the actual impact on future profitability would depend upon the extent to which finished goods prices are linked to input prices.

Of the Group's total polymer and film purchases, polycarbonate, polypropylene and high density polyethylene are the principal polymers used, with the remainder comprising a large number of different polymers and films. The Group has developed a good level of expertise in polymer purchasing and uses a number of suppliers to ensure it is purchasing at competitive prices.

### VOLATILE AND INCREASING ENERGY PRICES

The Group's exposure to energy costs is described on page 30 and is being managed in a number of ways. The Group is looking to maximise in-house energy generation from its combined heat and power (CHP) plants in the UK and France, thereby taking advantage of the greater efficiency of the CHP process. It is also investigating the potential for the use of renewable or low-carbon energy sources, including refuse-derived fuel. The Group continues to undertake a wide range of energy-saving projects aimed at increasing its energy efficiency and reducing its energy usage. In 2009/10, the Group increased its own energy usage by 0.5% compared with 2008/09, but its purchases from external providers fell, such that overall energy usage was down.

The regulatory developments in the energy market are monitored and the Group collaborates, when appropriate, with other higher energy users in the paper and other industry sectors to influence government on energy policy and the operation of energy markets. The Group maintains a centralised energy-purchasing approach in the UK and France, which enables it to obtain economies of scale in buying and to apply specialist expertise. Given the sensitivity of the Group's financial results to energy prices, the impact of energy costs are managed through the use of long-term supply contracts (which reduce the volatility of price movements) and the application of hedging techniques. The Group transacts hedging instruments with a number of counterparties and monitors its overall reliance and exposure against each counterparty.

The most significant energy risk relates to the purchase of gas in the UK, where a 10 pence per therm increase would reduce Group operating profit by circa £7 million.

## MOVEMENTS IN FOREIGN EXCHANGE RATES AND INTEREST RATES

These risks and the way in which they are managed through the Group's Treasury Committee and its subsidiary committees or groups are described on pages 30 and 31.

In terms of the effects of currency translation, the principal conversion rates which affect the Group's reported financial performance are sterling to the euro and sterling to the US dollar. An increase in sterling's value against the euro by 10 cents would decrease operating profits by around £3 million, principally due to the impact on the translation of profits in the Group's euro-denominated operations. This impact would be partially offset at a profit before tax level by a reduction in interest costs of circa £0.6 million due to translation of interest costs on the Group's euro debt. Similarly, a 10 cents increase in the value of sterling against the US dollar would reduce reported operating profits by around £0.3 million.

An overall one percentage point increase in interest rates across the debt held by the Group would increase interest costs by £1.5 million. However, as noted on page 30, we currently have 44% of our debt placed at fixed interest rates.

## THE FUNDING POSITION OF THE GROUP'S UK DEFINED BENEFIT PENSION SCHEME

The funding of the Group's UK defined benefit pension scheme is sensitive to a number of key factors: the value of the assets, of which 61% are invested in equities and 39% in bonds, gilts and cash; the discount rate, based on the yield on high quality corporate bonds, which is used to calculate the scheme's liabilities; and the expected mortality rate of the scheme's members. The funding position of the scheme has deteriorated during 2009/10 as described on page 31. The Group faces the risk that this funding position may deteriorate further over time. The Group and the scheme's trustee have sought to mitigate this risk through the scheme's investment strategy and through having increased the contributions made to the scheme by both the members and the Group. The regulatory environment for pension schemes and their trustees has changed in recent years, in particular with the Pensions Act 2004: the presence of a deficit in a scheme may now oblige the trustee or possibly the Pensions Regulator to seek some further funding of the scheme in the event of a significant corporate action or perceived decline in the Group's financial covenant. The sensitivity of the funding position to the key assumptions is detailed in note 25. On 30 April 2010, the scheme commenced the triennial actuarial valuation, the results of which will be available by the end of 2010/11. At that time the Group expects to reach agreement with the trustees as to the increased level of

pension contributions necessary to repay the deficit.

## THE CONTINUING AVAILABILITY OF BORROWING FACILITIES, INCLUDING COMPLIANCE WITH BORROWING COVENANTS

The Group's borrowing facilities and their management through the Treasury Committee are described on pages 30 and 31. The Group has committed facilities of £566.5 million (2008/09: £625.9 million) and, as at 30 April 2010, £255.5 million was drawn against these facilities. The facilities are provided by a range of banks that typically have a credit rating of BBB+ or greater. The Group is required as a condition of its borrowing facilities to remain within certain covenants. These are detailed in the Financial Review on page 30. In the event that a breach of covenant occurs, borrowing under the facility becomes repayable on demand.

The Group has cash deposit, borrowing and transactional relationships with a range of institutions. The counterparty risk is carefully monitored to ensure that the risk of an individual counterparty failure would not curtail the Group's ability to manage foreign exchange, energy or impinge significantly on its borrowing facilities. Cash deposits are placed with institutions of credit rating A or greater. In countries where this is not possible, deposits are held with strong local banks.

## COMPETITIVE RISK

DS Smith operates in competitive markets. Aggressive pricing from competitors may cause a reduction in our revenues and margins. We aim to build long-term relationships with our customers in order to become an integral part of their supply chain and help them reduce costs. We also ensure that we are the supplier of choice by focusing on innovation for our customers and maintaining high standards of service.

## CUSTOMER CREDIT RISK

Although the Group has a broad base of customers, the financial failure of one or more of the Group's key customers may have a material impact on the results in a particular segment and result in a significant loss of future business. Given the current environment we are closely monitoring credit risk across our customer base. The potential effect of the failure of any particular Group customer is limited as no single customer represents more than 2% of the Group's revenue.

## SERIOUS BREACHES OF THE LAW OR OTHER REGULATIONS

The Group's Key Corporate Values, which are described in more detail in the Corporate Responsibility Review on pages 38 and 39

and are available in full at: [www.dssmith.uk.com/pages/Policies.asp](http://www.dssmith.uk.com/pages/Policies.asp) on the Group's website, require all employees to comply with all relevant laws and regulations in the countries in which they operate. The Group recognises the risk that substantial fines, or other penalties, may be imposed for non-compliance with laws and regulations relating to competition, environmental, health and safety or other matters, and has control mechanisms, ongoing programmes and systems, and special initiatives in place for monitoring compliance. It also carries out training programmes for employees and has systems in place to share expertise and best practice on these matters. The Group has a Workplace Malpractice Policy, and a process for employees to report any suspected wrongdoing in confidence, that is in place across its international operations where such reporting is permitted by law.

## INCREASING COSTS IN THE MEDIUM TERM RELATED TO CLIMATE CHANGE AND CARBON DIOXIDE (CO<sub>2</sub>) EMISSIONS

As a result of its substantial energy usage, the Group is likely, in the medium term, to be increasingly subject to regulation and taxation of its CO<sub>2</sub> emissions. The details of this and the actions being taken to reduce the Group's future energy usage and CO<sub>2</sub> emissions are described in the Corporate Responsibility Review on page 38 and in the statement of the Group's strategy for managing its energy costs on page 30.

## PRODUCT LIABILITY

The Group's packaging products, many of which are supplied into the food and beverage industries, may give rise to potentially substantial product liability claims in the event of a failure of the packaging to perform its function when in use or from contamination of the product by its packaging. The potential for such claims is reduced by the fact that the majority of the Group's packaging is used as secondary, or transit, packaging and does not come into direct contact with the products it ultimately protects. The Group takes all reasonable steps to ensure the safety and adequate performance levels of its packaging through design, manufacturing control processes, technical testing and other means while having appropriate product liability insurances in place. It also looks to minimise its product liability risk through its relevant terms and conditions of trading.

## OTHER SOCIAL AND ENVIRONMENTAL MATTERS

The Group's management of other social and environmental risks is described in the Corporate Responsibility Review on pages 34 to 39.