

Back on the growth track



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FY07 result above 'consensus'

CKL reported FY07 NPAT of A\$5.05m, up 12.2% on the pcp and 5.5% above our estimates ('consensus'). This better than expected result was driven by a top line recovery in addition to lower raw material and occupancy related costs in the 2H. The result also highlighted a significant improvement in operating and free cashflows – a new trend we expect to continue in the foreseeable future.

Earnings upgraded for FY09-10

We have upgraded our estimates for FY09 by 2.0% and FY10 by 2.9%. Upgrades are due to higher interest income and lower interest expense associated with expected debt retirement. We have also made a minor adjustment to our FY08E earnings (↓ 0.9%) to reflect higher depreciation charges and rising electricity costs, which are partly offset by lower raw material costs.

Solid platform to grow earnings and cashflow

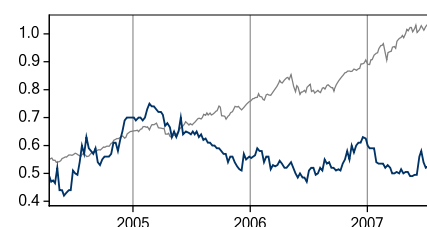
We're expecting a solid result in FY08 and beyond driven by continued top-line growth, operational efficiencies and low capital requirements. We believe CKL has just exited a capital intensive phase (2005-07) and is well positioned for a period of strong growth (08-09) requiring minimal capital outlay. We are forecasting double-digit earnings growth for the next 2 years, which at current levels implies an attractive FY08 free cashflow yield of 13%.

Buy recommendation retained

Buy recommendation retained with a price target of A\$0.75ps. Our positive stance on the stock is premised on (1) attractive valuation - the stock trading 28% below our DCF of A\$0.76cps; (2) a solid growth outlook with a focus on the higher margin segments of the Australian carton board market; (4) strong management team, who own a significant proportion of stock; and (5) corporate appeal.

Stock Data

Price	A\$0.540
Price Objective	A\$0.750
Date Established	5-Jul-2006
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	A\$0.470-A\$0.640
Mrkt Val / Shares Out (mn)	US\$37 / 80.5
Average Daily Volume	41,259
ML Symbol / Exchange	XBVVF / ASX
Bloomberg / Reuters	CKL AU / CKLAX
ROE (2008E)	10.6%
Net Dbt to Eqty (Jun-2007A)	64.8%
Est. 5-Yr EPS / DPS Growth	4.1% / 7.0%
Free Float	68.0%



- ColorPak Ltd - ALL ORDINARIES INDEX

Estimates (Jun)

(A\$)	2006A	2007A	2008E	2009E	2010E
Net Profit b/f Abnormals	4.5	5.1	5.6	6.2	6.7
EPS	0.056	0.063	0.069	0.077	0.083
EPS Change (YoY)	-17.1%	12.2%	10.1%	11.0%	7.7%
Dividend / Share	0.028	0.028	0.030	0.033	0.035
Free Cash Flow / Share	(0.034)	(0.014)	0.070	0.073	0.057

Valuation (Jun)

	2006A	2007A	2008E	2009E	2010E
P/E	9.7x	8.6x	7.8x	7.0x	6.5x
Dividend Yield	5.1%	5.1%	5.6%	6.0%	6.5%
EV / EBITDA*	7.1x	6.1x	5.5x	5.0x	4.7x
Free Cash Flow Yield*	-6.3%	-2.7%	13.0%	13.5%	10.6%

* For full definitions of *iQmethod*SM measures, see page 8.

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08 August 2007

iQprofileSM Colorpak Ltd.

Key Income Statement Data (Jun)

(A\$ Millions)	2006A	2007A	2008E	2009E	2010E
Sales	71	72	78	82	87
Operating Expenses	(60)	(59)	(64)	(68)	(73)
EBITDA	11	13	14	14	15
Depreciation & Amortization	(2)	(3)	(3)	(3)	(3)
EBIT	9	10	10	11	12
Net Interest & Other income	(2)	(3)	(2)	(2)	(2)
Associates	NA	NA	NA	NA	NA
Pretax Income	6	7	8	9	10
Tax (expense) / Benefit	(2)	(2)	(2)	(3)	(3)
Net Profit b/f Abnormals	5	5	6	6	7
Non-Recurring Items	0	0	0	0	0
Net Income (Reported)	5	5	6	6	7
Avg F Diluted Shares Outstanding	80	80	80	80	80

Key Cash Flow Statement Data

EBITDA	11	13	14	14	15
Change in Working Capital	(2)	0	(1)	(1)	(1)
Deferred Taxation Charge	(1)	1	0	0	0
Other Adjustments, Net	0	0	0	0	0
Cash Flow from Operations	3	9	8	8	9
Capital Expenditure	(6)	(10)	(2)	(3)	(4)
(Acquisition) / Disposal of Investments	0	0	0	0	0
Other Cash Inflow / (Outflow)	0	0	0	0	0
Cash Flow from Investing	(6)	(8)	(2)	(3)	(4)
Shares Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	(2)	(2)	(2)	(2)	(3)
Cash Flow from Financing	2	0	(3)	(3)	(3)
Free Cash Flow	(3)	(1)	6	6	5
Net Debt	32	33	30	26	24
Change in Net Debt	NA	NA	NA	NA	NA

Key Balance Sheet Data

Property, Plant & Equipment	25	28	28	27	28
Other Non-Current Assets	0	0	0	0	0
Trade Receivables	14	13	13	14	15
Cash & Equivalents	0	0	3	5	7
Other Current Assets	1	1	1	1	1
Total Assets	94	97	99	102	107
Long-Term Debt	29	33	32	31	31
Other Non-Current Liabilities	0	0	0	0	0
Short-Term Debt	3	1	1	1	1
Other Current Liabilities	2	2	2	2	2
Total Liabilities	46	46	45	45	45
Total Equity	48	51	54	58	62
Total Equity & Liabilities	93	97	99	102	107

iQmethodSM - Bus Performance*

Return on Capital Employed	7.7%	8.3%	8.5%	8.9%	9.0%
Return on Equity	9.7%	10.2%	10.6%	11.0%	11.1%
Operating Margin	12.4%	13.8%	13.6%	13.6%	13.5%
EBITDA Margin	15.3%	17.6%	17.4%	17.2%	16.9%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	0.8x	1.8x	1.4x	1.4x	1.3x
Asset Replacement Ratio	2.7x	3.6x	0.8x	0.9x	1.4x
Tax Rate (Reported)	30.4%	30.0%	30.0%	30.0%	30.0%
Net Debt-to-Equity Ratio	66.9%	64.8%	55.1%	45.6%	39.4%
Interest Cover	4.1x	3.7x	4.1x	4.5x	4.8x

Key Metrics

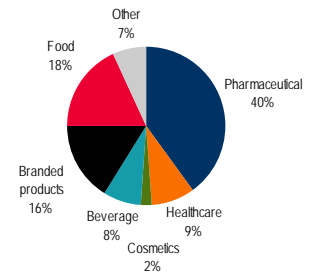
Franking	100%	100%	100%	100%	100%
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 * For full definitions of iQmethodSM measures, see page 8.

Company Description

Colorpak is a major participant in the A\$600m folding-carton segment of Australia's paper and board packaging industry. The company's products are heavily exposed to the higher margin pharmaceuticals and healthcare industries. The company is based in Melbourne, Australia.

Chart 1: CKL revenues by segment



Source: CKL FY07 result

Stock Data

Price to Book Value 0.8x

Table 1: Result Summary

	FY06A	FY07A	Δ on pcp
Sales Revenue	68.6	71.0	3.6%
EBITDA	10.8	12.7	16.8%
D&A	-2.3	-2.9	24.0%
EBIT	8.5	9.8	14.9%
Net Interest	-2.1	-2.6	25.3%
EBT	6.5	7.2	11.6%
Tax Expense	-2.0	-2.2	10.0%
OEI	0.0	0.0	0.0%
NPAT	4.5	5.1	12.2%
EPS (A\$ cents)	5.6	6.3	12.2%
DPS (A\$ cents)	2.8	2.8	0.0%

Source: Merrill Lynch estimates

FY07 result above 'consensus'

CKL reported FY07 NPAT of A\$5.05m, up 12.2% on the pcp and 5.5% above our estimates ('consensus'). This better than expected result was driven by a good recovery in sales revenues and lower raw material and occupancy related costs in the 2H. The result also highlighted a significant improvement in operating and free cashflows.

After 18 months of disappointing results, we are encouraged to see CKL's earnings back on the growth track. Given our expectations of strong earnings and cashflow growth over the next 2-3 years and our belief that CKL is trading well below its fundamental value, we maintain our Buy recommendation.

Key takeaways

▪ Sales recovery in the 2H

Sales in the 2H rose 7.7% vs pcp and 3.3% vs 1H, driven primarily by improved trading conditions and continuous focus on the higher margin segments – particularly pharmaceutical - of the Australian carton board market. Note that CKL's revenues have grown at a compound annual rate of 15.8% over the last 10 years. While we do not expect CKL to maintain this level of growth, we believe the company is well positioned to continue to grow sales at reasonable rates (+5%pa) in the near future.

▪ Strong cash flow generation

OCF rose strongly to A\$9.1m (vs A\$3.4m in FY06). Importantly, FCF was also positive in the 2H. After 2 years of significant investment in equipment items, we believe CKL has finally exited a capital intensive phase and is now positioned for a period of strong growth requiring minimal capital outlay. We expect CKL to generate strong cash flows for the next 2-3 years.

▪ Gearing back to more comfortable levels

CKL's gearing (net debt / net debt + equity) fell from 43% in the 1H to 39% at the end of June. Due to CKL's size and concentrated earnings stream, we are encouraged to see gearing falling below 40%. Given the (relatively) low capex burden expected for the next 2 years, we expect CKL to retire some debt and reduce gearing further to 30-35%. As a result, we see interest cover ratio rising above 4x in FY08.

▪ Higher electricity prices to bite in FY08

CKL's electricity contracts expired in June, forcing the company to sign up a new 12-mth supply agreement at considerably higher prices. Under this new contract, we expect CKL to be paying prices 75-80% above the original contract. Our new estimates incorporate higher electricity costs from FY08 onwards. However, potential exists for electricity prices to retreat in 2009, allowing CKL to re-negotiate its contracts (due in June/July 08) at lower levels.

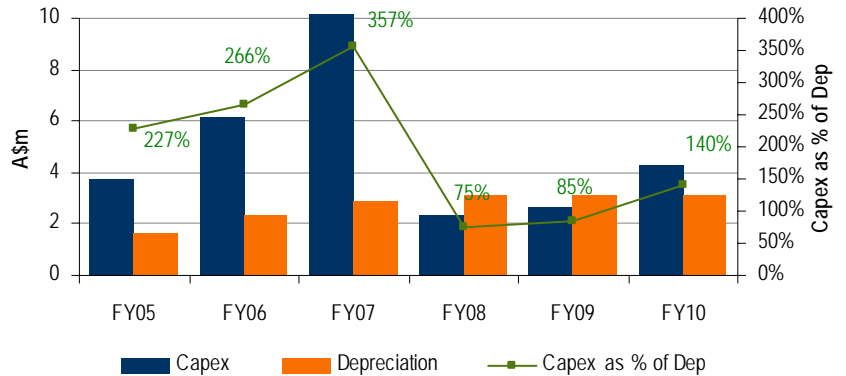
▪ No guidance provided, but outlook looks positive

No specific guidance was given. CKL said it expects continued sales growth in NSW and Victoria. Despite rising input costs – primarily electricity charges – CKL is confident that earnings will grow at similar rates to sales growth.

Solid platform to grow earnings and cashflow

Whilst we consider the packaging industry highly capital intensive, the capex burden on packaging companies tends to oscillate, with periods of high capex followed by periods of (relatively) low capex. Typically, a company will grow to a point where it is running at full capacity and/or its machinery will be obsolete and a significant capital outlay is required for the company to move forward. The capital is spent, allowing another 2-3yr of low capital growth before the process starts over.

Chart 2: CKL capex and depreciation estimates



Source: Merrill Lynch estimates

We believe CKL has just exited a capital intensive phase (2005-07) and is well positioned for a period of strong growth (08-09) requiring minimal capital outlay.

What to do with excess cashflow?

Given our expectations of strong free cashflow for the next 2 years, the key question now is how CKL will reinvest or use this cash. We see three alternatives:

- **Repay debt:** the most likely option. CKL has already stated its plans to use some free cash to reduce its debt levels. Our numbers assume that CKL will retire some debt in FY08 and FY09 - years of expected low capex.
- **Bolt-on acquisitions:** We believe the likely opportunities for CKL are private companies at the smaller end of the market that have complementary operations, strong management and modern machinery. Depending on the size of the acquisition, CKL may look to raise equity to fund any acquisition.
- **Special/higher dividends:** CKL's payout ratio is around 40-45%. In case the company can't find any attractive acquisitions, it may decide to change its dividend policy or to declare a special dividend. Note that CKL has A\$5.03m in franking credits available (already excluding the proposed final dividend of 1.75cps).

Earnings changes

Post the result, we have made minor adjustments to our FY08 forecasts to reflect higher depreciation charges and rising electricity costs, which were partly offset by raw material costs. The net impact was a 0.9% reduction to our estimates.

We have upgraded our estimates for FY09 by 2.0% and FY10 by 2.9%. Upgrades are due to higher interest income (from improved cash position) and lower interest expense associated with the retirement of some debt in FY08 and FY09.

Table 2: Earnings changes

Year end June		FY08E	FY09E	FY10E
Sales Revenue				
Was	A\$m	77.3	82.0	87.0
Is	A\$m	76.7	81.5	86.4
Change	%	-0.8%	-0.6%	-0.6%
EBIT				
Was	A\$m	10.5	11.0	11.5
Is	A\$m	10.4	11.1	11.6
Change	%	-0.8%	1.1%	1.5%
NPAT				
Was	A\$m	5.6	6.1	6.5
Is	A\$m	5.6	6.2	6.7
Change	%	-0.9%	2.0%	2.9%

Source: Merrill Lynch estimates

Valuation changes

DCF valuation

Our DCF for CKL remained unchanged at A\$0.76ps. This is based on a WACC of 10.7% and a terminal growth rate of 3%. Whilst we consider the DCF valuation to be the most appropriate methodology to value this company, we recognise that the stock also looks attractive on different metrics such as PER.

PER valuation

We apply a through-the-cycle multiple for the stock of 11x, a 30% discount to the market multiple of 15.5x. In our view such discount is reasonable, given CKL's inherent liquidity/size issues and the cyclical industry it operates in.

Applying this 11x multiple to FY08 EPS of 6.9cps, we derive a valuation for the stock of A\$0.76ps. Importantly, were the stock to reach our price target of A\$0.75ps in 12 months time, CKL would be trading on a forward PER of 9.7x, which we do not view as demanding.

Table 3: CKL PER valuation

	FY07A	FY08E	FY08E
Through-the-cycle PER Multiple	11.0x	11.0x	11.0x
EPS Pre-Goodwill (diluted)	6.3	6.9	7.7
Value per ordinary share	\$0.69	\$0.76	\$0.84

Source: Merrill Lynch estimates

Buy recommendation maintained

Post the FY07 result, we remain comfortable with our Buy recommendation. Our positive stance on the stock is premised on:

- **Solid growth outlook:** driven by underlying growth in key markets, continued market share gains and a focus on higher margin segments (pharmaceutical);
- **Strong management team:** management have a solid track record of sales growth and also own a significant proportion of stock;
- **Attractive dividend yield:** FY08 fully franked dividend yield of 5.6%;
- **Inexpensive valuation:** the stock is trading on a PER of 7.8x FY08E and 28% below our DCF of A\$0.76ps; and
- **Corporate appeal:** at current prices, we believe CKL could be a prey in the future rationalisation of the Australian carton board market.

Financials

Table 4: Statement of Financial Performance

Year ending June (A\$m)	2006A	2007A	2008E	2009E	2010E
Trading revenue	68.6	71.0	76.7	81.5	86.4
- change	17.7%	3.6%	8.0%	6.3%	6.1%
EBITDA	10.8	12.7	13.5	14.2	14.7
- change	-3.3%	16.8%	6.6%	5.1%	3.7%
Depreciation	-2.3	-2.9	-3.1	-3.1	-3.1
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	8.5	9.8	10.4	11.1	11.6
- change	-10.8%	14.9%	6.3%	6.6%	4.8%
Net interest	-2.1	-2.6	-2.5	-2.3	-2.1
Pre-tax profit	6.5	7.2	7.9	8.8	9.5
Tax expense	-2.0	-2.2	-2.4	-2.6	-2.9
Outside equity interests	0.0	0.0	0.0	0.0	0.0
Net profit att. to s/hers	4.5	5.1	5.6	6.2	6.7
- change	-15.4%	12.2%	10.1%	11.0%	7.7%
Net significant items	0.0	0.0	0.0	0.0	0.0
Reported NPAT	4.5	5.1	5.6	6.2	6.7
EPS change pre goodwill	-17.1%	12.2%	10.1%	11.0%	7.7%

Source: Merrill Lynch estimates

Table 5: Ratios

Year ending June (A\$m)	2006A	2007A	2008E	2009E	2010E
Profitability Ratios					
EBIT margin	12.4%	13.8%	13.6%	13.6%	13.5%
NPAT margin	6.6%	7.1%	7.3%	7.6%	7.7%
NOPLAT pre goodwill	5.9	6.9	7.3	7.8	8.1
Invested Capital	87.1	91.5	93.6	96.4	100.4
ROIC (after tax)	6.8%	7.5%	7.8%	8.1%	8.1%
ROIC - WACC	-3.9%	-3.2%	-2.9%	-2.6%	-2.6%
ROE	9.7%	10.2%	10.6%	11.0%	11.1%
ROA	9.6%	10.3%	10.6%	11.0%	11.1%
Gearing / Cashflow Ratios					
Debt / Equity	67%	65%	60%	54%	51%
Debt / Debt+Equity	40%	40%	37%	35%	34%
Debt / EBITDA	3.0x	2.6x	2.4x	2.2x	2.1x
CFO / Debt	11%	27%	25%	27%	28%
EBITDA / Interest	5.2x	4.8x	5.3x	5.7x	6.1x
EBIT / Interest	4.1x	3.7x	4.1x	4.5x	4.8x
Dividend cover	2.0x	2.3x	2.3x	2.4x	2.4x
Gearing (ND/ND+E)	40%	39%	36%	31%	28%
Free cashflow yield	-6.3%	-2.7%	13.0%	13.5%	10.6%

Source: CKL, Merrill Lynch estimates

Table 6: Statement of Financial Position

Year ending June (A\$m)	2006A	2007A	2008E	2009E	2010E
Cash	0.0	0.3	2.6	5.0	7.0
Receivables	13.8	13.2	13.3	14.1	15.0
Inventories	7.2	8.1	8.6	9.2	9.9
Other	1.1	0.8	0.8	0.8	0.8
Current Assets	22.0	22.4	25.3	29.2	32.7
Receivables	0.0	0.0	0.0	0.0	0.0
Inventories	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equipment	25.1	28.4	27.6	27.1	28.4
Intangibles	46.1	46.1	46.1	46.1	46.1
Other	0.3	0.0	0.0	0.0	0.0
Non-Current Assets	71.5	74.5	73.7	73.3	74.5
Total Assets	93.5	96.8	99.0	102.4	107.1
Accounts Payable	10.8	9.2	9.2	9.9	10.5
Borrowings	3.1	0.6	0.6	0.6	0.6
Provisions	1.8	1.8	1.8	1.8	1.8
Other	0.0	0.3	0.3	0.3	0.3
Current Liabilities	15.8	11.8	11.8	12.5	13.1
Accounts Payable	0.0	0.0	0.0	0.0	0.0
Borrowings	28.9	32.8	31.8	30.8	30.8
Provisions	1.0	0.9	0.9	0.9	0.9
Other	0.0	0.5	0.5	0.5	0.5
Non-Current Liabilities	29.8	34.1	33.1	32.1	32.1
Total Liabilities	45.6	45.9	44.9	44.6	45.3
Net Assets	47.9	50.9	54.1	57.9	61.9
Share Capital	38.9	38.9	38.9	38.9	38.9
Reserves	0.0	0.3	0.3	0.3	0.3
Retained Profits	9.0	11.8	15.0	18.7	22.8
Shareholders' Equity	47.9	50.9	54.1	57.9	61.9
Outside Equity Interests	0.0	0.0	0.0	0.0	0.0
Total Shareholders' Equity	47.9	50.9	54.1	57.9	61.9

Source: CKL, Merrill Lynch estimates

Table 7: Statement of Cashflows

Year ending June (A\$m)	2006A	2007A	2008E	2009E	2010E
EBITDA	10.8	12.7	13.5	14.2	14.7
Working capital	-2.1	0.1	-0.7	-0.8	-0.8
Net interest paid	-2.2	-2.6	-2.5	-2.3	-2.1
Tax paid	-3.1	-1.1	-2.4	-2.6	-2.9
Other	0.0	0.0	0.0	0.0	0.0
Operating cashflow	3.4	9.1	8.0	8.5	8.9
Capex	-6.1	-10.2	-2.3	-2.6	-4.3
Sale of Assets	0.2	2.4	0.0	0.0	0.0
Net investments	0.0	0.0	0.0	0.0	0.0
Acquisitions/Divestments	0.0	0.0	0.0	0.0	0.0
Investing cashflow	-5.9	-7.9	-2.3	-2.6	-4.3
Free cashflow (OCF-Capex)	-2.7	-1.2	5.7	5.8	4.6
Equity raisings	0.0	0.0	0.0	0.0	0.0
Dividends paid	-2.0	-2.2	-2.4	-2.4	-2.6
Net borrowings	4.5	2.2	-1.0	-1.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Financing cashflow	2.4	0.0	-3.4	-3.4	-2.6
Effect of exchange rate	0.0	0.0	0.0	0.0	0.0
Net change in cash	-0.1	1.2	2.2	2.4	2.0

Source: CKL, Merrill Lynch estimates

Price objective basis & risk

Colorpak Ltd (XBVVF)

Our price objective for CKL of A\$0.75/share is underpinned by our DCF valuation of A\$0.76/share. Were the stock to reach our price target in 12 months time it would be trading on a forward PER of 9.7x which we do not view as demanding.

The risks to our price objective are product substitution, competition, rising raw material costs, management instability and customer attrition.

Analyst Certification

I, Mario Maia, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

*iQmethod*SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

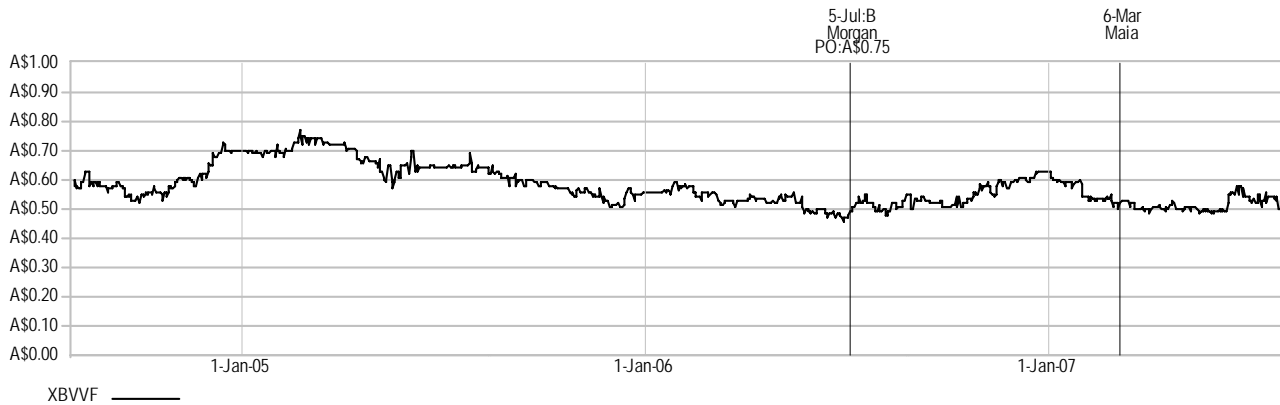
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Important Disclosures

XBVVF Price Chart



B : Buy, N : Neutral, S : Sell, PO : Price objective, NA : No longer valid

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of July 31, 2007 or such later date as indicated.

Investment Rating Distribution: Packaging Group (as of 01 Jul 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2	28.57%	Buy	0	0.00%
Neutral	3	42.86%	Neutral	1	33.33%
Sell	2	28.57%	Sell	0	0.00%

Investment Rating Distribution: Global Group (as of 01 Jul 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1675	47.16%	Buy	435	29.21%
Neutral	1633	45.97%	Neutral	438	29.67%
Sell	244	6.87%	Sell	47	21.66%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

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