# Colorpak Limited

**14 December 2011**

**Valuation and key data:**

| | |
|---|---|
| ASX code | CKL |
| Share price (cps) | 68 |
| Valuation (cps) | 83 |
| Prem/(Disc) to price | 22% |
| Shares on issue (m) | 81.2 |
| Market Cap. ($m) | 55.2 |
| 12mth price range (cps) | 60 - 76 |

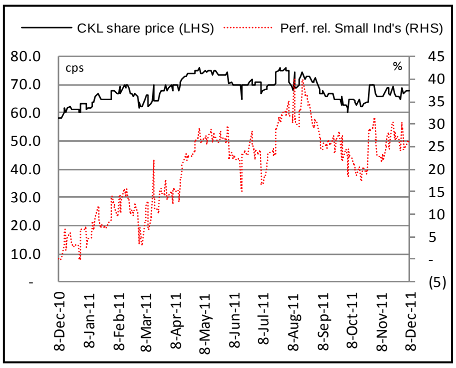
**Summary Financials:**

| **June Y/E** | **11a** | **12e** | **13e** |
|---|---|---|---|
| Rev. ($m) | 127.4 | 207.0 | 208.8 |
| *change* | 58% | 62% | 1% |
| NPAT ($m) | 7.1 | 7.7 | 8.4 |
| *change* | 10% | 9% | 8% |
| EPS (cps) | 8.7 | 9.5 | 10.2 |
| *change* | 10% | 9% | 8% |
| DPS (cps) | 3.3 | 3.3 | 3.5 |
| Tangible ROE | 48% | 31% | 31% |

**Valuation multiples:**

| | | | |
|---|---|---|---|
| PER(x) | 7.8 | 7.2 | 6.7 |
| Div. Yield | 4.8% | 4.8% | 5.2% |
| EV($m) | 89.4 | 100.2 | 98.5 |
| EV/EBIT (x) | 6.0 | 6.2 | 5.8 |

**Abs. & Rel. Share Price Performance**




*Source: IRESS*

# Key points

**We value Colorpak Limited (CKL) at 83 cps, up 22% from the current share price of 68 cps.** The 83 cps valuation implies a 12 mth forward PER of 8.5x and EV/EBIT of 6.8x. Both these valuation multiples are c.85% of the respective Small Industrial's averages.

CKL provides investors with defensive revenues and profits as well as the potential for growth.

## Defensive revenues and profits

Since 2003, revenues from the folding carton industry have remained largely unchanged (local production) despite the GFC (c.$612m-c.$623m). The steady nature of industry revenue is a result of the non cyclical nature of the packaged products which CKL's customers offer (eg, pharmaceutical, food, fast food, beverages).

Despite steady 'top line' industry conditions, an impressive feature of CKL is that it has **achieved increases in market share** (prior to the Carter Holt Harvey (CHH) acquisition) **yet maintained its profit margins.** CKL's revenue has increased from c.$48m in FY02 to c.$85m in FY11 whilst increasing its EBIT margin from 12.1% in FY06 to 14.9% in FY11. CKL has also built a track record for acquiring complimentary businesses (6 in 12 yrs) although the purchase of CHH was a transformational event taking the company to revenues of c.$207m p.a.

## Growth options

The main growth option for the company is achieving economic returns from the recently acquired CHH business. The achievement of a conservative FY14e EBITDA margin of c.5.3% for the acquired CHH business produces incremental EBITDA of c.$6m, **which represents 40% growth from the $15.0m achieved by the traditional CKL business in FY11a.**

## Operational and valuation comps with international peers

Relative to international peers, CKL's gross returns (ie revenue/tangible assets) are at the upper end of the range, and net returns (ie NPAT/tangibles assets) are similar. **The largest variance is CKL trades at a c.30-40% valuation discount to its larger international peers.**

## Sensitivities

There are a number of key sensitivities (listed in this report) but the key determinant of future profit and valuation is EBITDA margins from the acquired CHH revenue streams.

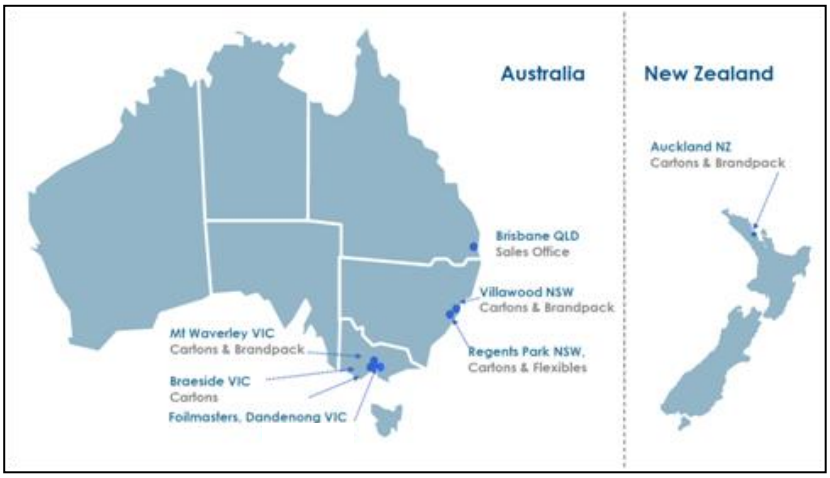
The 83 cps valuation of CKL includes a FY14e EBITDA margin of c.5.3%. The upside case is 7%+ EBITDA margins, which if achieved without material revenue attrition will increase the valuation to c.105+ cps. If CHH continues to achieve virtually no profit, the CKL valuation declines to c.57 cps.

To date, the integration of CHH is progressing well and to plan.

# Contents

# Company Overview

**Picture: Location of CKL's business operations**




***Source:*** *CKL presentation*

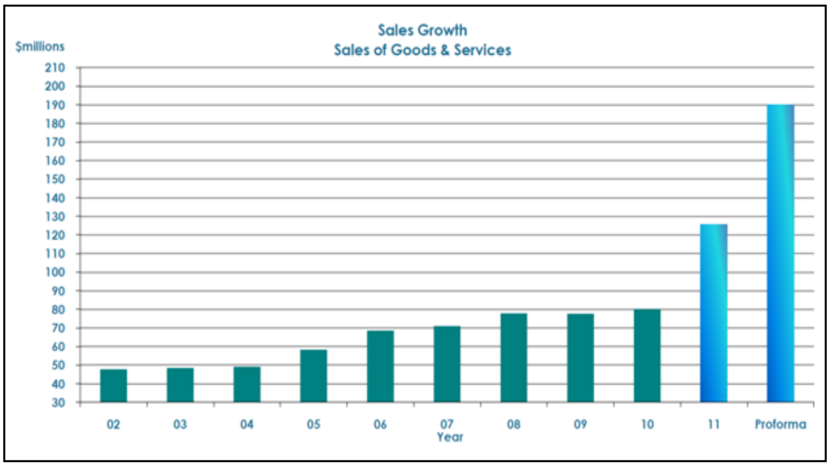
CKL designs and produces folding cartons, self adhesive labels, leaflets, printed and plain hard tempered aluminium foil, sachets, paper cups (new) and point-of-sale displays and other value-added paperboard packaging products. CKL listed on ASX in 2004 and now has c.770 staff.

CKL has acquired and integrated 6 businesses since 1998:

- 1998 – Foilmasters (Victoria)
- 2000 – Hale Foldpack (NSW)
- 2001 – Pemara Packaging (Victoria)
- 2004 – Castle Graphics (NSW)
- 2010 – Remedies printing business (NSW)
- 2011 – Carter Holt Harvey Cartons (NSW, Victoria & NZ)

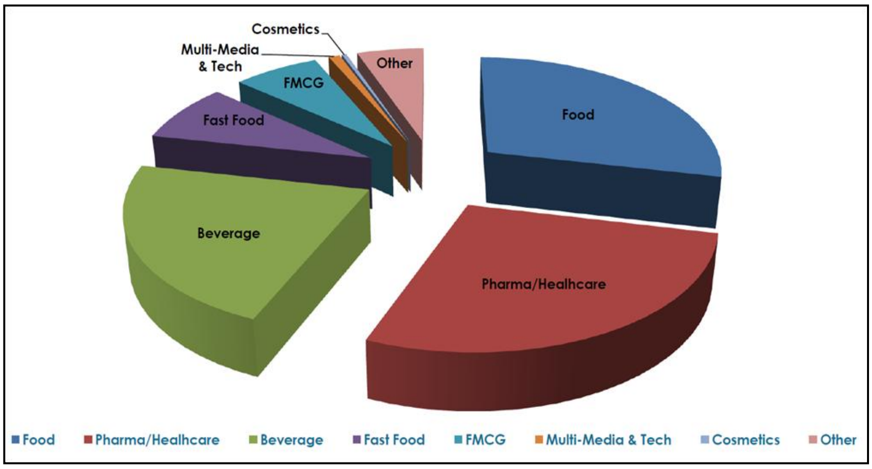
Following the acquisition of CHH, CKL is expected to achieve annualised revenues of c.$207m and operates 5 manufacturing sites in Melbourne (2), Sydney (2) and Auckland (1) and has a sales office in Brisbane.

**Picture: CKL Proforma Revenue post CHH acquisition**




***Source:*** *CKL presentation*

**Chart: Revenue by market segment (FY11a)**




***Source:*** *CKL presentation*

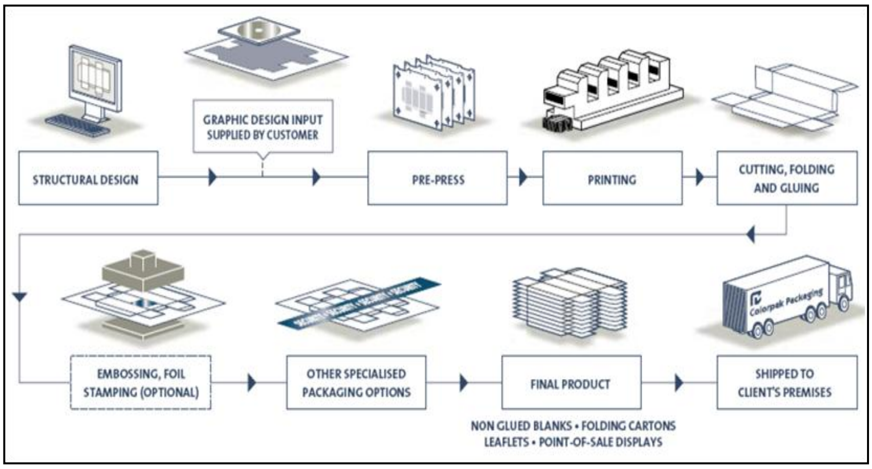
**The stability and growth of CKL's revenue (illustrated on the previous page) since 2002 is impressive**. It is an indication of the non-cyclical nature of demand for CKL's services and products as well as good management. Typically, customers enter 1-3 year contracts with CKL.

**CKL sources its paperboard from Amcor's Petrie Board Mill, the CHH Pulp & Paper Whakatane Mill in NZ, the US for its beverage customers and from Australian board merchants.** The paper board industry is competitive and although raw material prices can vary, customer contracts typically allow CKL to pass on price increases in raw material.

**CKL is the market leader with substantial market share in the pharmaceutical packaging sub segment of the folding cartons industry.** This is a premium product with high barriers to entry. Growth is driven by new products, an aging population and legislation.

The main components of CKL's folding carton production process are illustrated below and discussed on the following page.

**Picture: Production Process**




***Source:*** *CKL Prospectus*

CKL uses predominantly European machines which are superior to Asian alternatives and offers an integrated solution from design to shipping.

- **Structural and Graphic Design.** CKL design team works with customers to create packaging solutions that meet customer's marketing and in some cases meet regulatory requirements.

- **Pre-Press.** Ensures that the graphic design is compatible with the structural design template. A proof is produced for approval.

- **Printing.** Core capability is sheet fed lithographic offset printing and flexographic reel fed printing. Multiple techniques and finishing's are available and CKL is the exclusive member of the Waterless Printing Association.

- **Cutting, Folding and Gluing.** Machine accuracy and consistency are paramount to achieve required creaseability and functionality.

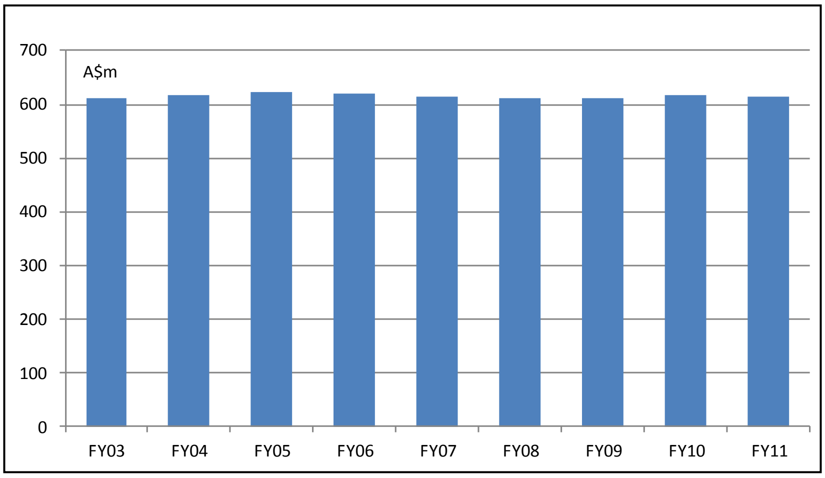
- **Embossing and Foil Stamping.** Offered under CKL's Foilmasters brand

- **Other specialised packaging options.** For eg, tamper-evident designs, binary code verification, insertion and folding of leaflets...

- **Shipping.** Shipped flat to customer's premises.

# Industry Overview

**Chart: Folding carton industry revenue estimate (local production only)**




***Source:*** *Industry data and estimates*

**The Australian folding carton industry revenue is c.$620m** (local production) and is segment of the $3.2bn paper and board packaging industry. **The industry is mature** and is primarily characterised by:

- Steady revenue @ c.$612m-c.$623m since 2003

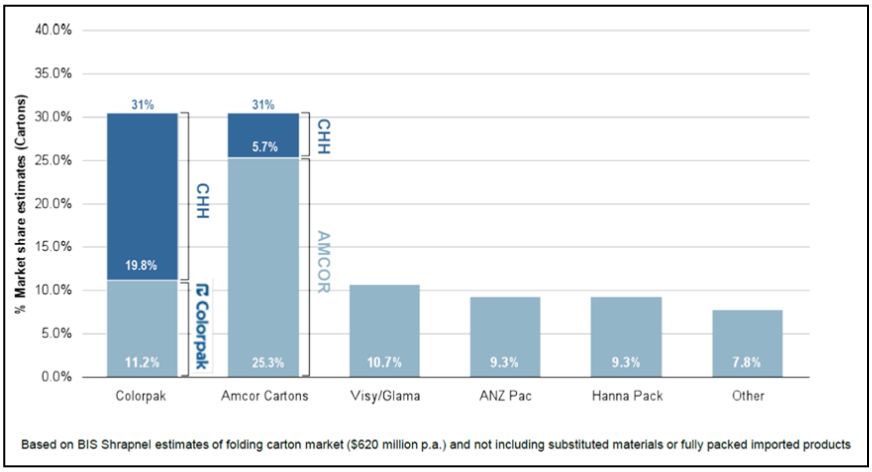
- An increase in imported paper board product, however, this has slowed since FY10 and may slow further with a lower AUD.

- Production processes subject to technological advancement which improves productivity and quality, and

- Customers demanding reliable service & product supply at lower cost.

An estimate of the market shares of the Australian folding carton industry are illustrated below. CKL and Amcor are now the industry leaders with market shares of c.31% each. The remaining participants have market shares of c.10% or less and include Visy, ANZPAC, HannaPack, Abaris.

**Picture: Market share of the Australia folding carton industry**




***Source:*** *CKL investor presentation*

The folding carton industry can be divided into two main components:

- The ‘short-run’ market that produces higher quality packaging for consumer products such as pharmaceuticals, cosmetics, medicines, technology and increasingly, premium food products.

- The ‘long-run’ market that produces higher volumes of product with less sophistication and is mostly the fast moving consumer goods such as fast food, beer, cereal and other food products.

It is expected that consolidation of the folding carton industry will continue in order to:

- Restore rational pricing. Margins, ROE and ROA in the market have declined to levels which are uneconomic. Rationale pricing is required to enable reinvestment.

- Increase volumes to reduce unit costs and drive other efficiencies.

- Requires scale to service national and international accounts.

CHH (pre CKL) and Amcor mainly focus on the ‘long run’ market and over many years competed aggressively on price. CHH (pre CKL) is thought to be responsible for most of the recent price discounting as evident in the lack of profit when CKL acquired the business. For the 4 months to 30/6/11, CHH under CKL ownership achieved profit of $0.4m from $40.9m of revenue.

Both CHH (pre CKL) and Amcor provided demand for their upstream paperboard manufacturing facilities, being Amcor’s Petrie Board Mill and CHH Pulp & Paper Whakatane Mill in NZ. These assets are highly capital intensive and require high utilisation rates to cover fixed costs. CKL does not have upstream manufacturing operations but the paperboard market is globally competitive.

The main barriers to entry include:

- Customer relationships which are only established over long periods of reliable service and product supply. CKL’s main point of differentiation is its clean processing conditions which meet the demands of the food and pharmaceutical sectors.

- Capital intensity due to expensive machines, and

- Technically demanding design and production processes.

# Carter Holt Harvey acquisition

## Headline financial estimates

The addition of CHH (excluding the Smithfield business) should add c.$119m of revenue and c.$4m of EBITDA to CKL in FY12e

**Table: CHH headline financials**

| | 12 mths to 31/12/09 | 4 mths to 30/6/11 | FY12e | FY13e | FY14e | FY15e |
|---|---|---|---|---|---|---|
| Revenue | 170.0 (1) | 40.9 | 118.8 | 118.8 | 118.9 | 118.8 |
| **EBITDA** | **4.0 (2)** | **0.8** | **3.6** | **5.2** | **6.3** | **6.9** |
| EBITDA margin | | 2.0% | 3.1% | 4.3% | 5.3% | 5.8% |
| **EBIT** | | **0.4** | **2.6** | **3.8** | **4.6** | **5.0** |
| EBIT margin | | 1.0% | 2.2% | 3.2% | 3.9% | 4.2% |

***Note: (1)** includes Smithfield; **(2)** 'in CKL hands'. CHH was broadly break even at acquisition.*
***Source:** CKL reports and estimates*

## Background

In December 2010, CKL announced the acquisition of the folding carton businesses of Carter Holt Harvey (CHH) conducted at Reservoir and Mount Waverley in Victoria, Villawood in NSW and Auckland in NZ. CHH also operated a business in Smithfield NSW but this was acquired by Amcor. The acquisition included Montage Solutions which provides pre-press and structural design services to the CHH carton and corrugated businesses as well as the trade.

Completion of the acquisition was achieved on 1st March 2011 and CKL's FY11 result included a 4 month contribution from CHH. CHH was effectively break even at acquisition primarily due to CHH's strategy of competing aggressively on price.

As part of the acquisition, CKL is mandated until March 2013 to acquire folding carton board in respect of the acquired CHH businesses in both Australia and NZ on competitive terms from the Reynolds Group's Whakatane Mill.

## Strategic Rationale

The strategic rationale for the acquisition was:

- Extension of customer offering throughout both Australia and NZ;
- Greater manufacturing capabilities;
- Increased relevance to suppliers as a result of greater scale;
- Broader customer base, and
- Financial benefits (examined below).

### Financial benefits

We estimate the pre tax IRR on the acquisition will be c.20%, and the FY13e and FY14e proforma EV/EBIT multiples will be < 6.6x and 5.4x respectively.

**Table: Net Cashflows, pre tax IRR and acquisition valuation multiples**

| | | FY11a | FY12e | FY13e | FY14e | FY15e | ... |
|---|---|---|---|---|---|---|---|
| **CHH EBIT** | | **0.4** | **2.6** | **3.8** | **4.6** | **5.0** | |
| *EBITDA margin* | | | 3.1% | 4.3% | 5.3% | 5.8% | |
| *EBIT margin* | | | 2.2% | 3.2% | 3.9% | 4.2% | |
| **CHH acquisitions costs:** | | | | | | | |
| Cash payment for base bus. | | -5.0 | | | | | |
| Transaction costs | | -1.4 | | | | | |
| Integration costs | | -2.2 | -10.0 | | | | |
| Working capital adj's (1) | | | -4.3 | | | | |
| Unwind of Provisions (2) | | | -1.0 | -0.9 | -1.5 | -0.9 | |
| **Total costs** | | **-8.6** | **-15.3** | **-0.9** | **-1.5** | **-0.9** | |
| **Net Cashflows** | | **-8.2** | **-12.7** | **2.9** | **3.2** | **4.1** | |
| **Pretax IRR (1) & (2) & (3)** | **19%** | | | | | | |
| **NPV of total costs (3)** | **-25.1** | | | | | | |
| **Proforma EV/EBIT** | | | **9.7** | **6.6** | **5.4** | **5.0** | |

***Note:*** ***(1)*** *this figure does not reflect any benefit from an improvement in working capital over time;* ***(2)*** *Upon acquisition of CHH, CKL took on $16.5m in liabilities including lease rentals that are not considered to be commercial in the current market as well as make good obligations under those premises leases and also some contracts with customers that were considered to be uneconomic. These figures do not reflect any benefits from actions such as sub leasing;* ***(3)*** *2.5% long term growth;* ***(4)*** *discounted at 9.5%, being CKL's cost of debt.* ***Source:*** *CKL reports and estimates*

### CHH acquisition and integration costs

As illustrated in the table above, consideration for CHH comprises many components:

- $5m upfront payment in FY11a;
- $1.4m of various acquisition related transaction costs in FY11a;
- $2.2m integration costs in FY11a;
- c.$6.7m of staff redundancy in FY12e. There was a net reduction of c.33 staff but redundancy has been offered to c.90 staff and c.57 new staff have been hired;
- c.$1.3 of premise relocation and other related in FY12e. Three production sites in Victoria rationalised to two, as well as expanding the Braeside site, and
- c.$2.0m for payout of leave entitlements in FY12e.

These are summarised in the table below.

**Table: CHH acquisition and integration costs**

| $m | FY11a | FY12e |
|---|---|---|
| Various acquisition related transaction costs | 1.4 | |
| Integration costs | 2.2 | |
| Staff redundancy costs | | 6.7 |
| Premise relocation and other | | 1.3 |
| Payout of lease entitlements | | 2.0 |
| **Total** | **3.6** | **10.0** |

***Source:*** *CKL reports*

CKL reports that the CHH integration is progressing well:

- Major customer engagement process largely complete and all major accounts met.
- Internal and external brand launches completed with formal events with strong customer engagement.
- New brand collateral working way through all sites.
- New IT program progressing well with first of 3 sites live on 1/9/11.
- Cost synergies identified and being delivered in a timely manner.

## The upside case

Our earnings estimates include the acquired CHH business achieving an EBITDA margin of c.5.3% in FY14e. There is upside potential to this estimate. Below we illustrate the IRR and acquisition valuation multiples if CKL achieves a 7.2% EBITDA margin from the acquired CHH revenues.

The pre tax IRR from the CHH acquisition increases to c.28% and the proforma EV/EBIT multiples falls materially to c.3.6x in FY14e.

**Table: Upside case (Net Cashflows, IRR and acquisition valn multiples)**

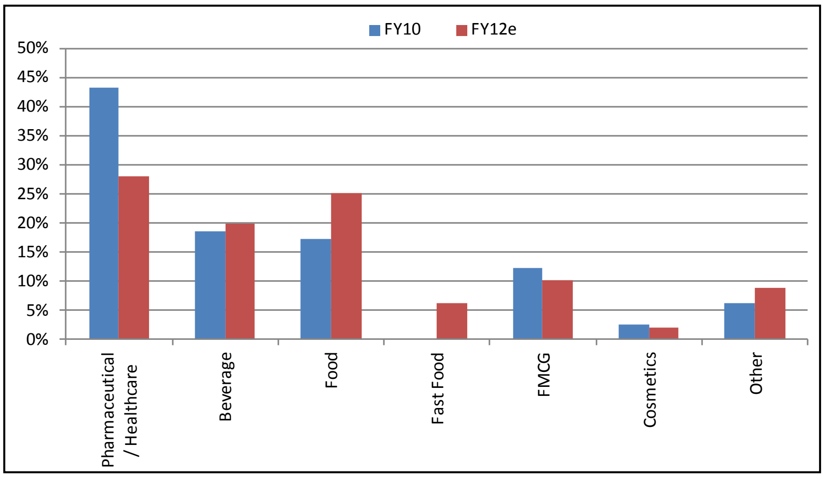
| | | FY11a | FY12e | FY13e | FY14e | FY15e | ... |
|---|---|---|---|---|---|---|---|
| **CHH EBIT** | | **0.4** | **2.6** | **5.7** | **7.0** | **7.5** | |
| *EBITDA margin* | | | 3.4% | 5.9% | 7.2% | 7.9% | |
| *EBIT margin* | | | 2.2% | 4.8% | 5.9% | 6.3% | |
| **CHH acquisitions costs:** | | | | | | | |
| Cash payment for base bus. | | -5.0 | | | | | |
| Transaction costs | | -1.4 | | | | | |
| Trans. related integration act's | | -2.2 | -10.0 | | | | |
| Working capital adj's (1) | | | -4.3 | | | | |
| Unwind of Provisions (2) | | | -1.0 | -0.9 | -1.5 | -0.9 | |
| **Total costs** | | **-8.6** | **-15.3** | **-0.9** | **-1.5** | **-0.9** | |
| **Net Cashflows** | | **-8.2** | **-12.7** | **4.8** | **5.5** | **6.6** | |
| **Pretax IRR (1) & (2) & (3)** | **28%** | | | | | | |
| **NPV of total costs (4)** | **-25.1** | | | | | | |
| **Proforma EV/EBIT** | | | **9.7** | **4.4** | **3.6** | **3.4** | |

***Note:*** ***(1)*** *this figure does not reflect any benefit from an improvement in working capital over time;* ***(2)*** *Upon acquisition of CHH, CKL took on $16.5m in liabilities including lease rentals that are not considered to be commercial in the current market as well as make good obligations under those premises leases and also some contracts with were customers that considered to be uneconomic. These figures do not reflect any benefits from actions such as sub leasing;* ***(3)*** *2.5% long term growth;* ***(4)*** *discounted at 9.5%, being CKL's cost of debt.* ***Source:*** *CKL reports and estimates.*

## Diversification

A major strategic benefit from the acquisition of CHH is it has significantly broadened CKL's customer base. This is illustrated in the chart below.

**Chart: Diversification of revenue following CHH acquisitions**




***Source:*** *CKL reports and estimates*

Pre the CHH acquisition, CKL derived c.45% of its revenue from the pharmaceutical / healthcare industry segment. Three customers each contributed revenues > 10% of total revenue and which aggregated to 41% of revenues.

Post the CHH acquisition, the pharmaceutical / healthcare industry segment contributes c.27%. CKL has a single customer that contributes revenues > 10% of the group's revenues (being 15%). The top 3 customers now contribute a little over 20% of total revenue. The table below provides examples of customers by segment and some comments on each segment.

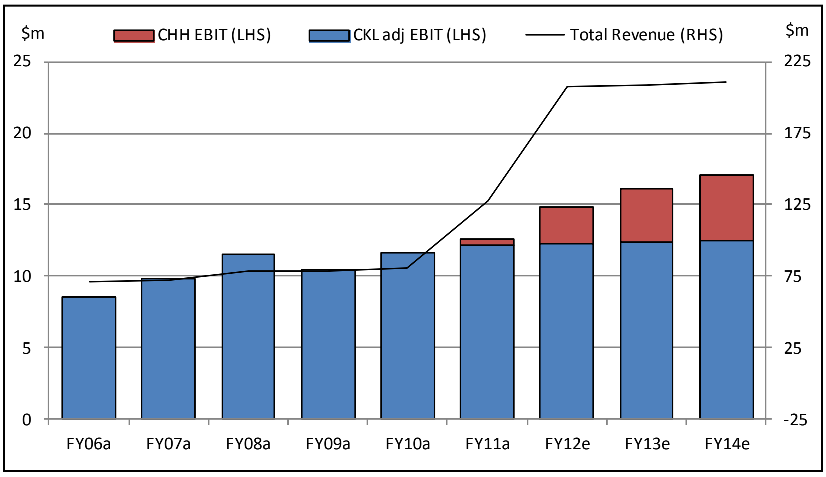
**Table: Revenue, Examples of Customers and comments by market segment**

| Market Segments | Revenue | | | Examples of Customers | Comments |
|---|---|---|---|---|---|
| $m | Old CKL (1) | New CKL (2) | Industry | | |
| Pharmaceutical /Healthcare | 35 | 58 | | AstraZeneca, Pfizer, GSK | Premium product, high barriers to entry, growth driven by new product launches, an aging population and legislation. |
| Beverage | 15 | 41 | | Graphic Packaging | Lower margin but has been growing. |
| Food | 14 | 52 | | McCains, Nestle, Goodman Fielder | Commoditised with some low margin volumes moving offshore. |
| Fast Food | - | 13 | | McDonalds, Pizza Hut, KFC | Has been achieving good growth since GFC due to consumers looking for more affordable and convenient options. |
| FMCG | 10 | 21 | | Cussons, Ingham, Kraft | High volume & continual product development. |
| Cosmetics | 2 | 4 | | L'Oreal, Jurlique | Premium product. |
| Other | 5 | 18 | | Telstra, MYOB | Environmental leaders |
| **Total** | **$81m** | **$207m** | **c.$630m** | | |

***Notes: (1)*** *FY10a reported by CKL;* ***(2)*** *FY12e.* ***Source:*** *CKL reports, Industry data and estimates.*

# Income Statement

**Chart: Revenue and EBIT (CKL & CHH)**



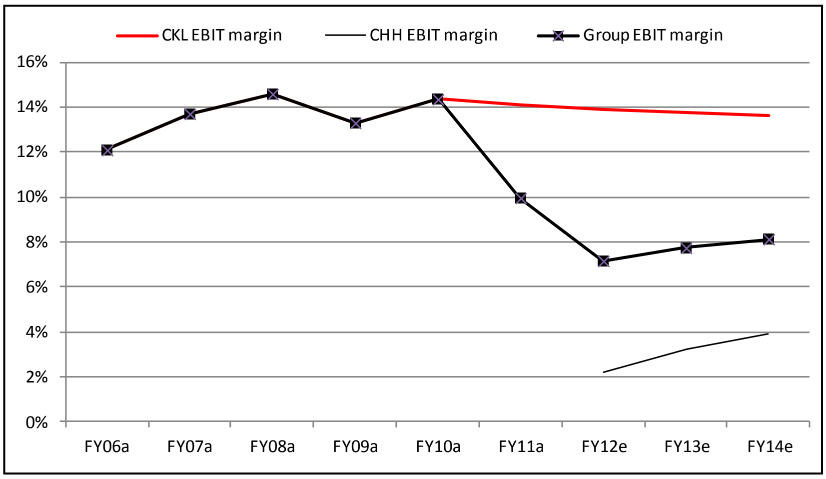

***Source:*** *CKL reports and estimates*

The most impressive aspect of CKL's historical financial results has been the maintenance of margins, unlike many of its competitors. Between FY06a and FY11a, CKL's EBIT margins have ranged between 12.1% and 14.9%. This is predominantly due to management's discipline with customer pricing, including its ability to pass-on increases in board prices to customers.

Raw materials and staff expenses comprise the vast majority (c.85%) of CKL's expenses. Between FY06a and FY11a, raw material and staff expenses consistently represented c.40% and c.30% of revenue respectively. This will change with the addition of the lower margin CHH business which reported profit of only $0.4m for the 4 months to 30/6/11.

The acquisition of CHH shall increase CKL's revenue to c.$207m in FY12e (CKL @ c.$88m + CHH @ $119m). A small improvement in CHH's EBIT margins will lead to large increases in group EBIT.

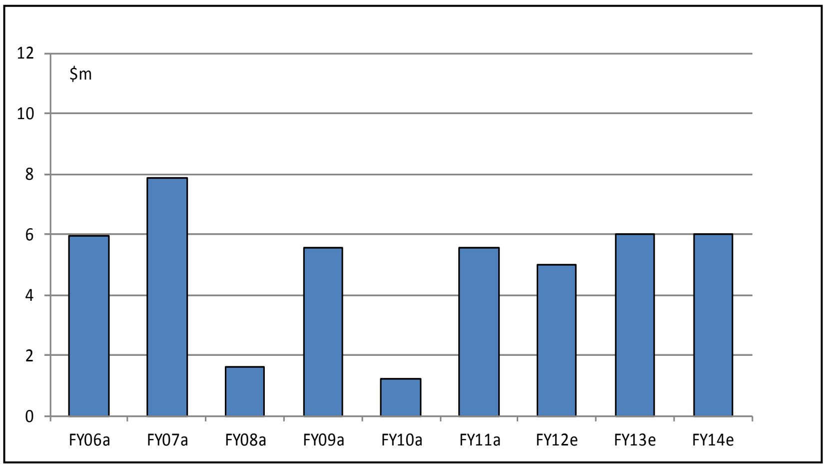
**Chart: EBIT margins**




***Source:*** *CKL reports and estimates*

# Cashflow

**Chart: Capex**



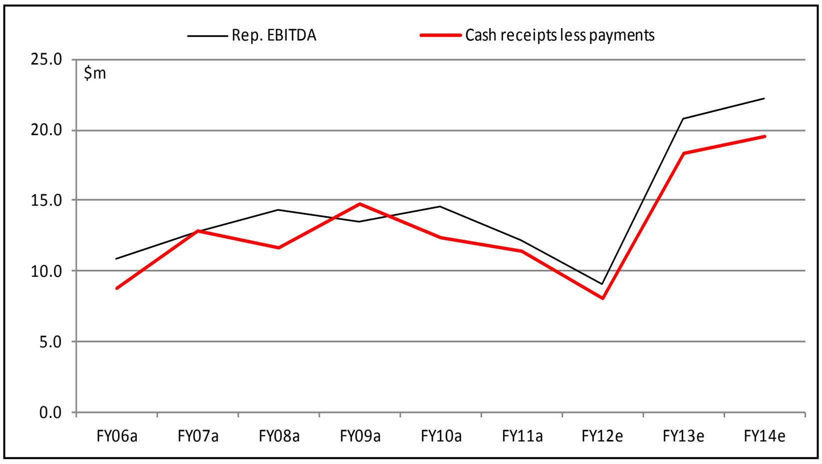

***Source:*** *CKL reports and estimates*

FY11 capex was $5.58m, the main item of expenditure being a cup and lid forming machine at the Braeside manufacturing site. CKL has provided guidance that FY12e capex will be c.$6m. The D&A charge is expected to increase from $3.1m in FY11a to $4.3m in FY12e, which indicates Free Cash Flow will be c.$2m below NPAT before a number of 'one offs' including:

- A payment of $4.3m for working capital adjustments in respect of the CHH acquisition, and
- One off integration costs of c.$8m + leave entitlement payouts of c.$2m.
- c.$3m for the unwind of unfavourable customer contracts and leases. We estimate the unwind will continue for c.5 years at c.$2-3m p.a.

FY11 cashflows were adversely impacted by the delay of a single payment of $2.08m which was received on 1st July 2011, so FY12 will see a boost to cash from operations.

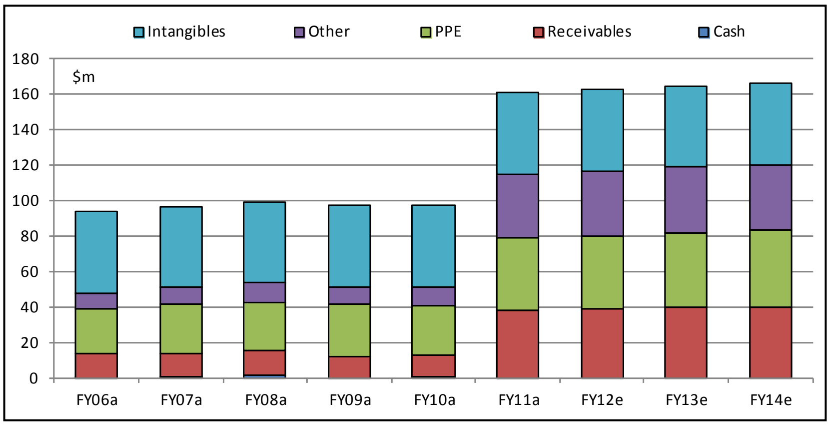
**Chart: Rep. EBITDA vs Cash receipts less payments**




***Source:*** *CKL reports and estimates*

# Balance Sheet

### Chart: Assets



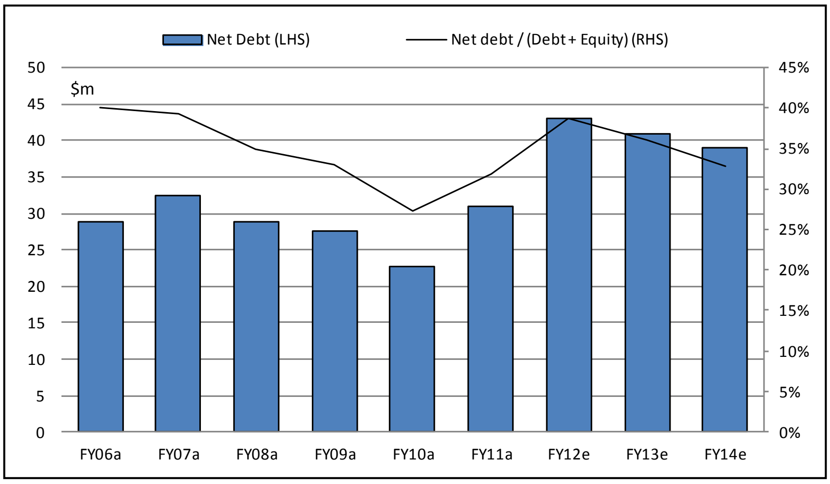

***Source:*** *CKL reports and estimates*

There are three major balance sheet items of note:

- The $46.1m of goodwill which is a result of the accounting treatment and structure adopted at the time of listing in 2004. None of the acquisitions since listing have added to goodwill.
- Gearing. Debt increased from $22.8m @ 30/6/10 to $34.3m @ 30/6/11, and is expected to increase further to c.$43m at 30/6/12.
- Increased provisions in relation to the CHH acquisition. CKL took on $16.5m in liabilities including lease rentals that are not considered to be commercial in the current market as well as make good obligations under those premises leases and also some contracts with customers that are considered to be uneconomic.

The FY12e book ROE and ROA is low at 11.8% and 5% but excluding the $46.1m of goodwill, tangible ROE and ROA increases to 32% and 7% respectively. Loan facilities are provided by NAB and BNZ and the bank bill facilities expire on 1/9/13, the trade finance loan facility on 30/4/14 and other bank facilities on 31/8/12. All debt facilities are expected to be renewed.

### Table: Net Debt & Gearing (Debt / (Debt + Equity))




***Source:*** *CKL reports and estimates*

# Appendices

## Financial and Valuation Summary

| Valuation & Investment Data | |
|---|---|
| ASX code | CKL |
| Share price (cps) | 68 |
| DCF valuation (cps) | 83 |
| Premium/(Discount) to price | 23% |
| Shares on issue (m) | 81.2 |
| Market Capitalisation ($m) | 55.2 |
| 12mth share price range (cps) | 60 - 76 |

| Headline Financials (June Y/E) | FY06a | FY07a | FY08a | FY09a | FY10a | FY11a | FY12e | FY13e | FY14e |
|---|---|---|---|---|---|---|---|---|---|
| Revenue ($m) | 70.7 | 71.8 | 78.8 | 78.8 | 80.8 | 127.4 | 207.0 | 208.8 | 210.7 |
| *change* | | *2%* | *10%* | *0%* | *3%* | *58%* | *62%* | *1%* | *1%* |
| EBITDA ($m) | 10.9 | 12.7 | 14.3 | 13.5 | 14.6 | 15.8 | 19.1 | 20.8 | 22.2 |
| *change* | | *17%* | *13%* | *-6%* | *8%* | *9%* | *21%* | *9%* | *7%* |
| EBIT ($m) | 8.5 | 9.8 | 11.5 | 10.5 | 11.6 | 12.7 | 14.8 | 16.2 | 17.1 |
| *change* | | *15%* | *17%* | *-9%* | *11%* | *9%* | *17%* | *9%* | *6%* |
| NPAT ($m) | 4.5 | 5.1 | 6.2 | 5.6 | 6.4 | 7.1 | 7.7 | 8.4 | 9.2 |
| *change* | | *12%* | *23%* | *-10%* | *14%* | *10%* | *9%* | *8%* | *10%* |
| EPS (cps) | 5.6 | 6.3 | 7.7 | 6.9 | 7.9 | 8.7 | 9.5 | 10.2 | 11.2 |
| *change* | | *12%* | *23%* | *-10%* | *14%* | *10%* | *9%* | *8%* | *10%* |
| DPS (cps) | 2.75 | 2.75 | 3.00 | 3.00 | 3.25 | 3.3 | 3.3 | 3.5 | 3.84 |
| Franking | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |
| Tangible ROE | | 228% | 111% | 65% | 57% | 48% | 31% | 31% | 29% |

| Valuation multiples | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| PER (x) | | | | | | 7.8 | 7.2 | 6.7 | 6.1 |
| Div. Yield | | | | | | 4.8% | 4.8% | 5.2% | 5.6% |
| Enterprise value ($m) | | | | | | 89.4 | 100.2 | 98.5 | 95.7 |
| EV/EBITDA (x) | | | | | | 4.7 | 4.8 | 4.4 | |
| EV/EBIT (x) | | | | | | 6.0 | 6.2 | 5.8 | |

## Financials

| INCOME STATEMENT | FY10a | FY11a | FY12e | FY13e | FY14e |
|---|---|---|---|---|---|
| Revenue | 80.8 | 127.4 | 207.0 | 208.8 | 210.7 |
| Expenses | -66.3 | -111.6 | -187.9 | -188.0 | -188.5 |
| **EBITDA** | **14.6** | **15.8** | **19.1** | **20.8** | **22.2** |
| D&A | -3.0 | -3.1 | -4.3 | -4.7 | -5.1 |
| **EBIT** | **11.6** | **12.7** | **14.8** | **16.2** | **17.1** |
| Net Interest inc./exp. | -2.5 | -2.5 | -3.8 | -4.2 | -4.0 |
| **Pretax Profit** | **9.1** | **10.2** | **11.0** | **11.9** | **13.1** |
| Tax | -2.7 | -3.2 | -3.3 | -3.6 | -3.9 |
| OEI | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Adj NPAT** | **6.4** | **7.1** | **7.7** | **8.4** | **9.2** |
| add/(less): sig. items (a/tax) | 0.0 | 8.8 | -7.0 | 0.0 | 0.0 |
| **Rep. NPAT** | **6.4** | **15.9** | **0.7** | **8.4** | **9.2** |

| CASHFLOW | FY10a | FY11a | FY12e | FY13e | FY14e |
|---|---|---|---|---|---|
| Rec's less pay's | 12.3 | 11.4 | 8.0 | 18.3 | 19.5 |
| Interest inc. | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 |
| Interest exp. | -2.3 | -2.6 | -3.8 | -4.2 | -4.0 |
| Tax | -1.0 | -2.6 | -3.1 | -3.5 | -3.8 |
| Other | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Operating cashflows** | **9.0** | **6.2** | **1.1** | **10.6** | **11.7** |
| Capex | -1.2 | -5.7 | -5.0 | -6.0 | -6.0 |
| Acq./sale of bus.'s | 0.0 | -8.6 | -4.3 | 0.0 | 0.0 |
| Other | 0.0 | 0.2 | 0.0 | 0.0 | 0.0 |
| **Investing cashflows** | **-1.2** | **-14.2** | **-9.3** | **-6.0** | **-6.0** |
| Equity | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Debt | -4.8 | 8.3 | 12.0 | -2.0 | -2.0 |
| Dividends | -2.6 | -3.4 | -2.7 | -2.8 | -3.0 |
| Other | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Financing cashflows** | **-7.4** | **4.8** | **9.3** | **-4.8** | **-5.0** |
| Change in cash | 0.4 | -3.2 | 1.2 | -0.2 | 0.7 |
| **Cash (EoP)** | **0.0** | **-3.2** | **-2.0** | **-2.2** | **-1.5** |

| CAPITAL | FY10a | FY11a | FY12e | FY13e | FY14e |
|---|---|---|---|---|---|
| Equity | 39.2 | 39.5 | 39.5 | 39.5 | 39.5 |
| Reserves | -0.6 | -0.4 | -0.4 | -0.4 | -0.4 |
| Retained earnings | 21.8 | 34.2 | 32.3 | 37.8 | 43.8 |
| Minorities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Shareholders equity** | **60.5** | **73.3** | **71.3** | **76.8** | **82.9** |
| | | | | | |
| Represented by: | | | | | |
| Cash | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Receivables | 12.6 | 38.2 | 39.1 | 39.4 | 39.8 |
| Inventories | 10.2 | 30.5 | 30.8 | 31.1 | 31.4 |
| Other | 0.6 | 1.8 | 1.8 | 1.8 | 1.8 |
| **Current assets** | **23.5** | **70.5** | **71.7** | **72.3** | **72.9** |
| PPE | 27.9 | 40.6 | 41.3 | 42.7 | 43.7 |
| Intangibles | 46.1 | 46.1 | 46.1 | 46.1 | 46.1 |
| Other | 0.0 | 3.8 | 3.8 | 3.8 | 3.8 |
| **Non current assets** | **74.0** | **90.6** | **91.3** | **92.7** | **93.6** |
| | | | | | |
| **Total assets** | **97.5** | **161.1** | **163.0** | **165.0** | **166.6** |
| | | | | | |
| Payables | 8.6 | 25.4 | 27.8 | 28.0 | 28.2 |
| Debt | 0.0 | 3.2 | 2.0 | 2.2 | 1.5 |
| Other | 2.5 | 13.6 | 7.0 | 8.2 | 7.8 |
| **Current liabilities** | **11.1** | **42.2** | **36.8** | **38.4** | **37.6** |
| Debt | 22.8 | 31.0 | 43.0 | 41.0 | 39.0 |
| Other | 3.1 | 14.6 | 11.9 | 8.8 | 7.1 |
| **Non current liabilities** | **25.9** | **45.6** | **54.9** | **49.8** | **46.1** |
| | | | | | |
| **Total liabilities** | **37.0** | **87.8** | **91.7** | **88.2** | **83.7** |
| | | | | | |
| **Net assets** | **60.4** | **73.3** | **71.3** | **76.8** | **82.9** |
| **Net Tangible Assets** | **14.3** | **27.1** | **25.2** | **30.7** | **36.7** |

# Main Sensitivities

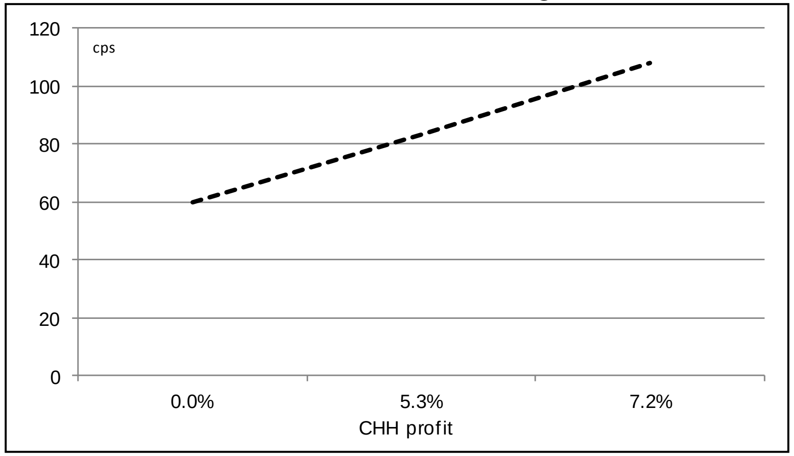
- **Margins.** Although CKL has been able to hold its EBITDA margins over many years, margin pressure is a threat. As discussed in this report, CKL is expected to benefit from achieving economic margins from the acquired CHH business and this is the main sensitivity for CKL's future profits and valuation.

  We derive a 83 cps valuation for CKL which includes a c.5.3% EBITDA margin in FY14e.

  If the contribution from CHH continues to be close to 0, the CKL valuation declines to c.57 cps.

  If the contribution from CHH increases to reflect an EBITDA margin of c.7%, then the CKL valuation increases to c.105 cps

  **Chart: CKL Valuation vs CHH EBITDA margin**

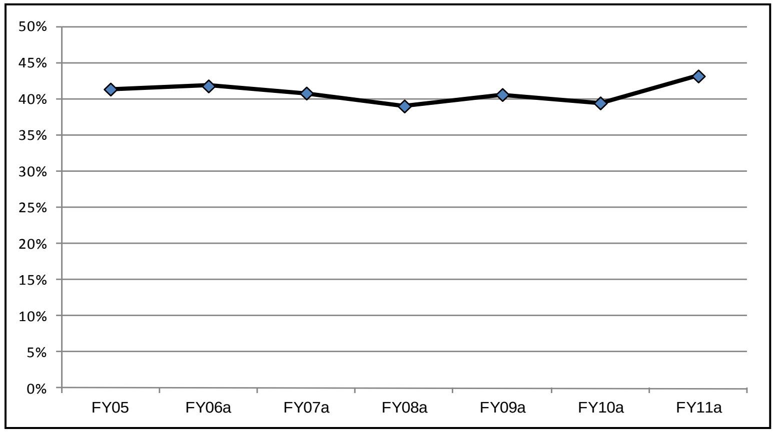



  ***Source:*** *CKL reports and estimates*

- **Customers.** Although the acquisition of CHH's folding carton business has significantly diversified CKL's customer base, CKL has a number of large customers which if lost would impact future profits.

- **Raw materials.** The folding carton industry is supplied with paperboard by local producers and imports through local paper merchants. Whilst supply shortages are uncommon, raw material prices are subject to fluctuations. Since FY05, CKL has successfully retained raw material costs as a proportion of revenue at c.39% - 43% as illustrated below left.

  **Chart: CKL raw material costs/Revenue**

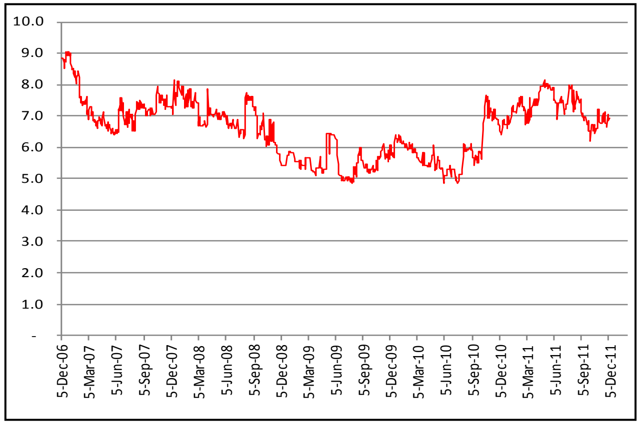



  ***Source:*** *CKL reports*

- **Imported product.** The proportion of imported product has increased to c.9% of total industry revenue, which is a threat to local producers. However, this has not changed materially since 2009. The recent depreciation of the AUD should act as a deterrent for customers considering importing product.

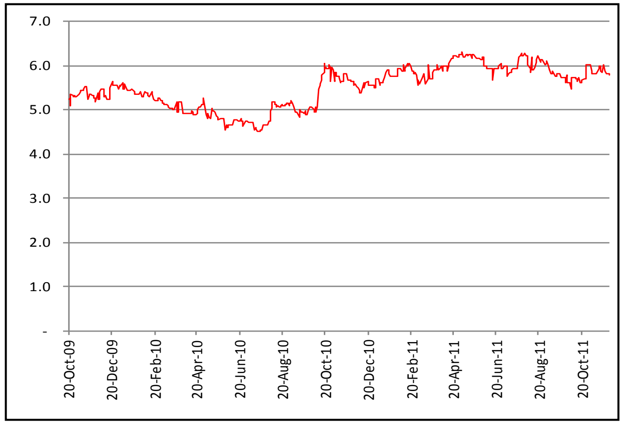
# Valuation Observations

### Chart: 12 month forward PER



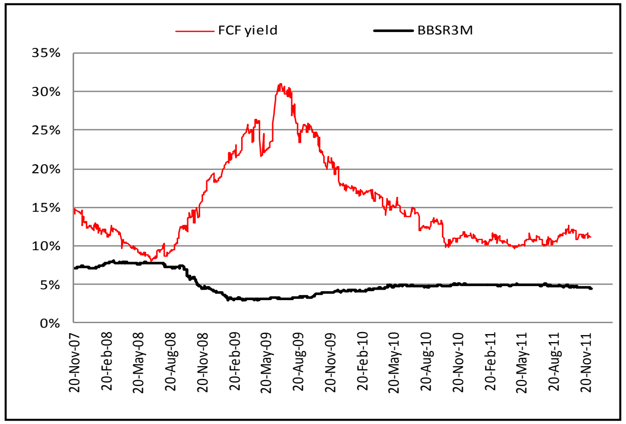

*Source: Reported and estimates*

### Chart: EV/EBIT



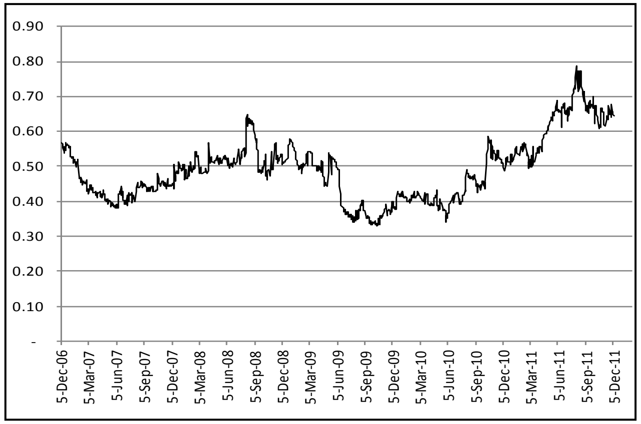

*Source: Reported and estimates*

### Chart: Free Cash Flow Yield vs 3 mth BB Swap



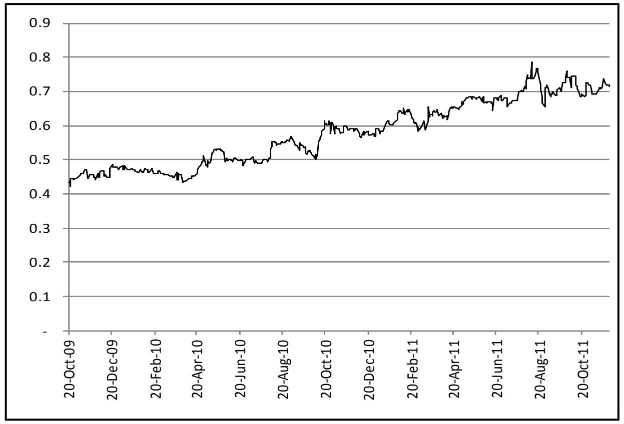

*Source: Reported and estimates*

### Chart: PER relative to ASX 100



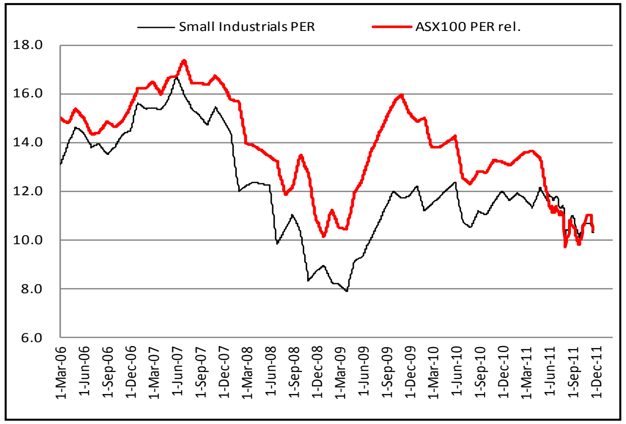

*Source: Companies and estimates*

### Chart: EV/EBIT relative to ASX 100




*Source: Companies and estimates*

### Chart: Small Ind. PER vs ASX 100 PER




*Source: Companies and estimates*

# Directors

- **Geoff Willis, Chairman** of CKL since January 2004. Mr Willis was the CEO of Hydro Tasmania from 1999 to 2006, and prior to that appointment he was a member of the Amcor senior management team from 1982 to 1998. Geoff is currently the Chairman of Aurora Energy Pty Ltd, Chairman of the Tasmanian Symphony Orchestra and a Trustee of the Tasmanian Museum and Art Gallery.

- **Alex Commins, Managing Director.** Mr Commins joined CKL in 1992 after starting his career in auditing and accounting. Mr Commins has been the Managing Director since January 2003 and maintains direct responsibility for CKL's strategy development, customer relationships. Mr Commins is a board member of the Victoria Chapter of the French Australian Chamber of Commerce and Industry.

- **Paul Commins, Executive Director.** Mr Commins joined CKL in 1993 after managing his own screen printing business. Mr Commins implemented the ISO 9001:2000 quality standard and played a key role in the integration of Pemara Corporation's folding carton division into CKL's Braeside operations in 2001. Between 1999 and 2002, Mr Commins was Managing Director of CKL. Mr Commins' primary focus is seeking productivity efficiencies for the business by the adoption of new technologies.

- **Ms Bronwyn Constance, Non-executive Director.** The early part of her career was spent with the ACI Group of companies, followed by senior financial roles with Kraft Foods Ltd in Australia and Asia, CFO of Pasminco Ltd and Finance Director of Nylex Ltd. Currently she is a director and chairs the audit committees of The Melbourne Market Authority and the Co-operative Research Centre for Advanced Automotive Technology.

- **David Heaney, Non-executive Director.** Mr Heaney joined CKL in January 2004 and has vast experience in banking and corporate finance gained with the National Australia Bank and subsidiary companies, where he held several senior management positions in Australia and the United States. Mr Heaney also serves as a director of the listed companies, Cyclopharm Limited and Dromana Estate Limited.

- **Ian Wightwick, Non-executive Director.** Until his retirement from full time employment in February 2004, Mr Wightwick was Managing Director and Chief Executive Officer of PaperlinX, which was demerged from Amcor, and listed on the ASX under his stewardship in 2000. PaperlinX grew by acquisition to be the largest international paper merchant, also having substantial paper manufacturing operations in Australia. Prior to PaperlinX, Mr Wightwick filled various executive marketing and divisional Managing Director roles in Amcor.

- **Mr Harry Commins, Alternate Director.** Mr Commins is CKL's National Manufacturing Director and is an alternate director for Paul Commins. Mr Commins joined CKL in 1992 after starting his career with a large printing company. Mr Commins oversees production, maintenance, crewing levels, and is a key driver on the Quality Assurance and Occupational Health and Safety committees. He plays a major role in CKL's assessment and development of new technologies. Mr Commins is also an integral part of the sales team in a technical capacity with new product development, promotional activities and as co-ordinator of capacity utilisation between the plants.

# International peers

## Company Name, Code, EV (US$m) and Company Description

| Company Name | Code | EV (US$m) | Company description |
|---|---|---|---|
| Mayr-Melnhof Karton AG | MMK-AT | 1,104 | MMK engages in the manufacture and sale of cartonboard and folding cartons in Europe. It operates through the Mayr-Melnhof Cartonboard (MM Karton) and Mayr-Melnhof Packaging (MM Packaging) segments. MM Karton manufactures and markets numerous grades of cartonboard, concentrating on coated cartonboard produced predominantly from recycled paper. |
| CCL Industries Inc. (Cl B) | CCL.B-CA | 1,265 | CCL provides specialty packaging and labeling solutions for the consumer products and healthcare industries. The company also provides packaging solutions to the Home & Personal Care, Premium Food & Beverage, Healthcare and Specialty markets worldwide. |
| Cascades Inc. | CAS-CA | 1,909 | CAS manufactures and markets packaging & tissue products composed of recycled fibres. It offers coated boxboard, containerboard, folding cartons and convert tissue paper for the commercial, institutional and retail markets. It has operations in North America and Europe. |
| Graphic Packaging Holding Co. | GPK-US | 3,878 | GPK provides paperboard packaging solutions for various products to multinational food, beverage, and other consumer products companies. The company also produce bags, labels, inks, coatings, flexible and specialty packaging, as well as paperboard grades, packaging machinery, and services. |
| Sonoco Products Co. | SON-US | 3,898 | SON manufactures industrial and consumer packaging products and provides packaging services. The company operates through two segments: Tubes and Cores/Paper and Consumer Packaging. |
| Rock-Tenn Co. Cl A | RKT-US | 6,306 | RKT manufactures packaging products, recycled paperboard, containerboard, bleached paperboard and merchandising displays. The company operates through four segments: Consumer Packaging, Corrugated Packaging, Merchandising Displays and Specialty Paperboard Products. |
| MeadWestvaco Corp. | MWV-US | 6,557 | MWV is a packaging company which provides packaging solutions to many of brands in the healthcare, beauty and personal care, food, beverage, tobacco and home and garden industries. |
| Klabin S/A ADS | KLBAY-US | 8,816 | KLBAY engages in manufacturing, selling, and distributing paper to the internal and external market. It produces, exports, and recycles paper in Brazil. It also manufactures cardboards, corrugated boxes, industrial sacks, envelopes, wood, pulp for paper production, dissolving pulp and tissue. |

# Appendix – International peers

### Comparison of Gross Returns [(1)], Efficiency [(2)] and Net Returns [(3)]

| Coy Code | Gross Return (1) | | Efficiency (2) | | Net Return (3) | |
|---|---|---|---|---|---|---|
| | FY11a/e | FY12e | FY11a/e | FY12e | FY11a/e | FY12e |
| MMK-AT | 126% | 122% | 13% | 13% | 8% | 8% |
| CCL.B-CA | 97% | 101% | 19% | 19% | 7% | 7% |
| CAS-CA | 101% | 107% | 7% | 9% | 0% | 1% |
| GPK-US | 120% | 125% | 14% | 15% | 4% | 5% |
| SON-US | 156% | 164% | 12% | 13% | 9% | 9% |
| RKT-US | 62% | 110% | 14% | 15% | 2% | 5% |
| MWV-US | 68% | 69% | 17% | 18% | 4% | 4% |
| **Median** | **101%** | **110%** | **14%** | **15%** | **4%** | **5%** |
| **CKL (FY12e/FY13e)** | **169%** | **168%** | **9%** | **11%** | **6%** | **8%** |
| **Variance** | **68%** | **53%** | **-33%** | **-29%** | **56%** | **40%** |

***Notes:* *(1)* *Revenue/Tangible Assets;* ***(2)*** *EBITDA margins;* ***(3)*** *NPAT/Tangible Assets*
***Source:*** *Factset, CKL reports and estimates*

# Appendix – International peers

### Comparison of Reinvestment [1], Revenue growth and EPS growth

| Coy Code | Re-investment (1) | | Revenue growth | | EPS growth | |
|---|---|---|---|---|---|---|
| | FY11a/e | FY12e | FY11a/e | FY12e | FY11a/e | FY12e |
| **MMK-AT** | 7.8% | 5.9% | 10% | 0% | 8% | 3% |
| **CCL.B-CA** | 6.3% | 6.6% | 5% | 4% | 16% | 12% |
| **CAS-CA** | 3.8% | 3.4% | 2% | -6% | -42% | -93% |
| **GPK-US** | 3.7% | 4.7% | 0% | 2% | 633% | 45% |
| **SON-US** | 6.0% | 5.1% | 15% | 10% | 31% | 4% |
| **RKT-US** | 4.9% | 2.3% | 80% | 79% | -5% | 24% |
| **MWV-US** | 2.7% | 8.1% | -6% | 6% | 97% | 32% |
| **Median** | **4.9%** | **5.1%** | **4.8%** | **4.4%** | **16%** | **12%** |
| | | | | | | |
| **CKL (FY12e/FY13e)** | **2.4%** | **5.0%** | **nm** | **nm** | **5%** | **24%** |
| **Variance** | **-51%** | **-3%** | **nm** | **nm** | **nm** | **nm** |

***Notes: (1)*** *Capex / Tangible Assets*
***Source:*** *Factset, CKL reports and estimates*

## Appendix – International peers

### Valuation comparison

| Coy Code | EV/EBITDA | | EV/EBIT | | PER | |
|---|---|---|---|---|---|---|
| | FY11a/e | FY12e | FY11a/e | FY12e | FY11a/e | FY12e |
| **MMK-AT** | 4.2 | 3.9 | 6.3 | 5.8 | 10.9 | 10.7 |
| **CCL.B-CA** | | | | | 11.9 | 10.6 |
| **CAS-CA** | 6.4 | 5.0 | 20.8 | 11.1 | 94.4 | 9.1 |
| **GPK-US** | 6.4 | 5.4 | 12.7 | 9.8 | 13.4 | 10.2 |
| **SON-US** | 6.8 | 6.0 | 9.9 | 8.9 | 13.3 | 12.7 |
| **RKT-US** | 10.5 | 5.4 | 15.0 | 8.3 | 10.6 | 8.8 |
| **MWV-US** | 6.2 | 6.2 | 9.8 | 9.6 | 14.7 | 14.0 |
| **Median** | **6.4** | **5.4** | **11.3** | **9.3** | **13.3** | **10.6** |
| | | | | | | |
| **CKL (FY12e/FY13e)** | **4.5** | **3.9** | **5.8** | **5.0** | **7.4** | **6.0** |
| **Variance** | **-29%** | **-28%** | **-49%** | **-46%** | **-44%** | **-43%** |

***Source:*** *Factset, CKL reports and estimates*

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