

Colorpak Limited

7 February 2012

Valuation and key data:

ASX code	CKL
Share price (cps)	72
Valuation (cps)	82
Prem/(Disc) to price	14%
Shares on issue (m)	81.5
Market Cap. (\$m)	58.7
12mth price range (cps)	60 - 76

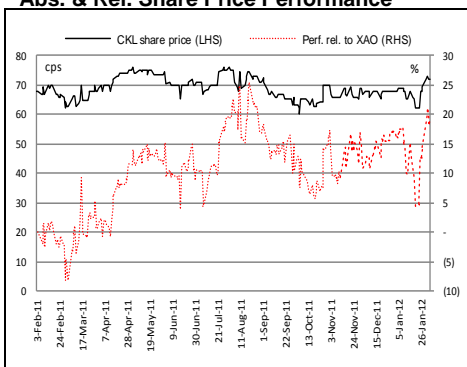
Summary Financials:

June Y/E	11a	12e	13e
Rev. (\$m)	127.4	195.3	196.6
change	58%	53%	1%
NPAT (\$m)	7.1	7.5	8.5
change	10%	7%	13%
EPS (cps)	8.7	9.2	10.4
change	10%	6%	12%
DPS (cps)	3.3	3.3	3.8
Tangible ROE	48%	29%	34%

Valuation multiples:

PER(x)	8.3	7.8	6.9
Div. Yield	4.5%	4.5%	5.2%
EV(\$m)	95.8	104.0	102.3
EV/EBIT (x)	6.3	6.3	5.8

Abs. & Rel. Share Price Performance



Source: IRESS

The Colorpak share price has outperformed the All Ordinaries Index by c.20% over the previous 12 months.

Investment overview

Colorpak Limited (CKL) provides investors with defensive revenues and profits as well as the potential for growth. 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.**

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.**

We value CKL at 82 cps, up 14% from the current share price of 72 cps. The 83 cps valuation implies a 12 mth forward PER of 8.4x and EV/EBIT of 6.6x. Both these valuation multiples are c.70% of the respective Small Industrial's averages.

Key points

- **CKL announced its 1H12 result and the headline results are:**
 - **Underlying NPAT of \$4.8m, up 26% pcp.** Reported NPAT was -\$2.2m vs +\$2.8m pcp. As previously flagged by the company the reported result was impacted by the restructuring associated with the acquired CHH business. The reported result was also impacted by higher factory costs as a result of the Reservoir site closure and transfer of business to two other CKL Victorian sites.
 - **Underlying EPS of 5.8 cps, up 25% pcp.**
 - **Interim dividend of 1.75 cps, ff, unchanged from 1H11.**
- **The integration of CHH is progressing to plan.** The business is now managed as a single entity and rebranded as Colorpak. The IT program is progressing well and rationalisation of premises is now complete.
- **CKL provided guidance that:**
 - **"The CHH acquisition has increased the company's exposure to seasonality with the first half now stronger than the second."** This is largely due to increased exposure to the beverage sector which typically has higher sales during the 6 months to December. **Expecting c.55% / c.45% revenue split between 1H / 2H12.**
 - **"The underlying results of the business continue to track well."**

Headline 1H12 Financial Results

Table: Headline 1H12 Financial Results

\$m		1H11	1H12	Change
Revenue		43.5	104.1	139%
EBITDA		8.0	10.5	32%
D&A		-1.4	-2.0	
EBIT		6.6	8.6	30%
Net interest income		-1.1	-1.7	
Pretax Profit		5.4	6.8	26%
Tax		-1.6	-2.1	
Adj NPAT		3.8	4.7	26%
Significant items (a/tax)		-1.0	-7.0	
Rep. NPAT		2.8	-2.2	
EPS	cps	4.7	5.8	25%
DPS	cps	1.5	1.5	0%

Source: CKL reports

Income statement

- **Revenue is \$104.1m vs \$43.5m pcp.** The large increase follows the inclusion of a full 6 month contribution from the acquired Carter Holt Harvey folding carton (CHH) business.
- **Underlying EBITDA is \$10.5m vs \$8.0m pcp.** The EBITDA margin is 10.1%, down from 18.4% pcp due to the acquired lower margin CHH business.
- **Underlying EBIT is \$8.6m vs \$6.6m pcp.** The D&A charge is \$2.0m vs \$1.4m pcp due to the acquired CHH fixed assets.
- **Underlying NPAT is \$4.8m, up 26% pcp.** Reported NPAT was -\$2.2m vs +\$2.8m pcp. As previously flagged by the company the reported result was impacted by the restructuring associated with the acquired CHH business. The reported result was also impacted by higher factory costs as a result of the Reservoir site closure and transfer of business to two other CKL Victorian sites.

A breakdown of the restructuring, integration and business combination costs is illustrated in the table on the page which follows.

- **Underlying EPS is 5.8 cps, up 25% pcp.**
- **DPS is 1.75 cps, ff,** unchanged from the interim dividend paid in FY11.

Table: Restructuring, integration and combination costs (b/tax)

	\$m
<u>Restructuring and integration costs</u>	
Redundancies	6.6
Premises provisions	1.8
Moving costs	0.7
Equipment and inventory provisions	0.2
Integration costs	<u>0.5</u>
Total restructuring and integration costs	9.8
<u>Business combination costs</u>	
Computer set-up	0.1
Rebranding	0.1
Other	<u>0.0</u>
Total business combination costs	0.2

Source: CKL reports

Cashflow

- Excluding restructuring costs, operating cashflow is \$8.1m vs \$5.6m pcp. Operating cashflow in 1H12 benefitted from a \$2.08m receipt which was received on 1st July 2011 relating to FY11 performance. However, this was almost entirely offset by \$1.9m of customer receipts that were due in 1H12 but not paid until early January.
- Net capex in 1H12 is \$1.9m, and CKL has provided guidance that FY12 capex will be c.\$5m.
- During 1H12, CKL paid another \$4.4m in settlements to the vendors of the CHH business as a result of higher working capital at the date of acquisition.
- Operating cash flow in 1H12 included an improvement in working capital of \$3.7m.
- At 31/12/11, net debt was \$43.6m vs \$34.2m at 30/6/11. The debt / (debt + equity) ratio has increased to 38.6% which is higher but remains relatively modest.

CHH integration and restructuring

- CHH integration is well advanced and progressing to plan.
- Rationalisation of premises is now complete.
- Business now managed as single entity and rebranded as Colorpak.
- IT program progressing well.

Outlook Guidance

- “the 2nd six months will continue to be heavily focused on integration activities across the business and we will be driving for efficiencies”
- “The CHH acquisition has increased the company’s exposure to seasonality with the first half now stronger than the second.” This is largely due to increased exposure to the beverage sector which typically has higher sales during the 6 months to December. Expecting 55% / 45% revenue split between 1H / 2H.
- “The underlying results of the business continue to track well.”

Financial benefits from the CHH acquisition

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	
<i>EBITDA margin</i>		3.1%	4.3%	5.3%	5.8%	
<i>EBIT margin</i>		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⁾		-4.4				
Unwind of Provisions ⁽²⁾		-1.0	-0.9	-1.5	-0.9	
Total costs	-8.6	-15.4	-0.9	-1.5	-0.9	
Net Cashflows	-8.2	-12.8	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

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	
<i>EBITDA margin</i>		3.4%	5.9%	7.2%	7.9%	
<i>EBIT margin</i>		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⁾		-4.4				
Unwind of Provisions ⁽²⁾		-1.0	-0.9	-1.5	-0.9	
Total costs	-8.6	-15.4	-0.9	-1.5	-0.9	
Net Cashflows	-8.2	-12.8	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.

In terms of the sensitivity between the CHH EBITDA margin vs CKL group valuation, we estimate the following:

- **83 cps valuation** for CKL which includes a c.5.3% EBITDA margin in FY14e (assuming our CHH revenue estimates).
- 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** (assuming our CHH revenue estimates).

Other key sensitivities

In addition to future EBITDA margins from the acquired CHH business, the other key sensitivities are:

Customers

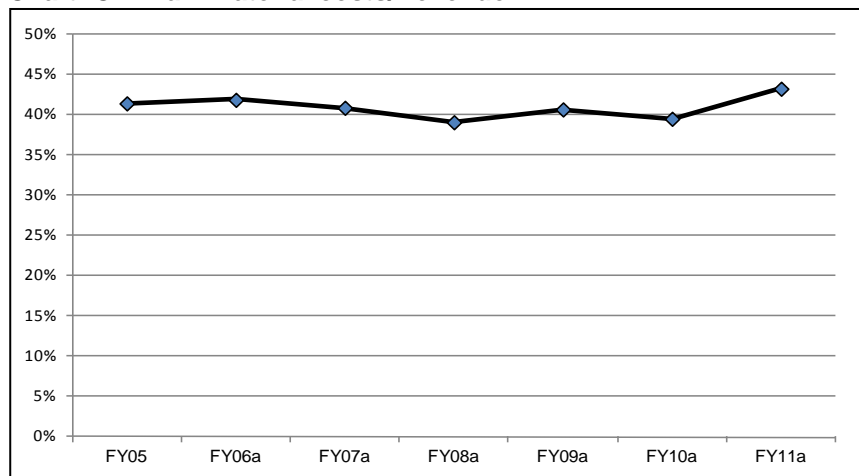
Although the acquisition of CHH's folding carton business has significantly diversified CKL's customer base, CKL has a number of large customers which if lost would impact future profits.

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. A depreciation of the AUD should act as a deterrent for customers considering importing product.

Financial and Valuation Summary

Valuation & Investment Data									
ASX code	CKL								
Share price (cps)	72								
DCF valuation (cps)	82								
Premium/(Discount) to price	14%								
Shares on issue (m)	81.5								
Market Capitalisation (\$m)	58.7								
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	195.3	196.6	198.0
<i>change</i>		2%	10%	0%	3%	58%	53%	1%	1%
EBITDA (\$m)	10.9	12.7	14.3	13.5	14.6	15.8	19.3	21.1	22.6
<i>change</i>		17%	13%	-6%	8%	9%	22%	9%	7%
EBIT (\$m)	8.5	9.8	11.5	10.5	11.6	12.7	15.2	16.4	17.5
<i>change</i>		15%	17%	-9%	11%	9%	19%	8%	7%
NPAT (\$m)	4.5	5.1	6.2	5.6	6.4	7.1	7.5	8.5	9.4
<i>change</i>		12%	23%	-10%	14%	10%	7%	13%	11%
EPS (cps)	5.6	6.3	7.7	6.9	7.9	8.7	9.2	10.4	11.5
<i>change</i>		12%	23%	-10%	14%	10%	6%	12%	10%
DPS (cps)	2.75	2.75	3.00	3.00	3.25	3.3	3.3	3.8	4.00
Franking	100%	100%	100%	100%	100%	100%	100%	100%	100%
Tangible ROE	0%	228%	111%	65%	57%	48%	29%	34%	31%

Valuation multiples				
PER (x)				
			8.3	7.8
			6.9	6.3
Div. Yield			4.5%	4.5%
			5.2%	5.6%
Enterprise value (\$m)			96.1	104.2
			102.6	99.7
EV/EBITDA (x)			5.0	4.9
			4.5	4.5
EV/EBIT (x)			6.3	6.3
			5.9	5.9

Financials

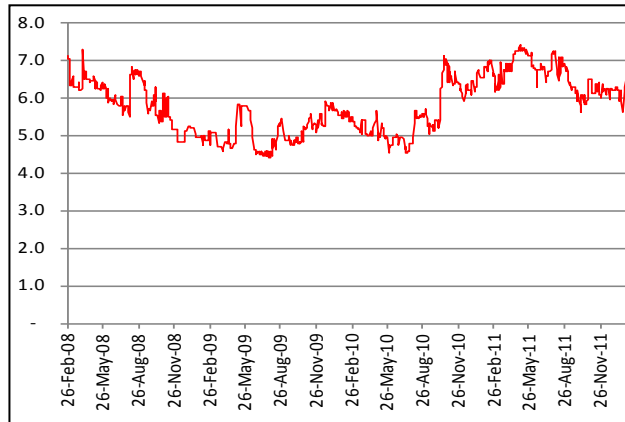
INCOME STATEMENT	FY10a	FY11a	FY12e	FY13e	FY14e
Revenue	80.8	127.4	195.3	196.6	198.0
Expenses	-66.3	-111.6	-176.0	-175.5	-175.4
EBITDA	14.6	15.8	19.3	21.1	22.6
D&A	-3.0	-3.1	-4.1	-4.7	-5.1
EBIT	11.6	12.7	15.2	16.4	17.5
Net Interest inc./exp.	-2.5	-2.5	-4.3	-4.3	-4.1
Pretax Profit	9.1	10.2	10.8	12.1	13.5
Tax	-2.7	-3.2	-3.3	-3.6	-4.0
OEI	0.0	0.0	0.0	0.0	0.0
Adj NPAT	6.4	7.1	7.5	8.5	9.4
add/(less): sig. items (a/tax)	0.0	8.8	-7.0	0.0	0.0
Rep. NPAT	6.4	15.9	0.6	8.5	9.4

CASHFLOW	FY10a	FY11a	FY12e	FY13e	FY14e
Rec's less pay's	12.3	11.4	18.9	18.6	19.9
Interest inc.	0.0	0.1	0.0	0.0	0.0
Interest exp.	-2.3	-2.6	-4.0	-4.3	-4.1
Tax	-1.0	-2.6	-3.4	-4.8	-3.8
Other	0.0	0.0	-0.4	0.0	0.0
Operating cashflows	9.0	6.2	11.1	9.5	12.0
Capex	-1.2	-5.7	-4.8	-5.0	-6.0
Acq./sale of bus.'s	0.0	-8.6	-4.4	0.0	0.0
Other	0.0	0.2	-8.9	0.0	0.0
Investing cashflows	-1.2	-14.2	-18.1	-5.0	-6.0
Equity	0.0	0.0	0.0	0.0	0.0
Debt	-4.8	8.3	11.4	-2.0	-2.0
Dividends	-2.6	-3.4	-2.9	-2.9	-3.1
Other	0.0	0.0	-0.3	0.0	0.0
Financing cashflows	-7.4	4.8	8.2	-4.9	-5.1
Change in cash	0.4	-3.2	1.3	-0.4	0.9
Cash (EoP)	0.0	-3.2	-1.9	-2.3	-1.4

CAPITAL	FY10a	FY11a	FY12e	FY13e	FY14e
Equity	39.2	39.5	39.5	39.5	39.5
Reserves	-0.6	-0.4	-0.6	-0.6	-0.6
Retained earnings	21.8	34.2	31.9	37.3	43.5
Minorities	0.0	0.0	0.0	0.0	0.0
Shareholders equity	60.5	73.3	70.8	76.2	82.3
Represented by:					
Cash	0.0	0.0	0.0	0.0	0.0
Receivables	12.6	38.2	29.6	29.8	30.0
Inventories	10.2	30.5	24.8	25.0	25.2
Other	0.6	1.8	2.0	2.0	2.0
Current assets	23.5	70.5	56.4	56.8	57.2
PPE	27.9	40.6	41.3	41.6	42.6
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	91.2	91.5	92.5
Total assets	97.5	161.1	147.6	148.4	149.7
Payables	8.6	25.4	16.7	16.8	16.9
Debt	0.0	3.2	1.9	2.3	1.4
Other	2.5	13.6	2.7	2.7	2.4
Current liabilities	11.1	42.2	21.3	21.8	20.7
Debt	22.8	31.0	43.6	41.6	39.6
Other	3.1	14.6	11.9	8.8	7.1
Non current liabilities	25.9	45.6	55.5	50.3	46.7
Total liabilities	37.0	87.8	76.8	72.1	67.4
Net assets	60.4	73.3	70.8	76.2	82.3
Net Tangible Assets	14.3	27.1	24.7	30.1	36.2

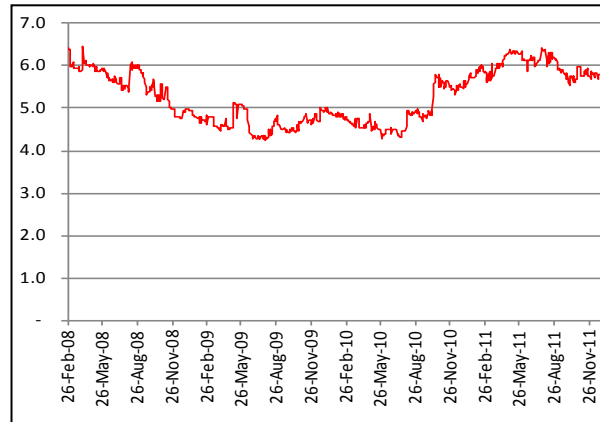
Valuation Observations

Chart: 12 month forward PER



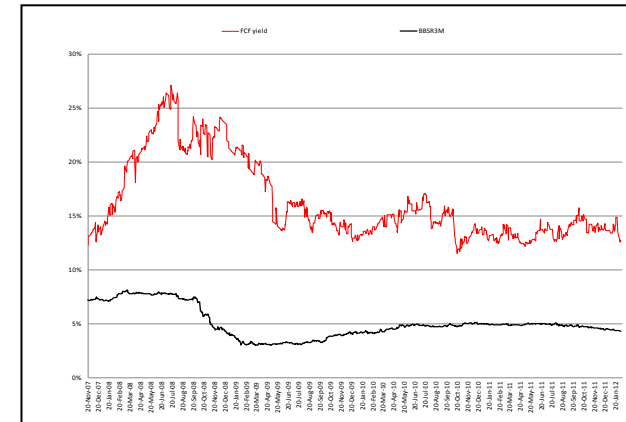
Source: Reported and estimates

Chart: EV/EBIT



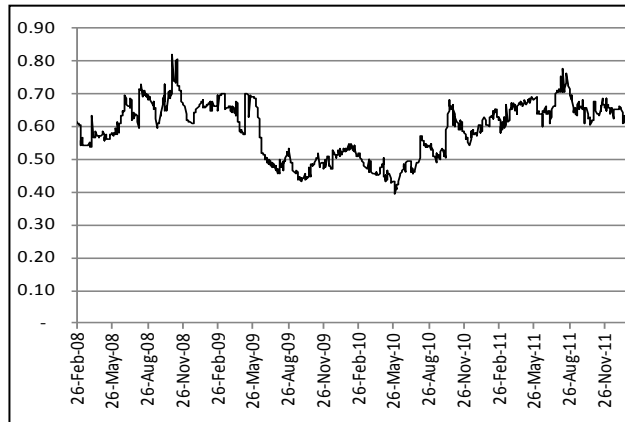
Source: Reported and estimates

Chart: Free Cash Flow Yield vs 3 mth BB Swap



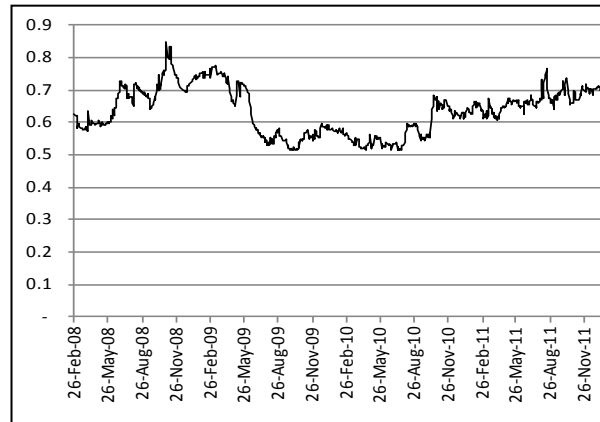
Source: Reported and estimates

Chart: PER relative to Small Industrials Index



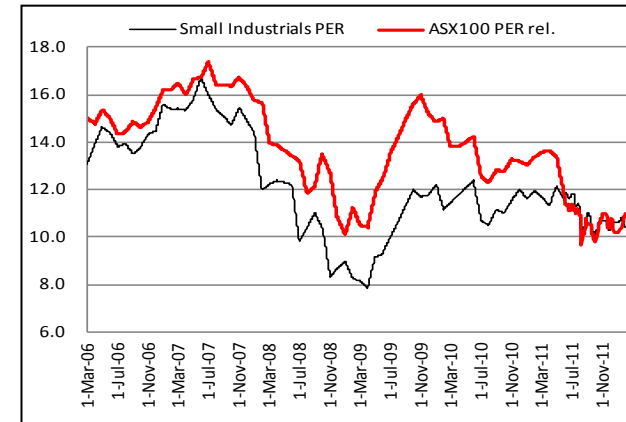
Source: Companies and estimates

Chart: EV/EBIT relative to the Small Industrials



Source: Companies and estimates

Chart: Small Ind. PER vs ASX 100 PER



Source: Companies and estimates

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