

Equity | Australia | Packaging
05 August 2009

FY09 Result

Merrill Lynch


A subsidiary of Bank of America Corporation

Mario Maia, CFA >>
 Research Analyst
 Merrill Lynch (Australia)
 mario_maia@ml.com

+61 2 9226 5766

FY09 result misses our number

CKL reported an FY09 NPAT of A\$5.6m, down 9% on the pcp and below our estimate of \$6.3m. A very weak June quarter where customers reduced inventory and raw material cost increases were not easily passed through was the primary reason for the decline in earnings given that *“trading was ahead of the previous year until March 2009”*.

Near term earnings downgraded

Given the quantum of weakness in the June quarter, we have downgraded our FY10 and FY11 estimates by 13% and 14% respectively. EBIT in 2H09 was 21% below the pcp and margins fell 290bp to 11.8% and although demand should normalise moving into FY10, at this point we have conservatively rolled this last quarter run rate out for 1H10.

Competitive environment but solid platform

Although competitive pressures exist which are limiting full pass through of input costs, we expect that inventory contraction is likely to be only a short term influence and the company has been successful in extending 4 of its key contracts during the year. Given the tough operating environment, the FY09 result and guidance illustrates that the company still has a solid growth platform.

Buy recommendation retained

Despite difficult trading conditions in Oz (especially in the last Q) due to a slowing wider economy, we still believe that the company has a robust business model which the market is not fully reflected in the current share price. The stock is trading on a PE of 6.0x, which in our view reflects a price well below its fundamental value (our DCF is \$0.83ps). We think CKL has corporate appeal and could be a prey in the future rationalisation of the Australian carton board market. Retain our Buy recommendation.

Estimates (Jun)

(A\$)	2008A	2009A	2010E	2011E	2012E
Net Profit b/f Abnormals	6.2	5.6	5.8	6.3	6.8
EPS	0.077	0.069	0.070	0.075	0.079
EPS Change (YoY)	22.9%	-10.8%	2.4%	6.7%	5.5%
Dividend / Share	0.030	0.030	0.030	0.030	0.035
Free Cash Flow / Share	0.073	0.055	0.066	0.056	0.061

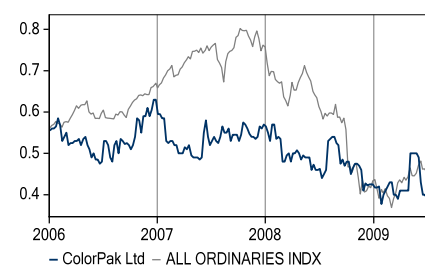
Valuation (Jun)

	2008A	2009A	2010E	2011E	2012E
P/E	5.4x	6.0x	5.9x	5.5x	5.2x
Dividend Yield	7.2%	7.2%	7.2%	7.2%	8.4%
EV / EBITDA*	4.4x	4.6x	4.3x	4.0x	3.8x
Free Cash Flow Yield*	17.6%	13.4%	16.1%	14.1%	15.6%

* For full definitions of *iQmethod*SM measures, see page 5.

Stock Data

Price	A\$0.415
Price Objective	A\$0.700
Date Established	4-Feb-2009
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	A\$0.385-A\$0.539
Mrkt Val / Shares Out (mn)	US\$28 / 80.5
Average Daily Volume	34,530
ML Symbol / Exchange	XBVVF / ASX
Bloomberg / Reuters	CKL AU / CKLAX
ROE (2010E)	9.9%
Net Dbt to Eqty (Jun-2009A)	49.3%
Est. 5-Yr EPS / DPS Growth	0.9% / 3.7%
Free Float	68.0%



- ColorPak Ltd - ALL ORDINARIES INDX

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Refer to important disclosures on page 6 to 8. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4.

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iQprofileSM Colorpak Ltd.

Key Income Statement Data (Jun) (A\$ Millions)

	2008A	2009A	2010E	2011E	2012E
Sales	79	79	82	86	89
Operating Expenses	(64)	(65)	(68)	(71)	(74)
EBITDA	14	13	14	14	15
Depreciation & Amortization	(3)	(3)	(3)	(3)	(3)
EBIT	11	10	11	11	12
Net Interest & Other income	(3)	(2)	(2)	(2)	(2)
Associates	NA	NA	NA	NA	NA
Pretax Income	9	8	8	9	10
Tax (expense) / Benefit	(3)	(2)	(2)	(3)	(3)
Net Profit b/f Abnormals	6	6	6	6	7
Non-Recurring Items	0	0	0	0	0
Net Income (Reported)	6	6	6	6	7
Avg F Diluted Shares Outstanding	80	81	82	84	86

Key Cash Flow Statement Data

EBITDA	14	13	14	14	15
Change in Working Capital	(3)	1	(1)	(1)	(1)
Deferred Taxation Charge	1	0	0	0	0
Other Adjustments, Net	0	0	0	0	0
Cash Flow from Operations	8	10	9	9	10
Capital Expenditure	(2)	(6)	(3)	(4)	(4)
(Acquisition) / Disposal of Investments	0	0	0	0	0
Other Cash Inflow / (Outflow)	0	0	0	0	0
Cash Flow from Investing	(2)	(6)	(3)	(4)	(4)
Shares Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	(2)	(3)	(2)	(2)	(2)
Cash Flow from Financing	(5)	(6)	(4)	(4)	(2)
Free Cash Flow	6	4	5	5	5
Net Debt	29	28	25	23	20
Change in Net Debt	NA	NA	NA	NA	NA

Key Balance Sheet Data

Property, Plant & Equipment	27	30	29	30	32
Other Non-Current Assets	0	0	0	0	0
Trade Receivables	14	12	14	14	15
Cash & Equivalents	1	0	1	1	4
Other Current Assets	2	1	1	1	1
Total Assets	99	97	101	103	108
Long-Term Debt	30	28	26	24	24
Other Non-Current Liabilities	1	2	2	2	2
Short-Term Debt	1	0	0	0	0
Other Current Liabilities	3	2	2	2	2
Total Liabilities	45	41	41	40	40
Total Equity	55	56	60	63	68
Total Equity & Liabilities	99	97	101	103	108

iQmethodSM - Bus Performance*

Return on Capital Employed	9.3%	8.3%	8.5%	8.8%	9.0%
Return on Equity	11.7%	10.0%	9.9%	10.2%	10.4%
Operating Margin	14.7%	13.4%	13.0%	13.0%	13.1%
EBITDA Margin	18.2%	17.0%	16.9%	16.8%	16.7%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.2x	1.8x	1.5x	1.5x	1.4x
Asset Replacement Ratio	0.6x	1.9x	0.9x	1.3x	1.3x
Tax Rate (Reported)	30.2%	30.1%	30.3%	30.3%	30.3%
Net Debt-to-Equity Ratio	53.6%	49.4%	41.8%	35.7%	29.2%
Interest Cover	4.4x	4.2x	4.3x	4.9x	5.3x

Key Metrics

Franking	100%	100%	100%	100%	100%
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* For full definitions of iQmethodSM measures, see page 5.

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.

Investment Thesis

Backed by a strong management team, which has a solid track record of sales growth and also own a significant proportion of stock, CKL should enjoy solid sales and earnings growth driven by underlying growth in key markets, continued market share gains and a focus on higher margin segments (pharma). Trading below its fundamental value, the stock has corporate appeal and could be a prey in the ongoing rationalisation of the Australian carton board market.

Stock Data

Price to Book Value 0.6x

Table 1: FY09 Result Summary

A\$m	FY08	FY09	Chg %
Sales Revenue	77.8	77.7	-0.2%
EBITDA	14.3	13.5	-5.6%
D&A	-2.9	-3	3.4%
EBIT	11.5	10.5	-8.7%
Net Interest	-2.6	-2.5	-3.8%
EBT	8.9	8	-10.1%
Tax Expense	-2.7	-2.4	-11.1%
NPAT	6.2	5.6	-9.5%
EBITDA Margin	18.40%	17.38%	-5.5%
EBIT Margin	14.70%	13.52%	-8.0%
EPS (A\$ cents)	7.7	6.9	-10.4%
DPS (A\$ cents)	4	3	-25.0%

Source: Company data

FY09 result - Very weak June quarter

CKL reported an FY09 NPAT of A\$5.6m, down 9% on the pcp and below our estimate of \$6.3m. A very weak June quarter where customers reduced inventory and raw material cost increases were not easily passed through was the primary reason for missing our estimate given that *“trading was ahead of the previous year until March 2009”*.

- **Revenue drivers:** Sales were 0.1% below the pcp at A\$77.7m, and the weak 4Q, where customers reduced inventory in response to the global recession, saw the actual outcome less than our forecast of 1.8%.
- **Cost drivers:** Raw materials costs rose 4% on the pcp and the unfavourable exchange rate movements increased the cost base.
- **Operating cash flow:** Net OCF was A\$10m, up 32% on the pcp, despite slower trading and NPAT. The improvement was due to tighter debtor management.
- **Capex:** Net capex was \$5.6m including a new press and dye-cutting machine for the Sydney operation which took advantage of the Government's investment allowance program.
- **Gearing (D/D+E):** Gearing decreased from 34.9% to 33.0% as expected, and gearing is now at its lowest level since the company listed. Net debt has been reduced to A\$27.8m.
- **Final dividend:** CKL declared a fully franked final div of 1.75cps and an interim div of 1.25cps, taking the total div for FY08 to 3.00cps (vs 4.00cps in FY08). This equated to a full year payout ratio of 43%. The final div will be paid on 5 Oct 09. The DRP announced last year will not be offered in respect to the div payable in Oct 09.
- **Outlook:** Given the unstable economic environment, CKL expects *“modest sales and profitability growth”* for FY10. OCF are expected to be robust, and opportunistic growth options will be considered.

Table 2: Summary of earnings changes

	FY10	FY11
NPAT Change	-14.1%	-15.0%
EPS Changes	-12.8%	-13.7%
DPS Changes	9.0%	9.0%

Source: ML estimates

Earnings changes

Given the quantum of weakness in the June quarter, we have downgraded our FY10 and FY11 estimates by 13% and 14% respectively. EBIT in 2H09 was 21% below the pcp and margins fell 290bp to 11.8% and although demand should normalise moving into FY10, at this point we have conservatively rolled this last quarter run rate out for 1H10. The final dividend payout ratio was higher than we were expecting and also the DRP has been ceased which we had previously expected to continue into FY10.

Buy recommendation retained

Despite difficult trading conditions in Oz (especially in the last Q), we remain comfortable with our Buy recommendation. Our positive stance on the stock is based on CKL's solid growth outlook, strong management team, attractive dividend yield (7% fully franked FY09), inexpensive valuation (stock trading at a 38% discount to DCF) and corporate appeal.

Price objective basis & risk

Colorpak Ltd (XBVVF)

Our DCF for CKL is \$0.75ps, based on a WACC of 11.2% and a terminal growth rate of 2.5%. 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. We apply a mid-cycle multiple for the stock of 8.5x, a 30% discount to the market multiple of 11.5x and a 20% discount to Amcor (10.5x). In our view such discount is reasonable, given CKLs inherent liquidity/size issues and the cyclical industry it operates in.

Applying this 8.5x multiple to FY09E EPS of 7.8cps, we derive a valuation for the stock of A\$0.67ps. Importantly, were the stock to reach our price objective of A\$0.70ps in 12 months time, CKL would be trading on a forward PER of 8.6x, which we do not view as demanding. The risks to our recommendation are product substitution, competition, rising raw material costs, management instability and customer attrition.

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	Nufarm Limited	NUFMF	NUF AU	Mario Maia, CFA
NEUTRAL				
	CSR Ltd	CSRLF	CSR AU	Ben Chan, CFA
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	James Hardie-ADR	JHX	JHX US	Ben Chan, CFA
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iQmethodSM 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	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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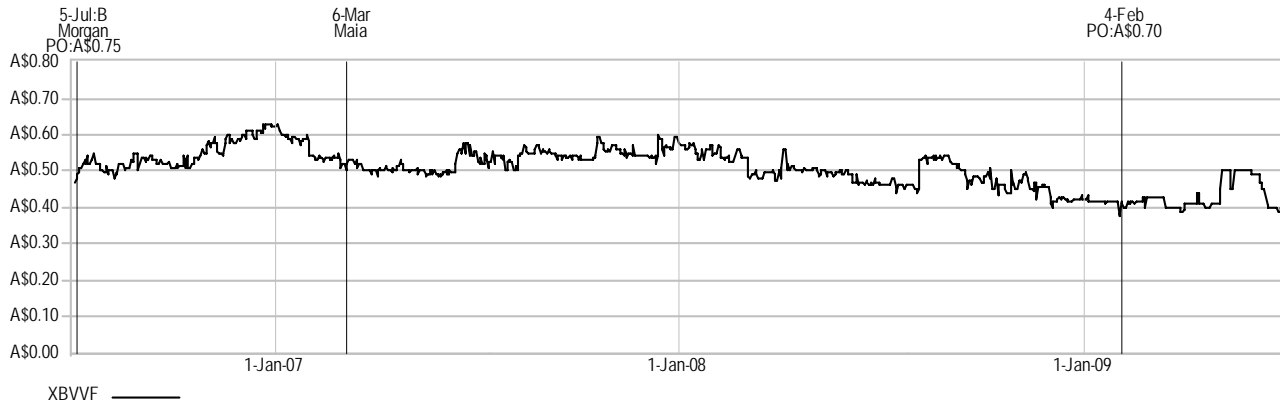
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XBVVF Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	8	47.06%	Buy	5	62.50%
Neutral	3	17.65%	Neutral	2	66.67%
Sell	6	35.29%	Sell	4	66.67%

Investment Rating Distribution: Global Group (as of 01 Jun 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1303	40.83%	Buy	602	51.10%
Neutral	807	25.29%	Neutral	362	51.49%
Sell	1081	33.88%	Sell	394	39.96%

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