Orora 15/08/2017 **FAT-AUS-835**

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Strong results boxed in

In our previous coverage we reviewed Orora's Investor Presentation and the company's long-term growth prospects which we continue to view favourably. Today, our key focus is on the company's Fiscal Year 2017 (FY17) results which were released last week.

Since posting the result, Orora's share price shot up over 12 percent on the back of the company's FY17 results being view incrementally positive in this regard, especially as it beat consensus expectations. On a year-to-date basis, the share price is only slightly outperforming the broad index by some 1.9 percent which is likely a reflection of the higher valuations the stock is currently trading at.

Nevertheless, taking a longer-term view, the company has a proven track record of growth and given its prudent acquisitions and strong potential in its North American Business, it may have room for further growth. The company also declared a final dividend of 6 cents, bringing its annual payout to 11 cents, up 1.5 cents on the previous year.

FY17 Results Review – Currency in A$ unless otherwise noted

Moving on down to the results, Orora reported an underlying net profit of $186.2 million at the end of June, up 14.4 percent compared to last year's result and is ahead of the consensus estimates of $180 million. This better than expected result was mainly due to the IntegraColor acquisition (now Orora Visual) proving to be accretive.

On that note, revenues inched up 4.9 percent to $4.04 billion with Australasia bringing in just about half (49.6%) of sales at $2 billion growing 2.3 percent year-on-year while the North American business bringing in the rest at $2.04 billion with a growth of 7.6 percent over the same period.

Taking a closer look, however, shows that the IntegraColor acquisition actually expanded almost threefold from $45.3 million in June 2016 to $177.5 million which means that this acquisition provided circa 70 percent of the $189.4 million increase. Going forward, management indicated that as IntegraColor continues to integrate, more gains are expected from additional synergies.

FINANCIAL SUMMARY (A$ mil)	FY16	FY17	Change %
Sales Revenue	3,849.8	4,039.1	4.9%
EBITDA	379.6	418.4	10.2%
EBIT	272.1	302.3	11.1%
NPAT	162.7	186.2	14.4%
EPS (cents)	13.6	15.6	14.6%
Return on Sales	7.1%	7.5%	
Operating Cash Flow	313.8	331.5	5.6%
Cash Conversion	76%	74%	
Dividend per share (cents)	9.5	11.0	15.8%
Net Debt	630	674	
Leverage	1.7x	1.6x	
Gearing	30%	30%	
RoAFE	12.7%	13.6%	

Source: 10 August 2017 Company Filing

EBIT came in at $302 million which was up 11.1 percent compared to last year's $272.1 million and was also above the consensus estimates of $299 million. From an underlying perspective, the two key drivers of FY17 EBIT were (i) productivity gains from domestic operations, and (ii) synergies from the IntegraColor acquisition. Combined, this cause EBIT margins to improve 41 basis points from 7.07 percent to 7.48 percent.

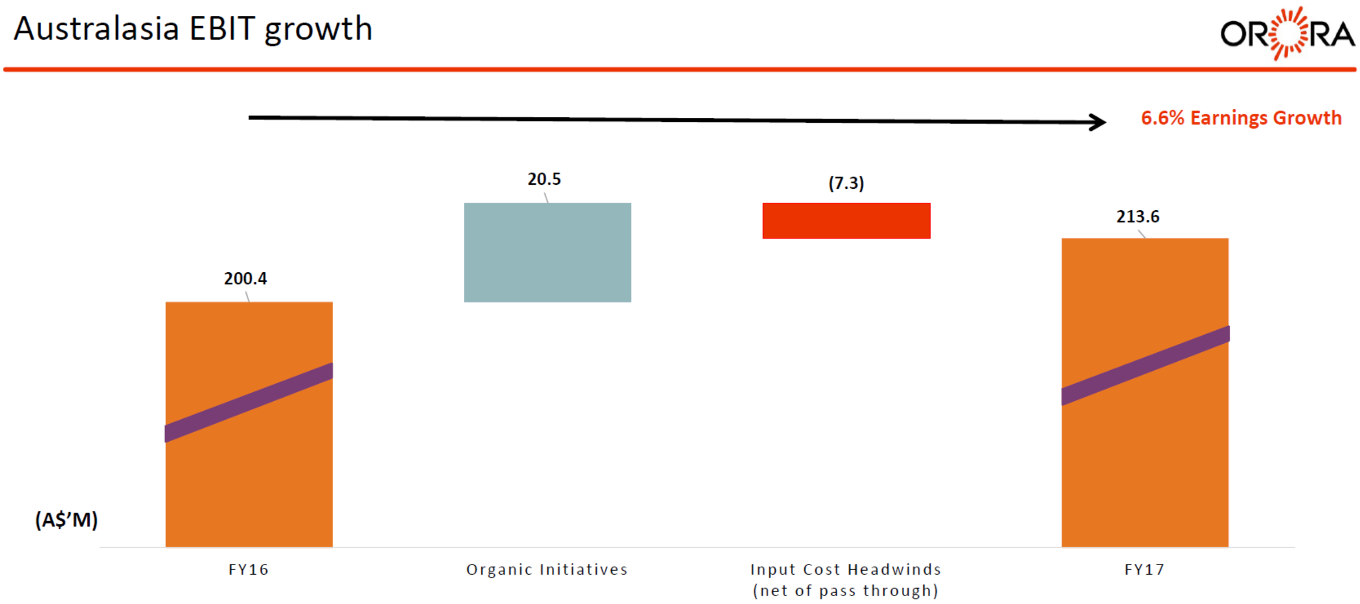
Going forward, management has hinted towards underlying earnings growth from a combination of organic growth and some acquisitions.

On Acquisitions, just a quick recap, the company also made two recent deals in the US with The Garvey Group and Graphic Tech for a consideration of US$54 million, in order to expand their point of purchase footprint in Chicago and Los Angeles. The two new acquisitions are expected to add approximately US$90 million in sales annually while adding in circa US$3 million in the first 2 – 3 years.

Segments

Looking at the segment performance in a little more detail, we note that (i) management was able to increase the return on average funds employed (RoAFE) in Australasia by 80 basis points to 12.4 percent despite experiencing issues in operations with unplanned maintenances disrupting operations. Despite that, sales managed to expand slightly (+2.3% yoy) as noted above.

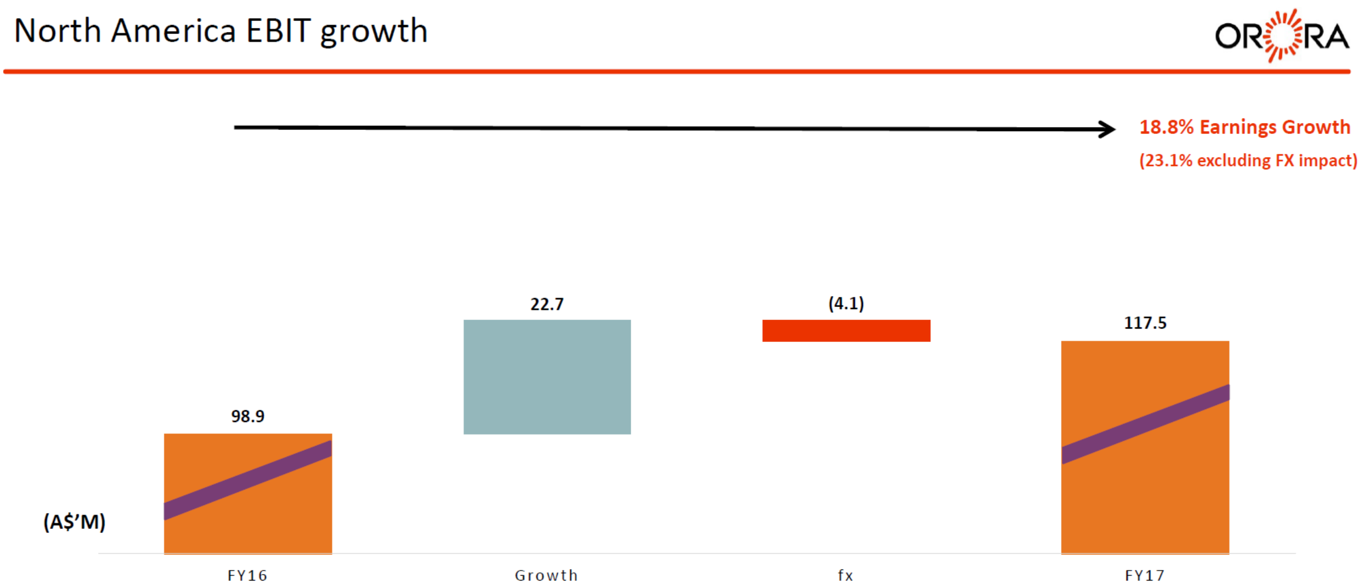
As has been the case in recent half-year results, the key driver was Orora's self-help programs to offset high energy costs and the final delivery of the B9 benefits. Overall, these had a combined impact of improving EBIT margins by 50 basis points to 10.7 percent bringing it to $213.6 million, up 6.6 percent.



Source: 10 August 2017 Company Presentation

The North America business, in contrast, continues to grow at a double-digit pace (+18.8% yoy) from a combination of efficiency gains and the aforementioned acquisition to $117.5 million.

Though margins are lower compared to Australasia at 5.8 percent, this has nevertheless improved by 60 basis points from the previous period and is likely to continued expanding as the company grabs more market share in higher value markets such as IT, Auto Parts and Pharmaceuticals.



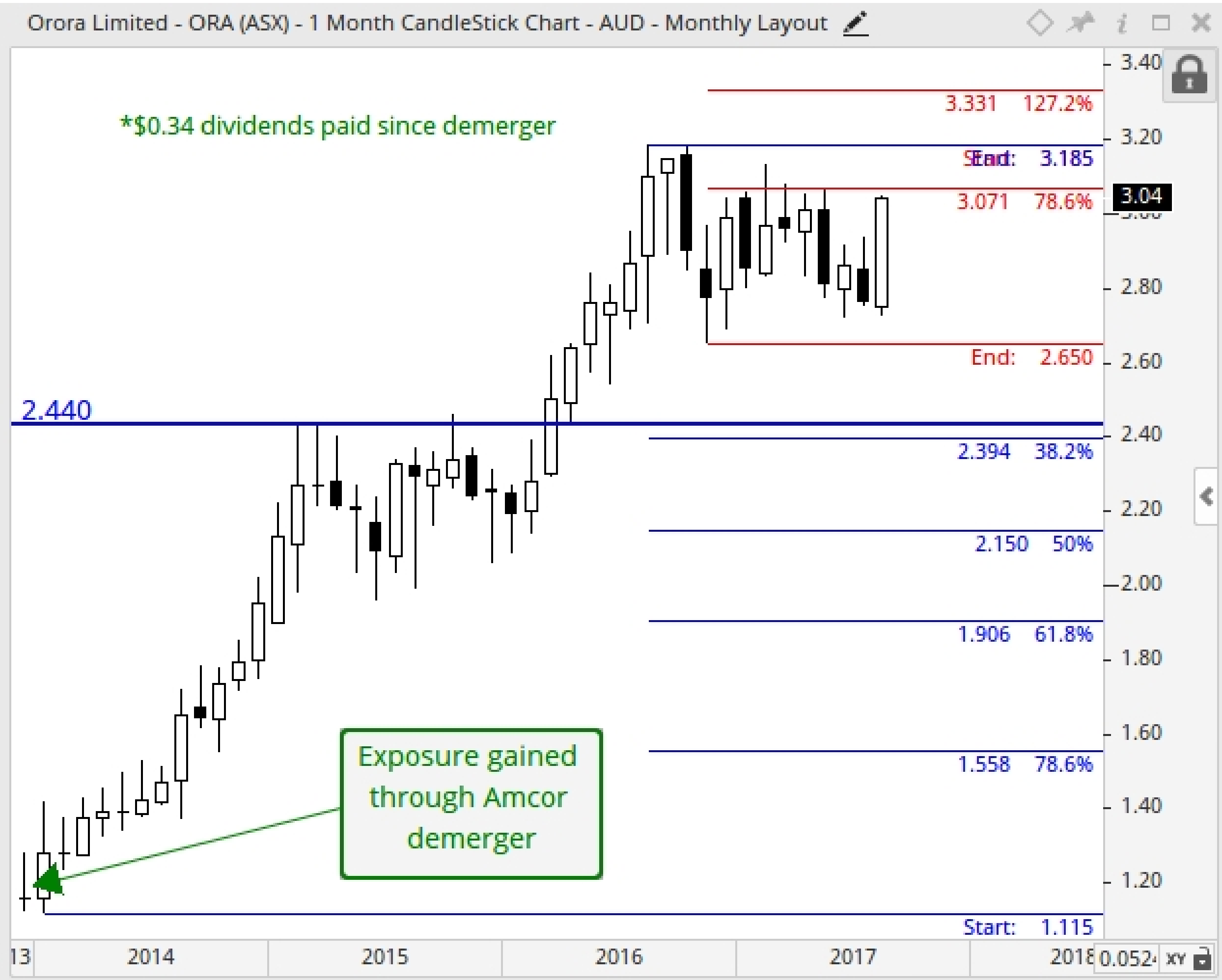
Source: 10 August 2017 Company Presentation

In a continuation of Orora's robust operating and financial health, we see continued growth in operating cash flows which increased 5.6 percent year-on-year to $331.5 million. While Orora's average working capital to sales ratio continued to fall below 10 percent and is now at 8.4 percent while return on average funds employed jumped to 13.6 percent from last year's 12.7 percent.

On the other hand, we note Orora's net debt increase of $44 million despite the robust cash generation (i.e. cash conversion of 74 percent, compared to management's target of 70 percent), leverage is now at 1.6x which is below their target of 2.0x – 2.5x and lower than last year's 1.7x.

Going forward, we believe the trade-off (of higher debt) to be worthwhile due to the growth in capital expenditures which amounted to $137.1 million including $14.9 million and $34.2 million on innovation and growth projects, respectively. We believe that management will continue to generate a positive return on the investment based on the current trajectory.

With reference to the monthly chart, initial support is situated at the November 2016 low of $2.65, followed by an additional layer located between $2.39 and $2.44 should the bears remain in control over the medium-term. This is made up of the 38.2% Fibonacci retracement (blue set of retracements) and structural support (horizontal solid-blue line) respectively. In order for the long-term technical outlook to strengthen, prices need to close (on a monthly-basis) above the 78.6% Fibonacci retracement (red set of retracements) of $3.07. Should this occur, then an activation of the next upside target of $3.33 being the 127.2% Fibonacci extension would then be confirmed to have triggered.



Turning to the daily chart, a zone of overhead resistance is marked between $3.13 and $3.19. This is made up of the February high (horizontal thin-red line) and the August 2016 high (horizontal solid-red line) respectively. Therefore, in order for the short-term technical landscape to further strengthen, a sustained break above this price range is required. However, it should be noted that the rapid increase in share price has resulted in the RSI venturing into overbought territory (exhaustion of short-term upward momentum). Hence, should the bears emerge over the near-term, a temporary pullback in price could follow. Positively, should this occur, we would view this short-term pause as corrective. Medium-term momentum is in favour of the bulls, as the share price has comfortably cleared both the 50 (red line) and 200 (green line) day moving averages.

Summary

We believe Orora remains well positioned to capitalise on any improvement in economic activity. As was the case in 2016, Orora was able to deliver solid results despite generally subdued market conditions through a combination of efficiency gains, business improvement initiatives, acquisitions, and favourable currency translations. <u>Looking ahead, we expect North America to remain the key earnings driver, at least over the near-to-medium-term.</u>

While there is no doubt that acquisitions (and efficiency gains) remain a key lever through which Orora can generate earnings growth in excess of the market's in which it operates, these are supplementary to what is a resilient earnings base. This is hardly a surprise given that Orora's products service predominantly defensive end markets, with around 80 percent of the company's output currently directed towards the food and beverage markets.

More broadly, Orora's end markets include the food/grocery, FMCG, agriculture, and industrial sectors in Australia, and the food, healthcare, technology, automotive, industrial, warehousing and shipping sectors in North America. While the offset to this is that organic sales growth is typically limited to GDP, management has the potential to boost its overall sales growth rate through (i) market share gains, new revenue streams or acquisitions, and (ii) productivity enhancements.

Orora is currently trading on 18.3 times FY18 earnings estimates, although this drops to 17.2 times the following year, with a partially (i.e. around 30 percent) franked dividend yield of 3.8 percent increasing to 4.1 percent in FY19. Given the resilient nature of the company's business, the growth opportunities in North America, and the scope for further cost reduction benefits, we remain favourably disposed to Orora's shares at the current levels.

Accordingly, Orora will remain firmly held in the Fat Prophets portfolio. We recommend the stock as a Buy around current prices for Members without exposure.

Disclosure: Orora is held with the Fat Prophets Concentrated Australasian Share, and Small & Mid-Cap Models.

Snapshot ORA

Orora

Latest Closing Price: $3.08

Orora is principally engaged in the manufacture of fibre packaging (recycled paper, corrugated boxes, cartons and sacks), beverage packaging (glass bottles, beverage cans and wine closures) in Australia and New Zealand, and also packaging distribution in North America. The company demerged from Amcor in December 2013.

Market Capitalisation:$3.70B

	FY1	FY2
Price to Earnings	18.3	17.2
Dividend Yield (%)	3.8	4.1
Price to Book	2.3	2.2
Return on Equity (%)	12.6	13.0
EV/EBITDA	9.7	9.3