Lodge Partners Research
ABN: 25 053 432 769
AFSL: 246271

BUY - $0.83

Colorpak Limited (CKL)

Stephen Cleugh: +61 3 9200 7032
s.cleugh@lodgepartners.com.au

Risks falling, underlying profitability improving

Company Data

ASX Code	CKL
Price	$0.83
12 month price target	$0.92
12 month dividend yield	4.2%
Implied return	15%
Shares on issue	81.5m
Market cap	$67.3m
Enterprise Value	$100.3m
12 Month price range	$0.48/$0.84
Monthly turnover	0.56m

Forecast Revisions

Carton Services	25.5%
Perpetual Ltd	13.5%
Blue Drive Pty Ltd	7.1%
Investors Mutual Ltd	5.5%

Earnings Summary

YE June	2013	2014F	2015F	2016F
Lodge adj profit	5.1	7.2	8.3	9.4
Report profit (pre sig)	5.1	7.2	8.3	9.4
EPS adj. (¢)	6.2	8.8	10.2	11.5
EPS growth	**14.8%**	**42.6%**	**15.7%**	**12.6%**
P/E ratio	**13.3 x**	**9.3 x**	**8.1 x**	**7.2 x**
DPS (¢)	3.5	3.5	4.0	4.6
Yield	**4.2%**	**4.2%**	**4.8%**	**5.6%**
Franking	100%	100%	100%	100%
Payout ratio	57%	40%	39%	40%
EV / EBIT	9.7 x	7.5 x	6.5 x	5.4 x
EV / EBITDA	6.8 x	5.5 x	4.8 x	4.3 x
CFPS (¢)	10.1	10.0	11.5	11.5
Price / CF	8.2 x	8.2 x	7.2 x	7.2 x
NTA per share	$0.32	$0.35	$0.41	$0.48
Price / NTA	2.6 x	2.4 x	2.0 x	1.7 x

Share Price Chart

Source: FactSet

Event: Following management discussions we have revised our forecasts and adjusted historical reported profits for non-recurring items.

Summary

We have **restated our historical Lodge adjusted net profit** to reflect the removal of other income relating to Unfavourable contracts in FY12 and FY13 of $2.1m and $3.5m respectively. This lowers our Lodge adjusted net profit to $4.4m in FY12 and to $5.1m in FY13.

On a restated basis this means that despite CKL reporting a fall of 10.5% in operating revenue in FY13 it was able to generate a similar level of EBITDA of $14.7m. This means that the rationalisation of operations in NSW and renegotiation of contracts allowed CKL to improve its **underlying EBITDA margins from 7.7% to 8.6%.**

Moving forward the major influences on profitability are:

- **Slow/flat revenue growth** from existing customers with CKL focused on its strengths in the quality end of the packaging/printing market, particularly in the Pharmaceuticals industry
- Installation of its **new Roland 6 colour press in Victoria** which will increase the existing machines capacity by 50% per hour. Some of this will be captured by CKL and some will be shared with its customer base to strengthen its relationships.
- Installation of its **new HP digital press in NSW** which will enhance CKL's ability to produce short run product and assist with its strong relationships in the Pharmaceuticals industry.
- Further **rationalisation of its two locations in Victoria into one** at Braeside. This will enable costs to be taken out of the current business.
- **Renegotiated board contracts** at Whakatane Mill in NZ (down 15%) and a **further reduction in inventory levels** of around $2m during FY14.
- **Closure of Amcor's Petrie Mill in Queensland** which will mean that a number of CKL's competitors will have to source their board supply from offshore or other locations. This should assist CKL's competitive position when pricing new business.

These influences are expected to produce and **improvement in EBITDA to $17.3m in FY14 and $18.3m in FY15,** This is reflected in an improvement in EBITDA margins to 10.1% and 10.5% in FY14 and FY15 respectively.

Strong operating cash flow is expected to cover capex of $6m in FY14 and $3.5m pa thereafter, pay a sustained dividend of 3.5 cps in FY14 and improved 4.0 cps in FY15 (a payout ratio in the order of 40%), and make debt repayments of $3m and $5m in FY14 and FY15 respectively.

Underlying interest cover improved to 3.3x in FY13 and this is expected to improve further to 5.4x in FY14, **well above CKL's banking requirements.**

We expect CKL's **debt levels to be down** to around $30 at the end of FY14 and to around the mid $20m's by the end of FY15. These numbers are **subject to management being able to find an opportunistic acquisition** in a related field or business. Historically CKL has paid between 3.5x and 5x EV/EBITDA for acquisitions and believes this price range is appropriate in an industry that is fairly capital intensive.

During **FY14 we have included in non-recurring items** the costs of the Victorian rationalisation of $2.4m pre-tax, or $1.7m after tax. These costs include the closure of Mt Waverley, move of the machine to Braeside (also $0.7m in capital cost), and a lower level of group staff by around 20.

ROE is expected to improve to 10.5% in FY15 which is **above the group's WACC.**

Conclusion

We are forecasting an adjusted net profit of $7.2m in FY14, a rise of 41%. This is equivalent to an EPS of 8.8 cents. This excludes the cost of rationalisation in Victoria. We expect the **dividend payment of 3.5 cps fully franked to be maintained in FY14, this is equivalent to a payout ratio of around 40%.**

Recommendation

Our valuation reflects CKL's exposure to an industry that is littered with road kill. Hence our valuation is based on CKL trading at a 45% discount to the Small Ords NTM PER, in line with historical levels. **This gives us a 12 month target price of 92 cps.**

Given the potential 15% upside from current share price levels we rank the stock as a BUY.

Result summary

Full Year to June 30th	FY12	FY13	% chg on pcp	
Profit and loss statement				
Sales revenue	191.8	171.7	-10.5%	Reduced due to loss of contracts following CHH, in particular Cussons & Fast Food in NZ
EBITDA	14.7	14.7	0.0%	Flat despite loss of rev. due to rationalisation of NSW and focus on regegotiation of contracts
Dep'n and amort'n	(4.0)	(4.4)	10.0%	
EBIT	**10.7**	**10.3**	-3.7%	Seasonality still tilted towards H1, however faster growth in H2 adjusted results
Net interest expense	(3.5)	(3.1)	11.4%	Lower interest rates and lower debt levels
Pre-tax profit	7.2	7.2	0.0%	
Tax expense	(2.8)	(2.2)	-23.2%	Tax rate now close to corporates rate
Lodge Adj. NPAT	**4.4**	**5.1**	14.8%	Good result but lower than we were expecting
Abn's / extra's	(7.6)	2.5	132.2%	Integration of CHH and rationalisation in FY12, income from unfavourable contracts removed
Reported NPAT	**(3.2)**	**7.5**	334.4%	
Tax rate (%)	38.9%	29.9%	-23.2%	
EBITDA margin (%)	**7.7%**	**8.6%**	11.7%	Improved margins are likely to improve further in FY14 due to renegotiation of board contracts
EBIT margin (%)	**5.6%**	**6.0%**	7.5%	
EPS	**5.4**	**6.2**	14.8%	
DPS	3.3	3.5	7.7%	Final dividend same as interim at 3.75 cps fully franked
Payout ratio	60%	57%	-6.2%	
Industry Sales Mix (%)				
Food	36.6%	36.6%	0.0%	
Pharma/Healthcare	26.8%	26.8%	0.0%	
Beverage	18.9%	18.9%	0.1%	
FMCG	6.1%	6.1%	0.0%	
Fast Food	3.7%	3.7%		
Other	7.9%	7.9%		
Cashflow statement				
EBITDA	14.7	14.7	0.0%	
Net interest paid	(3.5)	(3.1)	11.4%	
Tax paid	(2.8)	(2.2)	23.2%	
Gross cash from op'tions	**8.4**	**9.5**	12.5%	
(Inc) / dec in working cap.	5.3	6.6	24.5%	Improvement in working capital, debtor days and inventory levels
Other	(8.2)	(2.5)	68.9%	
Operating cashflow	**5.5**	**13.5**	145.5%	Strong operating capital used to reduce debt levels
Balance sheet				
Net debt / (cash) ($M)	38.9	33.0	-15.2%	Lower debt levels are well within banking covernants
Net debt / equity	58.1%	45.9%	-21.0%	
Net interest cover	3.1	3.3	8.7%	Improvement and are not an issue for CKL
Return on equity (%)	6.6%	7.0%	6.9%	Expected to improve further in FY14
ROFEavg	10.0%	9.8%	-2.5%	

Colorpak (CKL): $0.83

Mkt Cap: $67.3m

Valuation data

Year ending Jun	2012	2013	2014F	2015F	2016F
Lodge adj profit	**4.4**	**5.1**	**7.2**	**8.3**	**9.4**
Reported profit (post sig)	(3.2)	7.5	5.5	8.3	9.4
EPS$_{adj}$ (¢)	**5.4**	**6.2**	**8.8**	**10.2**	**11.5**
EPS$_{adj}$ growth	(37.4%)	14.8%	42.6%	15.7%	12.6%
P/E ratio	15.3 x	13.3 x	9.3 x	8.1 x	7.2 x
DPS (¢)	**3.3**	**3.5**	**3.5**	**4.0**	**4.6**
Yield	3.9%	4.2%	4.2%	4.8%	5.6%
Franking	100%	100%	100%	100%	100%
Payout ratio	60%	57%	40%	39%	40%
EV / EBIT	9.9 x	9.7 x	7.5 x	6.5 x	5.4 x
EV / EBITDA	7.2 x	6.8 x	5.5 x	4.8 x	4.3 x
FCFPS (¢)	(4.0)	10.1	10.0	11.5	11.5
Price / FCFPS	-20.4 x	8.2 x	8.2 x	7.2 x	7.2 x
NTA per share	$0.26	$0.32	$0.35	$0.41	$0.48
Pr / NTA	3.2 x	2.6 x	2.4 x	2.0 x	1.7 x

Profit and loss ($M)

Year ending Jun	2012	2013	2014F	2015F	2016F
Sales revenue	191.8	171.7	171.7	174.1	177.8
growth over pcp	*52.7%*	*(10.5%)*	*0.0%*	*1.4%*	*2.1%*
EBITDA	14.7	14.7	17.3	18.3	19.2
Dep'n and amort'n	(4.0)	(4.4)	(4.7)	(4.6)	(4.0)
EBITAg	**10.7**	**10.3**	**12.7**	**13.7**	**15.2**
Goodwill amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	**10.7**	**10.3**	**12.7**	**13.7**	**15.2**
growth over pcp	*(15.7%)*	*(3.7%)*	*22.8%*	*8.2%*	*11.0%*
Net interest expense	(3.5)	(3.1)	(2.4)	(1.8)	(1.8)
Pre-tax profit	7.2	7.2	10.3	11.9	13.4
Tax	(2.8)	(2.2)	(3.1)	(3.6)	(4.0)
Effective tax rate	*38.9%*	*29.9%*	*30.0%*	*30.0%*	*30.0%*
Preference dividends	0.0	0.0	0.0	0.0	0.0
Minorities	0.0	0.0	0.0	0.0	0.0
Lodge adjustments	0.0	0.0	0.0	0.0	0.0
Lodge adj profit	**4.4**	**5.1**	**7.2**	**8.3**	**9.4**
Reported Net Profit pre-adj.	4.4	5.1	7.2	8.3	9.4
Adjustment	(7.6)	2.5	(1.7)	0.0	0.0
Reported net profit	(3.2)	7.5	5.5	8.3	9.4

Balance sheet ($M)

Year ending Jun	2012	2013	2014F	2015F	2016F
Cash	0.0	0.0	2.2	3.5	4.4
Receivables	31.4	25.4	26.6	26.6	27.0
Inventories	28.2	23.4	21.5	21.8	22.2
Other	1.3	2.7	2.7	2.7	2.7
Current assets	**60.9**	**51.5**	**53.0**	**54.6**	**56.3**
Net PPE	40.6	40.1	41.5	40.4	39.9
Investments	0.0	0.0	0.0	0.0	0.0
Goodwill	46.1	46.1	46.1	46.1	46.1
FITB	6.4	3.1	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Non-current assets	**93.1**	**89.3**	**87.6**	**86.5**	**86.0**
Total assets	**154.0**	**140.8**	**140.6**	**141.1**	**142.4**
Debt	38.9	33.0	30.0	25.0	20.0
Provisions	25.6	18.0	18.0	18.0	18.0
Other	22.6	18.1	18.1	18.3	18.7
Total liabilities	**87.1**	**69.1**	**66.1**	**61.3**	**56.7**
Equity / reserves	38.7	38.9	38.9	38.9	38.9
Retained profits	28.3	33.0	35.6	40.9	46.7
Total s/h funds	**67.0**	**71.9**	**74.4**	**79.7**	**85.6**
Minorities	0.0	0.0	0.0	0.0	0.0
Total funds emp.	**105.9**	**104.9**	**102.2**	**101.2**	**101.2**

Cashflow ($M)

Year ending Jun	2012	2013	2014F	2015F	2016F
EBIT	10.7	10.3	12.7	13.7	15.2
Net interest paid	(3.5)	(3.1)	(2.4)	(1.8)	(1.8)
Dep'n and amort'n	4.0	4.4	4.7	4.6	4.0
Tax paid	(1.8)	0.2	0.0	(3.6)	(4.0)
Gross cash from op'ns	**9.4**	**11.8**	**14.9**	**12.9**	**13.4**
(Inc) / dec in wk'g cap	5.3	6.6	0.7	(0.1)	(0.5)
Inc / (dec) in Other Liab.	(1.7)	(7.9)	0.0	0.0	0.0
Other	(7.5)	3.0	(1.5)	0.0	0.0
Operating cashflow	**5.5**	**13.5**	**14.2**	**12.9**	**12.9**
growth over pcp	*110.6%*	*n/a*	*n/a*	*(9.1%)*	*0.1%*
Investing cashflows					
Capital expenditure	(4.5)	0.0	(6.0)	(3.5)	(3.5)
Asset sales	0.0	0.0	0.0	0.0	0.0
Investments	(4.3)	(5.3)	0.0	0.0	0.0
Divestments	1.3	0.6	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Financing cashflows					
Net equity raised	0.0	0.0	0.0	0.0	0.0
Dividends paid	(2.7)	(2.9)	(2.9)	(3.1)	(3.5)
Chg in loans	**7.4**	**(6.0)**	**(3.0)**	**(5.0)**	**(5.0)**
Other non-op flows	0.0	0.0	0.0	0.0	0.0
Net chg in cash	**2.7**	**(0.1)**	**2.3**	**1.3**	**0.9**

Ratio analysis

Year ending Jun	2012	2013	2014F	2015F	2016F
EBITDA / sales	7.7%	8.6%	10.1%	10.5%	10.8%
EBITAg / sales	5.6%	6.0%	7.4%	7.9%	8.5%
EBIT / sales	**5.6%**	**6.0%**	**7.4%**	**7.9%**	**8.5%**
Return on assets	6.9%	7.3%	9.1%	10.0%	11.0%
Return on equity	**6.6%**	**7.0%**	**9.7%**	**10.5%**	**11.0%**
Return on avg. funds emp.	**10.0%**	**9.8%**	**12.2%**	**13.5%**	**15.0%**
Net debt / (cash) ($M)	38.9	33.0	27.8	21.5	15.6
Debt / equity	58.1%	45.9%	40.3%	31.4%	23.4%
Net debt / equity	**58.1%**	**45.9%**	**37.3%**	**26.9%**	**18.2%**
Net Interest cover	3.1 x	3.3 x	5.4 x	7.7 x	8.4 x

Interims ($M)

Half yearly	1H12	2H12	1H13	2H13
Sales revenue	104.1	87.7	92.7	79.0
EBITDA	9.3	5.4	9.9	4.8
EBIT	7.3	3.4	7.6	2.7
Lodge adj profit	3.9	0.5	4.2	0.9
Reported profit	(2.3)	(0.9)	4.8	2.7
EBIT / sales	7.0%	3.9%	8.2%	3.4%
Adjusted EPS (¢)	4.7	0.7	5.1	1.1
Reported EPS growth on pcp			8.0%	62.9%
DPS (¢)	1.5	1.8	1.8	1.8
% of FY EBIT	68%	32%	60%	40%

Disclaimer

In accordance with section 949A of the Corporations Act 2001, any recipient of the information contained in this document should note that information is general advice in respect of a financial product and not personal advice. Accordingly the recipient should note that: (a) the advice has been prepared without taking into account the recipient's objectives, financial situations or needs; and (b) because of that, the recipient should, before acting on the advice, consider the appropriateness of the advice, having regard to the recipient's objectives, financial situation and needs.

Although Lodge Partners Pty Ltd ("Lodge") consider the advice and information contained in the document is accurate and reliable, Lodge has not independently verified information contained in the document which is derived from publicly available sources. Lodge assumes no responsibility for updating any advice or recommendation contained in this document or for correcting any error or admission which may become apparent after the document has been issued. Lodge does not give any warranty as to the accuracy, reliability or completeness of advice or information which is contained in this document. Except in so far as liability under any statute cannot be excluded, Lodge, its employees and consultants do not accept any liability (whether arising in contract, in tort or negligence or otherwise) for any error or omission in this document or for any resulting loss or damage (whether direct, indirect, consequential or otherwise) suffered by the recipient of this document or any other person.

Lodge, its employees, consultants and its associates within the meaning of Chapter 7 of the Corporations Act 2001 may receive commissions from transactions involving financial products referred to in this document and may hold interests in financial products referred to in this document.

General Securities Advice Warning

This report is intended to provide general securities advice. In preparing this advice, Lodge did not take into account the investment objectives, the financial situation and particular needs of any particular person. Before making an investment decision on the basis of this advice, you need to consider, with or without the assistance of a securities adviser, whether the advice is appropriate in light of your particular investment needs, objectives and financial circumstances.

Explanation of Lodge Partners recommendation system:

Recommendations are assessments of each Lodge Partners Analyst's view of potential total returns over a 1 year period.

Expected total Return is measured as (capital gain (or loss) + dividend)/purchase price

We have divided our recommendations into three main CATegories:

Buy: Expected Total Return in excess of 15% over a 1 year period.

Hold: Expected Total Return between 0% and 15% over a 1 year period.

Sell: Expected Total Return less than 0% over a 1 year period.

Analyst Verification

I verify that I, **Stephen Cleugh**, have prepared this research report accurately and that any financial forecasts and recommendations that are expressed are solely my own personal opinions. In addition, I certify that no part of my compensation is or will be directly or indirectly tied to the specific recommendation or financial forecasts expressed in this report.

Contact Lodge Partners:

Melbourne
Level 5, 60 Collins St
Melbourne Vic, 3000

Phone: +61 3 9200 7000
Fax: +61 3 9200 7077
www.lodgepartners.com.au