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**Sector:** Materials

**Industry:** Corrugated & Paper Packaging

**Ticker:** WRK

## COMPANY OVERVIEW

WestRock (WRK) is a corrugated and paperboard packaging company. It is the second-largest paper packaging company in the United States with total assets worth over \$25.4 billion. WestRock was formed in 2015 with the merger of two public companies, Rock-Tenn and MeadWestvaco. It separates itself among its competition by striving to be innovative and a leader in sustainability. These qualities along with acquisitions have supplied WestRock with revenue growth of over 150% since the merger. WestRock also benefits from its vertical integration and closed-loop supply chain. They are involved in every step from the wood procurement to the recycling of old containers.

### REVENUE SEGMENTS:

- Consumer Packaging
  - Products in this segment include beverage carriers, labels, merchandising displays, packaging machinery, and paper-based product packaging that you would typically see in a grocery store.
  - 13 mills, 100+ converting facilities, 4.2M tons mill capacity
- Corrugated Packaging
  - Products in this segment include cardboard boxes for e-commerce, food service containers, automated packing machinery, kraft paper for paper bags, and paper pulp.
  - 19 mills, 150+ Converting facilities, 60+ distribution facilities, 12.3M tons mill capacity

### MANAGEMENT:

- Chief Executive Officer & President - Steve Voorhees
  - Voorhees has been CEO & President at WestRock for the past 8 years while he has been an employee at WestRock since 2000. Prior to working at WestRock, Voorhees was a Senior Vice President at an oil & energy company for 20 years.
- Chief Financial Officer - Ward Dickson
  - Dickson has been at Westrock since 2013. Prior to working at WestRock, Dickson was a Finance Vice President at CISCO from 2009-2013.
- Chief Innovation Officer - Patrick Lindner

- Lindner is the newest executive at WestRock as he was hired less than a year ago. Lindner previously served in multiple leadership and executive roles at Dupont for over 10 years. Contrary to the typical professional career path of someone with a PhD in Chemistry, Lindner has proven to be successful as an executive leader; while still applying his technical knowledge to lead innovation.

## INVESTMENT THESIS

We recommend a **BUY** for WestRock at \$38.01 for the following reasons:

- We found it to be undervalued compared to its top four competitors
- Its focus on sustainability is a key advantage in the market
- They have the broadest portfolio of paper and packaging products among competitors
- It's acquisitions, specifically, its acquisition of KapStone will spur further growth
- Input prices are down due to China's new recycling regulations
- Westrock currently has a dividend yield of 4.79% which is the highest in its industry
- Institutional holders of WestRock stock are increasing their positions

## KEY DRIVERS

**SUSTAINABILITY INITIATIVE:** WestRock has consistently strived to be at the forefront of sustainability and green initiatives. They are one of the largest recyclers of corrugated and paper containers in the United States and 100% of the recycled pulp is used internally. 35% of the pulp used by WestRock is recycled pulp, the highest level in its industry. Their sustainability efforts begin in the forests where they help manage over 300,000 acres of woodlands in the U.S and Brazil. We believe their sustainability efforts will pay off as consumer demand shifts more and more to products and containers that are eco-friendly.

WestRock recently won the NextGen Cup challenge which was managed by Starbucks and McDonalds. WestRock created a coffee cup that is easily recyclable and compostable and won a multi-year deal with Starbucks and has already successfully recycled 25 million cups. Plastic packaging continues to face increased scrutiny in the media and the demand for eco-friendly and recyclable options like paperboard packaging continues to rise.

**DIVERSIFIED PRODUCT PORTFOLIO AND INNOVATION:** WestRock has the most diverse product portfolio in its industry and is a leader in innovation. These two factors are not mutually exclusive, their focus on innovation has created the ability for WestRock to find advantages in many different facets of the paper packaging industry. Since 2015 Westrock has filed for over 3,370 patents, and in two of the past three years, they have won the innovation award in the paperboard packaging industry. Another key innovative solution that is helping drive revenue growth is WestRock's right-size packaging machine. They created a machine that can recognize the size of what is coming through on a conveyor belt and

choose a box that will have the least amount of empty space. Solutions like these not only reduce costs for WestRock, they also contribute to their sustainability efforts.

**ACQUISITIONS AND SYNERGIES:** Since 2015 WestRock has acquired 11 companies which have helped it gain market share and diversify its product portfolio.



The largest of these acquisitions is its most recent acquisition of KapStone which was acquired in November 2018. At the time it was acquired KapStone had assets worth \$3.35 billion and a net income of around \$345 million. KapStone was a smaller rival of Westrock and had been growing, its revenues had doubled over the five years before the acquisition. WestRock expects to realize more than \$200 million in run-rate synergies by the end of 2021. Currently, WestRock is realizing the synergies ahead of schedule and will most likely reach \$200 million before 2021.

## RISKS

**DEPENDENCY ON LARGE CUSTOMERS:** WestRock is regularly bidding for new business or the renewal of existing business. The loss of business from larger customers, or the renewal of business on less favorable terms, may adversely impact financial results.

**HIGH DEBT TO EQUITY:** Westrock increased their debt/total assets by 10% (25% to 35%) to acquire KapStone. Increasing their total debt by 60%. Though synergies were promised to positively affect financial results in the long-run, investors were wary of the increase in leverage and capital expenditures.

**ENERGY COSTS:** A majority of the non-renewable energy WestRock uses is natural gas. The cost of natural gas tends to fluctuate and at times sees spikes in cost. High energy costs could increase operating costs and make products less competitive compared to similar or alternative products offered by competitors.

WestRock distributes most of its products by truck and rail. This makes them vulnerable to an increase in coal and gas prices. WestRock may not be able to completely absorb a strong price increase, causing them to increase their own prices, thus making them less competitive.

In fiscal 2018, the profitability of WestRock's operations in the U.S. was negatively impacted by higher transportation costs as trucking companies raised prices to address a shortage of drivers and strong demand.

## PERFORMANCE

With regard to total return since October of 2016, WestRock was outperforming the Containers and packaging industry but dipped below the industry after a negative surprise earnings call and the acquisition of KapStone.

The sub-industries WestRock operates in have grown significantly. Paperboard Packaging has increased by 25% LTM while Corrugated has increased by 14% LTM.

WestRock's poor stock price performance is primarily due to their high debt/equity ratio, fears of an economic downturn, and they have missed a few quarterly sales estimates. It is worth mentioning their sales have been growing at an impressive rate and they have also been beating EPS estimates.

In October of 2018, BMO Capital Markets downgraded the industry due to fears of a capacity surge while also lowering their target price for Westrock from \$80 to \$54 (a 32% decrease). Goldman Sachs removed WestRock from their 'Conviction List' of companies to buy. Simultaneously, WestRock suffered \$100 million in damages and production halts from hurricane Michael. This run of negative events, caused WestRock's stock price to drop 20% from late September to late October 2018.



## VALUATION

To find an intrinsic value of WestRock's stock we used two valuation methods – a discounted cash flows model and a historical average multiples method. We weighted each at 50% as we thought that they both were valid and provided equal explaining power. Using these methods our target price for WestRock is \$47.91

**DISCOUNTED CASH FLOWS MODEL:** In our discounted cash flows model we used a WACC of 8.5%. WestRock's current estimated is around 6.5% but as they de-lever we expect this to return to a higher level. Their average WACC since the merger in 2015 is around 8% and to make our price estimate a little more conservative, we used 8.5%. For the perpetual growth rate, we used 2% which was the commonly accepted rate for WestRock. The short-term cash flows and revenue projections were taken from Bloomberg estimates.

**MULTIPLES METHOD:** For our multiples method valuation we decided to use WestRock's closest four competitors which are Packaging Corp of America, International Paper Co, Sonoco Products Co, and Graphic Packaging Holding Co. We chose to look at price/earnings (P/E) as a multiple to compare them to their competitors. To be conservative in our valuation we decided to look at what it historically trades at and found that over a 5-year history it usually trades 9% P/E discount compared to competitors. WestRock is trading at 24% below the mean P/E, this means it is trading at 15% below its historical average. Using this 15% discount we calculated a target price of \$43.71

	Mkt Cap	Sales (M)	P/E	EV/EBITDA
<b>WestRock</b>	9.78 B	17,874	11.1	6.5
<b>Peer's Mean</b>	9.44 B	10,448	14.6	8.6

## OWNERSHIP OF WESTROCK

1. The Vanguard Group, Inc
2. Capital Research & Management Co.
3. BlackRock Fund Advisors
4. SSgA Funds Management, Inc.
5. JPMorgan Investment Management, Inc

### Ownership Statistics



SHARES OUT  
257,342,000  
86.80% TOTAL OWNERSHIP

- 85.45% Inst. Ownership
- 43.48% Top 10 Inst. Holders
- 1.31% Insider Ownership
- 13.24% Unknown