WestRock Co. (WRK)

Updated February 5th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$38	**5 Year CAGR Estimate:**	16.3%	**Volatility Percentile:**	73.7%
Fair Value Price:	$54	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	2.6%
% Fair Value:	70%	**5 Year Valuation Multiple Estimate:**	7.5%	**Growth Percentile:**	22.3%
Dividend Yield:	4.8%	**5 Year Price Target**	$66	**Valuation Percentile:**	92.7%
Dividend Risk Score:	B	**Retirement Suitability Score:**	A	**Total Return Percentile:**	90.8%

Overview & Current Events

WestRock was formed in July 2015 by the merger of Rock-Tenn and Mead-Westvaco. It is a leading provider of differentiated paper and packaging solutions. In its fiscal 2018, which ended on 9/30/2018, the corrugated packaging segment and the consumer packaging segment generated 55% and 45% of its total revenues and 72% and 28% of its pre-tax income, respectively.

WestRock completed the acquisition of KapStone Paper on November 3rd. WestRock paid $35 per share of Kapstone and assumed approximately $1.36 billion of debt for a total enterprise value around $4.9 billion. WestRock will finance the transaction through the issuance of new debt. The deal has increased the leverage (Net Debt/EBITDA) of WestRock to 2.89. Consequently, the company's management has set a goal to reduce leverage to 2.25-2.50 this year. The acquisition of KapStone will enhance product offerings and the geographical presence of the company. Management expects $200 million in synergies.

In late January, WestRock reported (1/31/19) its financial results for the first quarter of fiscal 2019. In the quarter, the company grew its revenues by 11%, mostly thanks to the acquisition of KapStone and price hikes. However, the price hikes were more than offset by cost inflation and the impact of hurricanes. As a result, adjusted earnings-per-share decreased 4.6% over last year, from $0.87 to $0.83. On the bright side, earnings-per-share exceeded analyst estimates by $0.05. However, management has now become somewhat less optimistic for next quarter's results, mostly due to higher input costs. Although management expects the second half of the fiscal year to be much stronger than the first half, the market has punished the stock with a 7% plunge since the earnings release, despite the 2.5% gains of the S&P 500 over the same period. Management did not provide specific numbers for revenue and earnings in its guidance.

On one hand, this is likely to be another strong year thanks to the full-year impact of the implemented price hikes and the expected synergies from the acquisition of KapStone. On the other hand, there are increasing concerns over a surge in the global supply of containerboard products in upcoming years. This helps explain the 46% plunge of the stock of WestRock in the last 12 months amid record earnings.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	----	----	----	----	----	----	$3.89	$2.53	$2.62	$4.08	***$4.35***	***$5.29***
DPS	----	----	----	----	----	----	$0.38	$1.50	$1.60	$1.72	***$1.82***	***$2.20***
Shares	----	----	----	----	----	----	257.0	251.0	254.5	259.2	***260.0***	***265.0***

WestRock has a short and somewhat volatile historical record; we prefer to be somewhat conservative in our growth forecasts. Since its foundation in its current form, the company has grown its earnings-per-share at a 1.6% average annual rate. Moreover, the global supply of containerboard products is expected to surge in the years ahead. This factor, which is out of control of WestRock, will adversely affect its margins. On the other hand, the company is likely to benefit from two major growth drivers, namely the growing North American corrugated market and the synergies from the takeover of KapStone. Overall, we expect WestRock to grow its earnings-per-share at an approximate 4.0% average annual rate over the next five years, from $4.35 this year to $5.29 in 2024. We have lowered our earnings-per-share forecast for this year by 5%, from $4.60 to $4.35, due to the worse outlook of management amid higher input costs.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	----	----	----	----	----	----	15.2	16.8	20.3	14.9	***8.7***	***12.5***
Avg. Yld.	----	----	----	----	----	----	0.6%	3.5%	3.0%	2.8%	***4.8%***	***3.3%***

WestRock is trading at a price-to-earnings ratio of 8.7, which is much lower than its 4-year average of 16.8. Due to its short historical record, its increased amount of debt from the KapStone acquisition, and the heating competition in its business, the stock warrants a reduced valuation. We thus assume a fair price-to-earnings ratio of 12.5 for the stock. If the stock approaches our fair valuation level over the next five years, it will enjoy a 7.5% annualized gain.

Safety, Quality, Competitive Advantage, & Recession Resiliency

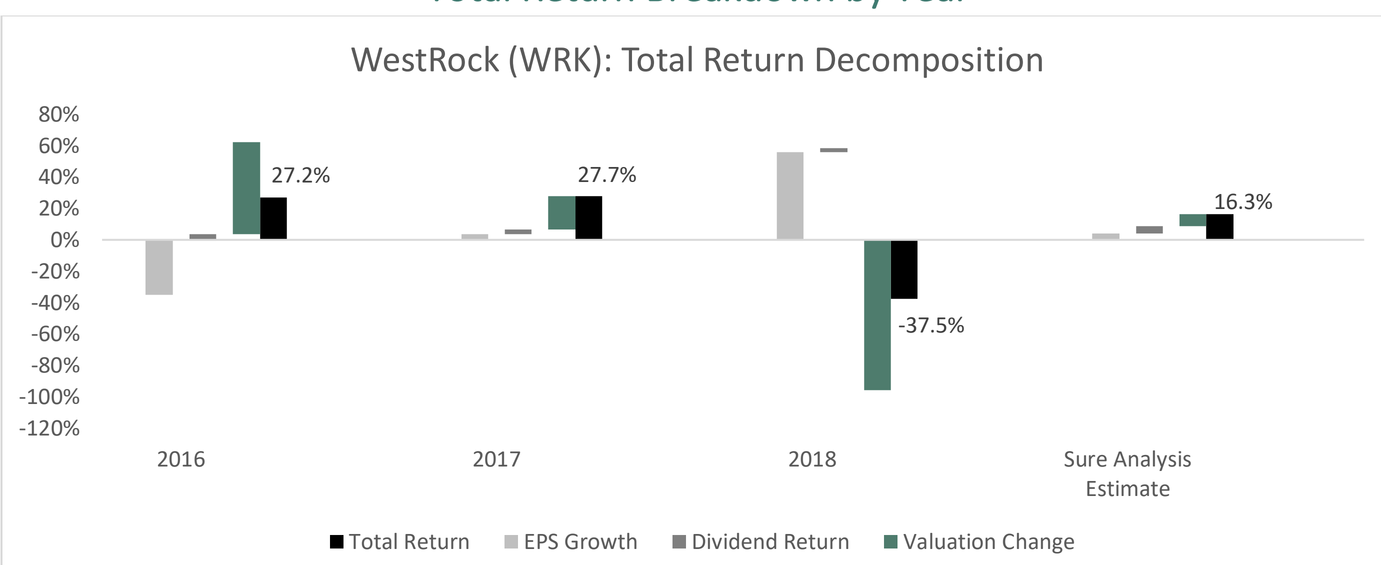
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	----	----	----	----	----	----	9.8%	59.3%	61.1%	42.2%	***41.8%***	***41.6%***

WestRock cannot control the total supply of paper products. As a result, it is vulnerable to the total production volume of its competitors. The company currently offers a 4.8% dividend yield which is more than twice the current yield of the S&P (2.0%). The company's stock has a reasonable payout ratio of less than half earnings. We expect WestRock to see earnings drawdowns during severe recessions somewhere in the 20% to 50% range. Even in a very negative scenario, the company's dividend would still be covered by earnings.

Final Thoughts & Recommendation

WestRock is poised to achieve record revenues and earnings this year. However, it recently lowered its guidance for this year and its stock has plunged 46% in the last 12 months due to increasing fears over a surge in the global supply of its products. As a result, the stock has become markedly cheap and can thus offer a 16.3% average annual return over the next five years, in the absence of a recession. We rate WestRock as a buy at current prices due to its high yield, strong expected total returns, and reasonable payout ratio.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	2812.3	3001.4	5399.6	9207.6	9545.4	9895.1	11125	14172	14860	16285
Gross Profit	762.7	720.1	991.9	1532.7	1846.5	1933.6	2138.3	2758.6	2740.2	3393.9
Gross Margin	27.1%	24.0%	18.4%	16.6%	19.3%	19.5%	19.2%	19.5%	18.4%	20.8%
SG&A Exp.	330.8	339.9	541.2	927.5	954.3	1023.6	1145	1961.9	1661.8	1974.1
D&A Exp.	150	147.4	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Operating Profit	431.9	380.2	450.7	605.2	892.2	910	993.3	796.7	1078.4	1419.8
Op. Margin	15.4%	12.7%	8.3%	6.6%	9.3%	9.2%	8.9%	5.6%	7.3%	8.7%
Net Profit	222.3	225.6	141.1	249.1	727.3	479.7	507.1	-396.3	708.2	1906.1
Net Margin	7.9%	7.5%	2.6%	2.7%	7.6%	4.8%	4.6%	-2.8%	4.8%	11.7%
Free Cash Flow	305.7	271.1	262.3	187.3	592.1	617.6	618.1	891.7	1121.9	1421
Income Tax	91.6	64.7	69.5	136.9	-21.8	286.5	233	89.8	159	-874.5

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	2884	2914.9	10566	10687	10733	11040	25372	23038	25089	25361
Cash & Equivalents	11.8	15.9	41.7	37.2	36.4	32.6	207.8	340.9	298.1	636.8
Accounts Receivable	305.5	333.5	1109.6	1075.6	1134.9	1118.7	1575.4	1592.2	1886.8	2010.7
Inventories	275.1	269.5	849.8	861.9	937.9	1029.2	1761	1638.2	1797.3	1829.6
Goodwill & Int. Ass.	887.7	900.3	2638.8	2660.4	2561.5	2617.5	7442	7377.4	8857.6	8699.6
Total Liabilities	2101	1897.5	7187.4	7280.9	6420.6	6732.3	13589	13208	14703	13878
Accounts Payable	233.9	252.3	780.7	708.9	802.1	812.8	1231.4	1054.4	1492.1	1716.8
Long-Term Debt	1349	1128.9	3445.8	3412.5	2844.8	2984.7	5621.9	5789.2	6554.8	6415.2
Shareholder's Equity	776.8	1011.3	3371.6	3405.7	4312.3	4306.8	11652	9728.8	10343	11469
D/E Ratio	1.74	1.12	1.02	1.00	0.66	0.69	0.48	0.60	0.63	0.56

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	7.5%	7.8%	2.1%	2.3%	6.8%	4.4%	2.8%	-1.6%	2.9%	7.6%
Return on Equity	31.4%	25.2%	6.4%	7.4%	18.8%	11.1%	6.4%	-3.7%	7.1%	17.5%
ROIC	9.9%	10.5%	3.1%	3.7%	10.4%	6.6%	4.1%	-2.4%	4.4%	10.9%
Shares Out.	----	----	----	----	----	----	257.0	251.0	254.5	259.2
Revenue/Share	36.52	38.38	53.46	63.90	65.33	67.77	64.19	54.95	58.11	62.68
FCF/Share	3.97	3.47	2.60	1.30	4.05	4.23	3.57	3.46	4.39	5.47

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.