WestRock Co. (WRK)

Updated November 12th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$39	**5 Year CAGR Estimate:**	5.5%	**Volatility Percentile:**	63.8%
Fair Value Price:	$37	**5 Year Growth Estimate:**	2.0%	**Momentum Percentile:**	17.0%
% Fair Value:	106%	**5 Year Valuation Multiple Estimate:**	-1.1%	**Growth Percentile:**	10.4%
Dividend Yield:	4.8%	**5 Year Price Target**	$41	**Valuation Percentile:**	53.5%
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Total Return Percentile:**	33.8%

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, with a market capitalization of $10 billion. In its fiscal 2019, which ended on 9/30/2019, the corrugated packaging segment and the consumer packaging segment generated 64% and 36% of its total revenues and 78% and 22% of its pre-tax income, respectively.

WestRock completed the acquisition of KapStone Paper in November, 2018. The deal increased the leverage (Net Debt/EBITDA) of WestRock to 2.9 but the company has been reducing its debt at a fast clip since then. Since the end of last year, WestRock has reduced its debt by $757 million. The acquisition of KapStone has enhanced the product offerings and the geographical presence of the company.

In early November, WestRock reported (11/7/19) financial results for the fourth quarter of fiscal 2019. In the quarter, the company grew its revenues by 10% thanks to the acquisition of KapStone, which was partly offset by lower corrugated volumes and prices. Adjusted earnings-per-share fell 4%, from $1.29 to $1.24, mostly due to higher interest expense. Nevertheless, earnings-per-share exceeded analysts' estimates by $0.05. As a result, WestRock has now exceeded analysts' earnings-per-share estimates in 17 of the last 18 quarters. Moreover, the company achieved $90 million of run-rate synergies from the acquisition of KapStone towards its $200 million target.

Due to heating competition in the business of WestRock and the resultant pressure on product prices, we expect earnings-per-share to fall from their nearly all-time high level of $3.98 to about $3.35 in this fiscal year.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	---	---	---	---	---	$3.89	$2.53	$2.62	$4.08	$3.98	***$3.35***	***$3.70***
DPS	---	---	---	---	---	$0.38	$1.50	$1.60	$1.72	$1.82	***$1.86***	***$2.16***
Shares[1]	---	---	---	---	---	257.0	251.0	254.5	259.2	259.0	***258.0***	***250.0***

There are increasing concerns over high inventories in the containerboard market right now and a surge in the global supply of containerboard products in upcoming years. This helps explain the almost 50% decline of the stock of WestRock since early 2018 amid almost record earnings.

WestRock has a short and somewhat volatile historical record and hence 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 0.6% average annual rate. Moreover, the global supply of containerboard products is expected to surge in the years ahead. This factor, which is out of WestRock's control, 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. We expect the company to grow its earnings-per-share by about 2% per year on average over the next five years.

[1] In millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	---	---	---	---	---	15.2	16.8	20.3	14.9	9.8	***11.6***	***11.0***
Avg. Yld.	---	---	---	---	---	0.6%	3.5%	3.0%	2.8%	4.7%	***4.8%***	***5.3%***

WestRock is trading at a price-to-earnings ratio of 11.6, 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 increased competition in its business, the stock warrants a reduced valuation. We assume a fair price-to-earnings ratio of 11.0 for the stock. If the stock reaches our fair valuation level over the next five years, it will incur a -1.1% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

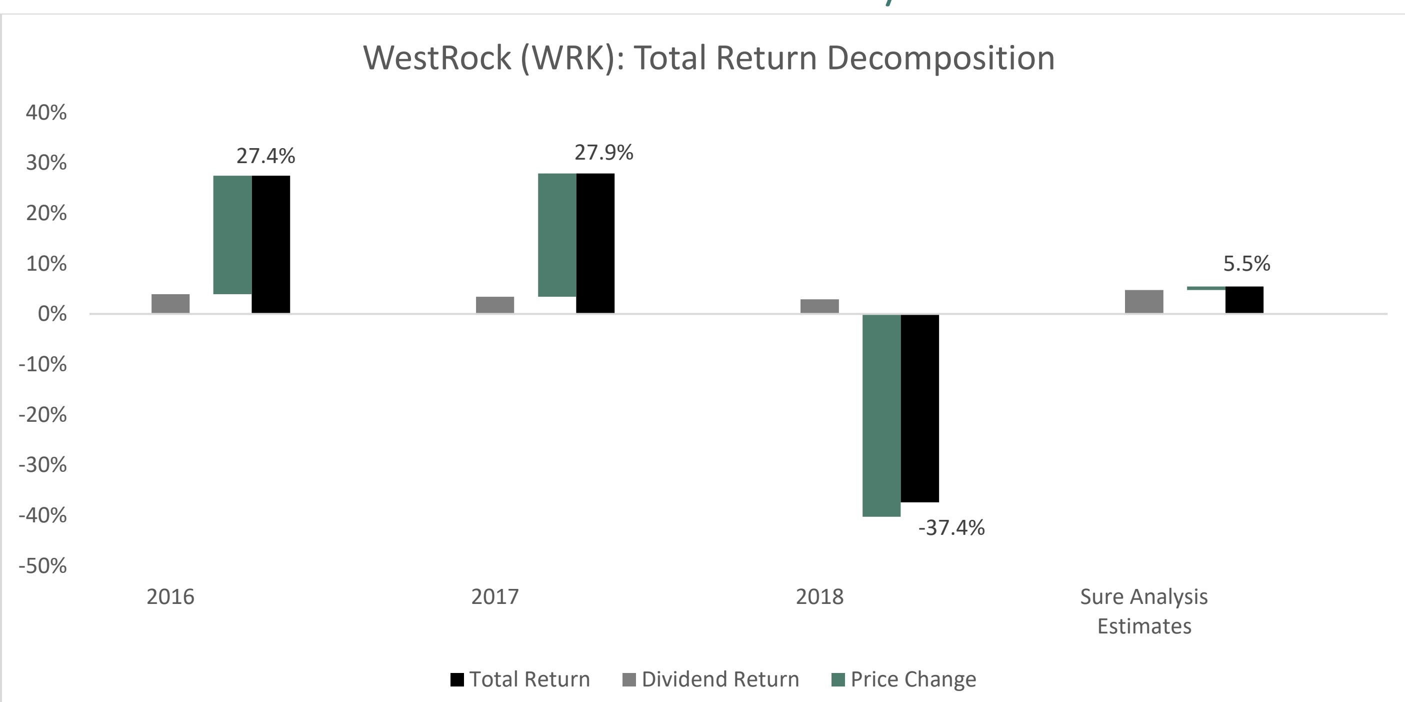
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	---	---	---	9.8%	59.3%	61.1%	42.2%	45.7%	***55.5%***	***58.3%***

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 almost triple the current yield of the S&P (1.8%). The stock has a reasonable payout ratio. Even in a negative scenario, the company's dividend would still be covered by earnings. On the other hand, investors should be aware of the leverage of the company, as interest expense consumes 26% of operating income. This renders the stock vulnerable to a potential downturn.

Final Thoughts & Recommendation

WestRock has rallied 23% in less than three months. As a result, the stock is not as attractive as it was in our previous research report, in August. In the absence of a recession, we expect WestRock to offer just a 5.5% average annual return over the next five years thanks to its 4.8% dividend and 2% earnings growth, which could be partly offset by a small valuation headwind. Consequently, we have lowered the rating of the stock from "buy" to "hold".

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.