WestRock Co. (WRK)

Updated August 25th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$31	**5 Year CAGR Estimate:**	6.8%	**Market Cap:**	$7.4 B
Fair Value Price:	$29	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	8/13/2020
% Fair Value:	108%	**5 Year Valuation Multiple Estimate:**	-1.6%	**Dividend Payment Date:**	8/25/2020
Dividend Yield:	2.6%[1]	**5 Year Price Target**	$38	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	N/A

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 $7.4 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. The acquisition of KapStone has enhanced the product offerings and the geographical presence of the company.

In early August, WestRock reported (8/4/20) financial results for the third quarter of fiscal 2020. Revenue decreased -9.7% over last year's quarter due to lower corrugated prices and a decrease in sold volumes caused by the pandemic. As a result, adjusted earnings-per-share fell -22%, from $0.98 to $0.76, but exceeded analysts' consensus by $0.32. The company has missed analysts' earnings-per-share estimates only twice in the last 21 quarters.

WestRock is currently facing a strong headwind due to the global recession that has resulted from the coronavirus. Due to the pandemic, management pulled its guidance for the year and cut the quarterly dividend by -57% in the previous quarter, from $0.465 to $0.20, in an effort to reduce the debt load by up to $1.0 billion until the end of next year. On the bright side, a recent report from Paper & Pulp Week indicated that containerboard and paper prices have stabilized lately. The stock of WestRock rallied 10% on the release of the report.

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	***$2.60***	***$3.48***
DPS	---	---	---	---	---	$0.38	$1.50	$1.60	$1.72	$1.82	***$1.07***	***$1.08***
Shares[2]	---	---	---	---	---	257.0	251.0	254.5	259.2	259.0	***261.0***	***250.0***

WestRock has a short and somewhat volatile historical record. Since its foundation in its current form, the company has grown its earnings-per-share at a 0.6% average annual rate. Moreover, even before the pandemic, there were increasing concerns over high inventories in the containerboard market and a surge in the global supply of containerboard products in upcoming years. This factor, which is out of WestRock's control, will adversely affect its margins. Furthermore, WestRock will be hurt this year by the fierce recession caused by the coronavirus. However, we expect the pandemic to subside and the company to recover from next year. In addition, WestRock is likely to benefit from the growing North American corrugated market in the long run. Overall, we expect the company to grow its earnings-per-share by about 6% per year on average over the next five years off this year's low base.

[1] Forward dividend yield.

[2] 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	***11.9***	***11.0***
Avg. Yld.	---	---	---	---	---	0.6%	3.5%	3.0%	2.8%	4.7%	***2.6%***	***2.8%***

WestRock is trading at a price-to-earnings ratio of 11.9, 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 -1.6% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

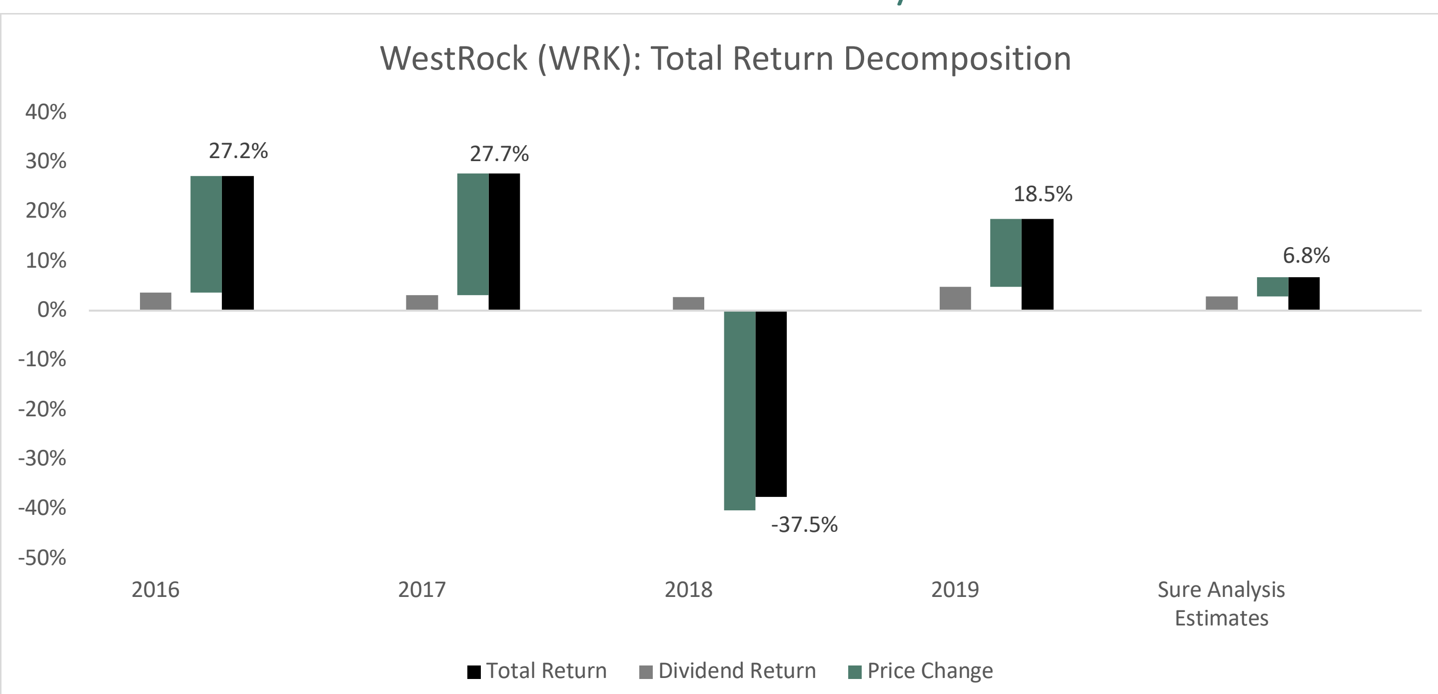
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	---	---	---	9.8%	59.3%	61.1%	42.2%	45.7%	***30.8%***	***30.9%***

WestRock cannot control the total supply of paper products. As a result, it is vulnerable to the total production volume of its competitors. Even worse, due to the high debt load that has resulted from the acquisition of KapStone, WestRock is vulnerable to the ongoing recession, which has resulted from the pandemic. Its interest expense consumes 30% of operating income while its net debt of $16.0 billion is about 23 times its annual earnings and hence it is excessive. The weak balance sheet of the company helps explain the recent dividend cut.

Final Thoughts & Recommendation

We expect the pandemic to subside and WestRock to recover from next year. However, the stock has rallied 30% since our last report, in May. As a result, the stock may offer just a 6.8% average annual return over the next five years. We have thus lowered our rating from “buy” to “hold”. Moreover, due to its high leverage, the company may come under stress if the recession lasts much longer than currently anticipated. Investors should keep this risk factor in mind.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	3001.4	5399.6	9207.6	9545.4	9895.1	11125	14172	14860	16285	18,289
Gross Profit	720.1	991.9	1532.7	1846.5	1933.6	2138.3	2758.6	2740.2	3393.9	3,749
Gross Margin	24.0%	18.4%	16.6%	19.3%	19.5%	19.2%	19.5%	18.4%	20.8%	20.5%
SG&A Exp.	340	541	928	869	938	1,026	1,750	1,457	1,731	1,709
D&A Exp.	147.4	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Operating Profit	380	451	605	892	910	993	797	1,031	1,335	1,640
Op. Margin	12.7%	8.3%	6.6%	9.3%	9.2%	8.9%	5.6%	6.9%	8.2%	9.0%
Net Profit	226	141	249	727	480	507	(396)	708	1,906	863
Net Margin	7.5%	2.6%	2.7%	7.6%	4.8%	4.6%	-2.8%	4.8%	11.7%	4.7%
Free Cash Flow	271	262	187	592	618	618	892	685	931	941
Income Tax	65	70	137	(22)	287	233	90	159	(875)	277

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2,915	10,566	10,687	10,733	11,040	25,372	23,038	25,089	25,361	30,157
Cash & Equivalents	16	42	37	36	33	208	341	298	637	152
Accounts Receivable	334	1,110	1,076	1,135	1,119	1,575	1,592	1,887	2,011	2,193
Inventories	270	850	862	938	1,029	1,761	1,638	1,797	1,830	2,108
Goodwill & Int. Ass.	900	2,639	2,660	2,562	2,618	7,442	7,377	8,858	8,700	11,345
Total Liabilities	1,898	7,187	7,281	6,421	6,732	13,589	13,208	14,703	13,878	18,473
Accounts Payable	252	781	709	802	813	1,231	1,054	1,492	1,717	1,832
Long-Term Debt	1,129	3,446	3,413	2,845	2,985	5,622	5,789	6,555	6,415	10,063
Shareholder's Equity	1,011	3,372	3,406	4,312	4,307	11,652	9,729	10,343	11,469	11,670
D/E Ratio	1.12	1.02	1.00	0.66	0.69	0.48	0.60	0.63	0.56	0.86

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	7.8%	2.1%	2.3%	6.8%	4.4%	2.8%	-1.6%	2.9%	7.6%	3.1%
Return on Equity	25.2%	6.4%	7.4%	18.8%	11.1%	6.4%	-3.7%	7.1%	17.5%	7.5%
ROIC	10.5%	3.1%	3.7%	10.4%	6.6%	4.1%	-2.4%	4.4%	10.9%	4.4%
Shares Out.	---	---	---	---	---	257.0	251.0	254.5	259.2	259.0
Revenue/Share	38.38	53.46	63.90	65.33	67.77	64.19	54.95	58.11	62.68	70.59
FCF/Share	3.47	2.60	1.30	4.05	4.23	3.57	3.46	2.68	3.58	3.63

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