WestRock Co. (WRK)

Updated May 13th, 2024 by Aristofanis Papadatos

Key Metrics

Current Price:	$51	**5 Year CAGR Estimate:**	1.0%	**Market Cap:**	$13.3 B
Fair Value Price:	$29	**5 Year Growth Estimate:**	10.0%	**Ex-Dividend Date:**	5/13/2024
% Fair Value:	178%	**5 Year Valuation Multiple Estimate:**	-10.9%	**Dividend Payment Date:**	5/22/2024
Dividend Yield:	2.4%	**5 Year Price Target**	$46	**Years Of Dividend Growth:**	3
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**Rating:**	Sell

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 $13.3 billion. In its fiscal 2023, which ended on 9/30/2023, the corrugated packaging segment, the consumer packaging segment, global paper and distribution generated 51%, 27%, 21% and 1% of its adjusted EBITDA, respectively.

On December 1st, 2022, WestRock acquired the remaining 67.7% stake in Gondi, a leading producer of corrugated and consumer packaging in Mexico. The deal cost $970 million. The acquisitions of KapStone in 2018 and Gondi have greatly enhanced the product offerings and the geographical presence of WestRock, which can now grow in the attractive Latin American market.

On April 8th, 2024, the European anti-trust regulator approved of the agreed merger of WestRock with Smurfit Kappa, an Irish packaging company with operations in several countries worldwide, in a cash-and-stock deal. If the deal materializes, the shareholders of WestRock will receive one share of Smurfit Kappa and $5 in cash for each share they own. The combined company will be the largest packaging company in the world, with annual sales of $34 billion. However, as we view Smurfit Kappa as somewhat richly valued, we do not consider the deal attractive for the shareholders of WestRock. The deal is expected by the two companies to close in July.

In early May, WestRock reported (5/2/24) financial results for the second quarter of fiscal 2024. The company posted a -9% decrease in its sales and a -49% decrease in its adjusted earnings-per-share over the prior year's quarter, from $0.77 to $0.39. The poor performance was caused by lower volume sales in the global paper and consumer packaging segments and lower prices amid lackluster demand. WestRock beat the analysts' consensus by $0.10. It has missed the analysts' estimates in only 5 of the last 36 quarters.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	---	$3.89	$2.53	$2.62	$4.08	$3.98	$2.74	$3.39	$4.76	$3.02	***$2.60***	***$4.19***
DPS	---	$0.38	$1.50	$1.60	$1.72	$1.82	$1.07	$0.93	$1.03	$1.13	***$1.21***	***$1.78***
Shares[1]	---	257.0	251.0	254.5	259.2	259.0	260.0	268.9	256.4	257.9	***255.0***	***250.0***

WestRock has a short and volatile historical record. Since its foundation in its current form, it grew its earnings-per-share at a 0.6% average annual rate until 2019 and incurred a decline in its earnings in fiscal 2020 due to the pandemic. Moreover, even before the pandemic, there were concerns over a surge in the global supply of containerboard products in upcoming years. This factor, which is out of WestRock's control, may adversely affect its margins. Moreover, the company is currently hurt by high cost inflation and interest expense. However, we view these headwinds as temporary and expect WestRock to benefit from the growing North American corrugated market in the long run. Given the low comparison base formed by the nearly 10-year low earnings-per-share expected in fiscal 2024 and the upcoming merger with Smurfit Kappa, we expect WestRock to grow its earnings-per-share by 10% per year on average beyond 2024.

[1] In millions.

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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	---	15.2	16.8	20.3	14.9	9.8	12.3	14.3	9.4	10.7	***19.6***	***11.0***
Avg. Yld.	---	0.6%	3.5%	3.0%	2.8%	4.7%	3.2%	1.9%	2.3%	3.5%	***2.4%***	***3.9%***

WestRock is trading at a price-to-earnings ratio of 19.6, which is much higher than its 9-year average of 13.7. The rich valuation has resulted from the upcoming merger with Smurfit Kappa. Due to its short historical record and its cyclical business, the stock warrants a reduced valuation. We assume a fair price-to-earnings ratio of 11.0 for the stock. If the stock trades at our fair valuation level in five years, it will incur a -10.9% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	---	9.8%	59.3%	61.1%	42.2%	45.7%	39.1%	27.4%	21.6%	37.4%	***46.5%***	***42.5%***

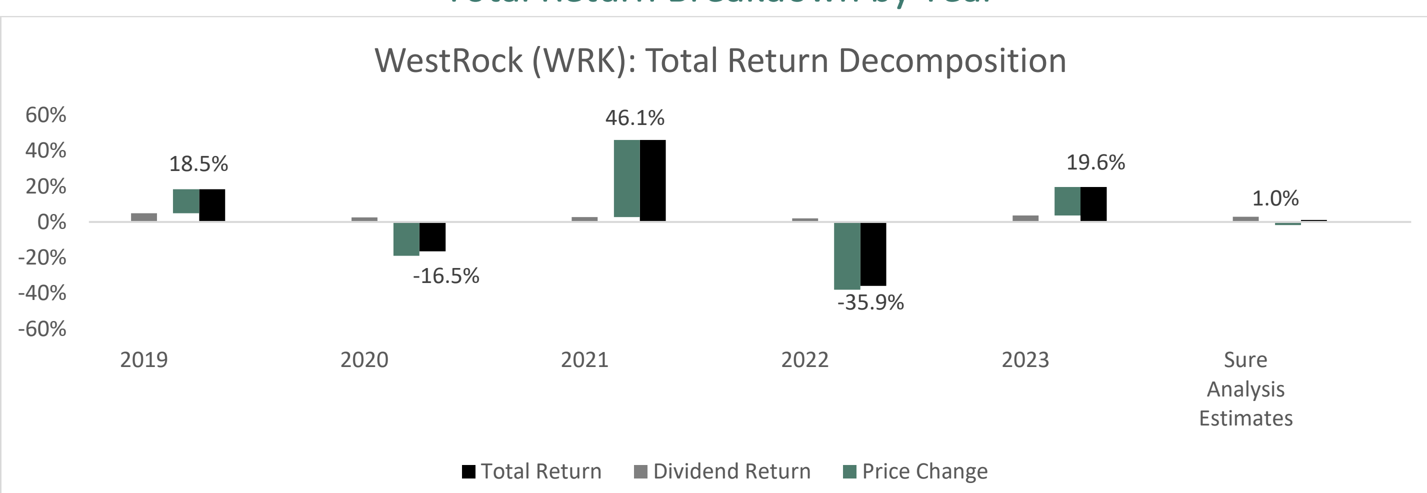
WestRock cannot control the total supply of paper products. As a result, it is vulnerable to the total production volume of its competitors. The business of WestRock is highly cyclical and hence investors should be especially careful before initiating a position in the stock. If they invest near the peak of the cycle, when business prospects usually look bright and the earnings multiple of the stock usually seems too low, they run the risk of incurring excessive losses.

Moreover, due to the material debt load that has resulted from the acquisitions of KapStone and Gondi, WestRock will be somewhat vulnerable whenever the next downturn in its business shows up. Its interest expense consumes 39% of operating income while its net debt of $13.5 billion is nearly 20 times its annual earnings and hence it is high. The weak balance sheet of the company helps explain the -57% dividend cut in 2020 amid the pandemic, despite a solid payout ratio of 66% before the dividend cut.

Final Thoughts & Recommendation

WestRock has recovered from the pandemic but it is now facing strong headwinds due to high cost inflation and a global economic slowdown. We view these headwinds as temporary, but the stock has rallied 85% in the last 12 months thanks to its expected merger and hence it has become much less attractive. It could offer a 1.0% average annual return over the next five years thanks to 10.0% growth of earnings-per-share and a 2.4% dividend, partly offset by a -10.9% annualized valuation headwind. The stock receives a sell rating.

Total Return Breakdown by Year



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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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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	9895.1	11125	14172	14860	16285	18,289	17,579	18,746	21,257	20,310
Gross Profit	1933.6	2138.3	2758.6	2740.2	3393.9	3,749	3,197	3,430	4,021	3,584
Gross Margin	19.5%	19.2%	19.5%	18.4%	20.8%	20.5%	18.2%	18.3%	18.9%	17.6%
SG&A Exp.	938	1,026	1,750	1,457	1,731	1,709	1,623	1,759	1,933	2,024
Operating Profit	910	993	797	1,031	1,335	1,640	1,173	1,314	1,738	1,219
Op. Margin	9.2%	8.9%	5.6%	6.9%	8.2%	9.0%	6.7%	7.0%	8.2%	6.0%
Net Profit	480	507	(396)	708	1,906	863	(691)	838	945	(1649)
Net Margin	4.8%	4.6%	-2.8%	4.8%	11.7%	4.7%	-3.9%	4.5%	4.5%	-8.0%
Free Cash Flow	618	618	892	685	931	941	1,093	1,464	1,158	685
Income Tax	287	233	90	159	(875)	277	164	243	270	(60)

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	11,040	25,372	23,038	25,089	25,361	30,157	28,780	29,254	28,406	27,444
Cash & Equivalents	33	208	341	298	637	152	251	291	260	393
Accounts Receivable	1,119	1,575	1,592	1,887	2,011	2,193	2,143	2,587	2,684	2,592
Inventories	1,029	1,761	1,638	1,797	1,830	2,108	2,023	2,173	2,317	2,332
Goodwill & Int. Ass.	2,618	7,442	7,377	8,858	8,700	11,345	9,629	9,278	8,816	6,825
Total Liabilities	6,732	13,589	13,208	14,703	13,878	18,473	18,132	17,564	16,980	17,346
Accounts Payable	813	1,231	1,054	1,492	1,717	1,832	1,674	2,124	2,252	2,124
Long-Term Debt	2,985	5,622	5,789	6,555	6,415	10,063	9,431	8,194	7,787	8,584
Shareholder's Equity	4,307	11,652	9,729	10,343	11,469	11,670	10,631	11,670	11,402	10,081
D/E Ratio	0.69	0.48	0.60	0.63	0.56	0.86	0.89	0.70	0.68	0.85

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	4.4%	2.8%	-1.6%	2.9%	7.6%	3.1%	-2.3%	2.9%	3.3%	-5.9%
Return on Equity	11.1%	6.4%	-3.7%	7.1%	17.5%	7.5%	-6.2%	7.5%	8.2%	-15.4%
ROIC	6.6%	4.1%	-2.4%	4.4%	10.9%	4.4%	-3.3%	4.2%	4.8%	-8.7%
Shares Out.	---	257.0	251.0	254.5	259.2	259.0	260.0	268.9	261.5	255.9
Revenue/Share	67.77	64.19	54.95	58.11	62.68	70.59	67.82	70.08	81.29	79.37
FCF/Share	4.23	3.57	3.46	2.68	3.58	3.63	4.22	5.47	4.43	2.68

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