Sonoco Specialty Containers Acquisition Conference Call

Friday, 2nd September 2016

10.00am AEST

Sonoco Specialty Containers Acquisition Announcement

Operator: Ladies and gentlemen, thank you for standing by and welcome to Sonoco Specialty Containers Acquisition. At this time, all participants are on mute. After the presentation, there will be a question and answer session. If you would like to ask a question during this time, press *1 on your telephone. I must advise you that this conference is being recorded today, Friday, 2nd September 2016. Thank you. Mr Delia, you may begin your conference now.

Ron Delia: Okay, thanks operator, and thanks to everyone on the call for joining us this morning on reasonably short notice. I'll make some opening remarks and then we'll open up the line for questions.

This morning we're announcing an acquisition that we're really excited about, and it's in the Rigid Plastics business, in the Diversified Products space, which is one of the areas we spoke about last week as having significant growth potential for Amcor. We've reached an agreement to acquire the Speciality Container business from Sonoco Products Company in the US, and the acquisition cost of $280 million represents an EBITDA multiple of 8x, based on the last 12 months' EBITDA. And this is a very good, profitable business. It's a strong business with sales of about $210 million US dollars – all the numbers I'll refer to here are US dollars. The annual sales are about $210 million, and seven well-capitalised plants in North America. Six in the United States and one in Canada. The business also has strong and long-standing relationships with global multinationals, both existing and new customers for Amcor.

And I'll come back and talk more about the specifics of this deal shortly, but first I want to spend a minute to refer back to the comments I made last week when we released earnings in order to set the context. Amcor's portfolio of businesses is quite focused now. As you know, we're leaders in rigid plastics and flexible packaging and especially cartons for tobacco packaging. But despite that focus, there are substantial opportunities of growth in each of the businesses, and these opportunities will be organic and through acquisition. And one of the examples of this growth potential that we highlighted last week relates to this specialty container space in Rigid Plastics. These specialty containers are used in a variety of end markets outside of the traditional beverage space, and markets like pharmaceuticals, food, personal care, home care, wine and spirits and the like. And the customers are the large multinationals that you would know of in those segments, and it's a very attractive space to us. We've been playing in it for over ten years through the diversified products business unit in rigid plastics, and it's attractive to us for a number of reasons, all of which play to strengths.

First, there are a number of ways to differentiate through various raw materials and manufacturing processes and product features. So in that sense, it's a lot like flexible packaging.

Second, the customers are well known to us, both those that are existing customers and those that we'll acquire here, and we know how to work with them, particularly on innovation and product development.

And then lastly, in terms of the attractiveness of the space, this market is quite large and growing. It's over $10 billion in North America, and if you include Latin America there's probably another $3-4 billion to throw in that pool. Now, clearly we won't be interested in every part of that market, but our capabilities in [inaudible] markets and finding the right places to play and where to make money also enable us to be successful and profitable in this space.

So as I've mentioned, we set up our diversified products business over ten years ago, and we've been growing it steadily over that time, both organically and through acquisitions, including most recently the acquisition we announced in June of a business outside of Toronto. So the Sonoco acquisition is really the next step change in scale for this business, but we still remain underweight with about $750 million in sales, even after including the Sonoco sales. So it remains a rich pipeline of opportunities for us to pursue.

So in addition to getting bigger, we've been broadening our capabilities and product offering, and that's where we're really excited about Sonoco. So let me get back to that deal – this deal, specifically. The Sonoco acquisition significantly improves our value proposition and the opportunities for differentiation. In these market segments – in these end markets – the customers really value, and in some cases demand, a broad product offering. And Sonoco not only adds some complementary technologies and capabilities, but also really enhances our scale and credibility in some key areas, including and maybe in particular, more extensive extrusion blow moulding capabilities, which sets us up for stronger offering in home and personal care markets, and gives us further expertise in producing containers from polypropylene and polyethylene as well as multilayer containers. So it bolsters our experience in the resins space outside of the traditional PET.

Now, in terms of the financials, we expect this deal to have $50 million of PBIT by the third full year, which will be fiscal year 2020, and we expect the transaction to close around the end of this calendar year. So in fact we hit that level of earnings after three and a half years of owning the assets. And at that time, returns will have reached between 17% and 18%. So we anticipate, in addition, that growth opportunities will further enhance the returns through 2020 and beyond.

The $50 million PBIT uplift is inclusive of $20 million of synergies, and in total those synergies represent about 10% of sales, and they'll come from several areas, including procurement, operational improvement, and SG&A. And in this case, given the network of plants we're acquiring, we can also explore footprint synergies as well.

To complete the deal and realise these synergies, we will incur $20 million of transaction and integration costs; will be $10 million in cash and $10 million non-cash, which we'll recognise in the P&L. And in terms of phasing, in fiscal 2017 we expect synergy benefits will be offset by integration costs, so no net synergy impact. In fiscal 2018 we expect a net synergy benefit of $5 million, which is again net of integration costs. In fiscal 2019, the cumulative net synergy benefit-to-earnings will be about $15 million, with the remaining $5 million of synergies to benefit earnings in fiscal 2020. The acquisition will be debt-funded from our existing facilities, and in terms of impact on the balance sheet, we remain very comfortable with the ability to continue to fund future growth and take advantage of the low interest rate environment. And the benefits from this and other recent investments flow into future cash flows. And clearly in our results presentation last week, we spoke in some detail about leverage. Obviously we would have had this deal in mind, and the fact that we expect to be above 2.75x at December, and that again included the impact of this acquisition. Key point here is this doesn't change the deal we communicated last week in any way. Our pipeline remains robust, we have plenty of capacity available to us, we're comfortable with the balance sheet, so you should expect us to continue to be active through the rest of 2017.

Finally to close, the transaction is subject to regulatory approvals in the US, but we would expect that it closes and completes toward the end of the 2016 calendar year. So with those comments, operator, now I'd like to open the line for questions.

Operator: Alright. We will now begin the question and answer session. If you wish to ask a question, please press *1 on your telephone, and wait for your name to be announced. If you wish to cancel your request, please press the # key.

Our first question comes from the line of Mr Mark Wilson from Deutsche Bank. Please ask your question.

Mark Wilson: Thanks very much, Ron. Just looking at the business here, could you outline the process – was it an auction? And how long have you actually been looking at it?

Ron Delia: Yeah Mark, look, it wasn't a traditional auction. I think, you know, you'd have to ask Sonoco about the discussions they would have had, maybe, with others. I would suspect it was an asset that others would be interested in. And all up, our profits would have been going on for several months, I would say. It wasn't a long, protracted process, but as you can imagine, you know, several months from start to finish.

Mark Wilson: Okay, great, thanks. And how would you describe the differences between the business that you're acquiring and your existing diversified products business?

Ron Delia: Yeah, look, that's really what we're excited about. There's a factsheet that was attached to our news release, and it gives you a quick snapshot, but what I would say is that our traditional diversified products business is about two-thirds PET-based, so the resin we process is about two-thirds PET, one-third, what are called polyolefins, so those include polypropylene and polyethylene's, and as a result, there's some technology that we're in, but not in a very deep way. So these are extrusion blow moulding, in particular, which is the way you process polyolefins. And so Sonoco is basically a mirror image of our business. Their business is about two-thirds polyolefins, and one-third PET. And so when you put the two businesses together, we have a pretty even balance in terms of our mix of resins, and then the resulting production technologies. And the relevance of all of that is it broadens the adjustable market. It makes us much more credible in certain segments, particularly in home and personal care, but also some food applications. And so the outcome, as well, if you just take the end market mix is that we become much more balanced with a big presence in food, which continues, healthcare, home and personal care becomes roughly about a quarter of the combined sales – and then the legacy spirits and wine business we have, which is mostly PET is another 20% or so. So it's a great fit. It really – it gives us some new technologies in the form of decorations, silk screening and some labelling technologies which we don't have, which are additive, and then it really bolsters in a vey complementary way some of the production processes in resin processing that we currently do, but in a smaller way.

Mark Wilson: Thanks very much, Ron.

Ron Delia: Okay.

Operator: Our next question comes from the line of Mr Matt Spence from Merrill Lynch. Please ask your question.

Matthew Spence: Hi Ron, thanks. Just one question, can you talk a little bit about the underlying market growth? Just what segments are growing – yeah, just for starters. Thanks.

Ron Delia: Yeah, look. This set of markets in general – the Rigid Plastic space in general should grow at least at GDP and, I would say, beyond. Because there are still conversion opportunities from other substrates that occur, and importantly, like goes on in beverage, smaller units and smaller pack sizes is just a broad trend across consumer products in general, and packaged food and beverages, and home and personal care products inclusive. So you would think of this as a GDP plus type business in terms of underlying markets. Now, the end markets for the food – for the products themselves sometimes grow at lower rates than that, but in terms of package units, you know, you get a little bit of additional growth tick from the conversion and the mix towards smaller pack sizes.

Matthew Spence: Thanks very much.

Ron Delia: Yeah.

Operator: The next question comes from the line Kit Chow from JP Morgan. Please ask your question.

Kit Chow: Good morning, Ron. A couple of questions, first one on revenue synergies. I'm just wondering if you've done an assessment between your existing businesses and the Sonoco business and made a bit of an estimate as to what the potential revenue synergies – or revenue opportunities, I should say, from this deal could be?

And secondly, I think you briefly touched on the fact that this deal doesn't preclude you from doing other acquisitions despite your leverage being above the top end of the range. Would you be able to give a sense of how far above that range you'd be willing to go before it becomes a bit more of an issue?

Ron Delia: Yeah, sure. Look, on the revenue side, you know, there's a lot of upside here from revenue. The returns in the EBIT uplift we're talking about here are cost synergies only. Now, clearly, we would be very disappointed if we didn't get any upside from the revenue part of this. I mean, this is a, at its heart, an opportunity to expand our product offering and increase our ability to differentiate and add value to our customers. So there's no question that we expect revenue synergies here. We think as well that there's a bit of a symbiosis or a complementary impact that this deal has on our flexible packing business, because a lot of these customers are the same and, you know, we're just getting deeper into these end markets. So look, there's no question there's upside from the revenue side of things, and we would expect that to happen. We haven't quantified those in terms of the return expectations here as we've communicated them today.

Look, the second question is a good one. We spent a lot of time talking about that last week. I mean, clearly, we will be above our management range. We've also been below our management range at times, so it is a range. And I think for, you know, a number of years we've been quite consistent in saying that for the right opportunities we would go above that range. I think that the important thing is in terms of comfort level, when are we comfortable or when would we be uncomfortable, I guess, is the way you asked the question. I think that, you know, first of all we've got to make sure that the broad set of balance sheet metrics is strong, and in our case, interest cover is, you know, one of the two metrics we look at quite closely. And that's very strong. In fact, that was unchanged over the preceding 12 months. And I think, importantly, we've got to see a clear path to de-lever. And the reason we're comfortable is because we look forward at the cash flows that are going to come from the underlying operating business as well as the recent investments we've made in M&A and the flexibles restructuring investments, and we see, you know, substantial uplift in cash flow which will allow for de-leveraging. So really, I think – I guess we'd get uncomfortable – to answer it that way – if there was strain on other balance sheet metrics, or if we didn't see future cash flows coming through that would allow us to eventually start to de-lever. But at the moment, you know, that's not the case and we're quite comfortable with leverage specifically where it is. And again, just to reemphasise – as we did last week, we know that we'll be above 2.75 at December.

Kit Chow: Okay, thanks Ron.

Ron Delia: Thanks.

Operator The next question comes from the line of Mr Richard Johnson from Citi. Please ask you question.

Richard Johnson: Thank you very much, Ron. I got a couple, if I may. First of all, is it possible for you to give me a feel for what the recent profit record of the business has been, sort of going back to three years?

Ron Delia: Look Richard, that's a hard one. Sonoco I don't believe has broken up the profit of its business. I think that what you can see, though, is that it is a profitable business. So notwithstanding your questions about trends, you know, I think you can intuit from the multiple we paid and what that implies for EBITDA over the sales that this is quite a healthy business. And, you know, you can imagine that in terms of diligence in the business, we have gotten comfortable with its trajectory. So maybe I'll just sort of leave it with – just reaffirming what it is today, which is quite healthy and profitable.

Richard Johnson: Okay, that's great. Thanks. And then just going back to the question around revenue synergy, I was thinking, or wondering whether the fact that this makes a very significant difference to your non-PET solutions, whether that actually helps your strategic position in Latin America as well, where you're also underweight non-PET?

Ron Delia: No question it will. No question. I think, you know, one of the things that makes this a really attractive opportunity for us, and that we can deal with this business that maybe the seller either couldn't, or you know, didn't want to do, is to grow it. And, you know, clearly first we've got to capture the cost synergies in North America, then we've got to exploit the revenue synergies in North America, but also in South America at the same time. So no question, in South America at the moment we actually are not processing much polyolefin material. So it's not exclusively PET down there for us, but it's more heavily weighted towards PET than even the pie chart on this information sheet would imply for North America. So no question. It's additive to the speciality container business, or DP – Diversified Products in Latin America as well as it will be in the flexible space, just in terms of the broader product offering that we have.

Richard Johnson: Great, and then Sonoco themselves had previously been talking about needing to add blow moulding capacity in the US. Do you know, did they do that, or if they didn't, do you no longer now need to do it because of the synergies you'll have?

Ron Delia: You know, maybe in a roundabout way let me just answer the question of why I think this business is a better fit for us than them. You know, they're a good company. They've been around forever. A quality operator. They're in a variety of different segments or spaces in the packaging industry, including this business. And you know, I think that when faced with capital allocation decisions and the need to reinvest, whether it's for capacity, as you point out, or standard capabilities, I think that we're going to have a much greater appetite to do that. So, you know, whether they have or they haven't had, at a certain point in time, you know, it probably doesn't matter as much as that we are prepared to invest in this space and to grow it, and I think that certain message and mind-set will really resonate – well, we know it will. It's resonating with the customers in a way that maybe hadn't been there more recently.

Richard Johnson: Yeah, you make an interesting point, Ron. Because they themselves have always said that they're sub-scale in all their businesses except composite cans. So I was just wondering where that leaves their flexible packaging business.

Ron Delia: Yeah, I don't know. I don't know, you'd have to ask them.

Richard Johnson: Yeah. Anyway, so one for the future. And then just finally, the interest guidance you gave at the result, did that include this acquisition or not?

Ron Delia: Yeah, look, I think it's safe enough to use the range that we communicated at the results. You know, that guidance kind of goes hand in hand with the debt outlook that we had in mind, so I think that's probably a reasonable estimate, even including this acquisition.

Richard Johnson: Okay, thank you very much. That's really helpful– and well done. Thanks.

Ron Delia: Thanks, Richard.

Operator: The next question comes from the line of Mr John Purtell from Macquarie. Please ask you question.

John Purtell: Good morning, Ron. Just had a couple of questions. The first one on balance sheet. I know you touched on it earlier, but in terms of thinking beyond this deal, do you still see ample internal balance sheet capacity to fund further deals, say, of similar size if other good opportunities come along?

Ron Delia: Yeah, look John, we don't feel constrained. Now, you know the opportunity set in our space is mostly made up of smaller deals. It so happens we've been fortunate in the last six months or so to unlock two larger ones, but you know, going back before that, you know, it was quite some time before we did a deal, you know, since we had done a deal of $100 million. So I mean, my short answer to your question would be we're not constrained when we look at the opportunity set, and you know, we knew going into this year we'd be active again. And there's nothing that changes our view on whether or not that's feasible for us.

John Purtell: Thank you. Just a second question, the synergies are relatively high as a percent of sales at 10%. Can you elaborate just on why that is? You've sort of mentioned potential footprint rationalisation, so obviously that's part of it, but in terms of, you know, maybe fleshing out the opportunities for procurement and operational improvement?

Ron Delia: Yeah, I think – yeah, first maybe I'll just outline the buckets. I think procurement certainly will be a big one. Footprint and operational improvements is another, and then there's SG&A. And, you know, clearly there are aspects of overhead that would be duplicative here that we wouldn't need to maintain. So that one probably is easy to understand.

On the procurement side, look, we do buy these resins today, and the suppliers, you know, there's good overlap there. So the synergies on raw material procurement we expect to be quite substantial. Bear in mind that, you know, a lot of these commodities are linked to materials we buy for flexible packaging as well, so you know, we have a bit more of a weight in terms of our buy than you might see or you might think.

And then clearly footprint, right? And just out of respect for the process, I think, you know, I wouldn't say too much more specifically, but clearly you look at the footprint of this business and you look at the footprint of our business, and there's some opportunities. There's some clear overlaps and those can be quite accretive and go a long way towards this 10% synergy – this sales number that we've communicated. So those are the big buckets, John. I don't know if that is specific enough in terms of answering your question.

John Purtell: No, that's great. Thank you.

Operator: The next question comes from the line of Mr Larry Gandler from Credit Suisse. Please ask your question.

Larry Gandler: Thanks Ron. With $750 million in sales, Ron, is this business getting to the size where it may require its own management? Will it be broken out of Rigid Plastics? And how do you sort of think about how big this business can get before it gets its own management?

Ron Delia: Well, it's a good insight, given what we've done in Flexibles in the Americas. But I think the fact that we've grown this business now, we've done two acquisitions in the last couple of months here – three months, I guess. You know, it's indicative that we're giving a good shot to this business, we're having a good run growing it the way it is. I mean, you know, without giving out all the details, we've put a bit of a dream team, in terms of management, in this business. We've got some really high potential folks that have run businesses elsewhere for us at Amcor who are in this business. And they're in it to grow it, you know? They went in it when it wasn't as big as it is today for good reason. So, we've loaded it up, so to speak, with talent because, you know, we just know from prior experience that's the way you grow businesses. So it's got every bit the management capability that it needs to go well beyond the $750 million of sales.

And in terms of Rigid Plastics, you know, it's really complementary. The geographic – well, it's clearly in the same geography, but you know, from a procurement perspective, from an engineering and technical resource perspective, and most importantly, from an R&D perspective – I don't know if you've been to our technical centre in Manchester, Michigan but, you know, that's a showcase and that facility, you know, is world class by any dimension. And you know, it includes diversified products and polyolefin-type product development. So, you know, this one's not as clear, but I think it gets more benefits than impediments from being part of the bigger Rigid Plastics business. I think for a number of years, you know, because of the nature of the beverage business being so big and dominant probably for a number of years that maybe slowed it down a little bit, but we've loaded it up with the right people and we have the right mind-set and expectations that I think we're – there's nothing holding us back.

Larry Gandler: Okay, and the $750, does that include the Latin American DP sales?

Ron Delia: Yeah, I think there's about $50-70 million or so that's Latin America in there. I think we – yeah, I think that's about the number [inaudible].

Larry Gandler: So the two continents are managed under this one team.

Ron Delia: The Latin America business at the moment is not.

Larry Gandler: Okay. Okay, great. Thanks.

Ron Delia: Yep.

Operator: Again, if you would like to ask a question, please press *1 on your telephone keypad and wait for your name to be announced.

There are no further questions at this time. Please continue.

Ron Delia: Okay. Okay operator, well thank you. If there are no further questions, we might draw the call to a close here. Again, really excited today by this opportunity to take this business forward, and appreciate everybody dialling in on short notice here this morning. Thanks very much.

Operator: This concludes our conference for today. Thank you for participating. You may all disconnect. Again, this concludes our conference for today. Thank you for participating. You may all disconnect.

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