Amcor Alusa acquisition announcement. Conference Call

Monday, 18th April 2016
4pm Sydney time

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Acquisition Announcement Conference Call. At this time all participants are in a listen-only mode. There will be a presentation followed by a question and answer session, at which time if you wish to ask a question you will need to press *1 on your telephone. I must advise you that this conference is being recorded today, Monday, 18th April 2016. I would now like to hand the conference over to your first speaker today, Mr Ron Delia. Thank you. Please go ahead, sir.

Ron Delia: Okay, thanks Operator and good afternoon everyone, and thank you for joining the call today, particularly on short notice, to discuss Amcor's acquisition of Alusa, which is the largest flexible packaging business in South America. What I'd like to do to start is spend a few minutes providing an overview of the business and the strategic rationale and how this acquisition fits with our growth objectives and some further colour on Alusa. And then we'll take some questions at the end of my opening comments.

From a strategic perspective this is a very exciting and really transformational acquisition for Amcor's global Flexibles business. Nine months ago we created Flexibles America's business group, and our objective was to increase focus and accelerate disciplined growth in North and South America. And it's pleasing that within a relatively short period of time the business has made outstanding progress towards that goal, and will have almost doubled in sales with the acquisition of Alusa as well as the acquisition of Deluxe Packages in the United States.

Now the Alusa acquisition represents a unique opportunity to purchase the largest flexible packaging business in the region and establish a platform on which to grow. And with one transaction we immediately gain the scale and geographic diversity that enables us to be a key regional supplier to many large multinational customers, many of whom are our customers in other parts of the world. And combined with Amcor's innovation capabilities and technical strength, our value proposition in the region is very attractive. It's differentiated and in fact will be unique. And in turn this provides further opportunities to grow organically and also will increase the synergistic value of smaller bolt-on acquisitions. So strategically we think this one is a great fit and a home run.

Now, to provide some important context to you, the flexible packaging market in South America is approximately a $5bn market, and it's been growing about 3-4% per annum and the – which clearly is outpacing the growth in developed markets. And the strong growth in this region has been driven by demographic shifts, urbanisation, modernisation of the retail infrastructure, all of which drives the need for more sophisticated packaging for consumer goods. And we expect these trends to continue. So for this reason South America is an important market for our customers, and most of them are investing considerable amounts of money in this region to generate their own growth.

In terms of the transaction for an acquisition cost of $435 million – and I'll be speaking in US dollar terms – we've acquired one plant in each of Chile, Peru, Columbia and Argentina, and a broad range of capabilities, including film extrusion, flexo and gravure printing, and lamination. And the business is focused on producing high-performance structures, generates sales of approximately $375 million, and the customer base includes a range of multinational and large regional customers in the food, personal care and pet food end markets. And there's a high degree of overlap with Amcor's existing customer base.

And importantly, Alusa comes with a very strong management team. The business is well-capitalised. It's got a number of new assets, new presses installed in the last few years, and it also has strong local management in each of the country businesses which we know is a big success factor in emerging markets.

Synergies from the acquisition are expected to be around $25 million, which represents about 6.5% of sales, and they're predominantly in two areas. Firstly procurement, where Amcor will have the ability to leverage our global scale. And secondly, there'll be opportunities on the manufacturing side in terms of productivity, waste and the like, by applying the best practices available across Amcor's existing global Flexibles network. And lastly but importantly, there's a considerable cash benefit in working capital. The working capital for sales in Alusa is significantly higher than the level of working capital in the Amcor Flexibles businesses and this cash that's released will help finance any new capital expenditure requirements over the first few years. So it's expected that the synergy benefits will have a positive impact on earnings in second and third year. In the first year the estimated cost to achieve these synergies will be approximately $5 million-$10 million, and they're expected to partly offset the acquired earning stream.

Now, let me take this opportunity to address our thought process with regard to the return expectations for the acquisition. So inclusive of synergies and growth in the underlying markets, the PBIT's expected to be $65 million by the end of the third year of ownership, which will give returns of roughly 15%, with a clear path to 20% by the end of the fifth year. And our thought process really comes down to three or four points. First one is to know we expect 20% return on this investment, so that's in line with the return on funds employed for Amcor overall. But it'll take five years instead of three, and we're prepared to wait a little longer for a few reasons.

First, Alusa is a really unique asset in terms of its scale, its breadth and its quality. There's only one other business in the South American region of similar size, and it's essentially concentrated in one country. And the next largest players are less than half the size of Alusa, and they also tend to be focused on one market.

Alusa's got an attractive product mix and customer list, and so this business is big and broad and of high quality, which we know is tough to find in emerging markets.

Second, Alusa provides us with a differentiated customer value proposition which will clearly make us the partner of choice in Latin America. And we expect to enable us to grow at rates which should exceed growth in the underlying markets.

Third reason we're accepting a longer time horizon on this one is all about speed. The alternative path here would have been a string of smaller bolt-on acquisitions and Greenfield investments, and both of those will have their place in our growth plans, but an acquisition of this scale and quality just accelerates our agenda.

And then the fourth point which should go without saying is that we have a strong degree of conviction on our ability to capture these synergies. We – we've had good access to this business. It's part of a public company. And that's allowed us to focus a lot of our effort on developing detailed plans that'll be required to capture these benefits.

Now, just before I summarise and turn it over to questions, the final point I'll touch on is related to completion conditions and completion process. Alusa is owned in part at least by Techpack which is a public company listed on the Santiago Stock Exchange. And the transaction is subject to approval by Techpack's shareholders. We expect that approval and we expect closure to take place in the coming months, once the regulatory approvals are received and the final shareholder approvals are received.

So, look, in summary, this is an exciting and attractive opportunity, significantly expands our presence in the important Latin American region, and this unique platform provides an opportunity to position the business, to accelerate growth in this region both organically and via further acquisition. And I'm very confident and believe this opportunity will deliver strong returns for shareholders going forward. So with those opening remarks, Operator, I'm happy to turn the line over to you for questions.

Operator: Thank you. Ladies and gentlemen, 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. Once again, it's *1 if you wish to ask a question and wait for your name to be announced. Please note there may be a short pause as the questions are collated. We thank you for your patience.

Your first question comes from the line of Mr Keith Chow from JP Morgan. Please ask your question.

Keith Chow: Good afternoon, Ron. Thanks for taking the call. Just a couple of questions from my end. The first one is just with respect to the returns target. Perhaps I'm asking something reasonably obvious here, but is it the case that going forward your return target benchmark will now be 15% in year three and 20% by year five? Or is it the case that, you know, because this transaction is unique to an extent that, you know, those conditions or the 20% return in year three is waived for the time being?

Ron Delia: Yes, it's a good question, Keith. It's an obvious question. The short answer is no. You know, Amcor's ROFE is 20%, and so we need a path to get there. And so there's no change to the overall hurdle rates. This one does that in five years instead of three and, for the reasons I outlined, I think the uniqueness of Alusa means, you know, in this particular case we'd prepared to wait. I mean, this is a truly unique business. I'm not sure how well-known it is. I'd be happy to describe it in a bit more detail but it's – really boosts the customer value proposition and gets us in a more credible, scale-able position fast. So we're prepared to wait to five years on this one. And that said, I mean, we still believe this is a disciplined use of cash and a good opportunity to create shareholder value. I wouldn't read into this one that there's any wholesale change in return expectation.

Keith Chow: Sure. So I can read through that then bolt-on acquisitions still commanding a 20% return in three years, I'd assume?

Ron Delia: Yes.

Keith Chow: Okay. And I think you touched on the point briefly before, but part of the reasons why you're prepared to wait is the differentiated customer proposition. Can you just run through what you mean by that, please?

Ron Delia: Yes, look, our global Flexibles business is a leadership position in Europe and really a leadership position in the segments that we operate in and compete in in Asia, and we've highlighted, back almost a year ago, that the gap we have in the Americas. And the gap is not so much a portfolio gap for Amcor, but it's a gap in our ability to deliver value for big multinational customers who value consistent supply across the – around the globe and innovation and quality and product safety and all the things that Amcor represents. We've not been a big player in the Americas. And so part of that value proposition is now the ability to service those customers in the South American region in a big way. And this is part of a – a roadmap in South America. It's not the end of the story but it's certainly the platform which will allow us to be present and credible and supportive of our big multinational customers as they seek to grow in that region.

Now, Alusa serves a variety of customers, but over 40% of its sales are to multinationals, many of whom are Amcor customers in other parts of the world. And so, you know, there really is no other blue-chip international packaging company for those customers in that region. And, you know, we really believe that we have something unique now to offer as a result of this transaction.

Kevin Chow: Okay. So in that sense, I guess, is there opportunity for Amcor to generate revenue synergies, for example, which means that growth in the years forward could be more than 3-5% per annum, as per the market?

Ron Delia: Yes. Clear – I mean, the markets have been growing 3-4%, and clearly we would expect, once we get our arms around this business and Amcor-ise it, so to speak, and make the case to the customers and begin to build the growth plans, we would expect to be able to grow in excess of the market.

Kevin Chow: Yes. Thanks very much, Ron; appreciate it.

Operator: And our next question comes from the line of Mr Simon Fitzgerald from Evans & Partners. Please ask your question.

Simon Fitzgerald: Hi, thanks for taking my questions. Just firstly, can you just give us any more detail about the growth in this business at a top line level in the last sort of few years?

Ron Delia: Yes, the business has been growing along with the market. It's also done some acquisitions in the last few years. So it's a healthy business. It's obviously got good margins, and it's done right by its customers. Most of the customers in the business – well the multinationals and the top ten customers have been with the business for a long period of time, over 20 years in many cases. So it's been growing at least as strongly as the market. And the exciting thing here is the ability to leverage the relationships we have with these customers and the innovations that, you know, we currently supply to many of Alusa's customers in other parts of the world, back in South America. And we think that's the catalyst to jumpstart even further growth. But the business is – it's healthy and it's been growing in a healthy way with good margins for quite some time.

Simon Fitzgerald: Okay. And also is there any comments you can make about the quality or thereof of the equipment base etc., or whether there's any sort of identities that you – you've picked up in terms of unique challenges or etc.?

Ron Delia: No, listen, I think – I'm glad you asked the question. One of the things that we find really attractive about this business is the quality of the asset base. It's all, let's call it – let's say Western equipment, mostly European equipment, which is, you know, the exact same type of kit we have in our plants around the world. The businesses have been well capitalised, meaning the four Alusa plants. You know, they're self-contained, meaning that each of the four businesses currently produces blown film. Each of them does both flexo and gravure printing and each of them has lamination capability. So the quality of the asset base here is very, very high, and about as good as we've seen anywhere in the world in an emerging market for sure.

Simon Fitzgerald: And so the final one from me, just to be clear, to get the pathway between the 15% to the 20%, that sounds like additional revenue that's not there at this point in time. Would that be a fair thing to say?

Ron Delia: Yes, look, we think – the sources of return in this business – there's really four sources of returns. And these will be drivers of the year three returns, and they'll carry forward into – to the fifth year. But obviously there's the base business, which I've touched on, already is a very, very well-run, well-capitalised business with healthy margins. There's the synergies, and we've called out $25 million, which are mainly around procurement and manufacturing which, you know, there's a long way to go to optimise and bring up to Amcor standards. Growth in the underlying markets which, you know, as we've said, has been 3-4% for the last several years. And then there's improved customer value proposition which will allow us to grow at rates that we believe will be higher than the market. So I would say that we would expect all of those sources, those three sources beyond the base business, the synergies, the underlying market growth and the customer value prop, to generate the returns not just in year three but beyond. And then clearly the revenue story here is a compelling one which will take a little while to crank up, and that is, you know, clearly a big driver of the path between 15% and 20%.

Simon Fitzgerald: Right, thank you for taking my questions. Thanks.

Operator: And your next question comes from the line of Mr Scott Hudson from CLSA. Please ask your question.

Scott Hudson: Yeah, hi, thanks Ron. Just in terms of, I guess, the market, my understanding is that Brazil is by far the biggest market within the region. How does, I guess, Alusa help you to I guess gain access to that market, if at all?

Ron Delia: Well, it's a good question. Yes, look, Brazil's the single largest market in the Latin American region. It's important – it's an important one. Alusa exports a reasonable amount of product from a couple of its operations into Brazil, and there's some reasons why strategically that is a very viable and good way to service parts of that Brazilian market. And so that's the starting point.

I think the second point would be that the customers that Alusa services also are active in Brazil, and we will be now immediately more compelling to them as an option, not just in the Alusa domestic markets but also in Brazil.

And the third point I would say, Scott, is that this is, you know, not necessarily the end of the story. It's more the beginning. And so, you know, there'll be more to do to build out our platform in the rest of Latin America as well.

Scott Hudson: Okay thanks. And then just in relation to the process, is this a competitive process? Or were you the only, I guess, [inaudible] –?

Ron Hudson: Scott, look, I think there's a lot of folks who would be interested in the fact that it was not an option. It was a bilateral process and, you know, over quite some time given, the notice this company and its principles, we were able to secure the asset without an auction. But there's no question that folks in the industry would know the business and would have been interested for sure.

Scott Hudson: Thanks, Ron.

Ron Delia: Okay, thanks.

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

John Patel: Good afternoon, Ron. Just a couple of questions. Just firstly in terms of currency risk, how the – how does the business manage FX and, you know, other sales contracts similar to your existing ones, as far as, you know, US dollar sales or local currency?

Ron Delia: Yes. Look, John, it's a good question. The business is actually set up in a very similar way to our Rigid Plastics business. Now bear in mind our Rigids business operates in these countries – Colombia, Peru, Argentina – and we have a Flexibles – a capsules business in Chile. So we're operating in these countries now. And Alusa structures their commercial arrangements in a similar way. Depending on the country, the businesses either transact fully in US dollars or transact in a way that generates US dollar revenue on US dollar costs. So think about raw materials being priced in hard currency. And the pass-through[?] mechanisms are similar.

I think the business has – you know, has a healthy amount of contracts and we – we also – we expect that to increase as – as we take over and, you know, implement the Amcor way and, you know, some of our commercial practices. But in general it's been able to maintain quite healthy margins, and I think a big part of that is it's – the robustness of its commercial terms, which look very much like Amcor's.

John Patel: Thanks. And just a final one. Just in terms of the costs incurred to realise the synergies. I think you mentioned $5 million-$10 million; was that just in year one or is that in totum? And some sense of, sort of, the working capital benefits that will accrue here?

Ron Delia: Well, look, normally we would say that a dollar of synergies would take a dollar of cost, and in this case it's not too far off. We would expect though that some of the cash we'll spend will be capital in nature, as opposed to expense. But we would say that to be $5 million-$10 million that will run through the income statement. We would expect that to be mostly if not all in the first year. And so that's why we say in the first year, you know, the synergies will be basically offset by the cost to achieve. And then we'll get the synergy benefits, roughly half in year two and then the full amount of synergies by the third year.

Look, the working capital is substantially high. I don't know if I – if I'd say – I won't give you the number but it's significantly higher than our Flexibles business. I think I can safely say it's more than double. The working capital of the sales in this business would be more than double what we would see in our Flexibles business anywhere in the world. And I think it's largely a function of this business is operated as four separate country businesses and, you know, on the procurement side, doesn't have the scale necessarily that we might have to be able to negotiate terms, and I think similarly on the customer side. So, you know, I'd sort of maybe just leave it at that. But it's a big opportunity for us to generate cash.

John Patel: Thanks, Ron.

Ron Delia: Okay.

Operator: Your next question comes from the line of Mr George Clapham from Arnhem Asset Management. Please ask your question.

George Clapham: Hi Ron.

Ron Delia: Hey, George.

George Clapham: Just a couple of questions, one on the – the – you know, what you defined as the Latin American Flexibles market just broadly. And just trying to get a feel for the share that this business would have and the opportunity, given that there's one other player there. And –

Ron Delia: Yes.

George Clapham: – and secondly –

Ron Delia: Well we would say the market's about $5 billion across all of – across LatAm, and this business has sales of just shy of $400 million, which would say – which would make it the largest single player at about 8%. You know, bear in mind Amcor has some business already in Latin America. We've got a plant in Brazil, and we export out of Europe primarily into South America which, you know, between the plant in Brazil and the exports there's almost another $100 million in sales. So we would have about 10% of this market once the transaction closes. And then there would be a long tail. There's obviously one other player who has a sizeable position which is in Brazil. And then beyond that there's a long tail of smaller players in each of the country markets.

George Clapham: And what about the customer base in terms of the, you know, local versus multinational?

Ron Delia: Yes. Look, Alusa's got a very attractive customer base. It's about 40% global multinationals, and it's got another, say, 20% or so which are big regional players in South America which buy in a very similar way to the big global multinationals. Like we quite often talk about in emerging markets, our value proposition resonates with a certain customer type. Obviously, we know the Nestles and Kraft and Mondelezs and Unilevers of the world, but there's often big regional players that buy in the same – on the same basis looking for quality, looking for food safety, innovation, support, the ability to support their growth. So Alusa's business is about 40% MNCs and another sort of 20-25%, you know, big regionals that buy in a similar way. So we find it a very attractive customer mix – customer base.

George Clapham: Okay. And just on – we've only just sort of had a look at Techpack, so that – they've got – this is a big chunk of their business, is it, that they're selling?

Ron Delia: Yes. Look, George, this is a little bit of a confusing ownership structure, so maybe I'll just spend a minute describing it. Alusa is owned – well there's four businesses in Alusa, and Techpack, which is publicly listed, owns 100% of the Chilean business, 100% of the Argentine business and 50% of the Alusa businesses in Peru and Colombia. And Techpack also owns some other assets which are not part of this transaction. So Techpack itself is publicly traded, but there would be some noise in the numbers, Techpack's financials, that don't match one-to-one with Alusa, which creates a little bit of confusion. So the Alusa businesses are the four that I mentioned, and then the other 50% of the Alusa business in Peru and the Alusa business in Colombia is owned by a private equity firm called Nexus. And so this business really that we're acquiring is – essentially it's from two owners.

George Clapham: Okay, that's good. Thanks, Ron.

Ron Delia: Okay, thanks.

Operator: Once again, ladies and gentlemen, if you wish to ask a question please press *1 on your telephone and wait for your name to be announced.

Ron Delia: Any other questions, Operator?

Operator: Currently we don't have any questions, sir. Please continue.

Ron Delia: Okay, well look if there –

Operator: We have a question.

Ron Delia: Okay.

Operator: We have a question, just came in, from the line of Mr Scott Hudson. Please ask your question.

Scott Hudson: Yes, sorry, just one follow-up. In terms of that $5 billion market, are you able to give us some sort of indication of what percentage is sort of food and personal care and healthcare?

Ron Delia: Look, I can tell you that it would mirror what you see in other parts of the world. The – in the Alusa business – maybe I'll answer it that way. The Alusa business is roughly two thirds food, and the rest personal care and some other end markets. So it's a market that looks, in terms of composition, very much like other emerging markets [inaudible] in fact other markets at large. So I'd say it's roughly two thirds food.

Scott Hudson: Okay. That's all, thanks.

Ron Delia: Okay.

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

Ron Delia: Okay, Operator, anyone else in the queue?

Operator: Currently there are no questions. Please continue, sir.

Ron Delia: Okay. Look, Operator, if there are no further questions we might end the call. But before we do that, I just want to say thanks once again for joining again at short notice. But we're really excited about this acquisition. We think it's a really compelling opportunity for Amcor and we're – we look forward to keeping everybody up to speed as we get into it further. So thanks everybody and, Operator, we'll end the call there.

Operator: Thank you. Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may all disconnect.

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