Amcor Annual General Meeting 2017

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Investor Call Transcript

Ron Delia: Thanks, operator. Good afternoon and welcome to our 2017 AGM conference call. This is Ron Delia, Amcor's CEO, and with me today is Michael Casamento, Amcor's CFO. By now you've had a chance to see the materials we released earlier this morning, and before I open up for questions I would just like to take a few minutes to recap on a couple of the key points we covered in the formal meeting.

First, in relation to Amcor's strategy, there is absolutely no change here. We have a strong portfolio of businesses in four product segments, flexible packaging, rigid plastic containers, specialty cartons and closures, and we have multiple paths to winnings in these segments and real sources of differentiation through our capabilities, which provide competitive advantage.

The business generates strong cash flow and deploys that cash to deliver strong and consistent shareholders returns – this is what you all know as Amcor's shareholder value creation model – and there are significant growth opportunities both for organic and through acquisitions across all of the Amcor businesses, which gives us the confidence that we'll continue to deliver against this value proposition over the long term.

Our current operating priorities at any point in time will build on the foundation we have, and advance and accelerate our strategy. And for the last couple of years, those priorities have focused on generating our own growth, increasing the agility and pace of adapting operations in the context of a world which continues to move at an ever-increasing pace, and strengthening and engaging our team. And these priorities remain as critical to our success today as they have at any other time in the last two years.

In the medium term we're on track to deliver more than $100 million of further benefits by the end of the 2020 financial year from the prior period investments in restructuring and the Alusa and Sonoco acquisitions. Importantly this will be in addition to organic growth and further M&A. And over the longer term, we continue to see substantial growth potential across our entire portfolio, and in particular in the four focus segments that we've highlighted previously.

That's the summarised version of our strategy and priorities and outlook for the future, but the key point today here is no change whatsoever to what you've heard me say on many occasions in the past on those topics.

Turning now to an update on first quarter trading, there are three key messages from me this afternoon. First, parts of our business have had a good start to the year, but overall it was a difficult first quarter. In our outlook statements in August we made some cautionary comments related to market conditions and customer performance and raw material costs, and these issues have continued to worsen through the September quarter, especially in the emerging markets. And these challenges are not Amcor specific by any means, and we think we are actually advantaged in addressing them given our global footprint and our industry leadership positions as well as our execution capabilities.

So the second key message here is that we have already taken appropriate actions and moved quickly and decisively in response. As a result, we've implemented actions to flex capacity, increase prices and reduce costs. So the management teams are focused on what needs to be done to minimise the adverse impacts of the market conditions that we're seeing and are executing well.

So the third key message here is that, most importantly, as a result of these actions we're taking, and notwithstanding a more cautious outlook, we continue to expect PAT growth in constant currency terms for the 2018 financial year to be within the range of outcomes we expected in August, and the magnitude of the overall earnings growth will depend on trading conditions across the balance of the year and assume some improvement relative to the September quarter.

So let me step through what we're seeing in each segment starting with flexibles. Trading conditions and the performance of our businesses in developed markets have been in line with our expectations, and the benefits from the previously announced restructuring initiatives are consistent with the upgraded expectations we outlined in August. But the businesses in the flexibles segment have also experienced headwinds from rising raw material costs and weak performance across our emerging markets business. In terms of raw materials, as we described in August, raw material costs increased in the June 2017 quarter, and since that time we've seen further increases in the market prices for a number of key materials around the world, and raw material costs are actually up 10% from where they were at the beginning of the 2018 financial year. As always, we'll recover these costs over time and price increases have already been actioned across all of our flexibles business units with more occurring in the current quarter. But as is always the case, there's a time-lag between the impact of raw material cost movements and the related pricing actions, so as a result we estimate the adverse impact on PBIT in the flexibles segment for the first half of the year will be approximately €15-20 million.

In terms of emerging markets regarding those emerging markets businesses in the flexibles segment, we've seen good momentum in Eastern Europe for flexible food packaging and also in several healthcare and tobacco packaging markets, however, overall conditions have been weak with organic performance well below the long-term trend, particularly in Asia. And as well as the raw material costs increasing substantially in both Asia and Latin America during the September quarter, the weak trends we've seen through the last financial year in specialty carton volumes in Russia and in Asia have also continued.

So in response to these challenges, we've been moving with pace and intensity in two areas. Firstly, we've implemented price increases as raw material costs moved higher, and second, we're aggressively flexing down capacity in line with trading conditions and driving costs out of the business. So in summary, while we continue to expect the flexibles segment to deliver strong PBIT growth in the 2018 financial year in constant currency terms, this growth will depend on further raw material cost developments and trading conditions across the balance of the year. PBIT in the first half of the year is expected to be broadly in line with the prior year in constant currency terms, and this takes into account the time lag in recovering higher raw material costs, the trading conditions I described in the first quarter, as well as acquisition integration costs of approximately $5 million, which we highlighted in August.

Turning now to rigid plastics, the rigids business has performed well in the context of some significant challenges in key markets, and it's also worth recalling that the rigid segment had a very strong first half last year, with volumes in North America up by 5% and overall earnings up by nearly 12%. In August, we highlighted that North American beverage volumes in the June 2017 quarter were lower than the prior year, as Amcor customers experienced weaker sales. And we cautioned that the earnings outlook for the first half of the 2018 financial year would depend on volume developments over the balance of the summer. This same trend of weak customer performance and destocking has continued to negatively impact beverage and closure volumes in our first quarter. As a result, volumes in the North American beverage business in the first half are expected to decline at mid single-digit rates relative to the prior period, with hot fill volumes declining at around twice that rate.

In the rest of the rigid plastics segments, the business continues to grow and win share with the regional customers, and the speciality containers business has performed as expected. However, in Latin America, economic conditions are mixed but remain challenging overall and this continues to weigh on volumes. We expect this will continue to be the case in the near term.

In terms of our response to these market conditions, the management teams across rigid plastics have acted quickly and decisively. They've aggressively flexed capacity and they are further reducing operating and overhead costs. And in addition, the business is working to ensure our pricing keeps pace with the steep raw material cost increases as supply conditions in the PET resin market in particular tighten rapidly.

Now, taking into account the trading conditions in the September quarter, we still expect the rigid plastics business to deliver solid PBIT growth in the 2018 financial year, though this remains dependent on beverage volume in North and South America over the balance of the year. We anticipate earnings in the first half will be broadly in line with the prior year, taking into account the current trading conditions as well as the adverse impact of integration costs related to the Sonoco acquisition, which we previously described in August.

To summarise the trading update, there are three key takeaways today. First, while parts of the business are performing well and the challenges we highlighted in August relating to market conditions, customer performance and raw material costs have persisted or worsened through the September quarter, especially in emerging markets. Overall it's been a difficult start to the year. Second, we've been proactive in our responses. We've taken appropriate actions reflecting higher raw material costs in our pricing, flexing capacity and reducing costs. Our management teams have shown a capacity to deal with market challenges before, and the broader organisation is outstanding in its ability to execute. And finally, third message here – and most importantly notwithstanding a more cautious outlook – we continue to expect that PAT growth in constant currency terms for 2018 will be within the range of outcomes we expected in August, and the magnitude of overall earnings growth will depend on trading conditions over the balance of the year, and does assume some improvement relative to the September quarter.

So with those opening comments, I'm happy to take questions from the line.

Daniel Kang: Many thanks. Good morning, everyone. A couple of questions from me. Firstly, as we are already early into the second quarter, can we provide some colour as to how it has begun from first quarter? Have we seen an improvement? And just following on from that, are you able to quantify the level of market improvement that you are assuming n your guidance statement?

Secondly, I just wanted to ask in terms of price hikes. Are you seeing any pushback thus far in these initiatives? I note that some of your North American competitors are indicating that competition has intensified, which has made price hikes quite challenging.

And just a final one, probably to Mike. With regards to some of the potential US tax reform, are you able to detail how these changes might benefit Amcor? Thanks, guys.

Ron Delia: Thanks, Daniel. I might take the first two or three here and then Michael can talk about potential tax reform in the US.

First question you asked, was there any improvement in October, is what you're really referring to, because we've couched our comments as related to the first quarter. I think you can assume that our comments, and our outlook, also takes account the earlier parts of October, that we had some more visibility into, so there's no change related to the first quarter and to the last few weeks, so that would be the first point.

Second thing is you asked about quantifying the market improvement and how that factors into our guidance. I think it's fair to say that, as we've qualified a couple of times here, with the performance we had in the first quarter from a market perspective and volume perspective, we are expecting some improvement. It's difficult for us to quantify it precisely because we're also not giving point estimates here on guidance. What we would say is that some of the softness in the first quarter was not just market softness, but also fairly pronounced destocking in a couple of parts of the business, which eventually works itself through over time, and so we would expect to the extent that's been part of the challenge, that unwinds.

The last one you asked before we get to the tax side is pushback on price. The first thing I would say is we're the market leader in almost every business we participate in, so it's an obligation and an expectation of the market leader to put prices up when raw materials go up. That's how this industry functions and always has. And we've got a very good track record of leading, and we don't expect any pushback on raw material-related price hikes. These are well understood – the reasons are well understood, and we can talk more about them, but they primarily relate to the oil increases as well as supply disruptions, and they're clearly not Amcor-specific issues, so we're not expecting any pushback. It's always a difficult discussion, but ultimately that's the way the industry functions.

So I might just leave it there and then we'll pick off the last one here. Michael can speak to potential tax reform.

Michael Casamento: Yeah, hi Daniel. Thanks for the question. The tax reform in the US is still pretty unclear as to where it's heading. We're running different scenarios on some of the different changes that could or could not come through. Clearly if all that happened there was a corporate tax reduction, then we would have some benefit from that, but clearly that won't be the only change. So at this stage way too early to call. We continue to monitor it and run our scenario analysis, but as I say, I think it's too early to understand or to call on what impact that may or may not have for Amcor.

Daniel Kang: Okay, great. Thanks.

Ron Delia: Thanks, Daniel.

Mark Wilson: thanks very much, Ron. I was just wondering whether you could give us a few more details about the raw material price increases that you've seen by region. Where are they more pronounced? And just the mechanisms that you have in place to recover those and which regions do you think it will take longer to recover them?

Ron Delia: Yeah, that's a good question. The first thing I would say is we've seen increases around the world. They've been particularly pronounced in the Americas and in Asia, and those markets tend to be more linked for a number of reasons, including the trade flows and the dollar denomination of raw materials are better. But the headline would be, we've seen increases everywhere. We've seen increases for the whole calendar year, as you might recall us discussing in August. But from 1st July we've seen about a 10% increase across our basket of raw materials, and that's resins, it's films, it's aluminium and liquids, which are inks and adhesive.

So it's pretty pervasive across the board. Most pronounced in the Americas and in Asia, particularly for polymers, and the driver predominantly around the world has been oil and some supply tightness, but in the Americas in particular, the hurricanes and the other natural disasters have led to supply disruptions. So at points in time over the last two months there's been up to 60% of the polymer capacity taken out of the market. A lot of it's come back – most of it's back – but when you take out a couple of months of supply at that magnitude, it obviously leads to price increases. So I'm happy to provide more detail on where and what, but that's maybe a starting point.

Then the second part of your question was about recovery mechanisms, and those are pretty well refined in Amcor. Most of our business around the world, probably about two-thirds of it, is contract business, and any contract we have has very explicit rise and fall mechanisms that are pegged to published indices, and as the indices change, then the pricing changes. And those typically result in a lag – they typically are effective either every quarter or twice a year, so there's usually a three to six months lag. And they work pretty consistently around the world in the contracted part of the business. I will say in emerging markets they're a little less – the indices are a little less pervasive and a little less efficient, let's say, and so the timing and recovery typically takes a little bit longer than it might in some other markets. And we always – as you know, give a range of three to six months, and in the emerging markets it tends to be more towards the six month end of that time horizon.

The other third of the business is more spot, or it's not contracted, I should say. And in those instances we put the raw material price increases as they're incurred, and there's a more immediate effect on that part of the business.

Mark Wilson: Great, thanks Ron. And it does look as though those prices have started to come back in the last couple of weeks, so how long does that take for that to flow through into your business?

Ron Delia: Well, look, it depends on where they go from here across our basket. You're right, in some commodities there's been some easing, in other commodities there's actually been acceleration, and for us, we look across the whole basket and it really just depends, Mark. I mean, I think the impact that I alluded to this morning and this afternoon of €15-20 million, is based on the increases we've incurred already, and then the expected recovery horizon that I just described over three to six months. I think it's fair to say that we'll be watching closely what happens to raw materials from here.

Mark Wilson: Okay, great. Thanks very much, Ron.

Ron Delia: Thanks, Mark.

Michael Aspinall: Morning, guys. So some of the global consumer staples companies are seeing an improvement in the volumes in emerging markets. Can you just provide a bit of colour on what you've seen in terms of the different regions and what that means for the pricing dynamics as well?

Ron Delia: Yeah, look Michael, thanks for the question. The word I would use is mixed, we've seen a reasonable performance from some of our emerging markets businesses. I highlighted flexibles and Eastern Europe as one. I think some of the healthcare businesses and flexible packaging in South America and in Asia have done well. Tobacco packaging in Latin America has done well. But overall it's been a mix, and even in South America, if I just stay there for a second, in the bigger countries, Brazil and Argentina, which are predominantly rigid plastics for us, there's been some improvement. I'm not sure we're ready to call it a turnaround yet, but there's been some modest improvement. But in the Andean region, which includes Colombia, that market has deteriorated, and that's actually consistent with what many of the customers that we talked to have seen, particularly the big beverage companies that operate in Colombia.

So that's South America. I think Eastern Europe on the food side, personal care, flexibles is going well. On the tobacco packaging side, in particular in Russia, we've seen very soft volumes ahead of excise tax increases. In Asia it's mixed, as it always is. There's not really such a thing as Asia. It's a series of country businesses. We've seen reasonable sales growth in parts. In flexibles we've seen softer sales relative to long-term trends, in other parts of that business. And then in tobacco we continue to see softness, particularly in the Philippines, which has continued from the second half of last year as well. So I guess all up it's been a mixed bag for us at this stage.

Michael Aspinall: So it doesn't really sound like there's a lot of the issues in the recently acquired Alusa business. It sounds like they're in other areas.

Ron Delia: Well, Alusa's in South America and is a flexibles business, so it faces the same issues that we face in South America with depressed market conditions, and then as a plastics business it also has to wear higher raw material costs. And I would point out that raw material costs for us in emerging markets, back to Mark Wilson's question, have been particularly elevated, especially in Asia and Latin America. So that's also weighing on organic performance – not as much on the top line, but on the bottom line for us.

Michael Aspinall: Okay, thanks for that.

Ron Delia: Thanks.

John Purtell: Good afternoon Ron, how are you?

Ron Delia: Hey, how are you John?

John Purtell: Very well, thanks. I just had two questions. Just firstly on raw materials, just to understand the impacts there, essentially what you're describing is there's sort of two lots of raw material increases, one in the June quarter and one in the September quarter. And sort of that had a compound effect there?

Ron Delia: Yeah, so that's actually right. It's different by region and by commodity, but if I was to generalise I would say we did have some increases through the June quarter. We talked about those in August. At that point in time I would have said to you that it was predominantly in Europe, a little bit in North America, and Asia, actually we didn't have an inflationary pressures last year that were material. Since 1st July we've had oil up about 15-16%, so that effects the global markets. But the increases have been more pronounced and more spikey in the Americas and in Asia, and again, those markets tend to be quite linked. So if you want to sort of use it and describe it in two tranches, the second, more recent tranche has been particularly pronounced in the Americas and in Asia, and we would say it's pretty clear. A lot of that is the supply disruptions that we've seen.

John Purtell: And just to be clear, if prices stay stable, is there still a negative lag impact to be felt in the second half, or should we expect to see that there's a positive pull back in the second half?

Ron Delia: Well, if all things stay constant and raw materials stopped moving on the same date that all the pricing went to effect, then you'd have this three to six month lag, depending on the time to implementation. But you have to remember that it's not all completely linear and there's a difference between when we hit the full run rate of the recovery and then the actual impact. So it's unlikely that we get it all back in the second half – in fact, it's almost mathematically impossible that we get it all back in the second half. Even if nothing changed from here.

John Purtell: But the expectation at stable pricing, there'd be no further deterioration in the second half.

Ron Delia: No further increases, correct. And just to be clear, I mean, we will recover all of these increases. The question is what happens by 30th June 2018. That's a function of where do raw material prices go from here.

John Purtell: Okay, thank you. And just a last question, just on rigids – just your commentary there. You're obviously aware of a particular sort of customer and some of their volume issues, but the commentary more broadly suggests weakness in terms of US consumer. Obviously aware that the weather was not as favourable as before, but just what's happening there more broadly?

Ron Delia: Look, it's a good pickup. There's a couple of things going on in the beverage business for us, and some of it is the soft market, which affects every customer. And actually it's more easier to read through in terms of the retail sales numbers where you do see softness across the beverage categories at retail as well. You know, I think the weather in the summer months in North America was not favourable at all, and convenience store sales in several of the more important categories are down, and that also takes a bit of a bite. So you're seeing retail figures, although the declines are accelerating at retail based on some of the four-weekly data we see, but they're sort of mid to high single-digit declines. And then in our situation, because of a certain customer mix, there's been some pronounced destocking, which has exacerbated the market issues in the first quarter. Now we expect that to resolve itself obviously as inventories get back to target levels for the customers, but that has sort of amplified what has already been a series of soft market conditions.

John Purtell: Thanks, Ron.

Ron Delia: Thanks, John.

Daniel Kang: Yeah, just a quick one. Just on your comment on destocking, Ron. Do you have a sense of what level of inventory is at your customer level and how they compare to historical levels?

Ron Delia: It's very difficult to say, Daniel. The only thing we can try to, and we have very close relationships with these customers, but it's very hard to get complete transparency into what their stocking levels are, because there's multiple chains – there's multiple steps in the distribution chain, I guess I should say. What we try to do is just look at the trading patterns relative to our past experience and relative to retail, and in consultation with the customers, then we try to back into where we might be along the destocking path, but it is very difficult to zero in and quantify.

Daniel Kang: And in reference to your comment is the destocking path nearly at the end of that cycle. Would that be fair?

Ron Delia: Well, destocking in particular has been particularly impactful for us in the first quarter in two places. In North American beverage – we've had a pretty rapid destocking in that business, and now they're coming into the softer months from a retail side, so we'd expect that to sort of complete. The other place we've seen rapid destocking is in Russia in tobacco, and that's ahead of excise tax increases. And we know there's some planned plant shutdowns towards the end of this calendar year, and that along with the destocking we've already experienced gives us some sense that that is mostly behind us as well.

Daniel Kang: Thanks, Ron.

Ron Delia: Thank you.

Ron Delia: Okay, I think we'll leave it there. I just once again would like to thank everybody for joining us today, and thanks for your questions and appreciate your time. Thanks very much. With that we'll close this call, operator.