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Jan 06, 2020

## Packaging Corp. (PKG)

**$109.22** (As of 01/03/20)

Price Target (6-12 Months): **$116.00**

| | | |
|---|---|---|
| Long Term: 6-12 Months | **Zacks Recommendation:** (Since: 09/23/19) Prior Recommendation: Underperform | **Neutral** |
| Short Term: 1-3 Months | **Zacks Rank:** (1-5) | **3-Hold** |
| | Zacks Style Scores: | VGM:A |
| | Value: B \| Growth: B \| Momentum: B | |

## Summary

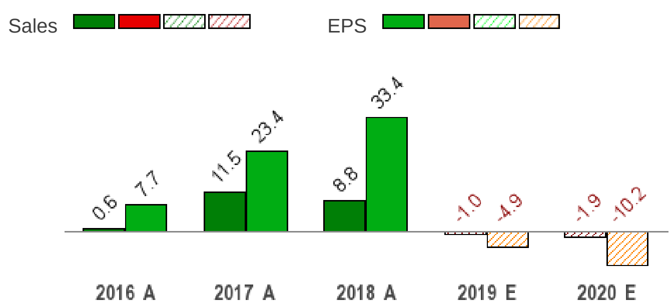
Packaging Corp projects earnings per share of around $1.70 for fourth-quarter 2019 compared with the prior-year quarter's $2.15 per share. The guidance reflects year-over-year decline of 21%. The company expects slightly lower prices, higher operating and converting costs in its segments as well as sequentially higher maintenance outage costs, for the fourth quarter. Nevertheless, Packaging Corp is poised to benefit from strong demand stemming from the booming ecommerce market that will lead to increase in box demand. The company's discontinuation of the production of uncoated free sheet and coated one-side grades at the Wallula mill will help the company to improve margins in the paper segment. It maintains a balanced approach toward capital allocation in order to profitably grow the company and maximize shareholders returns.

## Price, Consensus & Surprise


## Data Overview

| | |
|---|---|
| 52 Week High-Low | **$114.78 - $85.41** |
| 20 Day Average Volume (sh) | **579,084** |
| Market Cap | **$10.3 B** |
| YTD Price Change | **-2.5%** |
| Beta | **1.68** |
| Dividend / Div Yld | **$3.16 / 2.9%** |
| Industry | **Containers - Paper and Packaging** |
| Zacks Industry Rank | **Top 25% (63 out of 252)** |
| Last EPS Surprise | **1.1%** |
| Last Sales Surprise | **-0.4%** |
| EPS F1 Est- 4 week change | **0.0%** |
| Expected Report Date | **02/04/2020** |
| Earnings ESP | **0.0%** |
| P/E TTM | **13.5** |
| P/E F1 | **15.9** |
| PEG F1 | **3.2** |
| P/S TTM | **1.5** |

## Sales and EPS Growth Rates (Y/Y %)




## Sales Estimates (millions of $)

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|---|---|---|---|---|---|
| 2020 | | | | | 6,808 E |
| 2019 | 1,734 A | 1,760 A | 1,751 A | 1,698 E | 6,942 E |
| 2018 | 1,691 A | 1,768 A | 1,810 A | 1,747 A | 7,015 A |

## EPS Estimates

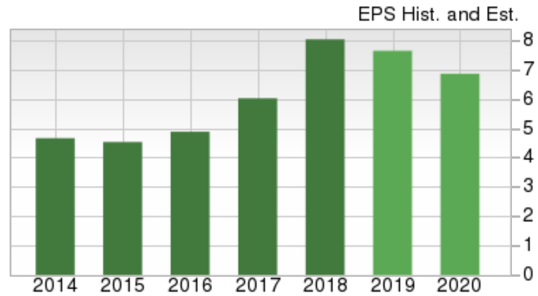
| | Q1 | Q2 | Q3 | Q4 | Annual* |
|---|---|---|---|---|---|
| 2020 | $1.52 E | $1.65 E | $1.70 E | $1.48 E | $6.86 E |
| 2019 | $1.98 A | $2.04 A | $1.92 A | $1.71 E | $7.64 E |
| 2018 | $1.55 A | $2.08 A | $2.23 A | $2.17 A | $8.03 A |

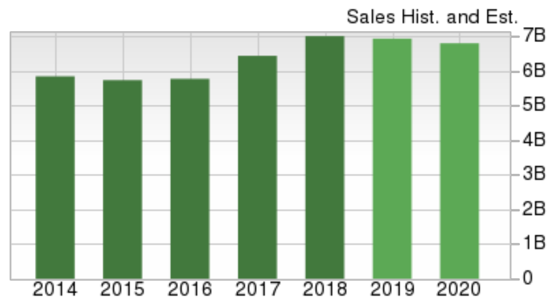
*Quarterly figures may not add up to annual.

The data in the charts and tables, except sales and EPS estimates, is as of 01/03/2020. The reports text and the analyst-provided sales and EPS estimates are as of 01/06/2020.

## Overview

Headquartered at Lake Forest, IL, Packaging Corporation of America is the third largest producer of containerboard products and the third largest producer of uncoated freesheet paper in North America. The company operates six containerboard mills, two paper mills, and 95 corrugated products manufacturing plants.




Packaging Corporation operates in three segments:

**Packaging segment** (85% of 2018 revenues) - From its containerboard mills, the segment produces linerboard and semi-chemical corrugating medium, which are mainly utilized in the production of corrugated products. The corrugated products manufacturing plants produce a wide variety of corrugated packaging products, including conventional shipping containers used to protect and transport manufactured goods, multi-color boxes and displays with visual appeal that aid in merchandising the packaged product in retail locations, and honeycomb protective packaging. The segment also produces packaging for meat, fresh fruit and vegetables, processed food, beverages, and other industrial and consumer products.

The segment sells containerboard and corrugated products to approximately 18,000 customers in over 36,000 locations.

**Paper segment** (14%) is the third largest manufacturer of uncoated freesheet in North America. The company manufactures and sells white paper, including commodity and specialty paper, which may have custom or specialized features such as colors, coatings, high brightness, and recycled content. White papers consist of communication papers, including cut-size office papers and printing and converting papers.

The segment serves over 150 customers in approximately 450 locations. These customers include office products distributors and retailers, paper merchants, and envelope and other converters.

**Corporate and Other** segment includes corporate support staff services, and related assets and liabilities. This segment also includes transportation assets, which are utilized to transport products to and from manufacturing sites and assets related to a 50%-owned variable interest entity — Louisiana Timber Procurement Company, L.L.C.

## Reasons To Buy:

> Packaging Corporation is poised to gain from the e-commerce boom that will fuel demand for boxes. Further, strong free cash flow and capital allocation approach bodes well.

- Packaging Corporation discontinued the production of uncoated free sheet and coated one-side grades at the Wallula, WA mill and converted the No. 3 machine to a virgin kraft linerboard machine with an annual capacity of 400,000 tons. This will assist the company in optimizing the entire containerboard system platform and improve its manufacturing and freight costs. According to the company, there are opportunities to increase capacity of the mill. This move will help the company continues improve profitability and margins in the paper segment.

- The company maintains a balanced approach toward capital allocation in order to profitably grow the company as well as maximize returns for the shareholders. Cash flow from operations came in at $340 million in the third quarter of 2019 and free cash flow was $247 million. The company spent $93 million on capital expenditures and made dividend payment of $75 million. The company ended the third quarter of 2019 with $738 million of cash. Packaging Corporation anticipates capital spending for current year to be $390-$410 million, with roughly 35-40% earmarked for strategic capital projects including organic growth, cost reduction, and efficiency projects. Further, share repurchases will bolster earnings.

- Packaging Corporation will benefit from the e-commerce boom that will lead to increase in demand in boxes. These days, customers find a lot of different channels to sell-through, including e-commerce. The company has a wide base of customers and expects the business to grow in the current year.

- The company's  corrugated product manufacturing plants produce a wide variety of packaging products, which include conventional shipping containers used to protect and transport manufactured goods, multi-colored boxes, and displays with strong visual appeal. In addition, Packaging Corporation is a large producer of packaging for meat, fresh fruit and vegetables, processed food, beverages, and other industrial and consumer products. The diverse product portfolio mitigates operating risks associated with any downturn in a particular product category.

## Reasons To Sell:

- Packaging Corporation projects earnings per share of around $1.70 for fourth-quarter 2019. Compared with the prior-year quarter's earnings per share of $2.15, the guidance reflects a year-over-year decline of 21%. For the fourth quarter, the company expects slightly lower prices, a seasonally less rich mix in corrugated products and slightly lower shipments with one less shipping day in the Packaging segment. Containerboard sales volume is also anticipated to be lower as the company intends to build some inventory prior to year end in preparation for the first-quarter 2020 scheduled maintenance outages at its three largest containerboard mills.

Packaging Corporation's results will likely be marred by lower prices, annual maintenance outages and higher converting costs. Containerboard sales volume is also anticipated to be lower.

- For the Paper segment, volumes are anticipated to be seasonally weaker, along with lower average prices. Due to cold weather, energy costs are likely to be higher for the current quarter. Other operating and converting costs are likely to be higher as well, which includes the costs associated with the start-up of the new Richland, WA box plant during the third quarter. Scheduled maintenance outage costs might be higher sequentially.

- Packaging Corporation functions in a highly competitive industry. Containerboard and commodity white paper products tend to intensify price competition. The corrugated packaging industry is also sensitive to changes in economic conditions, as well as other factors, including innovation, design, quality, and service. Intense competition could lead to a decline in its market share, as well as lower sales prices, both of which are likely to affect the bottom line and operating cash flows.

## Last Earnings Report

**Packaging Corp Q3 Earnings Beat Estimates, Sales Miss**

| Quarter Ending | 09/2019 |
|---|---|
| Report Date | Oct 23, 2019 |
| Sales Surprise | -0.44% |
| EPS Surprise | 1.05% |
| Quarterly EPS | 1.92 |
| Annual EPS (TTM) | 8.11 |

Packaging Corp reported adjusted earnings per share of $1.92 in third-quarter 2019, which surpassed the Zacks Consensus Estimate of $1.90. Earnings came in ahead of management's guidance of $1.91 per share. However, the reported figure declined 14% year over year.

The decline can be attributed to higher operating and converting costs and lower volume in the Paper and Packaging segments. However, these were partly offset by higher prices and mix in the Paper segment, lower annual outage expenses and lower freight and logistics expenses.

Including one-time items, earnings in the reported quarter was $1.89 compared with $2.18 in the prior-year quarter.

**Operational Update**

Sales for the third-quarter went down 3% to $1.75 billion from the prior-year quarter's $1.8.1 billion. The reported figure also lagged the Zacks Consensus Estimate of $1.77 billion.

Cost of products sold declined 2% year over year to $1.34 billion in the reported quarter. Gross profit went down 7% to $411 million from the $443 million witnessed in the prior-year quarter. Selling, general and administrative expenses rose 2% to $137 million from the $134 million incurred in the year-ago quarter.

**Segmental Performance**

**Packaging:** Sales in this segment went down to $1,490 million from $1,535 million in the year-earlier period. Segmental income, excluding special items, came in at $238 million for the reported quarter compared with $290 million witnessed in the comparable period last year.

**Printing Papers:** This segment's revenues declined 5% year over year to $243 million in the quarter thanks to discontinuation of the paper business in the Wallula Mill. Segmental income, excluding special items, improved to $48 million from the $33 million reported in the year-earlier period.

**Cash Position**

At the end of the third quarter, the company had a cash balance of $738.3 million compared with $293.8 million recorded at the end of the prior-year quarter.

**Outlook**

For the fourth quarter, for the Packaging segment the company expects slightly lower prices, a seasonally less rich mix in corrugated products and slightly lower shipments with one less shipping day. Containerboard sales volume is also anticipated to be lower as the company intends to build some inventory prior to year-end in preparation for first-quarter 2020 scheduled maintenance outages at its three largest containerboard mills.

For the Paper segment, volumes are anticipated to be seasonally weaker along with lower average prices. Due to cold weather, energy costs are likely to be higher for the ongoing quarter. Other operating and converting costs are likely to be higher as well, which includes the costs associated with the start-up of the new Richland, WA box plant during the reported quarter. Scheduled maintenance outage costs are anticipated to be higher sequentially. Considering these, the company envisions fourth-quarter earnings at $1.70 per share.

## Valuation

Packaging Corporation's shares are up 25.5% over the trailing 12-month period. Stocks in the Zacks Containers - Paper and Packaging industry is down 19.3% while the Zacks Industrial Products sector is up 21.3% over the past year.

The S&P 500 index is up 25.6% in the past year.

The stock is currently trading at 15.92X forward 12-month earnings, which compares to 16X for the Zacks sub-industry, 18.17X for the Zacks sector and 18.70X for the S&P 500 index.

Over the past five years, the stock has traded as high as 21.37X and as low as 8.94X, with a 5-year median of 14.33X.

Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $116 price target reflects 16.90X forward 12-month earnings per share.

The table below shows summary valuation data for PKG:

**Valuation Multiples - PKG**

| | | Stock | Sub-Industry | Sector | S&P 500 |
|---|---|---|---|---|---|
| P/E F12M | Current | 15.92 | 16 | 18.17 | 18.7 |
| | 5-Year High | 21.37 | 18.95 | 19.88 | 19.34 |
| | 5-Year Low | 8.94 | 7.13 | 12.58 | 15.17 |
| | 5-Year Median | 14.33 | 16.89 | 16.48 | 17.44 |
| P/S F12M | Current | 1.52 | 2.49 | 1.86 | 3.47 |
| | 5-Year High | 1.9 | 5.06 | 2.65 | 3.47 |
| | 5-Year Low | 0.78 | 1.46 | 1.51 | 2.54 |
| | 5-Year Median | 1.33 | 1.79 | 1.95 | 3 |
| EV/EBITDA TTM | Current | 8.2 | 24.68 | 17.04 | 12.01 |
| | 5-Year High | 11.78 | 27.66 | 17.4 | 12.86 |
| | 5-Year Low | 5.8 | 12.71 | 10.89 | 8.49 |
| | 5-Year Median | 8.36 | 15.29 | 14.67 | 10.66 |

As of 01/03/2020

## Industry Analysis **Zacks Industry Rank:** Top 25% (63 out of 252)


## Top Peers

| | |
|---|---|
| Berry Global Group, Inc. **(BERY)** | Outperform |
| Ball Corporation **(BLL)** | Neutral |
| Crown Holdings, Inc. **(CCK)** | Neutral |
| Graphic Packaging Holding Company **(GPK)** | Neutral |
| Sealed Air Corporation **(SEE)** | Neutral |
| Sonoco Products Company **(SON)** | Neutral |
| WestRock Company **(WRK)** | Neutral |
| Domtar Corporation **(UFS)** | Underperform |

## Industry Comparison Industry: Containers - Paper And Packaging

Industry Peers

| | PKG Neutral | X Industry | S&P 500 | IP Neutral | UFS Underperform | WRK Neutral |
|---|---|---|---|---|---|---|
| **VGM Score** | A | - | - | A | B | A |
| Market Cap | 10.34 B | 5.91 B | 23.66 B | 17.54 B | 2.14 B | 11.01 B |
| # of Analysts | 6 | 5 | 13 | 6 | 4 | 6 |
| Dividend Yield | 2.89% | 2.85% | 1.79% | 4.58% | 4.86% | 4.36% |
| **Value Score** | B | - | - | A | A | A |
| Cash/Price | 0.07 | 0.03 | 0.04 | 0.04 | 0.04 | 0.01 |
| EV/EBITDA | 8.26 | 10.75 | 13.88 | 7.43 | 4.25 | 6.59 |
| PEG Ratio | 3.14 | 1.89 | 1.99 | NA | NA | 2.97 |
| Price/Book (P/B) | 3.41 | 2.96 | 3.36 | 2.35 | 0.91 | 0.94 |
| Price/Cash Flow (P/CF) | 8.75 | 8.75 | 13.62 | 5.13 | 3.89 | 4.32 |
| P/E (F1) | 15.69 | 16.49 | 18.74 | 12.13 | 15.31 | 12.72 |
| Price/Sales (P/S) | 1.48 | 1.11 | 2.67 | 0.77 | 0.40 | 0.60 |
| Earnings Yield | 6.28% | 6.08% | 5.32% | 8.25% | 6.54% | 7.87% |
| Debt/Equity | 0.88 | 1.09 | 0.72 | 1.37 | 0.41 | 0.81 |
| Cash Flow ($/share) | 12.49 | 4.77 | 6.94 | 8.72 | 9.63 | 9.89 |
| **Growth Score** | B | - | - | B | C | B |
| Hist. EPS Growth (3-5 yrs) | 16.20% | 11.71% | 10.56% | 12.09% | 5.88% | 14.73% |
| Proj. EPS Growth (F1/F0) | -10.25% | 7.81% | 7.41% | -15.51% | -22.66% | -15.70% |
| Curr. Cash Flow Growth | 21.58% | 19.75% | 14.83% | 22.73% | -42.94% | 9.85% |
| Hist. Cash Flow Growth (3-5 yrs) | 17.00% | 8.06% | 9.00% | 3.57% | 2.56% | 23.04% |
| Current Ratio | 3.28 | 1.62 | 1.23 | 1.49 | 2.28 | 1.45 |
| Debt/Capital | 46.90% | 56.62% | 42.92% | 57.89% | 29.20% | 44.86% |
| Net Margin | 10.94% | 4.55% | 11.08% | 6.03% | 3.82% | 4.72% |
| Return on Equity | 26.92% | 20.02% | 17.10% | 26.97% | 11.17% | 8.81% |
| Sales/Assets | 1.01 | 0.93 | 0.55 | 0.67 | 1.08 | 0.60 |
| Proj. Sales Growth (F1/F0) | -1.93% | 4.52% | 4.20% | -3.23% | -6.12% | -0.29% |
| **Momentum Score** | B | - | - | A | D | C |
| Daily Price Chg | -1.35% | -0.85% | -0.61% | -1.76% | -1.47% | -1.77% |
| 1 Week Price Chg | -0.59% | -0.44% | 0.13% | -0.54% | -1.06% | 0.38% |
| 4 Week Price Chg | -2.79% | 0.63% | 2.60% | -3.87% | -1.16% | 6.75% |
| 12 Week Price Chg | 3.01% | 9.01% | 8.87% | 11.16% | 10.38% | 20.53% |
| 52 Week Price Chg | 31.77% | 17.96% | 29.34% | 10.80% | 7.43% | 11.64% |
| 20 Day Average Volume | 579,084 | 199,266 | 1,603,615 | 2,853,556 | 517,752 | 1,804,302 |
| (F1) EPS Est 1 week change | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| (F1) EPS Est 4 week change | 0.00% | 0.00% | 0.00% | 1.10% | 0.00% | 0.00% |
| (F1) EPS Est 12 week change | -4.50% | -3.22% | -0.57% | -5.19% | -20.53% | -1.03% |
| (Q1) EPS Est Mthly Chg | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | -0.74% |

## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

## Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

## Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

## Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

| | |
|---|---|
| Value Score | B |
| Growth Score | B |
| Momentum Score | B |
| VGM Score | A |

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

## Disclosures

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