ANU Student Managed Fund

Investment recommendation

Orora Limited

ASX code: ORA

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Notes:

All dollar amounts in this report are Australian dollars.

Glossary

AAE – Active Australian Equities

AE – Australian equities

ANU – The Australian National University

APC – Australian Packaging Covenant

CAGR – Compound annual growth rate

Capex – Capital expenditure

CBE – ANU College of Business and Economics

CUB – Carlton United Breweries

CY – Calendar year

DCF – Discounted cash flow

EBITDA – Earnings before interest, tax, depreciation, and amortisation

ESG – Environmental, Social and Governance

ETF – Exchange traded funds

FY – Financial year

GICS – Global Industry Classification Standard

IAC – Investment Advisory Committee

IC – Invested capital

IWSR - International Wine and Spirit Research

IOZ – iShares Core S&P/ASX 200 ETF

MoS – Margin of safety

NOPLAT – Net operating profit less adjusted tax

OPS – Orora Packaging Solutions

OV – Orora Visual

PCP – Prior comparable period

PMI – Purchasing Managers' Index

Premium+ – "Premium" and "Super-Premium" alcohol

R&C – Risk and Compliance

RBA – Reserve Bank of Australia

RoAFE – Return on average funds employed

ROI – Return on investment

ROIC – Return on invested capital

RSFAS – Research School of Finance, Actuarial Studies, and Statistics

RT – Relationship Team

SAP – Systems, Applications and Products

SME – Small to medium enterprise

SMF – ANU Student Managed Fund

SRI – Socially responsible investment

WACC – Weighted average cost of capital

YoY – Year on year

Portfolio recommendation

We recommend that the Student Managed Fund (SMF) establish a **10% weighting** in Orora Limited (ORA) within the Active Australian Equities (AAE) portfolio, funded by reducing holdings in the iShares Core S&P/ASX200 ETF (IOZ).

Investment thesis

Orora Ltd (Orora) is a global manufacturer and distributor of packaging products comprising of three segments: Australia, North America (OPS) and Saverglass. The Australia segment delivers aluminium cans and glass bottles to alcohol and non-alcohol beverage manufacturers. The OPS segment delivers corrugated boxes, closures, recycled paper linerboard, pop-up displays and supply-chain optimisation products. Saverglass is a recently acquired, global manufacturer of "premium" and "super-premium" (premium+) glass alcohol bottles.

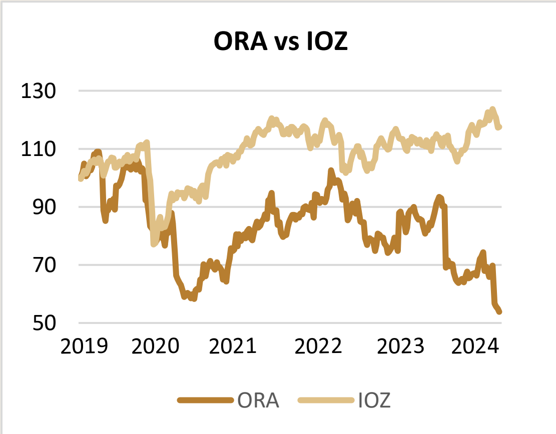
Orora is currently trading at $2.18, which is near its 52-week low. Following a downgrade to both OPS and Saverglass' FY24 earnings on April 14th, Orora's share price fell 25%. The OPS downgrade was due to volume softness reflecting weak demand in the US manufacturing sector, and the Saverglass downgrade due to downward pressure on demand as spirit and wine manufacturers are experiencing destocking.

OPS is undergoing a strategic shift towards a lower quantity of higher-margin contracts; and Saverglass is experiencing growth in consumer demand for its premium+ spirit and wine bottles despite its short-term subdued earnings as their primary customers (manufacturers) work through their excess inventories. This presents an opportunity to leverage the Fund's ability to outlast other investors for future cash flows with a high degree of visibility. To this effect, Orora provides more value to the investor profile of the SMF relative to the general market, and how it's been priced. Our DCF analysis produces a valuation of $2.58 per share, implying a MoS of 18.35%.

AUSTRALIA
ASX code: ORA

Price (at 07/05/2024)	$2.18
Valuation	$2.58
Margin of safety (MoS)	18.35%
Dividend yield (FY24F)	4.10%
EPS (24F/25F/26F)	15.9c/15.7c/18.2c
GICS	Materials
52-week range	$2.06 - $3.67
Recommendation	**Buy**
Key assumptions	
Required return on equity	9.09%
WACC	7.34%
Carbon intensity	
ORA	135.20
ASX200	163.28

Five-year price history



Our investment thesis is underpinned by the following considerations:

- Defensive and resilient cash flows from a diversified product portfolio across global markets.
- Strong competitive position in respective industries.
- Strategic capital expenditure projects driving future growth.
- Continued margin-accretive efficiency initiatives.

The key risks taken into consideration are:

- Uncertainty surrounding Saverglass integration.
- Sustained underperformance in OPS driven by structurally softer manufacturing demand.
- Elevated leverage following the Saverglass acquisition, stifling balance sheet flexibility.

Key upsides

Diversified and resilient cash flows

Orora's stable cash flows are attributable to group earnings being diversified across both products and services, as well as geographically within their global manufacturing and distribution networks. Underpinning cash flow resilience is Orora's customisation capabilities, making its products accessible to new customers in the market at all price points. Through this adaptable, multilayered approach to constructing earnings quality, Orora is well-positioned to maintain and capture new market share in its respective segments.

Australia

Since the A$1.72 billion divestment of their Australian Fibre business in FY20, the Australia segment has performed strongly. Streamlining Australian manufacturing into glass and aluminium allowed the segment to achieve a top 2 market position with large, reliable brand customers such as Coca-Cola, Carlton United Breweries (CUB) and Treasury Wine Estates. This strong market position was reflected in FY23 segment revenue increasing 14.1% YoY driven by net volume growth and price increases, alongside input cost pass-through strategies. Demand for canned beverages is expected to grow at a 1.92% CAGR over the next five years, and non-alcoholic canned beverages (73% of canned revenue) at 2.2% according to International Wine and Spirit Research (IWSR) and Ibisworld. With this increasing demand, Orora's canning lines are operating at 100% utilisation, including the recently commissioned Dandenong canning line. Orora's 60% market share presents an appealing future cash flow stream, aided by the high switching costs in this industry. In the glass market, Orora has faced recent volume softness due to weakened demand for beer and wine. Largely contributing to this has been the Chinese wine tariffs, with exports to China falling from 142 million litres in 2019 to 12 million litres in 2022. While demand is not expected to reach pre-tariff levels, Orora's 66% market share leaves them poised to capitalise on the renewed demand from tariff removals. Despite the positive figures regarding the growth in demand for packaged beverages, the risk of persistent high inflation suppressing household budgets is an ongoing concern that will be monitored going forward.

OPS

OPS faces cash flow challenges due to recent volume softness which is expected to persist until FY25. OPS revenue is strongly correlated with the US manufacturing Purchasing Managers' Index (PMI), which exceeded the growth threshold of 50 in March 2024 for the first time in 17 months (although April figures fell back below 50). Strategy changes, including expanding into Mexico and growing US sales forces aim to drive revenue growth and margin expansion. OPS' return on average funds employed (RoAFE) has risen consistently since FY21, reaching 22.3%, significantly higher than the pre-COVID level of 12.6%, demonstrating successful strategy implementation thus far. The segment's EBIT margin has grown at least 30bps annually since FY21, reflecting efficient cost-cutting measures. The recovery of the North American manufacturing industry will be underpinned by increased consumer demand. Seasonally adjusted consumer credit expanded from 0.8% annualised growth in December 2023 to 3.4% in February 2024. OPS maintains long-term customer relationships with an average customer tenure of 12-14 years, owing to high switching costs and OPS' specialised packaging capabilities, which allows them to produce custom-designed packaging, even in short runs, and maintain profitability. This specialised packaging accounts for 65% of OPS revenue.

Saverglass

Saverglass maintains a 33% market share in the global premium alcohol bottling industry. Since FY21, the company has achieved an average annual revenue growth of 18.9%, accompanied by a steady 6% average growth rate in volume over the past 15 years. Its competitive advantage lies in its highly customisable proprietary bottle range, which has fostered enduring partnerships with top-tier brands such as Grey Goose, Hendrick's and Chivas Regal. Despite the lower volumes driven by the customers' destocking their inventory, the underlying consumer demand for premium+ spirits and wines is expected to grow annually at 560bps and 180bps respectively through FY26 (IWSR). Saverglass has strategically responded to this growing demand by establishing two Acatlán Mexico furnaces for premium tequila bottles in 2018 and 2023. Tequila represents Saverglass' fastest growing customer base with a 13.4% brand-name CAGR from 2016-2022 (followed by vodka at 11.8%). Given that Saverglass' customer base is catering to consumers of higher-disposable income, inflation is viewed as less of a threat to this segment of the company. Saverglass' international scale provides mitigation against fluctuation of local input price swings. The seven manufacturing plants across four continents serve customers in over 100 countries and further supports the stability of their cash flows.

Advantageous competitive positioning

The packaging services industry is characterised by high capital requirements, creating high barriers to entry, and protecting existing firms from the threat of new market entrants. Orora experiences high customer loyalty as high switching costs for customers (due to supply chain integration and customisation contracts) diminishes both the bargaining power of customers and the threat of substitution across all segments. Orora's customisation abilities is another competitive advantage in all segments of the business. Orora's accessibility for short-run projects such as the AFL Championship cans, sets them apart in the market as their scale enables them to offer such products profitably.

Both Orora Australia and Saverglass face a low threat of substitution due to their emphasis on environmental and sustainability measures. Plastic, the primary substitute for glass and aluminium packaging, is encountering societal resistance due to its environmental impact, thus posing minimal threat to Orora's products. With regards to customer bargaining power, across the group no single customer accounts for greater than 5% of revenue, limiting the impact of customer bargaining power on cash flow stability. Saverglass' proprietary bottle range and premium manufacturing capabilities allows it to experience low competitive rivalry. Orora Australia, while holding a significant market share, encounters moderate rivalry with competitors including Visy and Amcor. The Australian segment protects and grows its market share through its specialisation capabilities and strong ongoing customer contracts. The threat posed by competitive rivalry is highest in North America, as OPS faces larger firms with greater scale and pricing power in package manufacturing and distribution. Orora's focus on custom solutions and ownership of patented goods, such as the Flexi-Hex sleeve, sets the company apart from generic packaging companies which helps to mitigate the risks to OPS' current market share.

Both Orora's Australian and Saverglass segments source inputs from global aluminium and silica markets, reducing reliance on individual suppliers and mitigating supplier bargaining power. Orora passes on aluminium price changes directly to customers through their contracts, ensures minimal impact on can margins. Though this agreement doesn't extend to the glass division, Orora maximises glass sourcing through government recycling schemes, while a historically steady global silica supply has aided stability in input prices. Similarly, in the OPS segment, Orora sources inputs from the global paper and pulp market, diversifying supplier risk.

Strong capital expenditure to support growth

Following the sale of its Fibre business in FY20, the Australia segment has prioritised expanding can capacity and customisation, investing over $250 million in growth capex since then. Notable investments include two $85 million additional canning lines in Dandenong and Revesby, each increasing can capacity by 10% and returning a minimum ROI of 15% according to management. Furthermore, these investments are expected to yield an additional $30 million in earnings by 2028. Orora has also enhanced customisation capabilities for can customers, with the completion of the Helio project enabling digital can printing, thereby increasing capacity and expanding margins, especially for short-run projects. In addition, Orora has invested in its glass manufacturing by constructing an oxygen plant, a $27.5 million investment subsidised by the Government to reduce carbon footprint and control costs. Both Orora's Australian and Saverglass segments require high maintenance capex, with furnace rebuilds required every 15 years at an approximate cost of $85 million each, resulting in yearly maintenance capex exceeding $125 million.

In the OPS segment, there has been a focus on expanding OPS's operating footprint further into Mexico. Recent capital expenditure in this segment includes consolidating the Tijuana facilities into Orora's single largest distribution site, the relocation of the Juarez facility and the addition of the Salamanca facility. These have collectively increased holding capacity and enabled greater on-site design capabilities. In addition, there have been improvements in operating efficiency since FY20 due to Orora's investment in Systems, Applications & Products (SAP) implementation. These efficiency improvements have contributed to a 310bps improvement in the OPS EBIT margins since FY20. The doubling of sales representatives to over 30 in Mexico in 1H24 offers OPS an opportunity to reach new customers, growing the potential for an additional earnings source as OPS increases their Mexican market share, an industry worth $1.5 billion.

Saverglass has significantly expanded its capacity to address rising demand, investing $735 million in capex over the last 5 years. This includes constructing a second furnace in Mexico for $150 million and acquiring and rebuilding the Belgian Ghlin furnace for $85 million. Strategically located near major alcohol producers, Saverglass plants minimise transport costs. Orora's recent acquisition positions it to leverage the substantial investments made by Saverglass, enhancing its market share.

Efficiency initiatives driving margin expansion expectations

Orora's management has indicated several measures implemented to increase operational efficiency and to expand margins across all three segments. OPS is the key focus for such margin expansion strategy as the segment historically has lower EBIT margins averaging just 4.6%, relative to 15.7% in the Australia segment, and 13.5% in Saverglass in FY23.

The OPS growth strategy is underpinned by evolving sales resources through SAP implementation to target margin improvements. With OPS's earnings contingent on low-margin contracts, management responded with an initiative to stop servicing low margin customers in FY23. Investment in a new sales force of more than 70 hires in the last 18 months has given OPS the opportunity to expand its customer base, partially offsetting losses from the low-margin customer churn. While this shift has contributed to a 4.9% decrease in OPS revenue, it coincides with an incremental EBIT margin accretion of 100bps from 4.9% in 1H23 to 5.9% in 1H24. Additionally, SAP implementation was introduced in FY21 to better harness real-time data and expand digital tools for per-account profitability and pricing strategies. The realisation of this investment is reflected in the 220bps increase in OPS' EBIT margin between FY21 and 1H24, contributing to segment RoAFE growth from 15.0% to 22.3% in this period. Due to the current transitionary nature of the OPS segment and low revenue expectations, we expect margins to slim significantly in 1H24, with recovery in 2025 and sustained expansion over the following 4 years of our forecast period. This delay in margin improvement is primarily due to the time lag associated with investment in margin-accretive software and digital capabilities being utilised effectively, and the two-year training period for each additional sales member employed. OPS management has had prior success in margin expansion projects, demonstrated by the recent expansion of the EBIT margin from 2.8% in FY20 to 5.9% 1H24. This information collectively drives our conservative expectations of a recovery to at least the current margin of 5.9% (which is the segment's all-time high), with positive future earnings in the segment once these changes are realised post-FY25.

Orora Australia's EBIT margin has remained steady since the sale of the Fibre business in FY20, oscillating between 14.8% and 18.6%, and currently sits at 15.7%. In the short term, we expect margins to slim substantially in Australia to 13.5% in 2H24. This comes as a result of expected glass volume softness in Australia, and cans increasing as a proportion of revenue. Additionally, the G3 furnace rebuild at an estimated cost of $16 million has been expensed rather than capitalised by management, which puts downward pressure on margins until its completion in 2H24. From FY25 until FY28 though, margin expansion is anticipated as the removal of Australian wine tariffs by the Chinese government will bolster glass volumes, since glass products have a greater margin than cans. In addition, management has indicated that the cans volume mix will be improved as slimline can demand has increased, made evident by Orora's slimline installation at Revesby operating at full capacity. Orora Australia is also insulated against an increase in input costs. Orora has a contracted agreement with cans customers that any dollar cost increase in the price of aluminium will be passed onto the customer in full. Whilst this does not fully protect margins, it means that they have remained resilient against aluminium price increases. This is demonstrated by the contraction of only 2% in margins from 2020 to 2022, while the aluminium price rose by 50% over the same period. With futures prices indicating that aluminium is expected to increase at a CAGR of 4% over the next five years, we have moderated our long-term EBIT margin forecast at 15%, below the current margin and lower than the margin has ever been since the sale of the Fibre business. In addition, Orora is positioned to benefit from any potential decreases in aluminium prices, exhibited in 1H24, where aluminium cost decreases contributed to a margin expansion of 70bps. Orora sources its glass from government recycling schemes, and the global silica market. Management has highlighted that the cost of glass inputs is negligible, and for glass products, the transportation of silica and glass to the furnace is more expensive than the inputs themselves.

Saverglass' EBIT margin is currently 11.9%, down from 13.5% prior to the acquisition. We anticipate that destocking will persist beyond management expectations - well into FY25, with our margin forecasted to be 11% in FY25. Beyond FY25, Saverglass is in an ideal position for margin expansion, as cost reduction synergies from the acquisition are able to be realised. This includes, according to management, a minimum $15 million in cost reduction synergies arising from Saverglass' integration into the Gawler glass plant. With Saverglass being privately operated until it was acquired by Orora in 2023, financial reporting data is scarce. As such, we have tempered our expectations going forward - we anticipate Saverglass' margins to recover a long-term figure of 12.5%, below the margin prior to the acquisition.

Risks to recommendation

Saverglass integration

Orora's acquisition of Saverglass was conducted on an EV/EBITDA multiple of 7.7x, at a value $2.16 billion. Such growth strategy by acquisition represents a risk for Orora, and Saverglass has largely underperformed both market and management expectations since the acquisition.

Destocking

In April 2024, management informed the market that Saverglass earnings were to be 14% lower than previously expected in FY24, resulting in a 25% decrease in Orora's market value over the following two weeks. The downgraded earnings expectations are attributed to the slower than expected destocking process being undertaken by Saverglass customers. Upon acquisition, management had indicated that they expected the destocking process following strong pandemic-induced growth to have been completed by "early calendar 2024", but this expectation has now been pushed back to mid-calendar 2024. With management's failure to foresee destocking lasting as long as it has, we are pessimistic regarding their revised expectations, and have modelled destocking to continue to early CY25, with the possibility that destocking will continue beyond this date.

Realising synergies

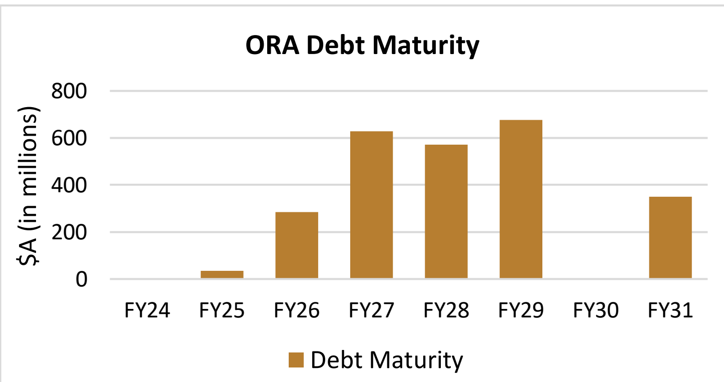
There are also company-specific risks regarding the Saverglass acquisition, including their ability to realise the expected synergies. Management announced a minimum of $15 million in cost reductions through the integration of Saverglass into the Australian Gawler plant. Additionally, there is opportunity for Orora to leverage existing supply networks and customers in the North American market to further engage Saverglass' presence in the region. However, there is a risk that these efficiencies and benefits are overstated by management and fail to materialise.

Sustained underperformance in OPS

Recently OPS has underperformed, with negative revenue growth of 15.9% to the prior comparable period (pcp) in 1H24, and 5.9% revenue decline in FY23. Management has cited these results are due to a combination of their margin expansion strategy, price deflation, and broader softness in the manufacturing sector. While the March PMI index rose above 50 for the first time in 17 months, April figures fell below the growth benchmark to 49.2. Sustained contraction in the manufacturing sector creates a risk to OPS, as a reasonable proportion of their revenue is derived from servicing customers producing durable goods. OPS is also exposed to reduced aggregate consumption more broadly. During the pandemic, OPS had a goodwill write-down of $86 million in the Orora Visual (OV) sub-segment, as it is heavily reliant on in-store shopping to drive revenue. This also presents a concern for the risk of persistent high inflation in North America which would suppress consumer spending and slow the recovery of the manufacturing sector. Overall, we view the OPS segment as vulnerable to a subdued long-term growth rate in the American economy.

Elevated leverage following Saverglass acquisition

Orora's acquisition of Saverglass added a further $850m in debt, bringing net debt to $1.7 billion and leverage to 2.6x Net Debt/EBITDA, with this expected to increase to 2.8x by the end of FY24. This will leave their balance sheet constrained in the short-term as they de-lever themselves through FY25, before $285 million and $628 million of debt matures in FY26 and FY27 respectively. With ample headroom to debt covenants (can withstand up to 4.4x Net Debt to EBITDA) and a 4.18x interest coverage ratio, we don't anticipate any serviceability issues. Rather, we recognise the risk of Orora's balance sheet being inflexible in a period where continued capital expenditure remains important to meeting shifting consumer demands. Orora also has $600 million of undrawn liquidity accessible, ensuring short-term stability in their working capital accounts.



Model summary

Orora is divided into three distinct segments in valuation, given each segment has unique and varying cost and revenue drivers. Our group revenue forecasts are conservative, as we expect revenue growth to settle below historical averages. Margin forecasts through FY28 are below current levels in all segments except for Saverglass, while ROIC also remains below historical averages.

The Australian segment revenue is modelled using a weighted average of macro factors which have a strong correlation to ORA's revenue as determined through a regression analysis, a forecast of the future demand for varying beverage types and their proportion of revenue, a forecast of the canning and bottling industry sizes, and the incorporation of the expected revenue from the recent capex projects. This produces a forecasted average growth rate of 4.55% through FY28 in this segment, below the historical average of 5.13%. For the OPS segment, we also used a weighted average of macro factors strongly correlated to OPS revenue including e-commerce revenue, the PMI, and the size of the US corrugated boxed market, before moderating these figures below the industry growth rate until FY27 to reflect the difficulties OPS is experiencing. By FY27, the process of churning through low-margin customers is expected to be completed, and the effects of sales force growth and expansion into Mexico will be realised. In the Saverglass segment, we forecast the revenue based on IWSR forecasts on premium spirits and wines. In addition, we factored in the effect of destocking by customers, and extended the effects of the destocking into halfway through FY25. Our Saverglass forecasted CAGR of 4.58% falls below the historical average of their 6% volume growth rate since FY08 (volume growth being the only available metric pre-acquisition).

When forecasting margins, due to the lack of data provided regarding the geographical cost structure of the business, we forecast EBIT margin for each segment directly. Australian margins were forecasted by incorporating aluminium price, product mix and revenue, and we estimate a long-term EBIT margin of 15%, below the current margin of 15.7%. We feel that 15% is conservative and is lower than the margin has been since of the sale of the Fibre business in FY20. OPS margins were estimated by incorporating our revenue forecasts, as well as our estimation of the success of management's margin expansion strategy going forward. We forecast a long-term EBIT margin of 5.9%, equivalent to that of today. We feel that this is a conservative figure considering management's recent success in margin accretive projects, being able to increase EBIT margin from 2.8% in FY20 to 5.9% in FY24H1. In the Saverglass segment, EBIT margin prior to acquisition was 13.5%, and is currently 11.7%. Management has indicated that the destocking will likely end halfway through CY24, but we have assumed that it will finish beginning CY25. We expect margins to expand marginally beyond FY26 and stabilise at 12.5%, as cost reduction synergies are realised, and revenue growth remains positive.

For capital expenditure, we modelled both base and growth capex to peak in FY25 at $245 million before settling at $200 million by FY28. This is informed by several key projects expected to finish by the end of FY25, such as the Revesby second canning line and Saverglass furnace rebuild. The model produces a ROIC between 9.53-13.86% excluding goodwill as returns from current elevated capital expenditure are realised. This is compared to a historical average of 15.07% and relative to a WACC of 7.34%. Due to the potential risks from Orora's acquisition of Saverglass, we added a 1% premium to the SMF's required rate of return for our model's cost of equity, resulting in a cost of equity of 9.09%. Additionally, we adopted a debt premium of 2% for their cost of debt resulting in a post-tax cost of debt of 4.62%.

Scenario analysis

ORA Three-Segment Scenerio Analysis

		OPS Bear Case			OPS Base Case			OPS Bull Case		
		Australia			Australia			Australia		
		Bear	Base	Bull	Bear	Base	Bull	Bear	Base	Bull
Saverglass	Bull	$2.28	$2.51	$2.79	$2.65	$2.86	$3.16	$2.75	$2.96	$3.25
	Base	$2.01	$2.21	$2.51	$2.37	**$2.58**	$2.89	$2.47	$2.68	$2.98
	Bear	$1.84	$2.04	$2.34	$2.20	$2.40	$2.71	$2.30	$2.50	$2.81

In the context of valuing companies as an expected outcome in a distribution of possibilities, having bear, base and bull cases for each of the three segments is deemed most appropriate. Each segment has substantially different factors contributing to their respective performance, and these factors are largely independent of each other. Full details of the assumption changes made for each scenario can be found in appendix H, but we note these scenarios are specifically designed to reflect the potential results of tangible events in the future, and the different combinations of them with each other. The scenario analysis implies that for the DCF valuation to be below the current market price, OPS and at least one other segment must be in the bear case with no segments being in the bull case.

SRI considerations

Orora does not breach the SMF's SRI policies and presents a case for preferential investment due to its climate action advocacy, active integration into the circular economy, emphasis on governance, and commitment to promoting social benefits. Orora ensures all aluminium used in production is 100% recyclable. Orora targets 60% recycled content in glass beverage containers, exceeding industry standards. As the SMF sets a standard to have a combined portfolio carbon intensity of greater than or equal to 30% less than the ASX200, concerns can be mitigated with respect to Orora as a carbon-intensive manufacturer. A 10% weighting in the stock would keep the SMF's equity portfolio 69% less carbon intensive than the ASX200, a testament to Orora's industry leading governance stance on climate change. The board shows promising long-term stances too, maintaining a code of conduct, anti-bribery, and whistleblowing policies to promote ethical conduct, thus representing sound governance. No evidence has been found regarding social violations related to human rights or labour practices concerning the conglomerate.

The SMF saw a unanimous vote to endorse Orora as a buy recommendation with consideration to the Fund's exclusion policy. While Orora produces packaging for the alcohol beverage sector, their involvement is strictly as a packaging supplier, not a direct manufacturer or seller of alcohol, maintaining alignment with statute 4.1 of the SMF SRI Policy. Alcohol-related packaging represents only a sub-segment within Orora's diverse product offerings. Our estimates suggest that less than 28% of the company's total revenue is derived from alcohol-related products. This indicates that their core business operations are not predominantly focused on alcohol; their focus on packaging neutrality distances them from the direct promotion or sale of alcohol. The SMF's alcohol exclusion policy is to avoid directly supporting companies whose primary business model centres on alcohol production and sales - Orora's role as a packaging supplier falls outside this direct revenue link.

Valuation summary and recommendation

Our discounted cash flow (DCF) model generates a base case valuation of $2.58. This valuation provides a MoS of 18.35%. Our scenario analysis is outlined in appendix H and provides a bull case valuation of $3.25 and a bear case valuation of $1.84. As a sense check, a weighted multiples valuation was conducted in appendix J with a valuation of $2.51 being produced, yielding a 15.10% MoS.

Valuation Summary	**Bear case**	**Base case**	**Bull case**
Share price (26/04/2024)	$2.18	$2.18	$2.18
Valuation	$1.84	**$2.58**	$3.25
Margin of safety	-15.60%	**18.35%**	49.08%
Required return on equity	9.09%	9.09%	9.09%
Cost of debt (after tax)	4.62%	4.62%	4.62%
WACC	7.34%	7.34%	7.34%

Orora offers sustainable cash flows from diversified exposures to stable markets. Despite experiencing a temporary softening in demand and destocking effects, Orora is undervalued based on its fundamental cash-flow earnings, presenting it as an attractive investment opportunity for the fund. In conclusion, **we recommend that the SMF establish a 10% weighting in ORA within the AAE portfolio**, funded through the sale of our holdings in the iShares Core S&P/ASX200 ETF (IOZ).

Appendices

Appendix A: Key financial summary

Financial year ($ million)	2021(A)	2022(A)	2023(A)	2024(E)	2025(E)	2026(E)	2027(E)	2028(E)
Total revenue	3538	4091	4291	4646	5054	5192	5389	5604
Revenue growth	-0.8%	15.6%	4.9%	8.27%	8.76%	2.73%	3.80%	4.00%
Adjusted EBITDA	366	400	437	507	607	652	692	732
Adjusted EBITDA margins	10.3%	9.8%	10.2%	10.9%	12.0%	12.6%	12.8%	13.0%
NOPLAT	191	232	282	212	294	321	347	376
NOPLAT margin	5.41%	5.67%	6.56%	4.57%	5.82%	6.19%	6.43%	6.72%
Invested capital (ex. goodwill)	886	991	1239	2528	2582	2644	2689	2735
Invested capital (inc. goodwill)	1531	1667	1932	4388	4448	4517	4567	4620
ROIC (ex. goodwill)	21.60%	23.3%	22.72%	9.53%	11.46%	12.23%	12.98%	13.86%
ROIC (inc. goodwill)	12.50%	13.9%	14.57%	5.20%	6.66%	7.16%	7.65%	8.21%
Free cash flow	281	96	17	-45	233	253	296	324
IC turnover (ex. goodwill)	3.99	4.13	3.46	2.08	1.96	1.96	2.00	2.05
EPS (c)	11.97	25.68	24.93	15.91	15.66	18.23	20.70	23.30
Financial year	**2029(E)**	**2030(E)**	**2031(E)**	**2032(E)**	**2033(E)**	**2034(E)**	**2035(E)**	**2036(E)**
Total revenue	5744	5887	6035	6185	6340	6499	6661	6828
Revenue growth	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%
Adjusted EBITDA	756	775	794	814	834	855	877	899
Adjusted EBITDA margins	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%
NOPLAT	374	383	393	403	413	423	434	445
NOPLAT margin	6.72%	6.72%	6.72%	6.72%	6.72%	6.72%	6.72%	6.72%
Invested capital (ex. goodwill)	2896	2968	3043	3119	3197	3276	3358	3442
Invested capital (inc. goodwill)	4781	4853	4927	5003	5081	5161	5243	5327
ROIC (ex. goodwill)	13.86%	13.86%	13.86%	13.86%	13.86%	13.86%	13.86%	13.86%
ROIC (inc. goodwill)	8.21%	8.21%	8.21%	8.21%	8.21%	8.21%	8.21%	8.21%
Free cash flow	332	340	348	357	366	375	385	394
IC turnover (ex. goodwill)	1.98	1.98	1.98	1.98	1.98	1.98	1.98	1.98
EPS (c)	23.10	23.94	24.81	25.71	26.65	27.62	28.62	29.66

Appendix B: SRI review

Environmental

Orora Limited's environmental measures focus on reducing greenhouse gas emissions and promoting a circular economy. The company aims to achieve net zero scope 1 and 2 emissions by 2050, from a 2019 baseline. This will be achieved by combining energy, waste, and risk management tactics and leveraging technology. Orora has a medium-term target to reduce scope 1 and 2 emissions by forty percent by 2035. In FY23, Orora began examining and implementing Scope 3 emission measures. These phased goals and scientific standards align with global sustainable development benchmarks. The company recognises that climate change poses risks to its future profitability. Therefore, it continually re-examines the sustainability landscape to identify emerging risks and opportunities to determine how it can best approach those of greatest importance to Orora.

Orora places great importance on recycling content, packages, and substrates. 100% of the aluminium they use in their manufacturing processes worldwide is recyclable. The company's target is to reach 60% recycled content for glass beverage containers, exceeding the 50% target set by the Australian Packaging Covenant (APC) organisation. To date, Orora's recycling rate has reached 38%. Orora has also implemented measures to minimise waste and pollution.

Social

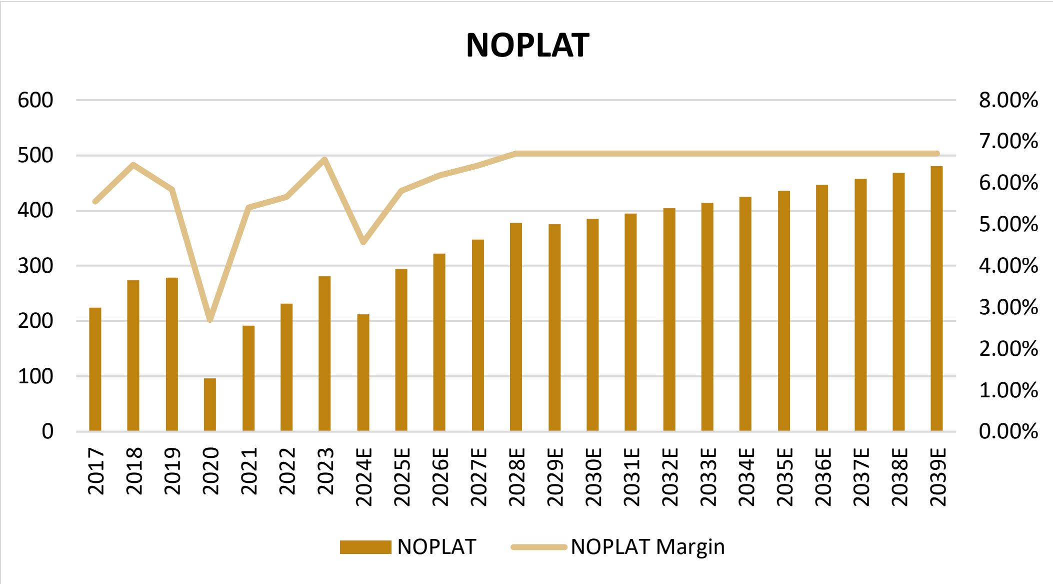
Orora has not breached any regulations pertaining to human rights or labour practices. Orora demonstrates a strong commitment to health and safety, guided by their Global Health & Safety Strategy which aligns with international standards. They transparently report progress, actively manage risks, prioritise serious injury prevention, and involve stakeholders in strategy development. The recent increase in minor injuries highlights the need for continued focus on incident prevention. Orora proactively addresses Modern Slavery risks with a board-approved Modern Slavery Statement, risk assessments in Mexico and China, and a new supplier onboarding process designed to ensure ethical alignment. Company-wide training on Modern Slavery and human rights demonstrates a commitment to awareness and responsible sourcing. Orora's Supplier Code of Conduct and Ethics Policy sets clear expectations for ethical practices and respect for human rights within its supply chain. Their Supplier Assessment Framework, complemented by tools like Sedex and EcoVadis, helps proactively identify and mitigate potential risks. Failure to address identified risks could jeopardise supplier relationships with Orora. Orora's board gender diversity of 33.33% exceeds the average of comparable domestic competitors, showcasing inclusion at leadership levels. Orora’s 8.4% gender pay gap falls marginally outside the ±5% range of acceptability. Orora upholds strong ethical standards by abstaining from any involvement or investment in the manufacture or sale of weaponry.

Governance

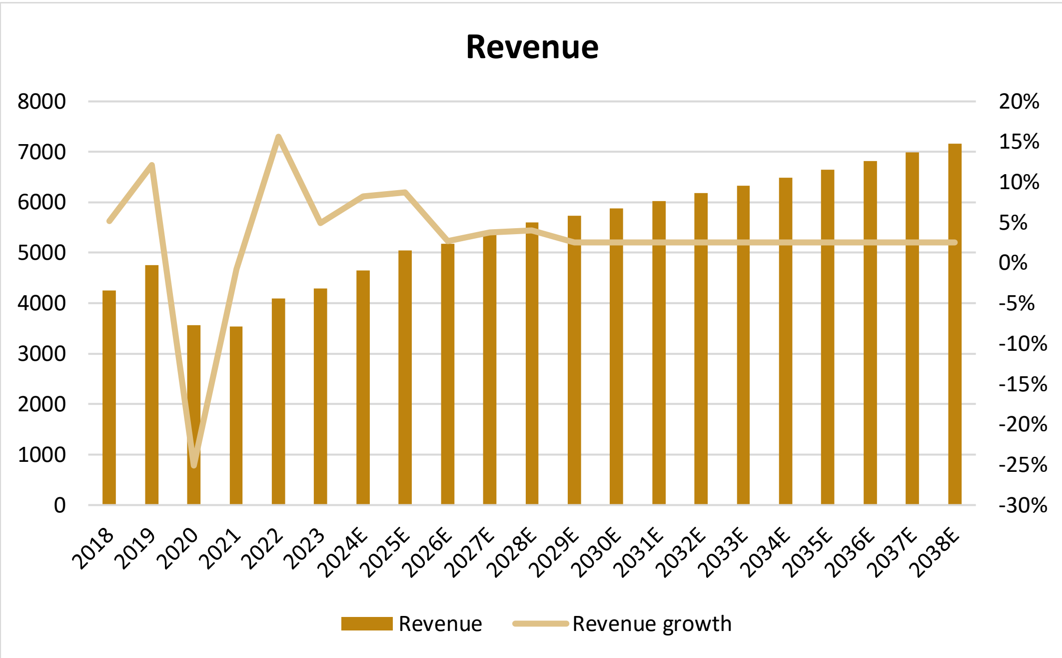
Orora promises to continue to refine their governance framework and practices to ensure they meet the interests of shareholders and other stakeholders. 83% of directors on the board have industry experience, providing a strong foundation for Orora's progress. The board also includes 33% female representation to promote gender diversity. Further, Orora’s board includes over 83% independent non-executive directors to guarantee independence. Orora meets its disclosure obligations and keeps the market fully informed of material information. Orora's Code of Conduct and Ethics Policy emphasises a culture of integrity and ethical conduct, evidenced by independent anti-bribery, anti-corruption and whistle-blower policies. Team members and third parties can report suspected misconduct by directors, strengthening oversight of directors' conduct. The board of Orora has developed procedures to assist directors to disclose potential conflicts of interest and all non-executive directors complete independence declarations every year. This avoids the potential bias in decision making.

Appendix C: Model inputs

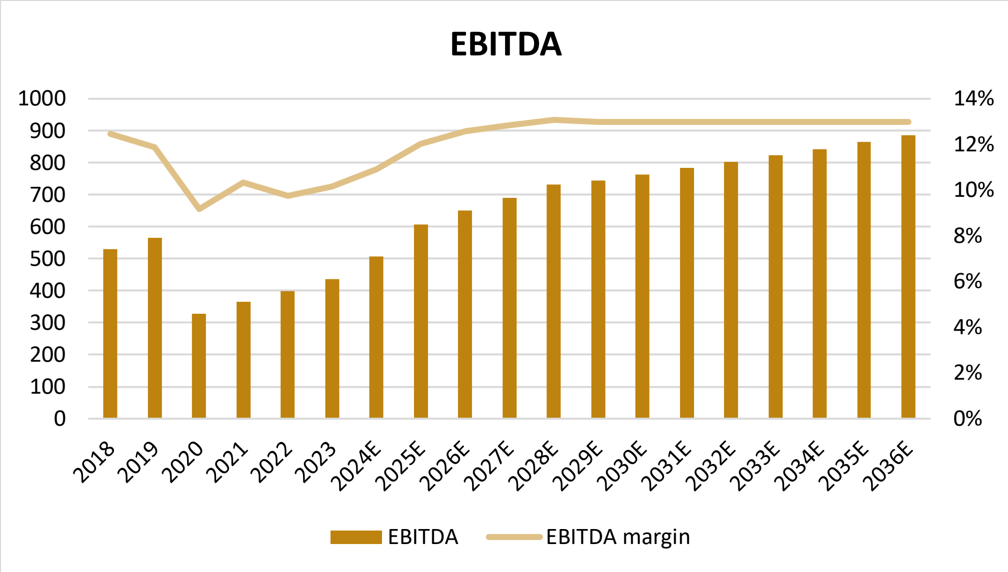
Base Case NOPLAT Forecasts



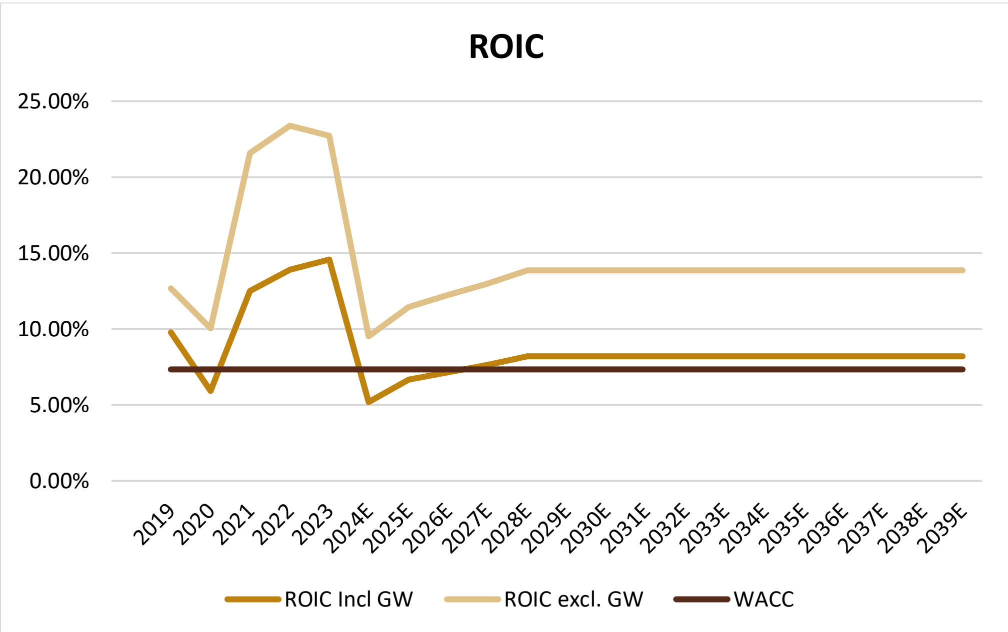
Base Case Revenue Forecast



Base Case EBITDA Forecast



Base Case ROIC Forecast



Appendix E: Revenue growth per segment

Segment	FY24(E)	FY25 (E)	FY26(E)	FY27(E)	FY28(E)
Australia	3.91%	5.17%	5.79%	2.83%	4.40%
OPS	-12.24%	0.0%	1.0%	4.0%	3.4%
Saverglass	24H1 revenue undisclosed	-4.0%	2.5%	4.3%	5.3%
Total growth	8.75%	9.19%	2.72%	3.80%	4.00%

Appendix F: EBIT margin forecast by segment

Segment	2024H1(A)	FY24(E)	FY25 (E)	FY26 (E)	FY27(E)	FY28(E)
Australia	15.70%	13.50%	13.75%	14.25%	14.75%	15.00%
OPS	5.9%	4.7%	5.4%	5.5%	5.8%	5.9%
Saverglass	11.70%	10.50%	11.0%	12.0%	12.0%	12.5%

Appendix G: Decomposition of revenue forecast

Base Case Australia segment revenue forecast decomposition

Key drivers	Weighting	2H24 (from H1)	FY25	FY26	FY27	FY28
Macro factors	10%	0.15%	2.17%	2.98%	2.91%	2.72%
Industry growth	60%	0.85%	2.31%	3.12%	1.97%	2.34%
Cans specific drink forecast	30%	2.27%	2.28%	2.79%	2.26%	2.14%
Effect of Capex ($million)	40% of expected increase in revenue incorporated – we feel the rest is incorporated in the industry + can forecasts	1.2	12.70	44.03	76.88	86.62
Total growth		3.6%	5.17%	5.79%	2.83%	4.40%

Note 1- If effects of CAPEX are not included, our target price is $2.46 (MoS 12.68%).
Note 2 - The macro factors included were: GDP growth and aluminium price growth weighted (we assume that Orora captures 80% of price increases).

Base Case OPS Packaging sub-segment revenue forecast decomposition

Key drivers	Weighting	2H24 (from H1)	FY25	FY26	FY27	FY28
Corrugated Cardboard growth	70% 24H2, FY25 70% onward	0.4%	0.8%	0.8%	0.8%	0.8%
E-commerce	5% 24H2, FY25 20% onward	5.7%	9.3%	13.1%	10.1%	7.8%
USA GDP growth	5% 24H2, FY25 10% onward	0.8%	1.8%	2.1%	2.1%	2.1%
PMI index	20% 24H2, FY25 0% onwards (lack of data)	4.6%	2.0%			
Total packaging revenue growth		1.8%	1.9%	4.5%	3.6%	2.9%

Base Case OV sub-segment revenue forecast decomposition

Key driver	Weighting	2H24 (from H1)	FY25	FY26	FY27	FY28
USA PoP display revenue	100%	3.4%	5.1%	8.4%	6.8%	5.8%

Base Case OPS segment revenue forecast decomposition

OPS revenue growth	2H24	FY25	FY26	FY27	FY28
Includes adjustments to reflect customer churn	-3.0%	0.0%	1.0%	4.0%	3.4%

Note – OPS packaging assumed to account for 80% of OPS revenue, and OV as 20% - consistent with 2021 figures.

Base Case Saverglass segment revenue forecast decomposition

Key drivers	Weighting	2H24	FY25	FY26	FY27	FY28
Premium wine demand	35% until 2027	0.9%	1.8%	1.8%		
Premium Spirits demand	65% until 2027	2.3%	5.6%	5.6%		
Premium alcohol demand	100% from 2027				5.3%	5.3%
Total revenue growth Includes destocking adjustments		H1 data unavailable	2.5%	4.3%	5.3%	5.3%

Note: Spirits currently account for 65% of Saverglass' revenue

Appendix H: Scenario analysis

Australia
Upsides in the Australia segment bull case include: the removal of the Chinese wine tariff on Australian wine; a shift towards sugar-free drinks as opposed to no consumption of soft drinks among health-conscious consumers; aluminium prices to fall. Downsides considered in the bear case include: removal of the wine tariff has no impact; ready-to-drink (RTD) products grow slower than expected; long-term shift away from alcohol by consumers.

North America (OPS)
Upsides in the North America segment bull case include: manufacturing industry continuing to perform well and PMI returning above 50; healthcare performs well; demand for fresh food packaging increases; small businesses increase profitability; paper costs remain low. Downsides in the OPS bear case include: manufacturing industry performs poorly; small businesses experience increased inflationary pressures; paper costs increase.

Saverglass
Upsides considered in the Saverglass bull case include: destocking concludes sooner than expected – European demand rebounds as a result; the expansion into North America through Orora's existing network is successful. Downsides in the bear case include: destocking persists longer than anticipated; American expansion is effectively non-existent; European demand remains subdued even following destocking.

After making adjustments to revenue, margins and capex for each scenario, below are the final EBIT margins yielded from each scenario, which were implemented as the assumption change in the model:

Scenario Analysis	2024H1(A)	2024H2(E)	2025(E)	2026(E)	2027(E)	2028(E)
OPS						
Base	5.9%	4.7%	5.4%	5.5%	5.8%	5.9%
Bull		5.3%	5.7%	5.9%	6.0%	6.2%
Bear		3.7%	4.5%	4.5%	4.7%	4.7%

Australia	2024H1(A)	2024H2(E)	2025(E)	2026(E)	2027(E)	2028(E)
Base	15.7%	13.5%	13.8%	14.3%	14.8%	15.0%
Bull		14.0%	15.7%	16.3%	17.3%	17.5%
Bear		12.8%	12.6%	13.3%	13.3%	13.3%

Saverglass	2024H1(A)	2024H2(E)	2025(E)	2026(E)	2027(E)	2028(E)
Base	11.7%	10.5%	11.0%	12.0%	12.0%	12.5%
Bull		12.5%	14.0%	14.5%	15.0%	15.0%
Bear		9.0%	9.0%	10.0%	10.0%	11.0%

Appendix I: Sensitivity analyses

WACC Sensitivity	
Adjustment	**Target Price ($A)**
Base - 1.5%	$ 3.83
Base - 1%	$ 3.35
Base -0.5%	$ 2.91
Base	$ 2.58
Base + 0.5%	$ 2.27
Base + 1%	$ 1.99
Base + 1.5%	$ 1.96

Exchange Rate (USD) Sensitivity	
USD/AUD	**Target Price ($A)**
1.45	$ 2.44
1.48	$ 2.48
1.51	$ 2.53
1.54	$ 2.58
1.57	$ 2.67
1.60	$ 2.72
1.63	$ 2.74

EBITDA Margin Sensitivity	
Adjustment	**Target Price ($A)**
Base - 1.5%	$ 1.79
Base - 1%	$ 2.06
Base -0.5%	$ 2.34
Base	$ 2.58
Base + 0.5%	$ 2.86
Base + 1%	$ 3.13
Base + 1.5%	$ 3.41

Franking % Sensitivity Analysis	
Franking %	**Added value per share to SMF ($A)**
0.0%	$ 0.00
5.0%	$ 0.03
10.0%	$ 0.06
15.0%	$ 0.09
20.0%	$ 0.11
25.0%	$ 0.14
30.0%	$ 0.17
35.0%	$ 0.20
40.0%	$ 0.23
45.0%	$ 0.26
50.0%	$ 0.28

Note: See Appendix K for further discussion on franking credits.

Appendix J: Multiples valuation

Valuation method	Target price ($AUD)	Weighting (%)
Next twelve months P/E	2.68	33.3
Relative P/E to industry	2.25	33.3
Average next twelve months P/E of competitors	2.61	33.3
Total	2.51	**100**

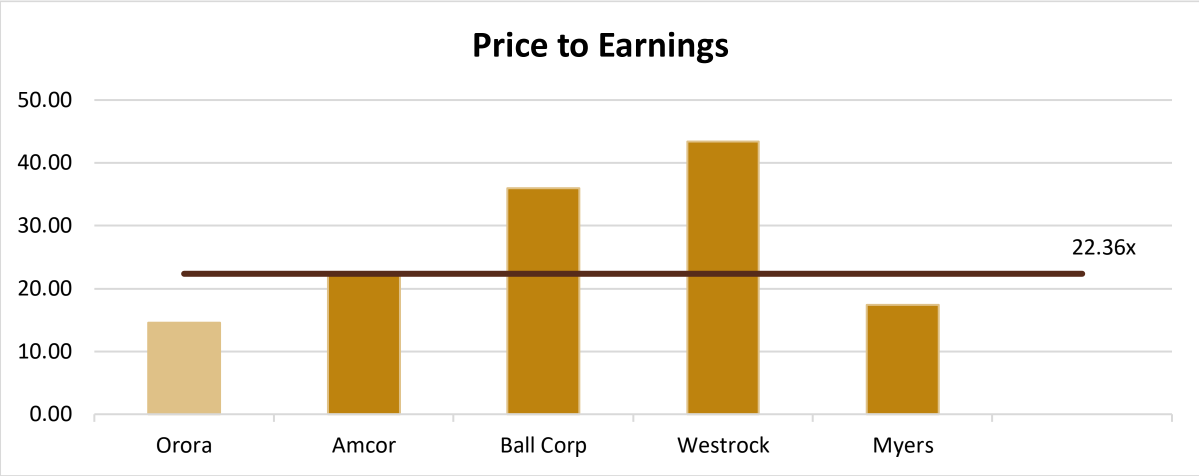
A multiples-based valuation serves as a supplementary verification for our primary DCF valuation. According to this secondary method, the target share price is $2.51, yielding an 15.10% MoS. This approach is employed as a complement due to its lack of granularity compared to a DCF analysis. While it relies on observable market data, it does not account for Orora's specific risk profile, growth prospects, or operational efficiencies.

Appendix K: Franking credits

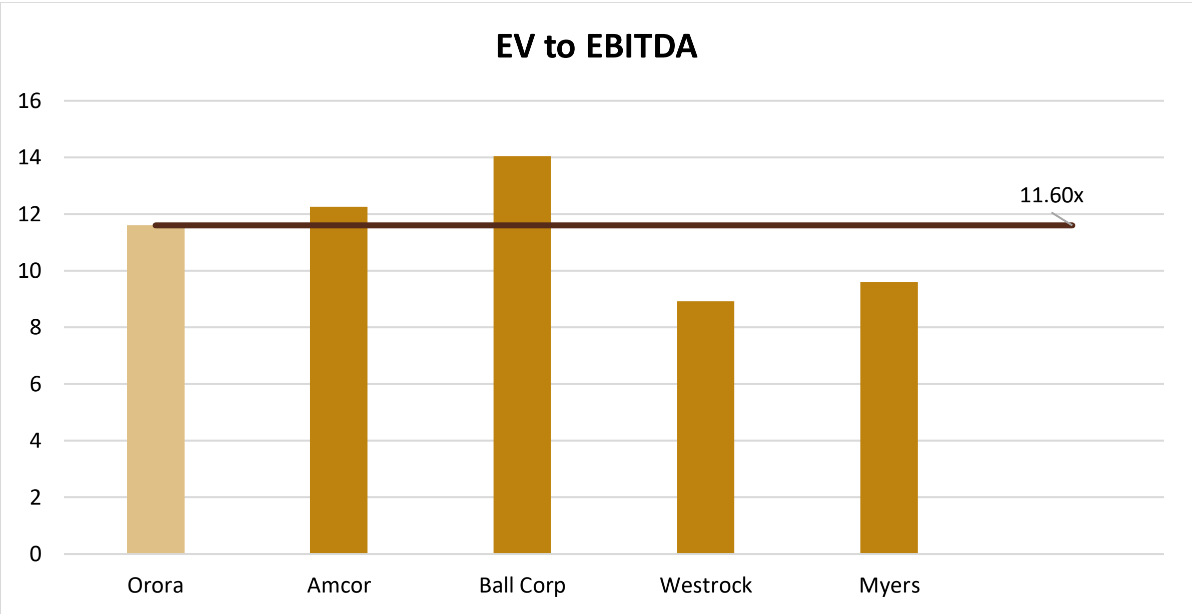
In our valuation approach, we assumed that Orora would be paying no franking credits going forward. This is a conservative approach to the valuation, but we felt it was most reasonable considering the 0% franking rate on the most recent dividend, and the acquisition of Saverglass which earns the majority of its earnings outside of Australia. In addition, we expect downward pressure on dividends in the short-term future due to higher debt obligations and high capex spending, which has us forecasting a dividend payout ratio below management's stated target range. Management has stated that they intend to frank future dividends to the greatest extent possible but has given no indication on the franking rate to expect. The last dividend that was franked was in June 2020, which was 50% franked, and the large majority of dividends prior to that were franked at 30%. Ultimately, we feel that it was worthwhile conducting a sensitivity analysis on future franking of dividends, but these figures should not impact our base case valuation.

Appendix L: Comparable Companies

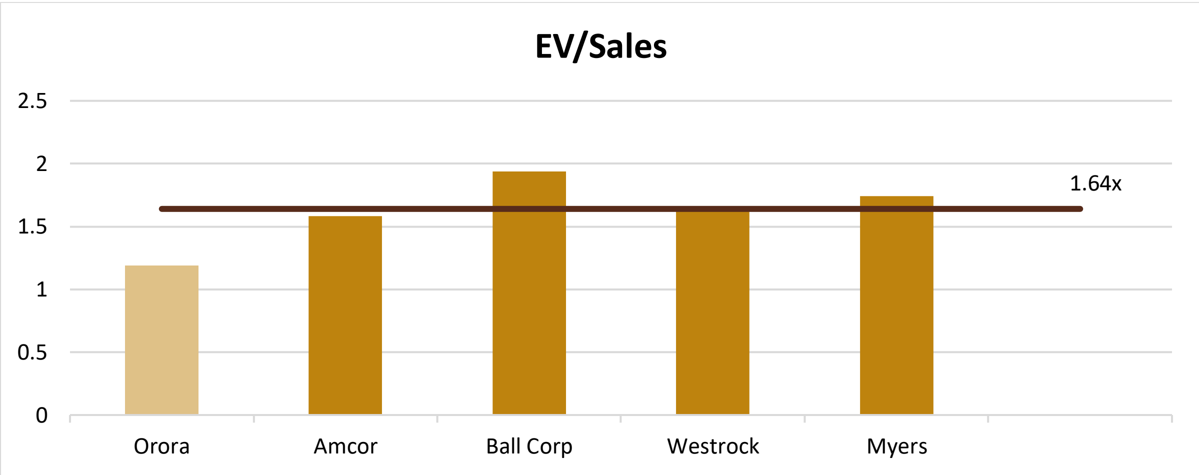
Price to Earnings Comparison



EV to EBITDA Comparison

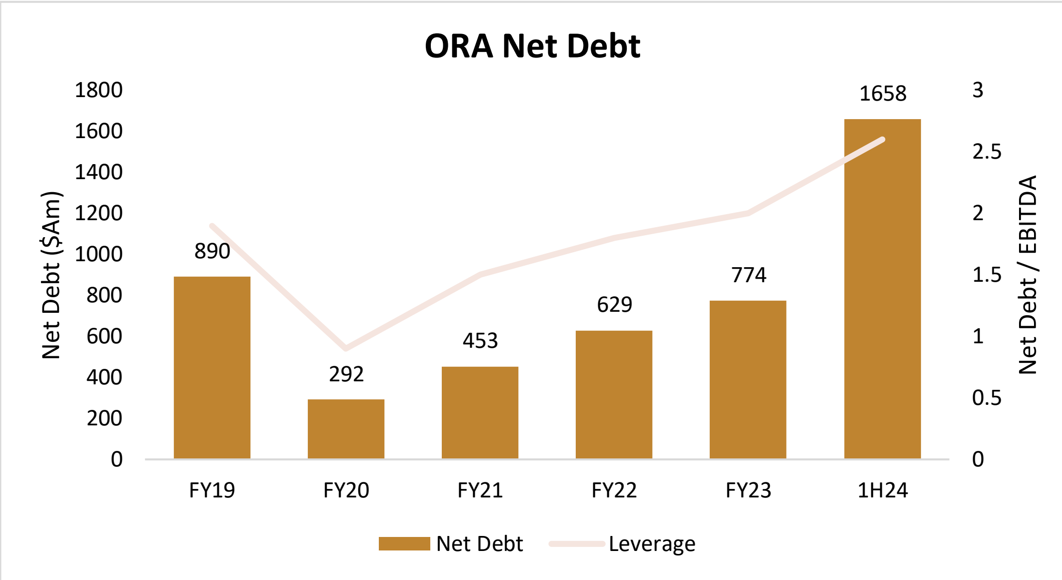


EV to Sales Comparison



Appendix M: ORA Historical Debt

ORA Net Debt



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