



Transcontinental Inc. Investment Paper

Team True North

Executive Summary

- **Business:** Transcontinental is a leading printing company in Canada. In 2018, it acquired Coveris, a leading flexible packaging manufacturer in the US to find growth as the printing business has been facing a secular decline.
- **Valuation:** The 2020 target price of \$24.4 per share.
- **Recommendation:** BUY for the following grounds:
 - Attractive potential upside of 65.6%.
 - Attractive dividend yield of 5.9%.
 - The printing business is generating solid operating cash flow despite its gloomy outlook.
 - The cash flow will help Transcontinental de-leverage and then pursue M&A opportunities in the packaging sector to find growth.
 - The flexible packaging business has bright outlook on the back of the growth of consumer spending in the US.
 - Management proved their vision and capability by divesting and rationalizing production of the declining business and acquiring business with better outlook.

Scenario Analysis - 2020 DCF Price				
	Weight	Upside case	Base case	Downside case
Target price - DCF Approach (\$)	50%	37.8	27.6	17.8
Target price - EV/ EBITDA (\$)	50%	27.9	21.2	8.3
Adjusted EBITDA - Printing (\$ million)		240.7	223.3	182.2
Target Multiple (*)		5.0x	4.3x	3.0x
Adjusted EBITDA - Packaging (\$ million)		211.1	201.0	169.9
Target Multiple (*)		10.0x	9.0x	7.0x
Weighted Average Price (\$)		32.8	24.4	13.0
Market Price (September 06) (\$)		14.7	14.7	14.7
Upside/ (Downside)		122.9%	65.6%	-11.6%

Notes:

- Sum-of-the-part DCF valuation was not carried out due to a lack of segmental information.
- Scenario analysis was performed to estimate Transcontinental's valuation if the known risks intensify. That said, the risks might not occur simultaneously.
- Target multiples are of comparable peers (Bloomberg).

Financial Projections

Financial Projections											
<i>US\$M otherwise stated</i>	2014A	2015A	2016A	2017A	2018A	2019F	2020F	2021F	2022F	2023F	2024F
Revenue	2,069	2,002	2,020	2,007	2,624	3,000	2,950	2,904	2,878	2,855	2,836
<i>Packaging</i>	49	113	220	308	977	1,592	1,608	1,624	1,657	1,690	1,724
<i>Printing</i>	1,604	1,565	1,353	1,501	1,443	1,306	1,241	1,179	1,120	1,064	1,011
<i>Others</i>	416	324	447	198	101	101	101	101	101	101	101
Adjusted EBITDA	360	379	390	397	459	439	424	423	417	411	406
<i>Packaging</i>	n.a.	n.a.	n.a.	36	117	191	201	211	215	220	224
<i>Printing</i>	346	359	363	371	332	248	223	212	202	191	182
<i>Others</i>	n.a.	n.a.	n.a.	-10	10	0	0	0	0	0	0
Operating Profit	169	284	213	303	367	208	219	209	191	197	189
Adjusted Operating Profit	257	277	283	311	334	314	294	284	265	272	263
Interest Expenses	20	6	16	18	37	57	47	46	41	36	32
Adjusted Income after Tax	185	211	209	229	232	196	188	181	171	179	176
<i>Growth</i>	<i>n.a.</i>	<i>13.9%</i>	<i>-1.1%</i>	<i>9.7%</i>	<i>1.5%</i>	<i>-15.8%</i>	<i>-4.2%</i>	<i>-3.7%</i>	<i>-5.4%</i>	<i>4.7%</i>	<i>-1.6%</i>
Adjusted EPS (\$)	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	2.8	2.4	2.3	2.2	2.1	2.2	2.1
Cash and Cash Equivalents	35	39	17	247	41	92	121	132	101	86	101
Total Debts	477	384	348	348	1,461	1,276	1,146	996	846	716	616
Shareholders' Equity	792	1,016	1,069	1,219	1,634	1,680	1,736	1,786	1,825	1,873	1,918
Total Assets	2,027	2,098	2,062	2,137	3,782	3,618	3,538	3,431	3,316	3,231	3,174
Operating Cash Flow	n.a.	n.a.	n.a.	n.a.	n.a.	341	343	345	344	339	339
Capex	n.a.	n.a.	n.a.	48.8	80	110	110	110	150	150	150

- Adjusted EBITDA: Operating earnings before the accelerated recognition of deferred revenue, accelerated depreciation, restructuring and other gains/ (losses), impairment of assets and reversal of the fair value adjustment of inventory sold arising from business combinations.
- Adjusted Operating Profit: Adjusted EBITDA minus (-) depreciation and amortization plus (+) amortization of intangible assets arising from business combinations.

Investment Risk Analysis

- Printing business: The flyer printing business is facing significant headwind due to the emergence of digital flyer which is more economical and environmental-friendly than the print flyer. The magazine and newspaper printing segments have also been witnessing a secular decline.
- Packaging business:
 - Potential risks associated with integrating and operating Coveris which is much larger in size than the pre-acquisition packaging business of Transcontinental.
 - Competition risk will be higher as companies in the industry pursue M&As, which make them more competitive through scale benefits. The merger between Bemis and Amcor is an example.
- Both businesses face raw material price risk (resin, paper...). Although the company has been able to secure pass-through term with customers, the risk persists due to the lag time (typically 90 days in packaging) and a possible negative impact on consumption (printing).
- In both businesses, Transcontinental deals with large customers who have relatively high bargaining power. Also, losing major customers will significantly impact the company performance.
- The company is highly leveraged after the acquisition of Coveris. The high leverage causes financial pressures and hinders the company's ability to pursue significant M&As to find growth.

Industry Overview

The US Flexible Packaging Market:

- The industry revenue in 2017 was estimated at US\$30 billion, of which 59% was attributed by sales to the food and beverage sector (Flexible Packaging Association).
- Raw material accounted for approximately 50% to 60% of cost of goods sold (Amcor – Scheme Booklet).
- The industry is characterized by the large number of companies (400). Top 10 companies accounted for approximately 50% market share in 2017. More consolidations are expected (Flexible Packaging Magazine).
- The industry is expected to grow at a CAGR of 2.0% during 2020 to 2024. That is in line with the expected annual growth in consumer spending of 2% p.a. (IBIS World, the US Plastic Film, Sheet and Bag Manufacturing Report).

Canadian Printing Industry:

- The industry revenue in 2019 is estimated at \$9.2 billion. The key target customer groups include manufacturers (21.1%), publishers (16.9%) and advertisers (15.1%) (IBIS World – Canadian Printing Industry).
- The industry has been witnessing a trend of revenue decline as digital media continues to gain popularity on the back of cost and environmental factors. IBIS World predicts an annual decline rate of 1.4% from 2019 to 2024.
- Particularly for the flyer printing segment, platforms such as Flipp and Reebee allure retailers due to cost effectiveness and better reach. From the environmental perspective, as an example, Metro Inc., a leading grocery retailer, targets to reduce paper used for flyers by 10% from 2019 to 2022.

Financial Projection – Income Statement

Income Statement - Base Case											
<i>US\$ M otherwise stated</i>	Audited					Projected					
	2014A	2015A	2016A	2017A	2018A	2019E	2020E	2021E	2022E	2023E	2024E
Revenue	2,069	2,002	2,020	2,007	2,624	3,000	2,950	2,904	2,878	2,855	2,836
<i>Growth</i>	-1.3%	-3.2%	0.9%	-0.6%	30.7%	14.3%	-1.6%	-1.6%	-0.9%	-0.8%	-0.7%
Packaging	49	113	220	308	977	1,592	1,608	1,624	1,657	1,690	1,724
Printing	1,604	1,565	1,353	1,501	1,443	1,306	1,241	1,179	1,120	1,064	1,011
Others	416	324	447	198	101	101	101	101	101	101	101
Accelerated Recognition	0	0	0	0	102	0	0	0	0	0	0
Adjusted EBITDA	360	379	390	397	459	439	424	423	417	411	406
<i>Margin</i>	17.4%	18.9%	19.3%	19.8%	17.5%	14.6%	14.4%	14.6%	14.5%	14.4%	14.3%
Packaging	n.a.	n.a.	n.a.	36	117	191	201	211	215	220	224
Printing	346	359	363	371	332	248	223	212	202	191	182
Others	n.a.	n.a.	n.a.	-10	10	0	0	0	0	0	0
Accelerated Recognition	0.0	0	0	0	102	0	0	0	0	0	0
Restructuring, Impairment of Assets a	(88)	7	(71)	9	(25)	(32)	0	0	0	0	0
Depreciation and Amortization	103	102	107	103	125	125	131	139	152	139	143
Amortization of Intangible Assets for	n.a.	n.a.	n.a.	n.a.	45	74	74	74	74	74	74
Operating Profit	169	284	213	303	367	208	219	209	191	197	189
Adjusted Operating Profit (*)	257	277	283	311	334	314	294	284	265	272	263
<i>Margin</i>	12.4%	13.8%	14.0%	15.5%	12.7%	10.5%	10.0%	9.8%	9.2%	9.5%	9.3%
<i>Growth</i>	10.3%	7.7%	2.4%	9.8%	7.5%	-6.0%	-6.6%	-3.4%	-6.6%	2.5%	-3.1%
Net Financial Expenses	20	6	16	18	37	57	47	46	41	36	32
Pretax Income	150	278	197	285	331	151	172	163	150	161	157
Income Taxes	39	16	51	73	81	36	41	39	36	39	38
Impact of US Tax Reform	0	0	0	0	37	30	0	0	0	0	0
Net Income	111	262	146	212	213	85	131	124	114	122	119
Adjusted Net Income	185	211	209	229	232	196	188	181	171	179	176
<i>Net Margin</i>	5.4%	13.1%	7.2%	10.5%	8.1%	2.8%	4.4%	4.3%	4.0%	4.3%	4.2%
Shares Outstanding (million)	78	78	78	77	83	83	83	83	83	83	83
EPS (\$)	1.4	3.3	1.9	2.7	2.6	1.0	1.6	1.5	1.4	1.5	1.4
Adjusted EPS	n.a.	n.a.	n.a.	n.a.	2.8	2.4	2.3	2.2	2.1	2.2	2.1
<i>Growth</i>	-726%	135%	-44%	46%	-6%	-15.8%	-4.2%	-3.7%	-5.4%	4.7%	-1.6%

Financial Projection – Balance Sheet

Balance Sheet - Base Case

US\$ M otherwise stated

	Audited					Projected					
	2014A	2015A	2016A	2017A	2018A	2019E	2020E	2021E	2022E	2023E	2024E
ASSETS:											
Cash and Cash Equivalents	35	39	17	247	41	92	121	132	101	86	101
Accounts Receivable	415	393	402	381	565	533	524	516	511	507	503
Inventory	94	116	120	117	306	288	283	279	276	274	272
Prepaid Expenses	15	16	16	18	25	23	23	23	22	22	22
Income Tax Receivables	16	15	6	17	7	6	6	6	6	6	6
Current Assets	575	579	560	780	943	943	958	955	916	895	905
PP&E - Gross	n.a.	n.a.	n.a.	n.a.	1,943	1,978	2,088	2,198	2,348	2,498	2,648
Less: Accum. Depn.	n.a.	n.a.	n.a.	n.a.	(1,054)	(1,202)	(1,355)	(1,517)	(1,691)	(1,854)	(2,019)
Net PP&E	566	568	566	501	889	776	733	681	656	644	629
Intangible Assets	253	258	217	171	747	695	644	592	540	489	437
Deferred Income Tax	152	182	171	139	18	18	18	18	18	18	18
Goodwill	420	460	510	505	1,150	1,150	1,150	1,150	1,150	1,150	1,150
Other Assets	61	53	38	41	35	35	35	35	35	35	35
Total Assets	<u>2,027</u>	<u>2,098</u>	<u>2,062</u>	<u>2,137</u>	<u>3,782</u>	<u>3,618</u>	<u>3,538</u>	<u>3,431</u>	<u>3,316</u>	<u>3,231</u>	<u>3,174</u>
LIABILITIES & EQUITY:											
Accounts Payable	302	340	316	305	432	407	400	394	390	387	384
Deferred Revenue and Deposits	61	51	55	45	16	16	16	16	16	16	16
Provision	20	10	10	6	4	4	4	4	4	4	4
Income Tax Payable	31	21	4	10	15	15	15	15	15	15	15
Current Liabilities	414	422	385	365	466	441	434	428	425	421	419
Revolving Debt	0	0	0	0	0	0	0	0	0	0	0
Current Portion of Long-term Debt	118	36	0	-	251	149	345	475	148	100	0
Term Loan	359	348	348	348	1,210	1,128	801	521	698	616	616
Total Debt	477	384	348	348	1,461	1,276	1,146	996	846	716	616
Deferred Income Taxes	85	64	43	44	98	98	98	98	98	98	98
Provision	30	6	3	1	2	2	2	2	2	2	2
Other Liabilities	229	206	214	159	120	120	120	120	120	120	120
Total Liabilities	1,235	1,082	994	918	2,148	1,938	1,801	1,645	1,492	1,358	1,256
Common Equity	366	368	362	372	642	642	642	642	642	642	642
Retain Earnings	416	626	701	852	980	1,025	1,082	1,131	1,171	1,219	1,264
Others	11	23	6	-4	12	12	12	12	12	12	12
Liabilities & Equity	<u>2,027</u>	<u>2,098</u>	<u>2,062</u>	<u>2,137</u>	<u>3,782</u>	<u>3,618</u>	<u>3,538</u>	<u>3,431</u>	<u>3,316</u>	<u>3,231</u>	<u>3,174</u>

Forecast and Valuation Assumptions

- **Revenue:**
 - Packaging: Revenue in 2019 is expected to decline by 2% which is in line with the year-to-date performance. Revenues in 2020 and 2021 are expected to grow at 1% p.a. which is lower than the forecasted growth of the industry to take into the possibility that Transcontinental needs more time to integrate and run Coveris smoothly. Revenue growth post 2021 are expected to be in line with that of the industry.
 - Printing: Printing revenue is expected to decline by 5% p.a. during the projection period to reflect the on-going trend.
- **EBITDA Margin:**
 - Packaging: Assuming EBITDA margin is gradually improved from 11.9% in 2018 to 13% in 2021 and stable afterward. The expected EBITDA margin is less than management target of 15% by 2021 as (1) Bemis, whose size is almost double that of Coveris, posted an EBITDA of 14% in 2018, and (2) there is no strong ground for management to fully realize the expected synergy of \$20 million as the combined packaging business did not increase in size significantly.
 - Printing: The EBITDA margin is expected to gradually reduce to 18% by 2021 as the Company might have to lower price to retain its business, especially in the print flyer segment. The margin is expected to be stable afterward assuming that Transcontinental is able to rationalize its production facility and labor force to cope with the expected decline in revenue.
- **Business Income Tax:** The effective business income tax is estimated at 24% as income from the US operation is subject to lower tax rate (21%) than that in Canada (approximately 26.7% of combined tax rate)
- **Capex:** Capex during 2019-2021 is assumed at \$110 million p.a. which is mainly for the big maintenance purpose as Coveris benefits from the \$140 million capex before the acquisition and as there is no foreseen expansion of the printing segment. Capex during 2022-2024 is forecast to be higher at \$150 million p.a. to accommodate the expected growth of Coveris.
- **Dividend:** Dividend is expected to be at 22% of operating cash flow as it was in 2018.
- **De-leveraging:** The remaining operating cashflow after capex and dividend payment is expected to finance for de-leveraging.
- **M&A:** Assuming no significant M&A during the projection period.

DCF Valuation

VALUATION ANALYSIS, FCFE - BASE CASE						
<i>US\$ M otherwise stated</i>	Projected					
	<u>2019E</u>	<u>2020E</u>	<u>2021E</u>	<u>2022E</u>	<u>2023E</u>	<u>2024E</u>
Free Cash Flow Calculation						
EBIT	314	294	284	265	272	263
Plus: Depreciation	199	205	214	226	214	217
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EBITDA	514	499	498	491	486	480
Less: Capex	(110)	(110)	(110)	(150)	(150)	(150)
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EBITDA Less Capex	404	389	388	341	336	330
Less: Taxes	(36)	(41)	(39)	(36)	(39)	(38)
Less: Changes in Working Capital	27	7	7	4	3	3
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FCFE	395	355	355	309	300	296
DCF Firm Value Calculation						
<i>Terminal Value Calculation</i>						
Terminal Value Growth Rate						(2.0%)
Projected Free Cash Flow						290
WACC	8.2%	8.5%	8.9%	9.2%	9.5%	9.8%
Terminal Enterprise Value						2,446
Implied Term. Value EBITDA Multiple						5.1x
DCF Firm Value At Year t						
Free Cash Flow to Firm at year t		355	326	259	228	203
Sum		1,372				
Terminal Value at year 0		1,913				

DCF Firm Value at year 0		3,284				
Net debt		1,025				
Equity value		2,260				
Shares outstanding		83				
DCF Value per Share (\$)		27				
EV/EBITDA		7.7x				
PE		12.0x				
Dividend yield		3.3%				

Appendix 1: DCF Valuation – Scenario Analysis

Scenario Analysis						
	Case	2020	2021	2022	2023	2024
Packaging Revenue Growth	Upside Case	2.0%	2.0%	2.5%	2.5%	2.5%
	Base Case	1.0%	1.0%	2.0%	2.0%	2.0%
	Downside Case	(3.0%)	(3.0%)	(3.0%)	(3.0%)	(3.0%)
Packaging Adjusted EBITDA Margin	Upside Case	13.0%	13.5%	14.0%	14.0%	14.0%
	Base Case	12.5%	13.0%	13.0%	13.0%	13.0%
	Downside Case	11.0%	11.0%	11.0%	11.0%	11.0%
Printing Revenue Decline	Upside Case	(3.0%)	(3.0%)	(3.0%)	(3.0%)	(3.0%)
	Base Case	(5.0%)	(5.0%)	(5.0%)	(5.0%)	(5.0%)
	Downside Case	(7.0%)	(7.0%)	(7.0%)	(7.0%)	(7.0%)
Printing Adjusted EBITDA Margin	Upside Case	19.0%	19.0%	19.0%	19.0%	19.0%
	Base Case	18.0%	18.0%	18.0%	18.0%	18.0%
	Downside Case	15.0%	15.0%	15.0%	15.0%	15.0%
Terminal Growth Rate	Upside Case					0.0%
	Base Case					-2.0%
	Downside Case					-3.0%

Appendix 2: Peers Comparable

Ticker	Name	Ticker	Mkt Cap (US\$ M)	P/E	EV/EBITDA T12M	Price to Sales	Net Sales T12M (US\$ M)	EBITDA Adj T12M (US\$ M)	Tot Debt LF T12M (US\$ M)	Debt/Assets LF
TCL/A CN Equity	TRANSCONTINENTAL INC-CL A	TCL/A CN	1,306	10.6x	5.5x	0.4x	3,077	459	1,276	35.3%
Packaging										
Median				16.5x	9.0x	1.2x	n.a.	n.a.	n.a.	35.6%
AMCR US Equity	AMCOR PLC	AMCR US	21,132	27.1	14.3	1.2	12,523	2,230	7,991	35.6%
SEE US Equity	SEALED AIR CORP	SEE US	8,080	14.5	10.6	1.3	6,250	1,219	4,740	69.4%
BERY US Equity	BERRY GLOBAL GROUP INC	BERY US	6,744	16.5	9.0	0.6	10,477	1,793	7,159	62.1%
WPK CN Equity	WINPAK LTD	WPK CN	3,034	20.1	9.0	2.6	1,174	261	0	0.0%
MNDI LN Equity	MONDI PLC	MNDI LN	12,690	9.3	6.9	1.2	11,365	2,700	3,598	28.7%
Printing										
Median				21.5x	4.3x	0.1x	n.a.	n.a.	n.a.	51.6%
QUAD US Equity	QUAD GRAPHICS INC	QUAD US	675	21.5	4.5	0.1	5,586	465	1,624	48.7%
LKSD US Equity	LSC COMMUNICATIONS INC	LKSD US	63	n.a.	4.2	0.0	4,857	317	1,342	54.6%
<i>Source: Bloomberg - November 02, 2019</i>										

THANK YOU