RESEARCH REPORT

February 26, 2018

Stock Rating	HOLD
Price Target	CAD $56.00
Current Price	CAD $50.41

Bear Case	Price Target	Bull Case
$47.00	$56.00	$58.00

Ticker	WPK
Market Cap (MM)	$3,277
EV/EBITDA NTM	11.7x
P/E NTM	22.7x

52 Week Performance

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Winpak Ltd.

Big Things, Small Package

Winpak Ltd. is a diversified plastics packaging company which presents a rare opportunity for the QUIC M&M team to explore a name with relatively low cyclicality and sizeable economics moats while still gaining exposure to the materials sector. More specifically, we are interested in Winpak for two key reasons:

1. Winpak has several admirable qualities such as its positioning in highly regulated end-markets (e.g. perishables and healthcare), consistent investment in well-positioned R&D capabilities, and a strong balance sheet financed with zero-debt.

2. Winpak's management also has a proven history of strong capital allocation and a high degree of patience in the pursuit of acquisition targets. Winpak's high incremental return on capital further illustrates this point.

Winpak's business fundamentals are of the most attractive within the QUIC M&M investable universe, however, from a valuation standpoint this does not appear to be an attractive time to enter the name. Moreoever, the uncertainty surrounding competitive pricing pressure as well as M&M's existing market position in packaging are additional barriers to buying the name. We plan to keep add Winpak to our watchlist in hopes of finding a better entry point. The M&M team will also be reaching out to additional sources for further clarification surrounding the competitive outlook of Winpak.

QUIC

February 26, 2018
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Company Overview

Winpak Ltd., headquartered in Winnipeg, Manitoba, is a manufacturer and distributor of plastic packaging materials and machines used mainly in the production of perishable foods and beverages in addition to health care applications. As a part of a global packaging group, the company operates production facilities across Canada, the U.S., and Mexico; however, it serves customers outside of North America, with business units for each of North America, Latin America, the Pacific Rim, and Europe. The company is majority-owned and operated by the Finland-based Wihuri Group, an international industry and trade conglomerate.

Within plastic packaging, Winpak operates in three business units: flexible packaging, rigid packaging and flexible lidding, and specialized packaging machines. Flexible packaging includes products such as barrier shrink bags, rollstock and speciality films, zipper stand-up pouches, and vacuum pouches. Rigid packaging includes products such as rigid plastic cups and trays, as well as custom plastic containers used by the food, dairy, beverage, and health care industries. Sales of these products are frequently accompanied by packaging machinery used to assemble products, making up the third segment. Winpak's customers are primarily perishable foods companies such as Danone, General Mills, Heinz, Kraft Foods, and Maple Leaf.

More than 80% of Winpak's revenue comes from the U.S.; however, more than 50% of production takes place in Canada. This means that fluctuations in the CAD/USD exchange rate can have a big influence on profit. As the CAD strengthens relative to the USD, many analysts are materially reducing target prices for WPK. However, Winpak is making moves to offset this risk by hedging 50-80% of one-year USD cash conversions into CAD. Further, the company has used USD as its reporting currency since 2004, which helps to minimize currency translation risk.

After disappointing performance in 3Q17, WPK's stock price trended downwards, falling almost 15% between November, 2017 and February, 2018. However, it saw an 11.53% jump on February 23 after CIBC upgraded the stock from a neutral rating to an outperform rating. Despite this, analyst sentiment is very mixed on the name with some firms reducing guidance due to increasing competition and tightening margins.

While these concerns are valid, the M&M team believes that Winpak's innovative technology and unique ownership structure give it a strong competitive moat in a fragmented industry. In addition, the company's exposure solely to plastics – a high-margin and high-growth sub-segment of packaging – gives WPK strong growth prospects relative to competitors playing in lower-value spaces.

EXHIBIT I

Winpak and Competitor Product Mix

		Product Categories			
Company	**Market Cap (B)**	**Plastic**	**Labels**	**Metal & Glass**	**Paper**
CCL Industries, Inc.	11.58	X	X	X	
Intertape Polymer Group, Inc.	1.25	X	X		X
Winpak Ltd.	3.28	X			

Source(s): Company Reports, CIBC World Markets

Industry Overview

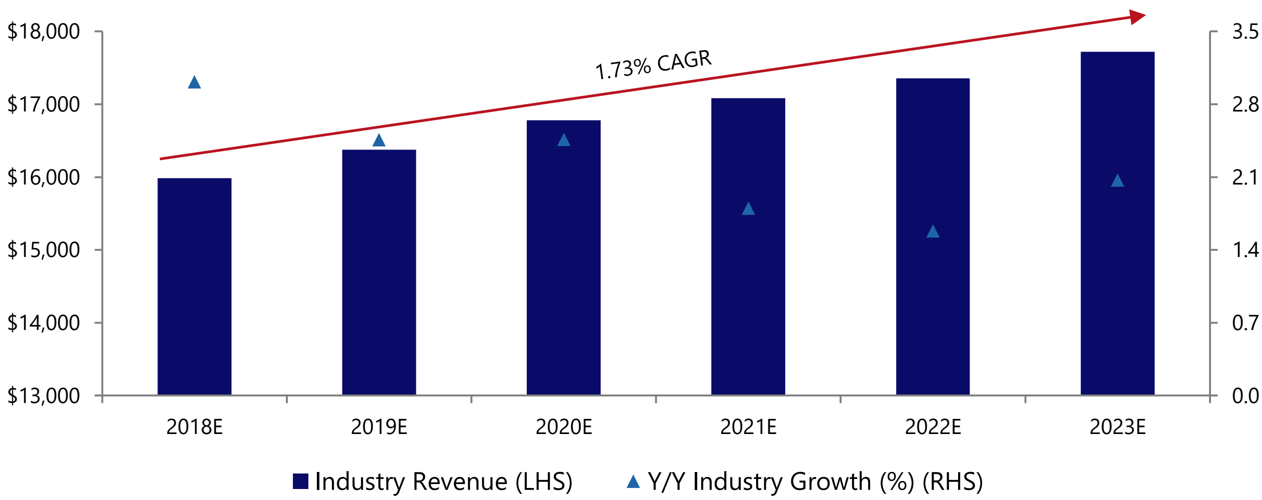
Firms in the packaging industry manufacture and sell materials and equipment used in the packaging process for customers, typically in the food & beverage, industrial, and health care industries. The global packaging industry is highly fragmented, with over 10,000 firms in North America alone providing solutions for a wide variety of packaging needs. The largest packaging companies in the M&M coverage universe are Intertape Polymer Group, CCL Industries, and Winpak.

Packaging is a highly commoditized and relatively stable industry, with revenues showing little correlation to broader economic trends. Despite being a commoditized business, technology and innovation do play a larger role in certain customers' buying criteria. Healthcare and higher-end products in other categories often demand specific technical requirements for safety and aesthetic reasons. Large amounts of revenues are generated from health care and other non-discretionary items such as packaged foods, where volumes tend to remain stable throughout recessionary periods. Demand for a certain portion of packaging revenues is attributable to more discretionary items, and is hence driven by consumer spending patterns. Outsourcing activities from firms subject to heavy regulatory burdens, such as pharmaceuticals and food manufacturing, is a significant growth driver. It is often easier for large firms in these industries to outsource their packaging to specialized firms to minimize risk and costs. Another growth trend is e-commerce. For smaller online merchants, outsourcing packaging is a viable way to reduce costs and maintain a lean physical footprint to optimize overhead.

The firms best positioned to generate outsized returns in this industry will have scale, a technological advantage, and sound management that is aligned with shareholders and experienced. The M&M team believes that Winpak has each of these elements and is well positioned to capitalize on future growth and consolidation.

Exhibit II

Packaging Materials and Machinery Industry Growth



Source(s): Company Reports, S&P Capital IQ

Investment Thesis I: Innovative Production Process

For producers of perishable food, Winpak's main end-use market, minimizing food wastage is essential. As a result, superior packaging quality merits higher prices, as the cost of packaging is just a fraction of the cost of wasting a large amount of food. Because of this fundamental feature of the food packaging industry, Winpak's superior production processes and high quality outputs give it a strong competitive advantage and revenue prospects.

The Company has invested heavily into R&D technology, developing its own conversion equipment, proprietary co-extrusion techniques, and custom resin blends. This allows it to produce superior multi-layer plastics without needing to bond multiple layers of film. With this process, Winpak is able to extrude 13 layers at a time, generating significant cost savings and high margins, while still creating products of the highest quality.

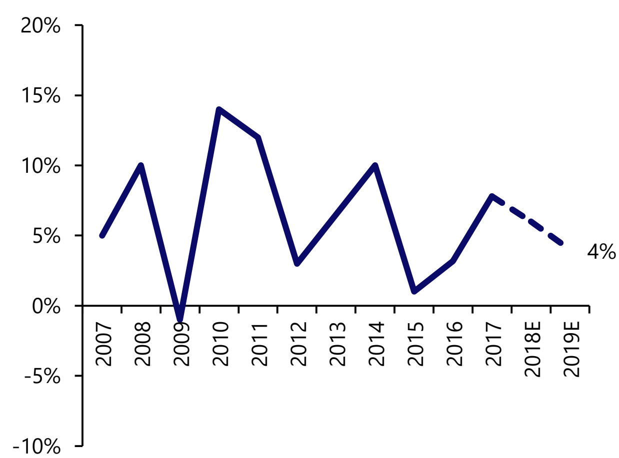
This approach has allowed Winpak to grow revenue well above GDP, which is impressive for a business like packaging which tends to track in line with general GDP growth. From 2007 to 2016, revenue grew at a CAGR of 6%, with a notable spike in 2010 and 2011 as Winpak recovered from the financial crisis. Much of this growth can be attributed to the Company's focus on flexible and rigid plastic packaging, which are among the highest-growth and highest-margin subsegments in the packaging industry. To capitalize on these segments, Winpak has primarily invested internally; however, it did make two strategic acquisitions in 2002 and 2008 to fill in gaps In its product line. That being said, this growth was not even close to that of diversified rival packaging player CCL, who achieved a CAGR of 16% over the same period.

From a sustainability perspective, it is important to consider whether Winpak's technology is easily replicable by a competitor looking to move into a higher-margin space. While this is a concern, the M&M team believes Winpak has a few key advantages. First, R&D investment is extremely capital intensive, and Winpak's ownership structure gives it access to capital through Wihuri. Further, the Company currently has no debt, meaning that it is in a strong position to either lever up to increase its R&D budget and respond to competitors. Second, switching costs and long-term contracts create a degree of stickiness. For Winpak, much of its revenue comes from large individual contracts that have been in place for the majority of its operating history. While losing one of these large contracts, the largest being 18%, would be catastrophic, this is extremely unlikely given the consistency of operations and length of the contracts.

Despite this apparent moat, recent concerns were raised when Q4 results included a statement that "competitive pressures, including new product development, industry capacity, and changes in competitors' pricing [could cause results to differ from expectations]." While this statement was ambiguous, it has provoked a strong reaction from the investment community, and makes the M&M team question whether competition may infringe on Winpak's R&D advantage in the future.

EXHIBIT III

Winpak Revenue Growth (2007-2017)



Source(s): Company Reports

Investment Thesis II: Strong and Aligned Management Team

Winpak is controlled by privately-held Finnish conglomerate Wihuri, which holds a 52.5% stake in the Company in addition to controlling Winpak's Board. Antti Aarnio-Wihuri serves as the Chairman of both Winpak and Wihuri's Boards of Directors. While this controlling stake limits the power of shareholders and reduces the size o the Company's tradeable float, it offers certain unique advantages over competitors. Winpak is able to access the operational experience and financial capacity of Wihuri.

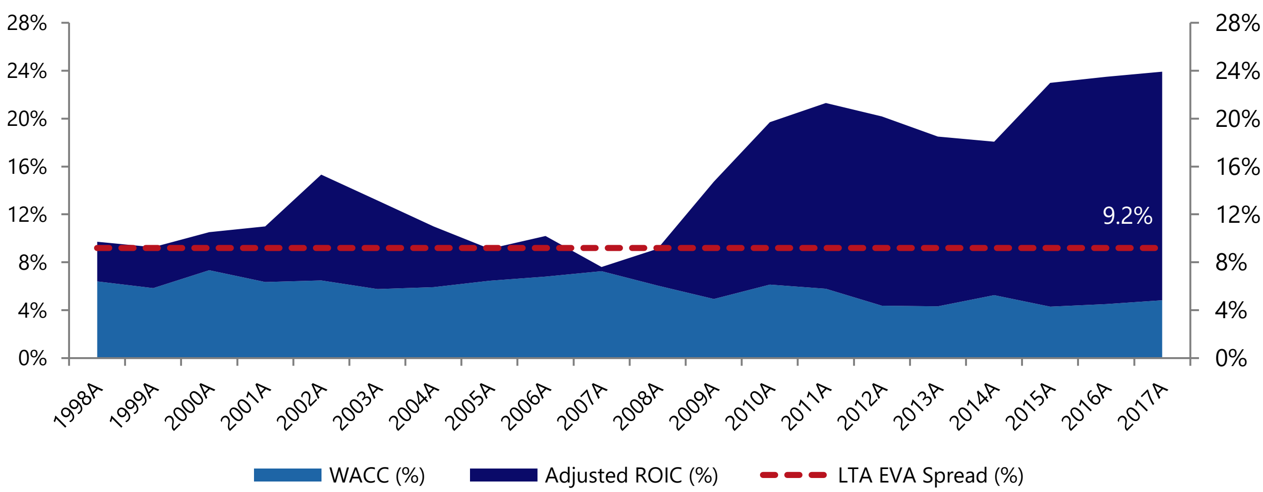
Over Winpak's history, management (Wihuri) has proven to be a highly patient and disciplined capital allocator. The Company currently has no debt and over $260MM in cash and equivalents, leaving ample flexibility to raise capital to finance potential acquisitions, capital projects, or issue special dividends. Winpak has pursued each of these avenues over its lifetime. Winpak's management has significant experience reinvesting capital to build internal capacity. Projects that expand capacity are only pursued when they meet management's predetermined hurdle rate of a 20% internal rate of return (IRR). This discipline ensures that capital is only deployed on projects that add extraordinary value.

Winpak pays a small dividend of $0.12 annually, representing a yield of 0.3%. Rather than increase the regular dividend, management prefers to pay out special dividends as they see fit. This gives them greater flexibility within their dividend policy, as they do not need to cut the distribution in the face of financial difficulties..

Winpak's disciplined approach to growth and capital allocation has served it extremely well over the past 20 years. It has consistently generated returns on invested capital in excess of its cost of capital. Since 1998, Winpak's ROIC has exceeded its WACC by 9.2%, on average (Exhibit IV). This is indicative of management's ability to allocate capital to profitable projects and manage its capital structure prudently.

EXHIBIT IV

Winpak LT ROIC Versus WACC Analysis



Source(s): S&P Capital IQ

Catalysts

Potential Acquisitions

Because of its ability to generate large amounts of free cash flow, Winpak has accumulated a significant cash balance (Exhibit V). This cash balance, along with its debt-free balance sheet, offers Winpak ample opportunity to complete an acquisition(s). Management's discipline in its acquisition strategy ensures that these deals will be accretive.

Special Dividends

Winpak's large cash balance, paired with its low and declining payout ratio, gives the Company a lot of room to raise the regular or issue a special dividend(s).

Capacity Additions

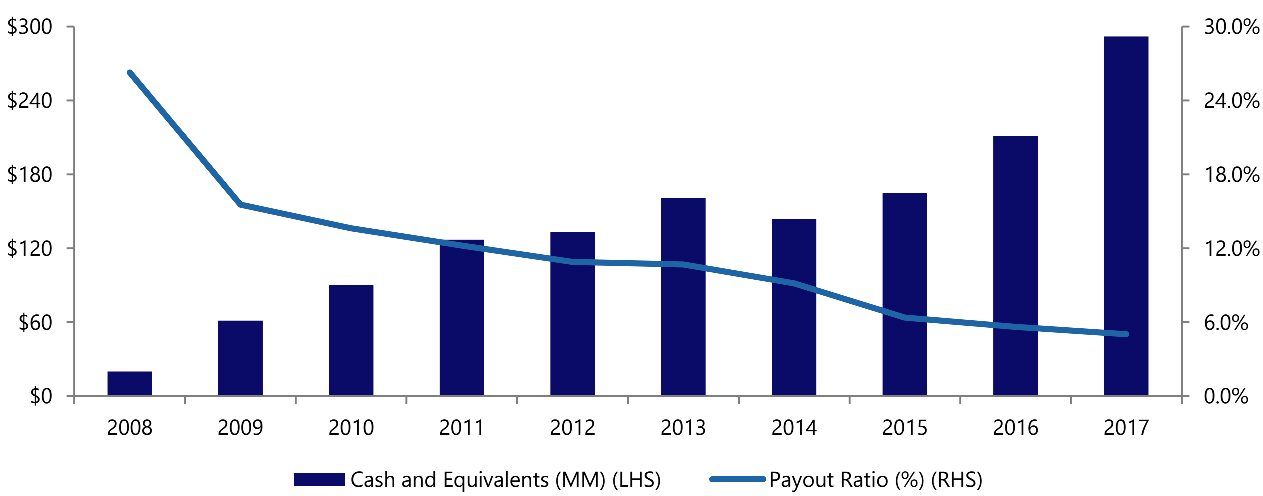
Management may decide to utilize its clean balance sheet to finance capital projects that increase capacity organically. This may be less likely than an acquisition. Manufacturing companies strive to maximize output from existing plants to spread overhead costs across a greater number of units. Gaining contracts from competitors allows the acquirer to shift some production to existing facilities to improve cost spreading and potentially divest other assets. This could make acquisitions more attractive, given a reasonable valuation and strong target company.

Receding Short Term Pricing Pressure

The price of many of Winpak's key inputs have risen sharply in recent quarters. Much of this price action, particularly for resin, has been attributable to Hurricane Harvey, which upset resin supply temporarily. Rising prices have contributed to falling margins, which have spooked the market and raised concerns about Winpak's long-term prospects. With certain price increases, such was seen with resin, being temporary in nature, investors should look past compressing margins and expect some widening in coming quarters.

EXHIBIT V

Winpak Financial Capacity and Dividend Analysis



Source(s): S&P Capital IQ

Risks

Rising Input Prices

As previously mentioned, the prices of many of Winpak's key raw materials are rising. A key input in plastics packaging, resin, has been facing growing prices since mid-2017 driven by severe weather in the U.S. and higher oil prices.

However, due to the small cost of packaging relative to the sale price of the goods being packaged, Winpak has historically been able to pass cost increases onto consumers. Moreover, Winpak has partly mitigated the impact of input price changes via indexing ~70% of its revenues to the price of raw materials with a 90 to 120-day lag.

Competition

As many competitors continue to look outside their traditional markets for growth opportunities, competition in the higher-margin verticals that Winpak competes in is intensifying. Being a relatively small player in the highly fragmented packaging industry, this poses a serious threat to Winpak's future volume growth and pricing power.

This risk is mitigated by the long-term relationships that Winpak has with its customers. Due to the low cost of the packaging relative to the product being packaged and Winpak's stellar reputation, there is little incentive for customers to switch to a competitor.

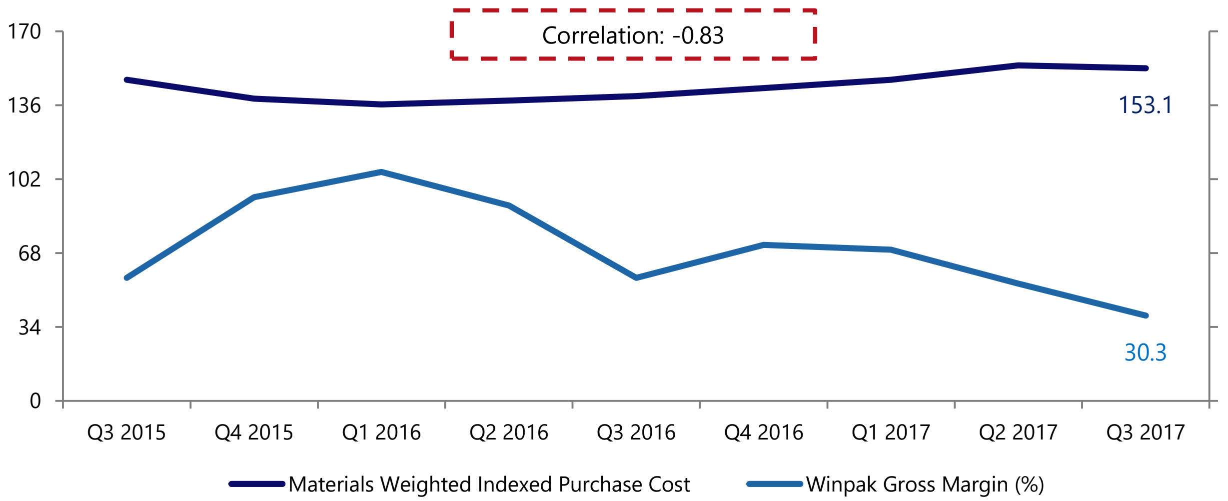
NAFTA Re-Negotiations

With over half of its production in Canada and over 80% of its sales in the U.S., Winpak is exposed to a great deal of risk from ongoing NAFTA re-negotiations. If tariffs or import quotas are imposed, Winpak would likely suffer significantly.

Winpak may be able to mitigate this risk by acquiring more production assets in the U.S. This could also help reduce transportation costs, as most of the Companies customers are located in the U.S.

EXHIBIT VI

Winpak's Pricing Power



Source(s): Company Reports, S&P Capital IQ

Valuation

EXHIBIT VII

Packaging Comparables Analysis

Company Name	Market Cap ($MM)	Enterprise Value ($MM)	EV / EBITDA 2018E	EV / EBITDA 2019E	Price / Earnings 2018E	Price / Earnings 2019E	Net Debt/EBITDA 2018E	Net Debt/EBITDA 2019E	FCF Yield	Gross Margin	Dividend Yield
CCL Industries Inc.	$9,129	$10,530	12.6x	12.0x	22.1x	20.4x	1.7x	1.6x	3.5%	30.5%	0.8%
Berry Global Group, Inc.	$7,229	$12,566	8.4x	8.3x	14.0x	13.3x	3.6x	3.5x	7.2%	19.5%	-
Sealed Air Corporation	$7,140	$9,804	10.9x	10.2x	17.4x	15.0x	3.0x	2.8x	8.1%	31.8%	1.5%
Bemis Company, Inc.	$4,066	$5,558	9.8x	9.3x	15.9x	14.4x	2.6x	nmf	6.4%	19.4%	2.8%
Brady Corporation	$1,997	$1,953	10.8x	nmf	18.5x	17.3x	nmf	nmf	5.4%	50.2%	2.2%
Intertape Polymer Group	$988	$1,292	10.2x	8.9x	16.2x	15.4x	2.4x	2.1x	nmf	22.0%	3.3%
Mean	**$5,092**	**$6,951**	**10.4x**	**9.8x**	**17.3x**	**16.0x**	**2.6x**	**2.5x**	**6.1%**	**28.9%**	**2.1%**
Median	**$5,603**	**$7,681**	**10.5x**	**9.3x**	**16.8x**	**15.2x**	**2.6x**	**2.4x**	**6.4%**	**26.2%**	**2.2%**
Winpak Ltd.	**$2,587**	**$2,323**	**11.7x**	**11.0x**	**22.7x**	**20.8x**	**nmf**	**nmf**	**3.3%**	**31.2%**	**0.2%**

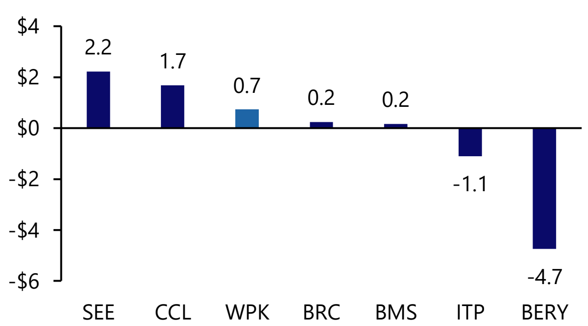
The selected comparables set for Winpak includes two Canadian names within QUIC's investable universe: Intertape Polymer Group and CCL Industries Inc. The additional four names are Winpak's closest competitors on NYSE stock exchange. They are all primarily or entirely plastics packaging companies.

Both Winpak and CCL trade at a premium relative to their peers on both an EV/EBITDA and P/E basis. The companies' low-debt capital structures, above-average gross margins, and strong capital allocation can help to partly justify the higher multiples.

To further analyze capital allocation strength, we applied Warren Buffet's $1 Test to each of the companies in the peer group over a 5-year interval. The test compares each company's retained earnings over a period of time to how much market value was generated over the same period of time. Buffett states that in order to pass his $1 Test, "for every dollar retained by the corporation, at least one dollar of market value will be created for owners". CCL and Sealed Air Corp. were the only two companies within the peer group to pass the test. Winpak followed with the third highest result, although it failed the test, generating $0.73 in market value for every $1 in retained earnings. Winpak's poorer performance in this test may be partly attributed to its management team's patient acquisition strategy. The team has been actively looking to make an acquisition since 2009 and while they have made multiple bids, none of have gone through as the company is unwilling to pay an unjustified premium. Meanwhile, the company's cash on hand continues to grow and they have over $366MM yet to be invested. Management's unwavering patience in acquiring is one of the traits of an "Outsider" CEO.

EXHIBIT VIII

Market Value Added for $1 in Retained Earnings



Source(s): S&P Capital IQ

Valuation - Historical ROIIC

EXHIBIT IX

Winpak's Historical Return on Incremental Invested Capital

	2011	2012	2013	2014	2015	2016	2017
CapEx	$50	$68	$55	$56	$74	$98	$64
R&D Expenses	$13	$14	$14	$17	$21	$23	$20
Incremented Invested Capital	**$63**	**$82**	**$69**	**$72**	**$95**	**$121**	**$84**
EBITDA	$126	$128	$142	$174	$251	$263	$253

2011 to 2017 Progression	
Cumulative Invested Capital	$586
Cumulative Change in EBITDA	$127
Return on Incremental Invested Capital	22%

WPK 7-Year CAGR	21%

EXHIBIT X

CCL's Historical Return on Incremental Invested Capital

	2011	2012	2013	2014	2015	2016	2017
CapEx	$81	$94	$116	$154	$172	$235	$286
Acquisitions	$19	-	$515	$87	$50	$637	$850
Incremental Invested Capital	**$100**	**$94**	**$632**	**$241**	**$222**	**$871**	**$1,136**
EBITDA	$239	$255	$339	$481	$608	$756	$959

2011 to 2017 Progression	
Cumulative Invested Capital	$3,295
Cumulative Change in EBITDA	$721
Return on Incremental Invested Capital	22%

CCL.B 7-Year CAGR	39%

Return on incremental invested capital is an effective metric to identify businesses that are strong compounders of capital and have opportunities to invest at a high rate of return moving forward. It is evident that both Winpak and CCL Industries have demonstrated high return on incremental invested capital. These internal growth rates are relatively in-line with the growth rate that the market has applied on the company stocks, as seen through the 7-year CAGR calculations.

Source(s): S&P Capital IQ

Portfolio Implications

Big Things Come in Small Packages

The M&M team recognizes that despite its smaller size than our typical holdings, Winpak is packed with strengths that make it stand out within our investable universe. To begin, the company's consistent and steady R&D commitment over the years has allowed it to identify which materials and aspects of production can be compromised to save costs and which are key to offering quality products to its long-run stream of clients. Moreoever, it holds a technological advantage in terms of cost and quality via company-owned conversion equipment, proprietary co-extrusion techniques, and custom resin blends.

Furthermore, Winpak offers a rare opportunity for the M&M team to gain exposure to a company with strong and patient management and sticky customers. Winpak's position in flexible packaging and packaging of drugs and perishables has helped the company build a moat in a typically commoditized product field. Similar to how Elon Musk compares lithium costs in producing EV batteries as "the salt on the salad," packaging costs are only cents while enclosed products tend to sell for significantly more. Consequently, in cases where packaging is at the core of product regulation and safety, such as with perishables, pharmaceuticals, and even condoms, clients are unlikely to take on the risk of switching to a competitor to save a meager amount in costs. Winpak further ties down customers through a growing implementation of personalization and mutually beneficial R&D efforts, where it works to find technological solutions specific to customers needs.

The company's zero-debt financing structure, support from Wihuri, and history of strong return on invested capital are additional aspects that make Winpak a strong company. If the company's patience in waiting for an acquisition target pays off, out team has high confidence in management's ability to successfully integrate the target and realize high returns from the transaction.

Is It Worth The Risks?

Despite our high confidence in the company's core moats and its management's competencies, a few concerns would need to be addressed before the M&M team could view Winpak as a strong investment. To begin, Winpak has indicated in its more recent earnings reports that the company is facing "increased competitive pricing conditions with specific customers". These pressures may prevent the company from transferring input cost increases to consumers. It is unclear how real the impact of these pressures has been and will be in the long run. Given that Winpak's impenetrable customer relationships in flexible packaging is an important aspect of our theses, more information is needed surrounding this statement before our team can consider investing in Winpak. Understanding this narrative better would allow the team to determine if the market's negative reaction to Winpak's most recent earnings release is justified.

Valuation is another key concern, given that the company trades at a very high multiple. While there is a possibility that a market overreaction caused the near 20% price decline in Winpak since July 2017, its current 20.8x P/E multiple is still quite high for an entry point, especially when comparing its close American competitors, which are trading at much lower multiples. Nevertheless, since Winpak, CCL, and Intertape Polymer are the only three sizeable Canadian packaging stocks and packaging is of the most stable sub-sectors in the Capped Materials Index, it is possible that this multiple premium can be partially attributed to Canadian relative funds seeking stable exposure to the materials index.

Fund-Level Implications

Lastly, by investing in Winpak via selling an even portion of the QUIC M&M portfolio's existing long-term holdings, the portfolio would be heavily overweight in packaging. This would mean a fundamental shift away from traditional mined commodity-type M&M holdings towards more stable, differentiated names. In addition, the M&M team's outlook on Winpak relative to CCL Industries, our current packaging holding, will determine how investment in packaging will be allocated. Ultimately, due to current confidence and outperformance by CCL, the team would want to see a large valuation gap between the two firms before partially or fully replacing our stake in CCL with Winpak.

Source(s): S&P Capital IQ

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