

# QUARTERLY INSIGHTS

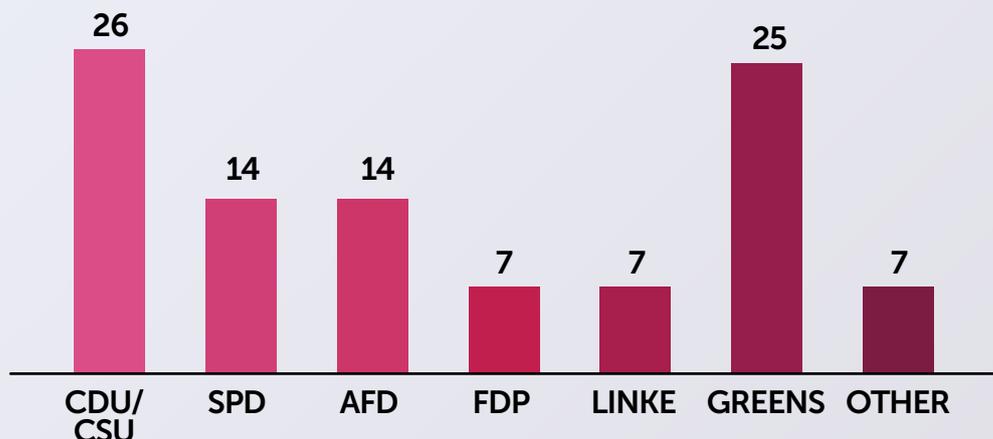
HOLD ASSET MANAGEMENT – THE CENTRAL-EUROPEAN VALUE-BASED EQUITY SPECIALIST

## MAYR-MELNHOF

Central-European company at the intersection of two powerful trends impacting Europe's investment landscape – A largely unrecognized opportunity

The first phenomenon to start with inevitably is negative interest rates, which is a nightmare for European savers. In search for yield investors are forced into something riskier than government bonds. Real estate prices are already quite elevated across Europe and corporate bonds are also pricey. This makes equities the only remaining option for investors. But with uncertain global macro developments the preference is clearly for stable, non-cyclical and low volatility businesses.

The other important topic is politics. What is the most recent trend in EU politics? No, it is not the increase of populism due to immigrants. That was a few years ago. It is going GREEN. Green party gained 60% more share of votes in the 2019 EU Parliamentary Election than before. In recent German polls (see below), the Green Party's popularity matched Merkel's CDU at the top. Polls also show that the most important issue Germany is facing is environment/climate change. As one of the first steps among many, the EU just decided to ban single-use plastics from 2021.



SOURCE: INFRATEST DIMAP FÜR ARD-MORGENMAGAZIN

Being value investors at HOLD AM we are usually not very keen on investing with big top-down themes as we think when these become widely recognized they are already fully priced in. But when it is not recognized... Let's meet Mayr-Melnhof Karton (MMK).

# INTRODUCING MMK

founded in 1950, is a family owned (57%) Austrian midcap company working in the carton packaging industry

MMK, founded in 1950, is a family owned (57%) Austrian midcap company working in the carton packaging industry. Midcap describes the visibility not the size of the business. Free float MCAP is slightly below EUR 1 billion and only a few analysts cover the stock. Actually, it is the largest cartonboard (base material for carton packaging) producer in Europe having a 22% market share in a concentrated industry. It is also the largest recycled carton producer in the world. On the conversion side, it is by far the largest carton packaging producer in EU having a 14% market share, which is more than double of the share of the second player. An example of their end products would be the box containing Nespresso capsules or corn flakes.

As an owner operated company MMK focuses on the long term. It is investing more in the business than its competitors, which gives it an edge both on the production cost side as well as on the technological leadership front. Speaking about the later, to our knowledge MMK operates the only commercial size barrier cartonboard (FOODBOARD) production line. The specialty of this advanced, fully recyclable and bio compostable mono-material product is that it 100% protects the internal contents from external moisture or contamination. This attribute widens the scope of use of carton for food packaging and makes an environmentally polluting secondary inner packaging layer such as plastic or aluminum foil unnecessary.

## WHY CARTON is interesting

As plastics become less desirable in Europe **carton is one of the most obvious packaging replacement** for a wide range of products. Consumer surveys in Europe show that cartonboard is perceived to be the **most environmentally friendly** packaging material by far. Carton is **more pricey than plastic** packaging therefore its use has been limited in the past. However perceptions change and EU is at the forefront of shaping this new trend, also thanks to affordability.

**According to surveys, around 50% of consumers are willing to pay at least 5% more for a product if it is ecologically more friendly.**

This change for carton packaging is not yet visible in the sales momentum, which allows value investors to buy MMK at a low valuation currently. But not for long as we see high probability for a change around the corner. MMK management states that they already see increasing communication activity with potential clients on this switch and to their estimate material sales impact is foreseen to be around 2021. Maybe too far of a timeline for short term investors but definitely matching our longer term investment horizon.

# MMK IS SIGNIFICANTLY UNDERVALUED

Even without green growth potential

MMK's share is clearly in the low volatility camp, which should be in high demand in Europe. Since the IPO in 1994 it was profitable every year. In its worst year - during the 2008 global crisis - its EPS decreased by 16% while Eurostoxx50's dropped by 43%. Its long term beta against Eurostoxx50 is around 0,5.

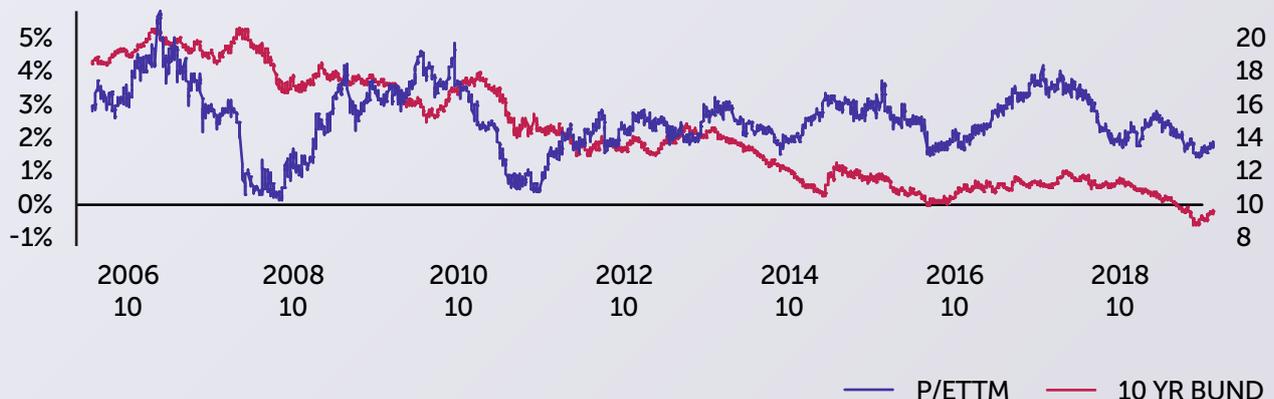
Why is it so stable?

Its end product is almost all used for consumer staples, mostly in Europe.

Furthermore, it mostly uses recycled fiber as an input. The price of recycled fiber is more stable than that of virgin fiber, which has a global market having China as an important swing factor there. Finally, the two segments - cartonboard production and packaging (conversion) - also balance each other. As an increase of virgin fiber input costs push conversion margins temporarily lower, it is beneficial to have a higher proportion of recycled inputs in production than competitors, which elevates cartonboard production (also sold for 3rd party, not only for own conversion) margins at the same period.

Valuation-wise, the company trades at around 12x forward P/E and 6,5 x EV/EBITDA with a low leverage of 1x ND/EBITDA. Given its strong industrial position it is continuously generating satisfactorily high and stable ROIC at around 12%, which is roughly double its estimated WACC. Given the low risk profile, MMK in our view is more comparable to a cash flow generating real estate investment. But prime offices in the EU now trade well below 4% yields, which is half of the earnings yield or sustainable cash flow generation yield of MMK. Finally, the valuation of MMK is now below where it was pre 2008 crisis even though long term risk free rates in core EU came down from 4% to negative levels! Not applying the current extreme government bond yields but a more reasonable 2,5% for risk free rate, MMK still deserves a 50% valuation premium from current levels in our view.

**MMK P/E VS 10 YR GERMAN BUND RATE**



SOURCE: BLOOMBERG, HOLD ASSET MANAGEMENT

# REASONS

for low valuation

MMK's market capitalization of EUR 2,2 billion and daily liquidity of EUR 0.5-1 million are limiting large investors but it is the right size for us. Analyst coverage is limited. Green growth opportunity is not yet discussed widely and short history rather shows slow sales dynamic for MMK due to EU economic weakness.

There is no clear short term catalyst but green growth could be the next big thing. However with negative yields as an imperative and the spread of quant strategies seeking mispriced equities we think there is an increasing chance of investors discovering MMK even without a significant catalyst. Meanwhile we are happy long term holders of a quality company compounding its value at an attractive rate.

**MMK PRICE DEVELOPMENT IN THE LAST 5 YEARS**



SOURCE: BLOOMBERG, HOLD ASSET MANAGEMENT