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Pro-Pac Packaging Reports 1H22 Results

Pro-Pac Packaging Limited (ASX: PPG) ("**Pro-Pac**" or "**the company**" or "**the group**") today announces its results for the half-year ended 31 December 2021 ("**1H22**").

1H22 Financial Highlights
Revenue up by 4% across the group at $244.7 million, with 7% revenue growth in core Flexibles business
PBT[1] down by $7.5 million at $4.2 million and PBT margin[2] down by 326 bps at 1.7% compared to 1H21 due to the impacts of challenging market conditions, primarily impacting the Flexibles business unit
Net debt[3] at $82.1 million and Gearing[4] at 3.3x (30 June 2021 – 1.5x)
Significant Highlights
TRIFR[5] reduced by 13% to 8.15 at December 2021 (June 2021: 9.36)
Continued to deliver on our operational strategy in the face of COVID-19 headwinds and focused on strategic priorities within our control
Increasing pipeline of demand, investment in capacity and technology, and focus on organic and acquisitive growth underpin revenue growth
ERP consolidation project on track with Supply Chain & Manufacturing pilot go-live scheduled for 2H22
Completed closure of Chester Hill facility and establishment of Centres of Excellence for Flexibles printing and conversion in Dandenong, Victoria

Commenting on the 1H22 results, Pro-Pac's CEO & Managing Director Tim Welsh said:

"The first half of FY22 has been a challenging period for the company as the impacts of the ongoing COVID-19 pandemic, including labour shortages, site closures and global supply chain disruptions, constrained our manufacturing capacity. We have developed mitigating strategies for the various COVID-19 impacts and have implemented a significant response to inflationary pressures in raw materials, freight and labour, as we continue to build a more resilient business.

"We have remained focused on delivering on our strategy and executing on the priorities within our control to capitalise on our investments. The closure of Chester Hill is complete, and our Centres of Excellence for Flexibles printing and conversion are now established in Dandenong, which provides a world class platform for growth. We remain focused on profitable growth, with organic and inorganic opportunities under active consideration.

While we expect the operating environment to remain challenging for the remainder of the financial year, steps taken by management, and investment in critical areas are expected to have a material positive impact on 2H22 and therefore we anticipate 2H22 PBT to be materially greater than 1H22."

1H21 Overview

As reported in Pro-Pac's trading update to the ASX on 20 December 2021, the impacts of the COVID-19 pandemic, particularly labour shortages, site closures and global supply chain disruptions, affected Pro-Pac's businesses throughout the first half of the financial year.

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Pro-Pac successfully managed employee safety and executed responses to a range of factors around continuity of operations throughout this period.

- **Global supply chain disruptions:** container freight and resin supply have been constrained, which has in turn has led to significant increases in cost and increased stock holdings. The rapid and significant resin inflation related not only to global supply chain disruptions but was also due to extreme weather events in the US during 2021 that restricted global supply, as well as higher general global demand for polyethylene products. Pro-Pac has introduced a freight surcharge to address increased freight charges. Price increases continue to be progressively and routinely implemented across our business units in response to increased resin costs, but there has been a lag in the timing to recover these costs. Global shipping delays are making the timing of deliveries unpredictable and extending our cash conversion cycle, particularly in the Industrial Specialty Packaging (**ISP**) business.
- **Site disruptions:** COVID-19 site disruptions and stoppages, closures across Victorian sites following storm activity and commissioning issues associated with the relocation of key assets from the decommissioned Chester Hill site all contributed to production backlogs, which delayed the introduction and impact of certain price increases.
- **Labour shortages:** labour costs on several sites were substantially above expectations to address backlogs and meet customer demand, particularly in the Flexibles business. While this is creating a temporary cost burden on the business, Pro-Pac has chosen to invest in this additional cost to ensure continuous customer service while also working on a range of strategies to manage labour supply in the short, medium and long term.

The full financial benefit of many of the initiatives outlined will be progressively realised in the second half of the financial year.

During the half year, revenue grew by 4% across the group to $244.7 million with 7% growth in Flexibles and 9% in ISP. However, PBT was down by $7.5m at $4.2m with the PBT margin down by 326bps at 1.7% compared to 1H21. This was primarily due to the stated impacts of cost inflation and COVID-19, which predominantly impacted the Flexibles business.

The company has continued to deliver on its strategy in the face of COVID-19 headwinds, and has focused on priorities within its control, such as the increasing pipeline of demand and opportunities, strategic investment in capacity and technology, and the pursuit of organic and acquisitive growth.

Financial Performance

Operating result

Key metrics	**1H22 $'000**	**1H21 $'000**	**Change**
Group results:			
Revenue	244,689	234,369	4.4%
Statutory profit before tax	184	8,841	(97.9)%
Statutory profit after tax	128	6,186	(97.9)%
Operating results:			
Underlying PBT[1]	4,217	11,686	(63.9)%
Underlying PBT margin[2]	1.7%	5.0%	(326) bps

- Revenue of $244.7 million (up 4.4% on pcp): stronger demand in Flexibles and ISP was offset by the continued re-basing of Rigid revenues post the peak of pandemic demand.
- Underlying PBT of $4.2 million: broadly in line with the guidance provided to the ASX on 20 December 2021. PBT margin was down 326 bps at 1.7% compared to 1H21 due to the impacts of challenging market conditions including cost inflation and COVID-19 impacts.
- Significant items of $4.0 million primarily included costs relating to the closure of Chester Hill, the establishment of the Centres of Excellence, integration and restructuring costs, and one-off costs associated with the ERP project.
- Statutory Profit before Tax of $0.2 million compared to $8.8 million in the pcp.

Balance Sheet

Key metrics	Dec-21 $'000	Jun21 $'000	Change
Working capital[6]	103,554	81,390	27.2%
Net debt[3]	82,066	51,016	60.9%
Gearing[4]	3.3x	1.5x	1.8x

- The balance sheet has supported significant investment in new technology over the last 3 years, which is starting to deliver growth.
- Working capital increased due to additional holdings of inventory to minimise manufacturing disruptions as a result of global supply chain delays. Receivables also increased, in part attributable to the usual seasonal nature of the group's supply to customers in the agricultural sector, and in part (circa $10 million) due to a significant increase in ISP growth, with export delays extending the cash conversion cycle for this business.
- Net debt was $82.1 million with gearing at 3.3x. Net debt increased due to lower earnings and the increased working capital noted above. There was also a $9.5m investment in capital expenditure during 1H22.
- Balance sheet: due to the factors noted above, gearing levels have temporarily increased. Management expect that initiatives introduced to combat these factors will see the gearing position return to more normalised levels over time.

Divisional Results

Flexibles

- Revenue up 7% at $144.9 million (1H21: $135.7 million); and
- PBT[1] down 70% at $2.9m (1H21: $9.7 million)

Revenue grew by $9.2m, $4.0m of which was due to the net impact of the Supreme acquisition and the Integrated Machinery divestment.

During the half year, the impacts of challenging market conditions have significantly impacted the Flexibles business.

This has resulted in a material decrease in the PBT of the Flexibles business. Price increases and a freight surcharge were introduced in December, however there has been a lag in cost recovery.

Additional capacity in lamination has been introduced in 2H22 and additional printing capacity is scheduled for commissioning in 2H22. The capacity of these assets has been pre-sold. There is also a strong pipeline of revenue demand in the Flexibles business to support 2H22 earnings.

Flexibles continues to develop and implement strategies to deal with labour shortages, but this remains an ongoing challenge across the market.

Industrial Specialty Packaging

The ISP business has continued its growth trajectory with:

- Increased revenue, up 9% at $68.0 million (1H21: $62.6 million)
- Significantly increased PBT, up 117% at $2.4 million compared to $1.1 million in 1H21.

ISP continues to deliver on its strategy for growth, centred around developing a customer centric value culture based on solutions-oriented partnerships. This result has been achieved despite the ISP business being impacted by global shipping and supplier delays, and labour shortages.

Price increases were introduced in November, at the same time as a roll out of a freight surcharge.

Rigid

The Rigid business has continued to adjust well to the new COVID-normal, re-basing production levels from peak COVID-19 demand and performing largely in line with expectation:

- Revenue down 12% at $31.8 million (1H21: $36.1 million)
- PBT down $1.8 million at $1.2 million compared to $3.0 million in 1H21.

Following a management and sales team restructure in November 2021, the Rigid business is focussed on converting the extensive new business pipeline. Early new business wins combined with price increases, freight surcharge, and the realisation of cost efficiencies, position this business well for 2H22.

Dividend

In light of 1H22 financial performance, ongoing COVID-19 disruptions, and taking a disciplined approach to responsible capital management, the Board has determined not to declare an interim dividend. The Board of Pro-Pac remains committed to rewarding shareholders in line with the performance of the business.

Outlook

With a strong pipeline of demand, Pro-Pac is introducing additional capacity in printing and laminating, and a variety of other actions have been taken to alleviate bottleneck issues, which are expected to help improve efficiency, service to customers and top line growth. Pro-Pac also continues to develop its labour supply strategies to address shortages.

These strategies, together with the relaxation in COVID-19 restrictions supporting a lower anticipated level of site disruption, are expected to provide a material positive impact in 2H22. However, the group expects the operating environment to remain challenging, particularly around labour shortages and shipping delays.

As a result of the above, Pro-Pac expects its underlying PBT for 2H22 to be in the range of $7.8m-11.8m (2H21: $7.1m) and therefore FY22 to be in the range of $12m-$16m (FY21 - $18.8m).

This announcement has been authorised for release by the Board of Directors.

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About Pro-Pac:

Pro-Pac Packaging Limited (ASX: PPG) is an innovative Flexibles, Industrial Specialty Packaging and Rigid packaging company with a diversified distribution and manufacturing network throughout Australia and New Zealand. Headquartered in Melbourne, Pro-Pac delivers bespoke packaging solutions for a broad group of blue-chip and SME clients in the industrial, food and beverage, health, agriculture and manufacturing sectors. For further information, please visit www.ppgaust.com.au

Forward-Looking Statements:

Some of the statements in this document constitute "forward-looking statements". These forward-looking statements reflect Pro-Pac's current intentions, plans, expectations, assumptions and beliefs about future events and are subject to risks, uncertainties and other factors, many of which are outside Pro-Pac's control. Important factors that could cause actual results to differ materially from the expectations expressed or implied in the forward-looking statements include known and unknown risks. Because actual results could differ materially from Pro-Pac's current intentions, plans, expectations, assumptions and beliefs about the future, you are urged to view all forward-looking statements contained in this document with caution.

[1] PBT refers to profit/(loss) before income taxes and significant items
[2] PBT margin refers to PBT divided by revenue
[3] Net debt is calculated as interest-bearing liabilities, less cash and cash equivalents before accounting for AASB 16 *Leases*
[4] Gearing is calculated as net debt divided by EBITDA (including any unconsolidated EBITDA attributable to operations acquired in last 12-months)
[5] Total recordable injury frequency rate
[6] Working capital refers to trade and other receivables, inventories, deposits and prepayments, less trade and other payables