

Mossberg's Investor Digest

Best Idea Profile

Graphic Packaging (NYSE: GPK)

DESCRIPTION:

Headquartered in Marietta, Georgia, Graphic Packaging is a leading provider of paperboard packaging solutions for a wide variety of food, beverage and other consumer products companies. The company is one of the largest producers of paperboard packaging (83% of sales – i.e. cereal and pizza boxes), multi-wall bags (12% of sales – i.e. bulk dog food bags) and specialty packaging (5% of sales). GPK has the #1 U.S. market share in paperboard packaging with 32% of the market, and #1 market share in multi-Wall Bag packaging with 34% of the market. The company's customers include some of the most widely recognized companies in the world including: Kraft Foods, Anheuser-Bush InBev, General Mills, SABMiller, Nestle, Kellogg, Unilever, Kimberly-Clark, Proctor and Gamble and many others. The company merged with Altivity Packaging last year, nearly doubling its size. The combined company employs approximately 14,000 people worldwide, has 42 folding carton facilities, 17 multi-wall and specialty bag plants, and 7 paperboard mills worldwide.

KEY INVESTMENT CONSIDERATIONS:

Food & Beverage markets stable during a down economy – Over 85% of the company's revenue are from food and beverage products, which tend to be more stable in a down economy. People eat at home more and less at restaurants. For example, dry dinner mixes are up 9%, frozen pizza snacks are up 11%, and domestic beer increased 8%.

Low-cost producer – GPK is the largest producer of new and recycled paperboard packaging material, with 55% and 31% market share, respectively. In addition to scale, GPK's vertically integrated ops allow it to have one of the lowest costs structures among its peers.

Industry consolidation provides pricing power...the big will get bigger – M&A activity over the past several years has consolidated the market into a few larger players, with more pricing power. Market share of the top 5 producers has increased from 44% in 2001 to 68% in 2008, according to Goldman Sachs and the Paperboard Packaging Council.

Lower natural gas prices to benefit costs – Natural gas is one of the largest costs in producing paperboard packaging. The October natural gas futures contracted closed at \$3.78 last week, about half of what it was this time last year. During 2009, the company hedged 70% of its natural gas needs at around \$9.00. It is now hedged 20% at around \$6.00 for 2010. On an annual basis, GPK uses around 10 million mmbtu's of natural gas. So, if the company is able to pay \$5 to \$6 for gas next year, it could save approximately \$20 to \$30 million.

Deleveraging reduces risk – GPK carries a significant amount of leverage with a net leverage ratio of 5.7x. The company has given guidance to reduce leverage by \$275 million during 2009 and has a stated leverage ratio goal of 4.3x by 2010. GPK is currently producing approximately \$500 million in annual adjusted EBITDA. Along with limited capex, and cost efficiency measures, GPK should generate ample cash flow to meet this goal. During late August, the company closed on \$180 million of 9.5% senior notes due in 2017. The proceeds will be used to call senior notes due 2011.

(NYSE: GPK)

Investment Data (as of 9/18/09)

Recent Price	\$2.29
52-Week Range	0.57 - 3.36
Fiscal Year End	December
Shares Outstanding	343 MM
Average Trading Volume (3 mos)	450,000
Market Capitalization	786 MM
Cash	161 MM
Long Term Debt	3.0 B
Enterprise Value (EV)	3.7 B
LT Debt/ Equity	5.3
BV/ Share	1.60
TTM Revenue	4.3 B
P/ Revenue	0.2x
TTM EPS	-0.24
P/ EPS	N/A
Adjusted TTM EBITDA	514 MM
EV/ EBITDA	7.2x

VALUATION:

Shares currently trade at 7.2x EV/ EBITDA, which is an attractive multiple for a market leader. Assuming this valuation remains unchanged, the equity value should increase as the company continues to pay down debt. If debt reduction continues at the recent pace (excluding one time benefits) of \$100 million to \$200 million/ year, that equates to a 13% to 25% increase in equity value. Longer term, lower leverage ratios and the resulting reduced risk should allow for multiple expansion. Over the past 5 years EV/EBITDA multiples for transactions in this space have ranged from 7x to 10x. Applying the higher end of the multiple range of 9x would yield a value twice the current level.

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