

North America Packaging

A start-up shows how e-commerce can capture share in packaging distribution

Packaging | Comment

Orora's (ORA.AX) recent full year results presentation stated that its North America distribution business will soon invest in e-commerce. The North American packaging distribution industry is a highly fragmented US\$50bn market. Orora holds about 3% market share and is a top 10 player. But it has not grown sales organically in recent years and its last 12 months' EBIT performance has been poor despite acquisitions. Similarly, Veritiv, a large ORA distribution competitor, reported declining sales in the past 12 months. Contrast that to market share growth of Uline, now the #1 player in the industry and entirely a *digital* wholesaler has grown sales from an estimated US\$2bn in 2014 to US\$5.8bn in 2019.¹ It is no wonder that ORA has stated an intention to invest in e-commerce.

New e-commerce approaches are entering the US distribution industry. We recall that in June the *Australian Financial Review* reported ([here](#)) about an e-commerce start-up, Packform, entering the North American packaging distribution market. Packform just won two Stevie Awards: Tech Startup of the Year (Gold) and Business Services Startup of the Year (Silver). These awards speak to the robustness of its tech stack and the digital business models that are transforming the packaging industry. We reached out to Packform and it was amenable to discussing with us its business and perspectives on e-commerce in US distribution market.

- Management indicates **Packform may capture meaningful share in a highly fragmented industry** through its strategy of *combining an e-commerce platform with the recruitment of experienced distributor sales reps*. Packform is capital light, cash flow positive, profitable and is analogous to a retail roll-out whereby each newly on-boarded dealer is a virtual point of distribution that brings cash and earnings.
- **ORA has stated that it intends to retain its North America** packaging distribution, manufacturing and promotional display business. We, on the other hand, think that ORA's commitment to the business is low as indicated by its freeze on growth investment for that division. After an expensive and delayed rollout of SAP, we can't envision ORA undertaking a major e-commerce initiative and leading the new industry direction, digital. Should a buyer appear for this business, we think ORA is likely a willing seller.
- **ORA's packaging distribution business is a rare asset that could potentially surprise in its transaction value.** Out of thousands of packaging distribution businesses in North America only 10 account for 37% of the market. Because traditional packaging distribution is a low-margin, competitive market, we value Orora's US operations at 7x EBITDA (pre-lease accounting) or A\$700mn (US\$500mn). The only other major recent transaction was perhaps in another era, 2015, Victory Packaging 2/3 ORA's size -- was acquired by Kapstone paper for US\$515mn-US\$690mn (9.4x- 12.5x LTM EBITDA) depending on whether you adjust for earn-outs and tax benefits. In a divestment, each one turn increment of EBITDAx would add about 15c to our ORA valuation.

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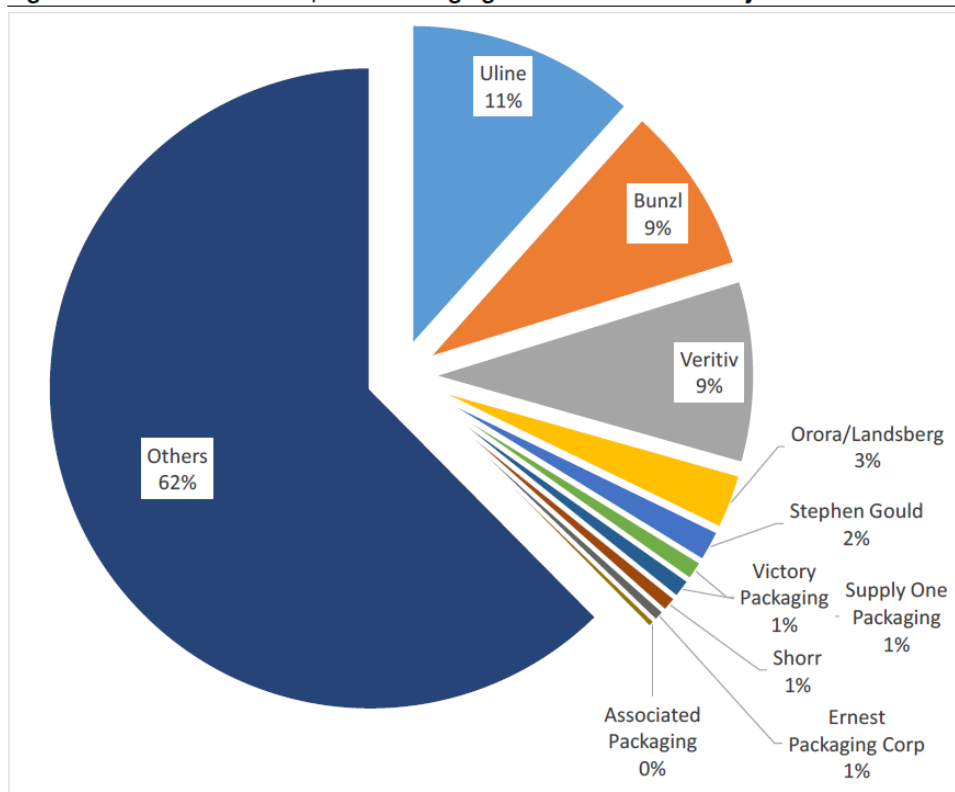
A look at a novel startup in the packaging distribution sector

The packaging distribution industry's fragmentation makes it a natural habitat for Packform

Packform has entered the US\$50bn packaging distribution market. This market is underpinned by corrugated paper packaging and supplemented by tapes, plastic packaging, cleaning products, work wear, etc. This is a highly fragmented market. There are perhaps over 5,000 distributors or dealers in North America. The likely reason such a fragmented distribution industry (downstream) remains is because the consolidated paper manufacturing industry (upstream) must keep large paper mills running 24/7 and feed corrugators with long production runs. It is therefore more efficient for *downstream* distributors to deal with many small corrugated box users with their multitudinous requirements.

Distributors can be large operations whose relationships with customers generally depend on sales teams remunerated primarily on commission. Also operating in this packaging marketplace are hundreds of broker/dealers that tend to be smaller operations and may hold limited or no inventory. (Separately, Bunzl is known for its salary-based sales force. Veritiv is believed to be transitioning all or part of its sales force to salary.)

Figure 1: North America US\$50bn Packaging Distribution and Facility Solutions market



Source: Company data, Credit Suisse

What is Packform?

Packform is a *managed* digital market place. As an electronic marketplace it, of course, connects buyers of packaging to sellers of packaging. But Packform's distinction as a *managed* marketplace is critical to its success, according to its management. On Packform, interactions between buyer and seller are sown and grown by former packaging industry sales execs. These *Packform Dealers* bring their industry expertise and relationships to Packform. They run their own businesses with their own book of customers, independently. (Note: all data residing on the system is owned by Packform.)

Packform Dealers introduce both suppliers and customers to the electronic platform. Its suppliers have their products uploaded on the platform. Its customers tender their purchase requirements via Packform Dealers or directly. Tenders are awarded on price, quality, lead time in a transparent fashion. Packform pays the supplier, arranges a single delivery and invoices the customer with a single invoice if required (unlike say Amazon which may result in multiple deliveries or invoices.)

Figure 2: The distributor value proposition and how Packform excels

| Distributor Proposition | Distributor | Packform |
|---|--|---|
| Range and Product Availability | Invests in inventory to offer range and availability benefiting customers <i>and suppliers</i> . (This is asset intensive requiring warehousing and working capital for which distributors expect a return.) | Essentially an avenue for unrivalled array of packaging products as more suppliers make themselves available on Packform. Packform does not hold inventory. <u>Inventory at the manufacturer</u> can be accessed to meet just-in-time needs of packaging end users. |
| Customer service, selling and quality | Trust in service (on-time, complete deliveries, low defect rates) protected by sales rep relationships. One-stop shop on one invoice. For suppliers, distributors act as an outsourced sales force. | Transparent fulfilment is a key feature of Packform. Packform dealers are in business for themselves motivating them to take extra care. Packform can be a one-stop shop on one invoice. |
| Value added services & custom design work | Has technical knowledge, design studios and cutting equipment to create novel packaging for customers. Custom packaging accounts for about 50% of the value of distributor sales. | Has technical knowledge and uses the Packform system to design and source custom packaging by way of tender often leading to lower prices. |
| Pricing | Uses scale and opportunistic procurement to obtain low pricing that can be passed to end-users | Uses low overheads and competitive tenders to overcome volume discounts. Pricing is transparent with no rebates and prebates. This has resulted in superior pricing for small- and mid-sized end users. |
| Logistics | Access trucking and warehousing networks. Same day services available. | Manufacturers deliver in accordance with customer requirements. Same day delivery is also enabled on Packform. Order tracking is standard. |

Source: Credit Suisse, McKinsey, Packform Management,

Packform could disrupt the distribution industry because it can make good on the distributor value propositions with low cost, less investment and in many instances greater effectiveness, according to Packform management. Management suggests that its transparency gives these smaller packaging users more control over their procurement choices. At least 50% of the packaging distribution market is made up of small- to mid-sized packaging users.

Transparent, comparative pricing

Increasingly, users of packaging have been making comparative costings and now expect transparent comparative pricing. Packform is a comparative evaluation tool for end users of packaging *and* suppliers of packaging. Smaller end-users of packaging may find that their lack of scale in achieving satisfactory pricing outcomes is compensated for on Packform because of its competitive pricing arena and low overheads.

Packform's lower operating cost

As a digital enterprise with very few staff, this would suggest Packform's overheads are lower than traditional industry players. The whole company employs about 28 people excluding dealers, according to management. Should Packform achieve US\$100mn of turnover its overheads and distribution expenses should not exceed 5% of sales using management calculations. By comparison, a traditional distributor such as ORA (with estimated distribution sales of US\$1.4bn) is likely to incur OH of 15%-25% of sales. (Veritiv – the largest publicly-listed packaging distributor reported SG&A and distribution expenses at 17% of revenue in 2019. Bunzl reported Employee Costs, Lease and Other Expenses at 19% of sales in 2019.)

Therefore, Packform's overhead on-cost to customers is much lower, enabling the company to reflect lower pricing for similar products, according to its management.

Disintermediation, control and effective procurement

Packaging purchasers – especially larger ones – increasingly aim to cut-out the middleman and procure from packaging manufacturers directly. But the flip side to that objective is that the end-user must manage their own procurement. Packform can address that problem for some large customers too. For large packaging end users that have their own procurement function, Packform can be a system-as-service (SAS) navigated directly by large company procurement staff rather than through a Packform Dealer. For small- and mid-sized companies Packform's transparency and low on-costs bring those end-users closer to the supplier with more control.

Packform's growth

Packform is growing like a retail roll-out where each new "store" – dealer -- seems to be generating incremental revenue and cash flow, according to Packform management. Market share growth does not need significant incremental capital. Packform's growth comes from recruiting experienced distributor salespeople that have strong customer relationships and technical knowledge. In most instances these salespeople have been working for one of the major packaging distributors operating in North America but in some cases they could be already self-employed dealers attracted to Packform by its system and marketplace. Packform says it could also onboard sole proprietor packaging brokers.

Packform management describe that dealers are most attracted to the business because Packform's low overheads leave more transaction value left over to be shared with the dealer than traditional distributor commissions. Moreover, the transparency and flexibility frees sales of people of time-consuming administration they are burdened with at major distributor organizations, according to Packform management.

Packform generates revenue outside packaging distribution

One of the important advantages with e-commerce distribution systems is that they can more easily reach across industries than terrestrial competitors. Today, we regard the packaging distribution market US\$50bn as distinct from the plumbing parts distribution market. But a system like Packform would not distinguish between such markets. According to McKinsey, the industrial distribution industry is about US\$2.5 trillion in revenue. McKinsey recently conducted a study of a 138 distributors tally US\$500bn in sales and then estimated the sizes of the following distribution industries. (Figure 4)

Figure 4: Select US distribution industries

| | Revenue US\$bn | EBITA Margin |
|--------------------|----------------|--------------|
| Autoparts | 241 | 8.1% |
| Building Products | 113 | 4.0% |
| Electrical | 171 | 4.9% |
| Electronics | 354 | 2.8% |
| General Industrial | 99 | 7.4% |
| HVAC and Plumbing | 263 | 8.9% |
| IT | 307 | 2.6% |
| Metals | 208 | 3.5% |
| Total | 1,756 | 5.0% |

Source: McKinsey

This means that an e-commerce start up can finance its penetration into one industrial segment with market share it was capturing from another industrial segment. Such a migration is much more difficult for Orora. Granted, ORA has pivoted from corrugated box distribution to a broader range of factory supplies – but it probably cannot pivot into electrical parts distribution.

Packform management has indicated that it is already exploring the use of its systems in healthcare distribution after demand created by the pandemic spurred healthcare companies to look for better procurement solutions.

Traditional distributors won't disappear but their target customer base may continue to diminish

Customers that value high-end customisation, service levels and complexity are likely to remain the domain of traditional distributors. For example, customers that require that distributors install and maintain packaging equipment are unlikely to rely wholly on e-commerce solutions for procurement of packaging.

Traditional distributors are likely to have to further reduce costs to compete with e-commerce distributors although structurally, traditional distributors have higher costs in warehouse rent and large sales forces.