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OI: Activist Highlights FCF Generation But Limited Growth, Volatile Earnings, Poor Management Team (Changing), & Poor Governance

- Owens-Illinois ("OI" / NYSE:OI), is the 112 year old market leader in manufactured glass containers across the globe with approximately 75 glass manufacturing plants in 21 countries with a management estimated replacement value as of February 2013 of over $13bn.

- OI provides divisional analysis by geographies: (1) Europe (39% of EBIT ex Corp expenses): Market leading (#1 or #2 market player) across markets where Wine and Beer segments represent approximately 55% of sales and 10 year average historical EBIT margin of 12%; (2) North America (26% of EBIT ex Corp expenses): Market leading position where Beer segment represents 55% of sales and a 10 year average historical EBIT margin of 12%; (3) South America (25% of EBIT ex Corp expenses): Monopoly in every country of operation except for Brazil where Beer represents 40% of sales and a 10 year average historical EBIT margin of 20%; and (4) AsiaPac (10% of EBIT ex Corp expenses): Market leader where Beer represents 55% of sales and a 10 year average historical EBIT margin of 16% which declined substantially in last 6 years as pricing pressure from smaller non-profit focused operators increases.

- Despite market leadership positions which have allowed OI to drive price increases generating incremental operating profit of $1.7bn since 2006, volume declines and the simultaneous increased manufacturing and distribution expenses have yielded operating profit declines of $1.6bn over the same timeframe.

- In February 2013, management held an investor day stating several key factors and targets: (1) Asset replacement value of $13bn; (2) 2015 EPS target of over $3.50; and (3) 2015 FCF target of over $400. Since the investor day, management has consistently reduced the EPS and FCF targets and most recently in April 2015 stated the new targets would be an EPS of $2.00 to $2.30 and a FCF of $250mm. Given the current firm value of $7.3bn, if the assets were really worth $13bn as claimed by management (or even $10bn) we estimate all of the assets would have already been sold. If the assets could only be sold for $7bn, then it's clear that the replacement value highlights a fundamental misallocation of capital by OI (i.e. spending $13bn for assets with $7bn of value).

- Despite the significant misses and the reduction to targets, management has been awarded significant Senior Management Incentive Plans (SMIP) and Long Term Incentive Plan (LTIP) awards based on targets that decline significantly and are constantly adjusted to the point that reviewing historical proxy documents highlights inconsistent figures.

June 8, 2015

OWENS-ILLINOIS (OI:NYSE)
PRICE TARGET: $28
CONSIDERATION: BUY BELOW $21

Market Information

Share Price $	$24.45
52 Week High	$35.16
52 Week Low	$22.85
3M Avg Vol. $mm	$24.29
Mkt Cap $bn	$3.9
Firm Value $bn	$7.3

Financials ($mm)	2012	2013	2014
Revenue	7,000	6,967	6,784
EBIT	567	564	448
% Margin	8.1%	8.1%	6.6%
% Growth	NM	(0.5%)	(20.6%)
Net Income	184	184	75
% Margin	2.7%	2.9%	1.4%
% Growth	NM	8.6%	(51.5%)
EPS	1.11	1.11	0.45
% Growth	NM	0.0%	(59.3%)
Div. Per Share			
Net Debt / (Cash)	3,342	3,184	2,948
Net Debt / EBITDA	3.4x	3.3x	3.4x
ROE	21.0%	17.3%	7.5%
ROIC	3.9%	4.2%	2.0%
5 Yr Avg ROIC			1.1%

Soulor Research
www.soulorresearch.com

Director of Research: Nicolas Carreras
ncarreras@soulorresearch.com

Owens-Illinois Overview

Owens-Illinois ("OI" / NYSE:OI), is the 112 year old market leader in manufactured glass containers across the globe with approximately 75 glass manufacturing plants in 21 countries with a management estimated replacement value as of February 2013 of over $13bn. OI provides divisional analysis by geographies: (1) Europe (39% of EBIT ex Corp expenses): Market leading (#1 or #2 market player) across markets where Wine and Beer segments represent approximately 55% of sales and 10 year average historical EBIT margin of 12%; (2) North America (26% of EBIT ex Corp expenses): Market leading position where Beer segment represents 55% of sales and a 10 year average historical EBIT margin of 12%; (3) South America (25% of EBIT ex Corp expenses): Monopoly in every country of operation except for Brazil where Beer represents 40% of sales and a 10 year average historical EBIT margin of 20%; and AsiaPac (10% of EBIT ex Corp expenses): Market leader where Beer represents 55% of sales and a 10 year average historical EBIT margin of 16% which declined substantially in last 6 years as pricing pressure from smaller non-profit focused operators increases.

Investment Case

Despite market leadership positions which have allowed OI to drive price increases generating incremental operating profit of $1.7bn since 2006, volume declines and the simultaneous increased manufacturing and distribution expenses have yielded operating profit declines of $1.6bn over the same timeframe. While OI has been keen to stress FX headwinds recently, the long term FX impact since 2006 on EBIT has been positive. Long term volume declines, competitive dynamics, and operational mis-steps have been the drivers of OI operating performance for the last decade. Partly as a result, nearly the entire OI management team is changing during 2015 with a change in CEO (end of 2015), the recent departure of the CFO (failed to obtain the CEO role and left end of March 2015) and the changes in the heads of the North American, European, and South American divisions.

Since 2007 (first year of reporting excluding the plastics division), the top line, EBIT, and Net Income growth rates are (1.5%), (8.2%) and (10.8%) respectively highlighting the lack of growth. During the timeframe, total assets and Invested Capital grew by (2.4%) and (3.4%) respectively and D&A has consistently been greater than capex. The GP margin declined from 21.1% to 18.5% and the EBIT margin declined from 10.7% to 6.6% and has been extremely volatile. We calculate Net Debt / EBITDA at approximately 3.9x as of Q1 2015 (3.4x Q4 2014) and with an average of 4.1x since the end of 2007 (creditors use an Adjusted EBITDA to calculate the leverage multiples which yields a 3.7x).

Europe is OI's largest market by total sales, total EBIT, and assets but it has the worst operating trends with negative growth, low EBIT margins and very low estimated ROA. In the Q1 2015 earnings call, management highlighted that in negotiating 4 to 6 year European contracts with customers they were forced to give up pricing increases in order to secure more volume. Management has consistently highlighted that in Europe smaller manufacturers are not profit oriented (not a positive industry dynamic). Should management continue to turn to lowering prices to secure volume, we would be extremely concerned given the competitive dynamics.

The next market for concern is AsiaPac with significant EBIT margin and estimated ROA declines and increasing competition. OI has substantially reduced its operations in AsiaPac as a result of the intense competition ($641mm impairment in 2011). In AsiaPac, competition reduced sales volume by 18% in 2014 and led to plant closures.

South America has the best margins and estimated ROA but also suffers from limited historical long term growth. North America is the second biggest OI market and has shown steadily improving margins and returns but once again limited to no growth. In South America, where OI holds monopoly power in every region other than Brazil the 7 year EBIT CAGR is only 3.7% and has been flat in the last 5 years.

Finally, corporate expenses over the last 8 years have averaged $457mm per year or roughly 48% of the yearly EBIT representing a significant drag. In other words, the absolute value of the corporate expenses has been greater than the operating profit of any one division at OI in almost every year for the last seven years.

In February 2013, management held an investor day stating several key factors and targets: (1) Asset replacement value of $13bn; (2) 2015 EPS target of over $3.50; and (3) 2015 FCF target of over $400. Since the investor day, management has consistently reduced the EPS and FCF targets and most recently in April 2015 stated the new targets would be an EPS of $2.00 to $2.30 and a FCF of $250mm. Given the current firm value of $7.3bn, if the assets were really worth $13bn as claimed by management (or even $10bn) we estimate all of the assets would have already been sold. If the assets could only be sold for $7bn, then it's clear that the replacement value highlights a fundamental misallocation of capital by OI (i.e. spending $13bn for assets with $7bn of value).

There are several operational areas of potential value creation which we do not have a firm understanding of but which we do highlight: (1) OI and investors have noted that asbestos charges should decline as the only people who can be involved in a claim had to be alive in 1958 (the last year OI produced Asbestos products) and to have purchased OI asbestos products; (2) Reduction in income statement pension expenses as OI could possibly move to mark to market accounting (estimated to yield $0.50 of EPS per year); (3) an end to all Restructuring charges which could be equivalent to $150mm per year; and (4) The OI effective tax rate is significantly below the government tax rates. OI highlights a US valuation allowance against its deferred tax assets of $927mm. We are uncertain of the usage of the valuation allowance, however, were we to assume and model the valuation allowance as a Net Operating Loss carry forward it would yield an NPV of $4.65 per share. In addition, OI has $376mm of foreign tax credits which expire between 2017 and 2024 which would yield $2.10 of value per share.

Despite the significant misses and the reduction to targets, management has been awarded significant Senior Management Incentive Plans (SMIP) and Long Term Incentive Plan (LTIP) awards based on targets that decline significantly and are constantly adjusted to the point that reviewing historical proxy documents highlights inconsistent figures. For example, pg 21 of the 2014 proxy shows a FCF of $329mm (consistent with all other investor presentations) yet on pg 32 the "Actual" FCF used for the calculation of the LTIP is $382mm which is convenient when Threshold / Target / Maximum FCF targets are $300mm / $335mm / $360mm. There is no explanation of the difference. It's likely that management added back the FX headwind (negative impact of approximately $40mm to the investor FCF amongst other items) however, FX tailwinds were never subtracted from operating results or management targets when the FX was helpful.

The ROIC incentive has several causes for concern, the leading of which is the definition of the EBIT: "excluding items that management considers not representative of ongoing operations". In 2011, OI had an impairment charge of $641mm (very significant given it represented 31% of the total AsiaPac assets) relating to the decline in Australian operations due to a reduced outlook in the future of Australian operations. The impairment charge was added back in OI's calculation of EBIT for the ROIC calculation (and adjusted EPS calculation); however, ultimately management chose to expand the AsiaPac operations increasing assets from $1bn in 2007 to $2bn in 2010 only to impair those assets by $641mm in 2011 (as of December 2014, OI reports AsiaPac assets of $1bn). The impairment is a significant failure on management's ability to allocate capital, management's most important duty to create shareholder value.

If you handed $1bn to an investment manager and the manager invested $500mm in Company A and $500mm in Company B. In the investor agreement, he investment manager obtains a $10mm bonus if there's a 10% or more increase in the value of the operations. One year later, the investment in Company A is worth $600mm and Company B went bankrupt and no longer exists ($500mm investment is worth $0). The Investment manager notes that the past year investment performance is +20% as the total loss in Company B is not included in the "value of the operations" definition and therefore the investment manager is entitled to the $10mm bonus. Would you accept the Investment Manager's definition of "investment performance" or "value of the operations."

Since 2007, the ROIC (and EPS) EBIT also add back "restructuring and impairment charges" (excluding the $641mm in 2011) of $967mm (approximately $121mm every year). Given the yearly nature of the restructuring charges, it's hard to understand how the Board of Directors or management do not define restructuring expenses as "representative of ongoing operations". The OI management team destroyed $1.6bn ($10 per share) of value since 2007 through impairments and restructuring.

Additional concerns regarding the ROIC Calculations include: (1) Historical ROICs from historical proxies do not match; (2) Calculating the ROIC based on management numbers in the proxy does not match the given ROIC number in the proxy; (3) Investor presentations which oftentimes include a diagram for ROIC don't give exact numbers but diagrams' ROIC numbers don't match the ROIC in the proxies; (4) Calculating the ROIC based on the EPS targets (starting in 2009 and calculating the implied delta on the retained earnings and invested capital) yields significantly higher ROIC targets then the ones used by the Board to calculate incentive awards (i.e. the 2011 EPS targets were $3.35 / $3.88 / $4.22 which implies ROICs of 13.3% / 13.9% / 14.7% but the Board target ROICs are 9.3% / 11.3% / 12.3%. Based on calculations, management would never have reached the ROIC targets in any of the last 5 years); and (5) Tax rate used is the management adjusted rate of approximately 24% (very likely used because of the net operating losses the business has historically been able to use to reduce its tax expenses) however, we don't believe that the 24% tax rate will continue into infinity. If management believe restructuring expenses are not normal then surely the below standard US and European government tax rates should not be used. We estimate the real ROIC in 2014 was 6.8% compared to the management given ROIC of 13.2%. Furthermore, we estimate the real ROIC since 2010 is half of the reported ROIC.

The EPS LTIP calculation has similar concerns regarding the adding back of restructuring and impairment expenses, which we disagree with for the reasons listed above. Including the two expenses would reduce the Adj. EPS 6 year average from $2.61 to $1.39.

In addition, the absolute EPS targets are a concern. In February 2013, management disclosed a 2015 EPS target of $3.50 per share however the "target" thresholds for the LTIP in 2013 and 2014 were $3.19 and $3.22 per share and the "minimum" was $3.01 and $3.04. If the public target is $3.50, $3.50 should be the minimum target for management to obtain incentive awards.

Furthermore, in March 2013 (several days after the February 2013 investor conference announcing the $3.50 EPS Target), management were awarded significant options at an exercise price of $26.07 per share which would imply a 7.5x PE multiple based on the $3.50 EPS Target. Was the OI board of directors saying that OI should trade at 7.5x PE? If the Board assumed a 15x PE multiple (average long term equity multiple / yield) on the $3.50 EPS target, the target price would be $52.50 or double the exercise price of the awarded options. Alternatively the OI Board could very well be saying that the real EPS (unadjusted) which OI can earn is $1.74 per share (15x PE and $1.74EPS = $26.07 a share).

In March 2014, management were awarded significant options at an exercise price of $33.62 per share implying a 9.6x PE multiple based on the $3.50 EPS Target. Was the OI board of directors saying that OI should trade at 9.6x PE, or alternatively that the real EPS (unadjusted) which OI could earn was $2.24 per share (15x PE and $2.24EPS = $33.62 a share).

Ultimately, OI has reduced the long term EPS and FCF targets by approximately 40% since 2013, it's difficult to understand how management could be awarded any incentive rewards during each of the last 2 years for such total failure. The OI Board of Directors has failed shareholders.

While several non-operational and operational factors as well as operational factors (a more speedy convergence of the Net Income to the real cash flow generation) could act as positive catalysts driving OI share price, the longer term growth dynamics are questionable, the margins are low and volatile, the potential for increasing capex, the negative impact of change in Working Cap in near term, and the management team's (which is being replaced) inability to allocate capital in value creative investments are OI Investment concerns.

What is the street saying and why is it wrong

Misinterpretation of volume growth, FX impacts, non-operational items, and assumptions of margin expansion and improved management team drive the street's perspective. A majority of the street fail to recognize the long term (not just short term) declines in volume which appears to be primarily caused by the shift from bottles to cans which is driven by pricing efficiency (cans are priced approximately 30% less than bottles). Some on the street have claimed that "performance consistency" will be a catalyst to drive valuation, however, OI performance has been consistent – constant restructuring without any improvements in margins and failures to achieve growth.

OI has received significant positive financial press as a result of the involvement of Activist Investor Atlantic Investment Management (AIM) (8% shareholding with an estimated buy-in price of $26.14) over the last 5 years.

AIM is a value oriented activist investor with a very successful track record dating back to 1992 (more than 7x the returns achieved by the S&P over 23 years). In addition, the fund manager has consistently presented at various value investor conferences such as the Value Investor Congress and the Sohn Conference. AIM investment strategy includes: (1) High concentration on best ideas (historically top 5 positions represent over 75% of AUM); (2) Stakes of 2% to 7% to help drive operational improvement; (3) Investing in strong franchises with high barriers to entry and limited technological obsolescence risk; (4) Strong Balance Sheet; (5) predictable recurring cash flow (repeat product and service revenues); (6) low insider ownership; and (7) Paying less than 8x EBIT.

In September 2010, AIM presented a 13 page OI investment case summary which highlighted: (1) 12 month price target (i.e. September 2011) of $45 (12x 2011E EBIT) with a low end of range of $27 (9x 2011E EBIT); (2) EPS power of $5.00 per share in 2013; 2013-2018 forecasted glass packaging growth of 7% / 3% / 2% / 1% in AsiaPac / South America / Europe / US; and (3) temporary 10% decline in volume.

In September 2014, AIM presented OI at the value investor congress highlighting: (1) price target of $50 per share based on a 15x PE multiple; (2) EPS power of $2.80 to $4.00 in 2015; and (3) declining asbestos liabilities should drive FCF growth by 3-4% a year going forward. In October 2014, AIM presented OI at the Sohn Canada Presentation with a $45 price target based on a 14x PE and $3.25EPS.

In December 2014, Atlantic published a letter to the Lead Director of the OI Board pushing for: (1) Announcing early retirement and succession plan for the CEO and Chairman roles –achieved; (2) Separate the roles of CEO and Chairman – achieved; (3) Implementing a modest dividend – not achieved however, OI announced a share repurchase plan; (4) Moving to mark-to-market pension accounting – not accepted; and (5) Re-initiating a $3.50+ EPS target – not achieved and looking more unlikely after OI reduced the 2015 EPS target in April 2015 (after reducing the target in February 2015 as well).

In May 2015, AIM disclosed it increased its stake in OI from approximately 7.3% in December 2014 to 7.8% which represents approximately 22% of AIM Invested Capital. Moreover, the AIM OI investment is the largest it's ever been.

AIM provides significant tailwind to the OI investment story both in the public media as well in actually driving improvements at OI; however, should AIM choose to exit its investment in OI, there could be a significant negative impact to the OI share price.

Estimate of Intrinsic Value

OI makes significant adjustments for asbestos liability, pension liability, restructuring expenses, and even currency headwinds (although never for currency tailwinds). None of the adjustments are included in the below valuation calculations because: (1) Asbestos: on the cash flow statement there the line item titled "future asbestos-related costs" is a positive cash inflow which is approximately equal (over 7 years) to the asbestos related cash outflow line item titled "Asbestos-related payments (i.e. over 7 years the cash impact is nearly $0); (2) Pension: on the cash flow statement there is the line item titled "pension expense" which has a positive cash impact almost exactly equal to the pension contributions cash outflow (over 7 years); (3) Restructuring: OI has had $967mm of restructuring expenses since 2007. The restructuring expenses have occurred in every year.

Based on non-adjusted financials, OI currently has 3.9x net debt / EBITDA (2014) and trades on 2015E EBITDA / EBIT and PE multiples of 8.3x / 13.3x / 18.3x.

A divisional DCF analysis SOP yields a base case valuation range of $13.43 to $17.15 and an upside case valuation range of $18.94 to $23.29. The base case assumes a consolidated 2014 – '20 EBIT CAGR of 8.8% driven by a significant reduction in corporate expenses and growth in Europe / NA / SA / AsiaPac of 1.9% / 4.4% / 3.7% / 7.7%. In addition, Capex as a % of sales is slightly higher than the last 7 year average in all regions except AsiaPac (we assume EBIT growth based on recovery of lost sales despite the 2011 impairment and more recent negative operating trends). Finally, we use a 35% tax rate across all regions.

The upside case assumes a consolidated 2014 – ’20 EBIT CAGR of 11.3% driven by significant growth in South and North America 5.9% / 5.7% respectively and Europe and AsiaPac growth of 3.2% and 8.8%. In addition, corporate expenses decline. In addition, Capex as a % of sales is slightly higher than the last 7 year average in all regions except AsiaPac. Finally, we use a 35% tax rate across all regions.

Separately we valued the US deferred valuation allowance as a normal NOL starting January 1, 2015 and reach an approximate value of $4.66 per share. Given the lack of understanding around the valuation allowance, we add back 25% of the value (approx. $1.17 value per share) to our DCF valuations in the base and upside cases. In addition, we calculate the European NOLs starting January 1, 2015 and reach an approximate value of $2.10 per share which we add back 100% of to the DCF valuations.

Trading multiples analysis is complicated given the divergence of unadjusted vs adjusted operational figures. We use a 15x PE multiple (or a 6.7% earning’s yield) as the standard to drive value and calculate the EPS after continued restructuring, asbestos and other expenses which are a constant feature of the past. Based on the base case we reach a PE valuation range of $21.57 to $34.16 (2017) and an upside case PE valuation range of $23.31 to $39.59 (2017). In addition, we assume the convergence of the real free cash flow generation with the Net Income with a 15x PE multiple yielding a value per share of $19.06 to $37.50.

We use a 10x EBIT multiple as the standard to drive value and calculate the EBIT after continued restructuring, asbestos and other expenses. The base case yields a value range of $15.07 to $34.32 (2017) and an upside case range of $16.68 to $40.32.

Finally, we apply a weight to all of our valuation methodologies (trading multiples and DCF) to obtain a blended weight valuation range of $17.91 to $30.26 and thereafter add back weighted values of the tax assets to obtain a final blended weighted valuation range of $21.22 to $33.61 (we accept that we are double counting the tax assets in the PE and EBIT multiples).

On February 2, 2015, OI announced that the Board of Directors authorized a new $500mm share repurchase plan through 2017 of which approximately $125mm was expected to be used in 2015. On February 4, 2015, OI announced it had executed a $100mm accelerated stock repurchase program.

On May 13, 2015, OI announced the $2.15bn acquisition of Vitro’s food and beverage glass container business. Vitro is a leading manufacturer with operations in Mexico and Bolivia. The Mexican glass volumes segment of food and beverage packaging is estimated to grow at a 2.4% CAGR through 2018. OI acquired LTM Revenue (adjusted and estimated) $945mm / EBITDA (adjusted and estimated) $278mm / Synergies $30mm / LTM Capex $61mm for an estimated transaction multiple of 7.7x excluding synergies and 7.0x including synergies. The transaction is expected to be EPS accretive in year 1 by $0.30 - $0.40 and by year 3 $0.50. The transaction is expected to be free cash flow accretive by greater than $100mm by year 3. At first glance, the transaction could drive the PF OI share price to $35.11 (7.7x Adj EBITDA ex synergies) or alternatively a 15x multiple on the EPS accretion would yield $7.50 of incremental value per share.

However, the transaction press release and presentation provide several causes for concern. First, the acquired financials are LTM but they are adjusted for a new contract and add the estimated 2016 operations of the contract. There is no separation of actual the LTM number from the current operations (what OI is paying for today) and the estimated incremental 2016 number (what OI is attempting to convince the market it will have). OI has a history of failing to meet estimates (In 2013, OI announced a $3.50 EPS target which has been consistently downgraded most recently in Q1 2015 to $2.00 to $2.30).

Second, OI is acquiring 56% of revenues and 76% of EBITDA of VITRO. The implied acquired EBITDA margin of 29% is 50% greater than the total consolidated VITRO EBITDA margin. In other words, VITRO consolidated EBITDA margin is 21% and the VITRO acquired business EBITDA margin is 29% - that's a wide disparity. If OI were acquiring a small portion of the consolidated VITRO EBITDA, the difference in the margins (Consolidated VITRO vs acquired VITRO operations) could be more rationale, however, OI is acquiring over 50% of the VITRO consolidated Revenues. Based on the figures, at first glance, PF Standalone VITRO 2016E EBITDA margin would be below 14% and VITRO trades for 3.7x 2016E EBITDA (we don't think this makes sense although we are not VITRO experts).

Third, there is no "cost" to achieving the incremental Sale / EBITDA / Earnings to the new business. Almost all revenue and profits require some form of maintenance capex and oftentimes growth requires additional investment (capex). If OI includes the 2016 incremental finances, there are both maintenance costs to the current operations and growth costs to achieve those finances. The expense to achieve the Revenues / EBITDA are part of the total "cost" of the acquired business and as such should be added back to the reported transaction price.

Assuming the estimated acquired LTM Revenue of $945mm is achieved, the current consolidated VITRO EBITDA margin would yield an EBITDA of $205mm or $73mm below the pre synergy $278mm reported number. We risk weight the incremental $73mm by 50% to obtain a real EBITDA of $241mm which would result in a transaction multiple of 8.9x (not 7.7x). In addition, we assume that there is no growth to the underlying business (i.e. the $241mm is a number that will exist in 2016) but there will be maintenance capex requirements. The VITRO capex as % of sales is 6.3% and for simplicity we assume the same capex requirements for the acquired business. There will be 2 years of maintenance which equals an additional $126mm of spend bringing the total purchase price to $2.28bn and the real transaction multiple to 9.4x. It is possible that in the acquisition agreement, OI will not be responsible for any capital investments in the acquired operations until after 2016. Should that be the case, the estimated acquisition multiple would be the 8.9x.

What could go right at OI

Since the ill-fated Investor day in February 2013, almost everything which management predicted has not come to fruition: global volume growth; reduced OI structural costs ($75mm by 2015); selective growth; emerging market growth with China integration; and regional target volume growth and margins. In February 2013, management had a plan to succeed and while it has not come good to date, the plan could go right in the future. After numerous years of cost restructurings, there may finally be an end to the expense and a margin improvement. In addition, the new / incoming management team could seek to provide significant positive "results" or "statements" to establish their credibility. It may be difficult for OI to continue to underperform by such a wide margin and should there be any recovery to management's previous market perspective OI share price could increase.

On May 13, 2015, OI announced the acquisition of Vitro S.A.B. de C.V's (VITRO) food and beverage glass container business in an all cash transaction of $2.15bn for approximately 7.7x LTM Adj EBITDA excluding synergies and 7.0x including synergies. The transaction is expected to yield: (1) $0.30 to $0.40 EPS accretion in year 1; (2) up to $0.50 of EPS accretion in year 3 as synergies are realized; and (3) over $100mm of FCF accretion by year 3. One of the key benefits to the transaction is the fact that VITRO signed a 7 year supply contract with CBI the entity OI recently entered into a long term JV with in Mexico.

At first glance, the transaction appears to potentially create significant shareholder value. However, as is usual with OI, the key metrics are confusing. For the transaction multiples, OI highlights VITRO EBITDA "3/31/15 LTM + estimate of full year 2016 new business signed in 2014". We've never seen any business announce a transaction using an LTM EBITDA including adjustments for incremental EBITDA 2 years down the line. Moreover, OI as a clear example of historical operational failures should be the last business to include any future estimates given the potential for failing to meet such estimates. The transaction is fully financed by new debt which was secured at low rates (potentially around Libor + 150bps) which should help performance. The synergy estimates represent 4.5% of cash costs. The transaction is expected to close within one year (and synergies to accrue one year after closing). Should OI meet any of the announced financials the transaction should create value for OI shareholders.

Source Documentation: All Publicly Available Online

1) OI Website
2) OI Annual Proxy Filings
3) OI Annual Reports
4) OI Investor Presentations
5) Yahoo Finance
6) Oressa Limited SEC Filings

Disclosures and Notices

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