SILVER RING
VALUE PARTNERS

O-I GLASS (OI) INVESTMENT OVERVIEW
VALUEX VAIL, JUNE 2023

Gary Mishuris, CFA | Managing Partner, Chief Investment Officer

BIOGRAPHY

GARY MISHURIS, CFA

Managing Partner,
Chief Investment Officer

Professional Experience:

- Silver Ring Value Partners (2016-present): Managing Partner, Chief Investment Officer
- F.W. Olin Graduate School of Business (2018-present): Instructor, *Value Investing Seminar*
- Manulife Asset Management (2011-2016): Managing Director, Lead Portfolio Manager of the U.S. Focused Value strategy
- Evergreen Investments/Wells Capital Management (2004-2010): Vice President, Senior Equity Analyst/Portfolio Manager
- Fidelity Management & Research (2001-2004): Equity Research Associate

Education:

Massachusetts Institute of Technology
Bachelors of Science in Economics, Computer Science (2001)

O-I GLASS (OI)

Thesis Summary

- ✓ Predictable, high-quality business with low cyclicality
- ✓ Aligned management team that has delivered and exceeded expectations
- ✓ Greatly improved safe balance sheet
- ✓ Misunderstood: past financials don’t accurately reflect current economics
- ✓ Cheap <u>and</u> undervalued stock

INVESTMENT PROCESS

Security Research and Valuation

Five-Step Research Process

Step 1	Step 2	Step 3	Step 4	Step 5
Company Quality Assessment	Analysis of Key Economic Variables	Financial Modeling	Valuation	Behavioral Checklist

The goal is to answer the following two questions:

- How predictable is the long-term economic outcome of the business?
- What is a reasonable range of intrinsic values?

INVESTMENT PROCESS

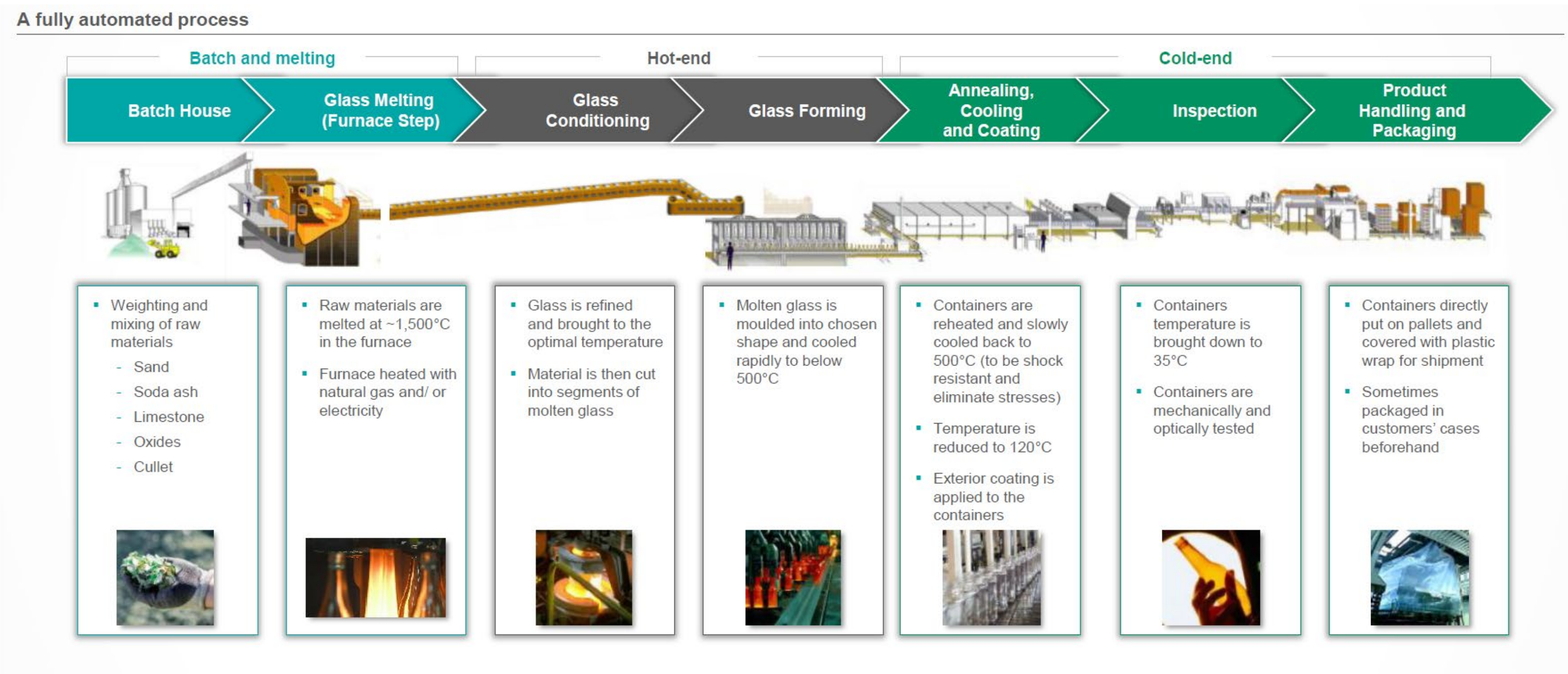
Security Research and Valuation

Step 1 **Company Quality Assessment**

- **Business Quality** – industry's structural attractiveness and company's sustainable competitive advantage
- **Management Quality** – track record of operations and capital allocation as well as alignment of incentives
- **Balance Sheet Quality** – ability to withstand temporary adversity without reducing security value

INVESTMENT PROCESS

Business Overview

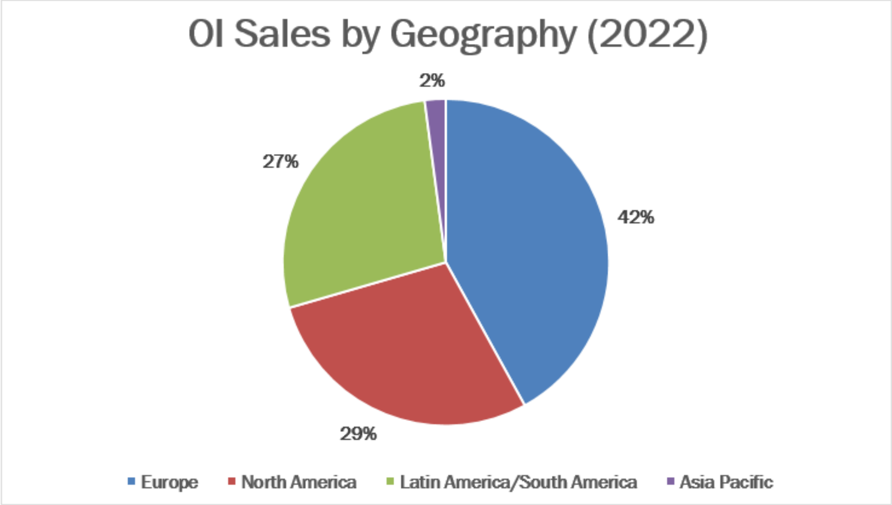


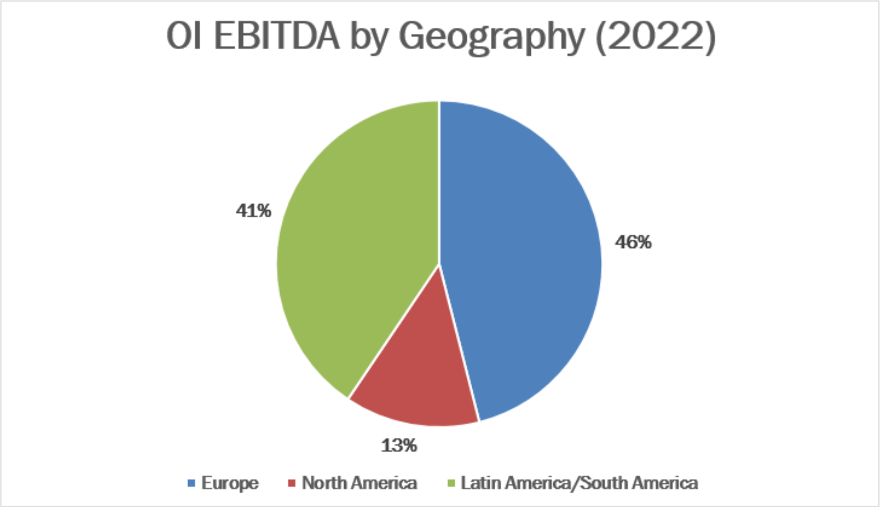
Source: Verallia 11/2019 Presentation

O-I Glass (OI) is one of the largest global glass container manufacturers, providing containers for food and beverage manufacturers

INVESTMENT PROCESS

Business Overview



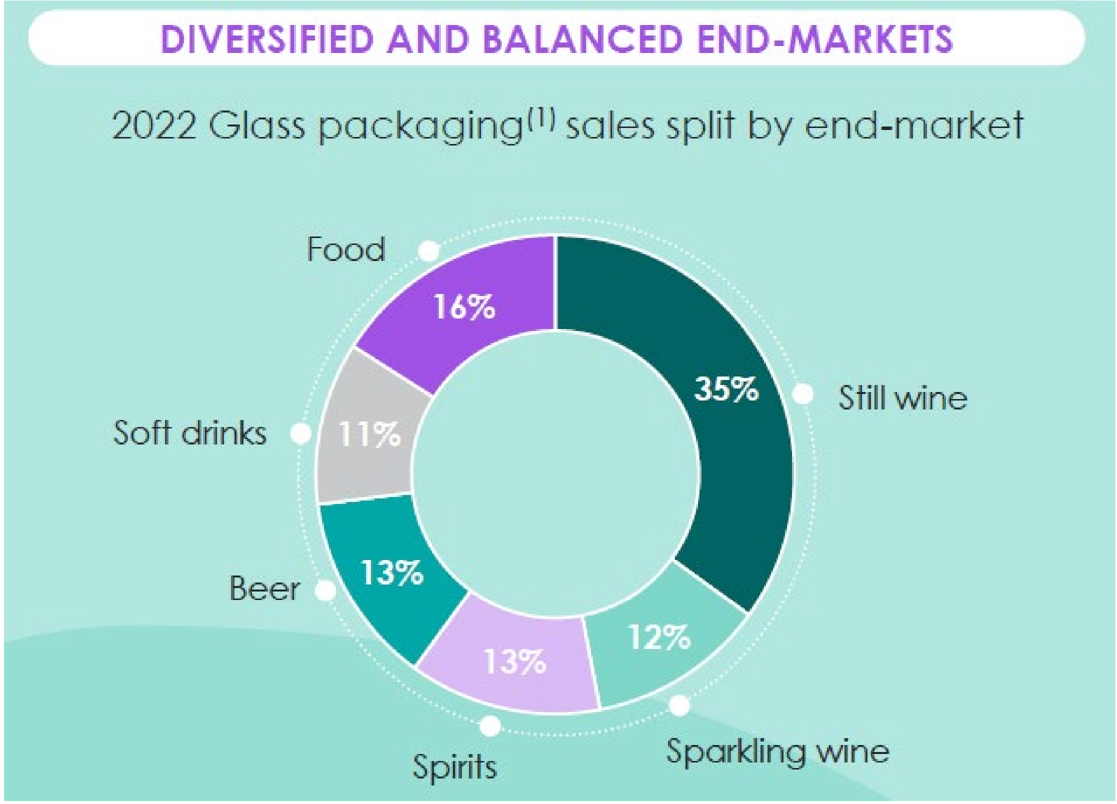


Source: Company reports, my estimates

OI is #1 in North America, a very close #2 in Europe and #1 in Latin America

INVESTMENT PROCESS

Business Overview



Source: Verallia FY2022 Results Presentation

INVESTMENT PROCESS

Business Quality: Structural Industry Attractiveness

Porter Five-Forces Analysis

- Barriers to Entry: High
- Power of Buyers: Medium
- Power of Suppliers: Medium
- Threats of Substitution: Medium
- Competitive Intensity: Medium

Conclusion: Glass Container Manufacturing industry is of **Above Average structural attractiveness**

INVESTMENT PROCESS

Business Quality: Structural Industry Attractiveness

Barriers to Entry

SIGNIFICANT TECHNICAL, CAPITAL AND LOGISTICS INVESTMENT REQUIREMENTS

Technical expertise

- Glass packaging production requires substantial know how / human expertise
- Skilled workforce and staff training are key
- High average seniority required for furnace operators and hot-end operators

Well-invested asset base

- Significant capex / lead time needed
  - Greenfield plant with total annual capacity of 80kt (one furnace) costs in excess of €80m
  - Limited impact from new additions (one new furnace represents less than 1% of total market)
  - Around two years to build a new plant
- High density / location is key (large quantity of volumes sold within 500km from production site)
- Glass plants have to operate 24/7

Established client base and scale

- Large customer base required to reach break-even volumes
- Need for new entrants to rapidly achieve large minimum volumes (>70% of capacity)
- Significant amount of fixed costs to be absorbed

Source: Verallia 11/2019 Presentation

Conclusion: High barriers to entry due to the amount of time (2 years) and capital needed to build new capacity. Even higher barriers to profitable entry due to the difficulty in obtaining clients in a mature market with switching costs.

INVESTMENT PROCESS

Business Quality: Structural Industry Attractiveness

Power of Buyers

	Customers	Customer concentration
Still wine	Mostly local	Low
Sparkling wine	Mostly local	
Food	< 10 global + local	
Non-alcoholic beverage	Significant share of global	
Spirits	6 global + local	
Beer	5 major players <50% Mostly global	High

Source: Verallia 11/2019 Presentation

Conclusion: Power of buyers is medium to high as a number of them are large, global players. Typical glass container company has 30%-50% of sales coming from top 10 customers. A few of the largest customers are vertically integrated into container manufacturing.

INVESTMENT PROCESS

Business Quality: Structural Industry Attractiveness

Power of Suppliers

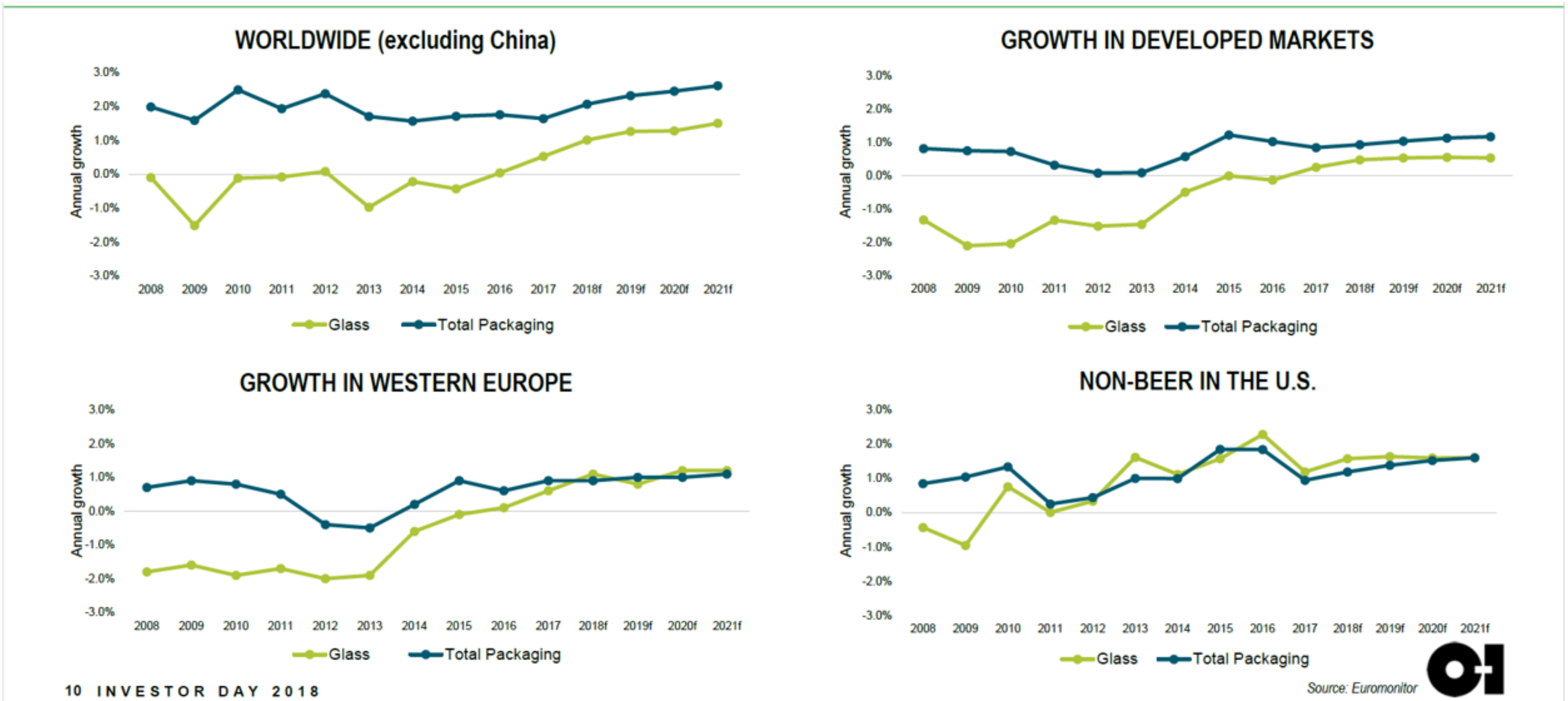
- Majority of the employees are represented by unions
- Container glass manufacturing requires a high percentage of technically skilled employees
- Commodity suppliers of energy/raw materials don't have market power, but glass container manufacturers are price takers

Conclusion: Power of suppliers is medium

INVESTMENT PROCESS

Business Quality: Structural Industry Attractiveness

Threat of Substitution

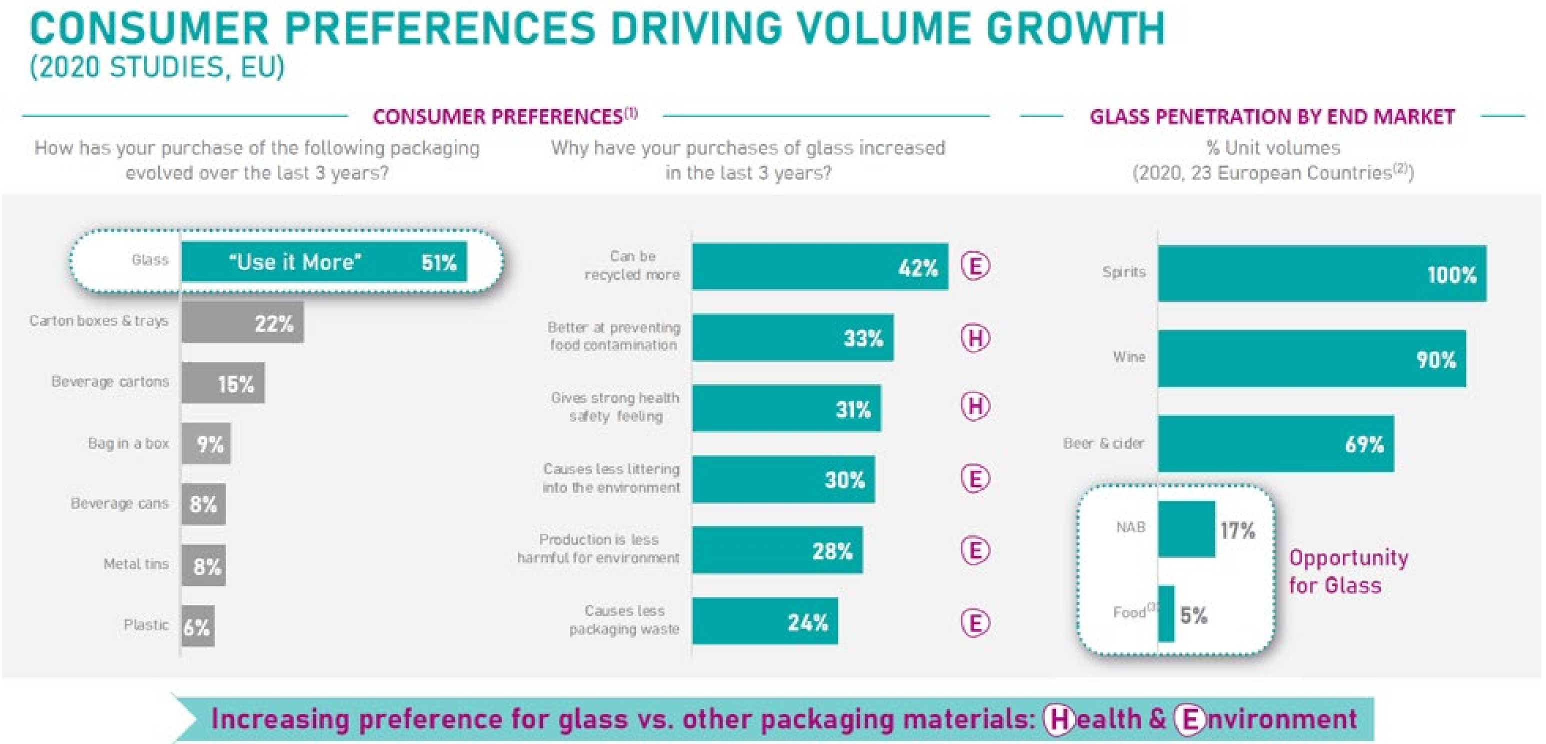


Source: OI 2018 Investor Day Presentation

INVESTMENT PROCESS

Business Quality: Structural Industry Attractiveness

Threat of Substitution



Source: Verallia 2021 Capital Markets Day presentation

<u>Conclusion</u>: Threat of substitution is medium, as some use cases are switching to aluminum (e.g. U.S. beer). However, in many markets glass containers are growing in-line with the overall packaging market.

INVESTMENT PROCESS

Business Quality: Structural Industry Attractiveness

Competitive Intensity

- European market is a concentrated oligopoly with Top 3 > 50% share
- U.S. market is mostly controlled by 2 large players
- Limited product differentiation outside of small niches
- High density limits cost-effective radius of a plant limiting switching by customers
- Glass container is a small portion of the total cost of the end product but in some cases can create perceived differentiation
- Limited supply growth
- Large, concentrated global customers have bargaining power, and in some cases their own glass container manufacturing capability

Conclusion: Competitive intensity is medium

INVESTMENT PROCESS

Business Quality: Competitive Advantage

Sources of Sustainable Competitive Advantage

1. Large Scale
2. Sticky customer relationships in a market with high switching costs

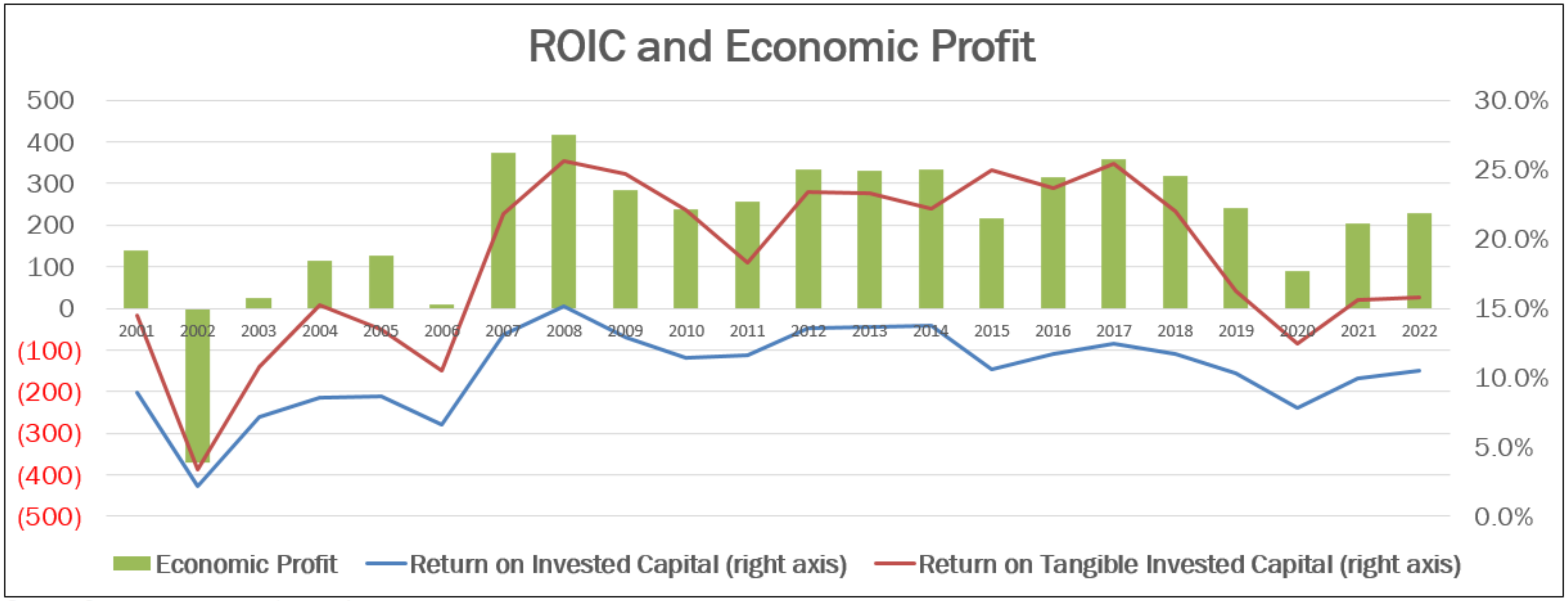
Sales (USD)		2022	Market Rank
OI North America		1,956	**#1**
Ardagh NA Glass		1,738	
OI EU		2,878	#2
Verallia (EU)		3,136	
Ardagh EU Glass		2,733	
Vidrala (EU)		1,440	
OI LatAm		1,879	**#1**
Verallia (LatAm)		449	

Note: OI stopped disclosing North America vs. Latin America split in 2018, above are my estimates based on partial 10-K disclosures and competitor company reports

Conclusion: **OI has a small competitive advantage**

INVESTMENT PROCESS

Business Quality: Validation



Source: Company reports and my estimates

- It is important to compare our qualitative analysis against historical financial metrics
- High quality businesses should have Return on Invested Capital (ROIC) well in excess of their cost of capital (WACC)
- Economic Profit is defined as: [ROIC – WACC] x Capital Employed

Conclusion: OI is an above-average business due to a combination of above-average industry attractiveness and a small competitive advantage

INVESTMENT PROCESS

Management Quality

What Determines Management Quality

1. Track-record of a) operating the business b) capital allocation
2. Alignment of incentives with shareholders

OI Management History

- Andres Lopez took over as CEO in 2016 after running the Latin American division, which is the company's crown jewel
- John Haudrich took over as CFO in 2019

Track Record

- Over-delivered on financial results despite a tough external environment (+)
- Shrank the business by exiting non-strategic Australia & New Zealand business (+)
- De-levered the balance sheet (+)
- Permanently eliminated the asbestos liability (+)
- Stayed away from large deals, focused on organic growth investment (+)
- Didn't buy back cheap shares (-)

INVESTMENT PROCESS

Management Quality

Track Record (cont'd)

O-I Glass Ratings and Trends

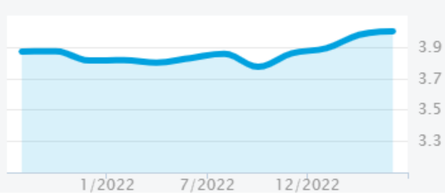
About Glassdoor ratings

Ratings may vary depending on what filters are applied, but ratings include reviews in all languages. Learn More

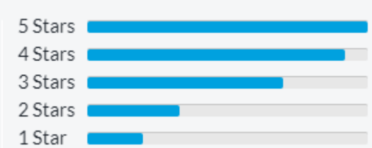
Overall	4
Culture & Values	3.4
Diversity & Inclusion	3.7
Work/Life Balance	3.4
Senior Management	3.2
Compensation and Benefits	4
Career Opportunities	3.6

- 77% Recommend to a Friend
- 77% CEO Approval
- 69% Positive Business Outlook

Overall Trend



Overall Distribution



Source: Glassdoor.com

INVESTMENT PROCESS

Management Quality

Alignment of Incentives

1. CEO owns over $20M of shares outright, likely the majority of his net worth
2. CFO owns over $5M of shares outright
3. Compensation is based on a combination of EBIT, FCF, EPS and ROIC, and is a reasonable attempt to align long-term incentives

INVESTMENT PROCESS

Management Quality

Competence/Track Record: Above Average

- **Operations:** Good
- **Capital Allocation:** Average

Alignment of Incentives: Above Average

Conclusion: Management quality is Above Average given good incentives and solid track-record.

INVESTMENT PROCESS

Balance Sheet Quality

What Determines Balance Sheet Quality

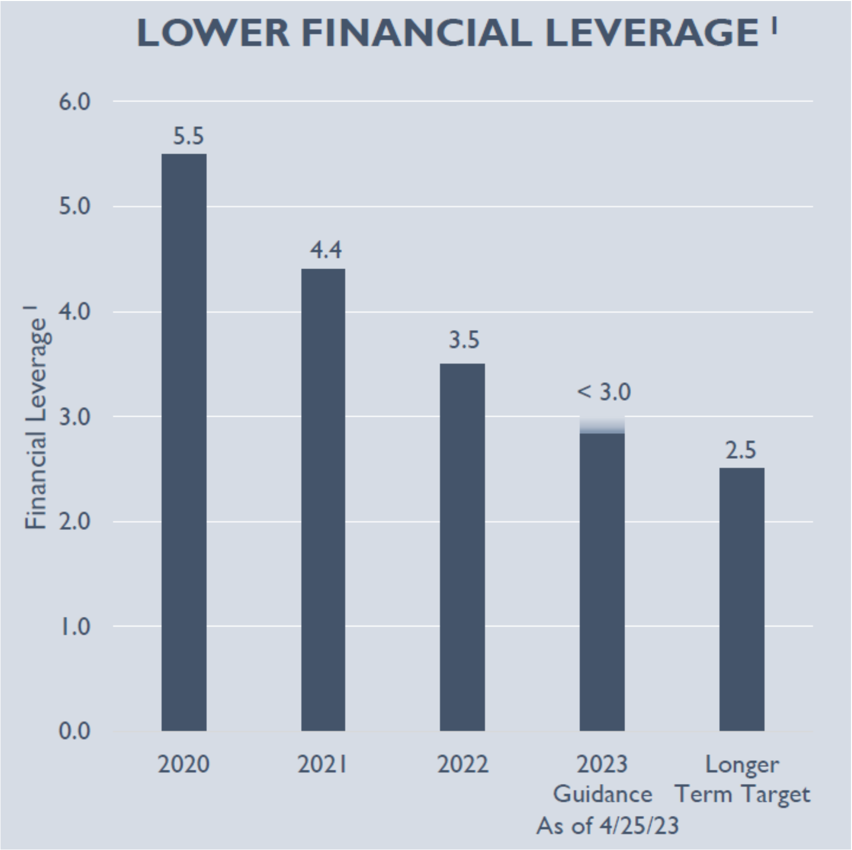
1. Ability to withstand temporary adversity without needing to raise capital
2. Appropriate leverage relative to profitability that doesn't necessitate the use of Free Cash Flow to reduce debt

Conclusion: Balance Sheet is of Above Average quality

- **Leverage already below sustainable levels and moving lower**
- **Only covenant (2.5x Secured Debt/EBITDA) leaves room for an event more severe than the 2008-2009 recession without any issues**
- **Strong cash flow generation allows for flexibility**
- **Pensions close to fully funded**
- **Asbestos liability completely resolved with no remaining risk**

INVESTMENT PROCESS

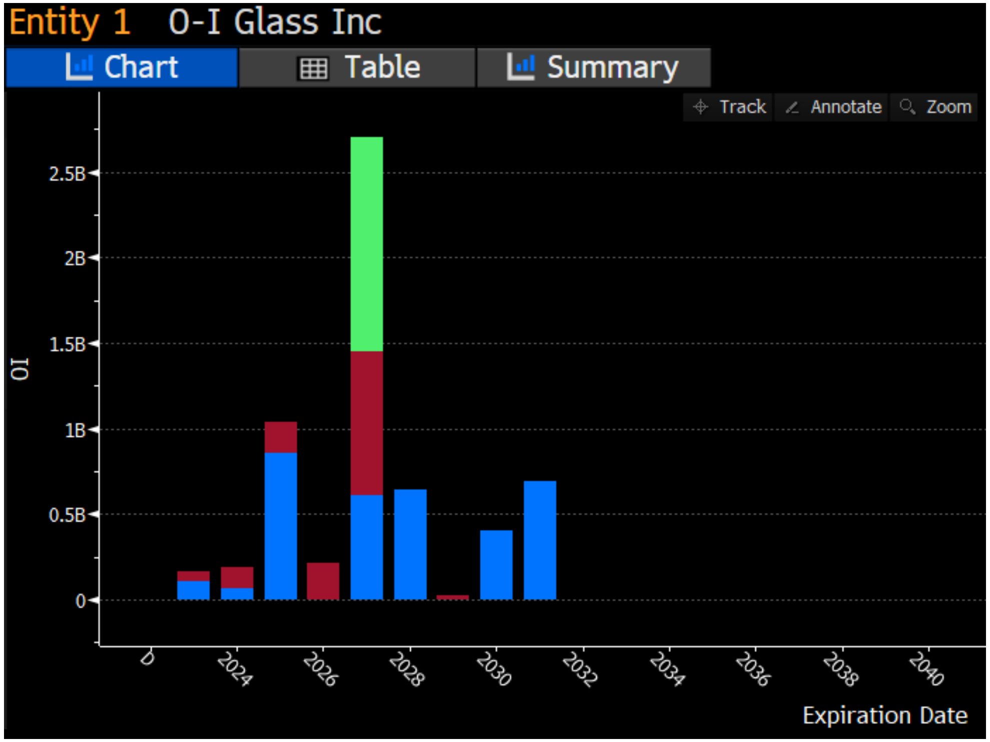
Balance Sheet Quality



Source: OI Q1 2023 earnings presentation

INVESTMENT PROCESS

Balance Sheet Quality



Source: Bloomberg

INVESTMENT PROCESS

Balance Sheet Quality

2008 - 2009 Recession Performance				
	2007	**2008**	**2009**	**2010**
Sales	7,567	7,540	6,652	6,633
M&A Impact Estimate				148
Adjusted Sales	**7,567**	**7,540**	**6,652**	**6,485**
EBITDA	1,481	1,495	1,209	1,268
M&A Impact Estimate				37
Adjusted EBITDA	**1,481**	**1,495**	**1,209**	**1,231**
Adjusted EBITDA Margin %	19.6%	19.8%	18.2%	19.1%
Incremental EBITDA Margin % (Peak to Trough)			**29.7%**	
Organic Sales Decline Peak to Trough			**-9.0%**	
Organic EBITDA Decline Peak to Trough			**-19.1%**	

Source: Company reports and my estimates

During the 2008-2009 recession, which was much more severe than a typical downturn, cumulative organic sales decline peak to trough was 9%, incremental EBITDA margin was 30% and peak to trough EBITDA decline was 19%

INVESTMENT PROCESS

Balance Sheet Quality

CAPITAL ALLOCATION PRIORITIES

#1

IMPROVE CAPITAL STRUCTURE

- ▲ < 3.0x leverage (2023)
- ▲ Glide path to ~ 2.5x leverage
- ▲ Elim. net unfunded pension

#2

FUND PROFITABLE GROWTH

- ▲ $630M expansion program (2022-2024)
- ▲ Continued portfolio optimization

#3

RETURN VALUE TO SHAREHOLDERS

- ▲ Anti-dilutive repurchases
- ▲ Evaluate additional repurchases
- ▲ Evaluate dividend

Source: OI Q1 2023 earnings presentation

INVESTMENT PROCESS

Security Research and Valuation

Step 2

Analysis of Key Economic Variables

- Identify key economic variables most likely to materially impact the long-term business outcome
- Establish a range of reasonable values for each variable under different scenarios

If we could only know 5 or fewer things about the business 10 years from now, what would they be?

1. Organic Sales Growth
2. Margins
3. MAGMA project growth investment outcome

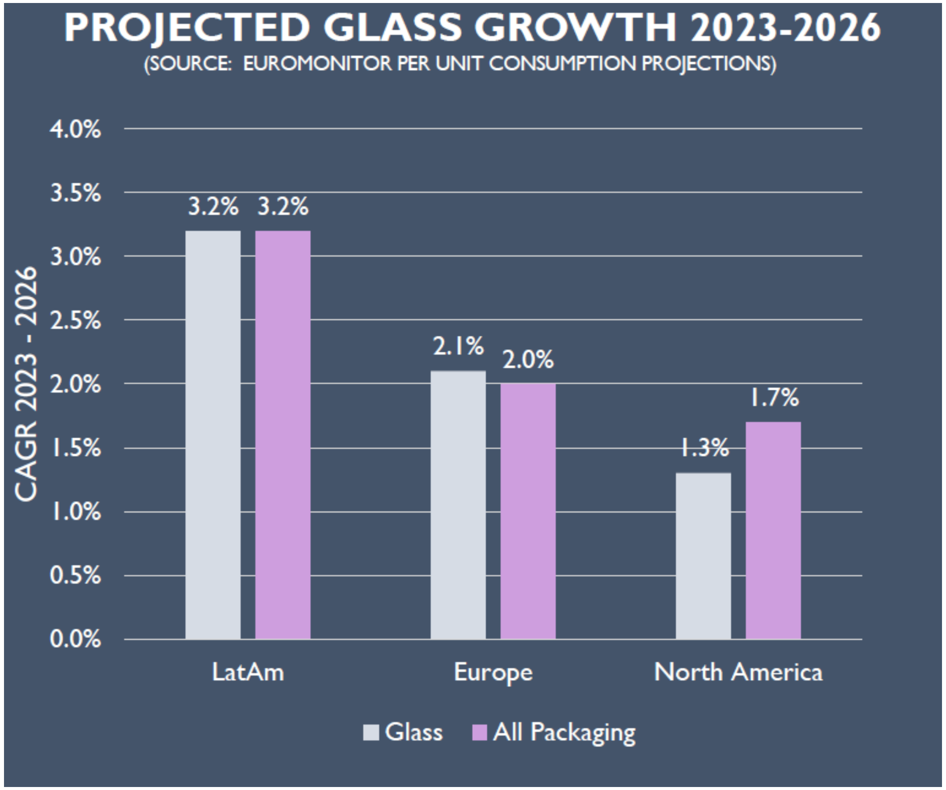
INVESTMENT PROCESS

Key Economic Variables – Organic Sales Growth

- 2%-3% average organic sales growth over the last decade
- Moderate cyclicality

INVESTMENT PROCESS

Key Economic Variables – Organic Sales Growth



Source: OI Q1 2023 earnings presentation

- Demand for glass packaging expected to grow low single-digits
- Given OI's large scale and scope it's reasonable to expect similar growth to that of the industry

INVESTMENT PROCESS

Key Economic Variables – EBITDA Margin (%)

EBITDA Margin %	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	AVG '13-'22
EBITDA Margin %	**25.5%**	**24.4%**	**21.6%**	**19.9%**	**18.5%**	**16.7%**	**19.6%**	**19.8%**	**18.2%**	**19.1%**	**16.9%**	**17.7%**	**17.6%**	**18.1%**	**17.5%**	**18.8%**	**19.3%**	**19.1%**	**18.8%**	**16.4%**	**17.4%**	**17.3%**	18.0%
Europe					18.1%	15.9%	19.5%	20.0%	17.5%	18.5%	16.7%	16.8%	15.9%	17.6%	14.2%	15.4%	16.3%	17.8%	19.0%	17.3%	19.5%	22.2%	17.5%
Americas					19.7%	18.9%	21.0%	18.3%	20.4%	21.7%	20.3%	21.5%	21.7%	21.4%	22.0%	24.1%	24.9%	23.8%	22.2%	20.0%	20.4%	19.6%	22.0%
North America					15.6%	14.1%	16.4%	12.9%	18.4%	18.4%	16.5%	20.1%	20.8%	18.5%	19.3%	19.7%	20.9%						
Latin America					31.3%	31.6%	31.9%	33.6%	26.7%	28.1%	26.3%	23.7%	23.3%	26.4%	27.3%	30.9%	30.4%						

Source: Company reports and my estimates; Company stopped breaking out North America vs. Latin America starting in 2018

- EU margins restored over the last 2 years via pricing initiatives
- North American margins depressed, but management recently renegotiated contracts which should lead to margin recovery
- Tight supply/demand for glass is giving the industry pricing power, and supply growth is limited and takes time
- Margins in a tight range even during recessions

INVESTMENT PROCESS

Key Economic Variables – MAGMA Growth Investment

MAGMA'S POTENTIAL BENEFITS

O-I expects MAGMA will significantly enhance O-I's capabilities and competitive position.

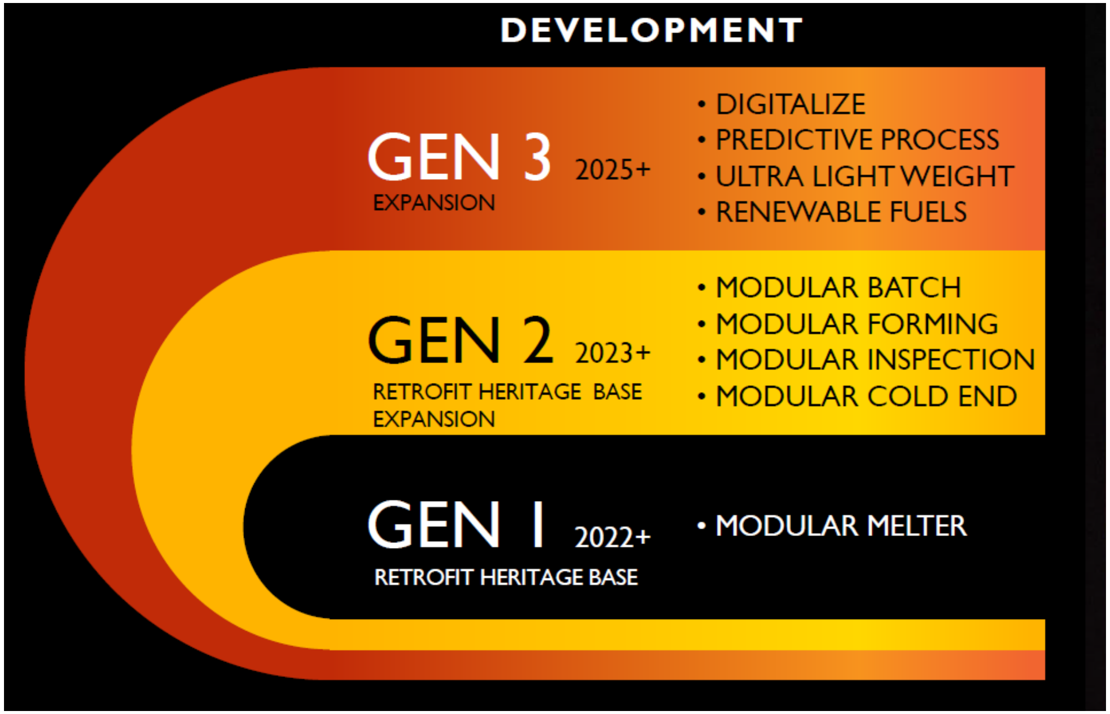
OBJECTIVES	MAGMA GEN 3[1] IMPROVEMENT VS HERITAGE (2025+)
1. FLEXIBLE	Achieve attractive economics at 15% lower utilization rate
2. SCALABLE	New melter reduces capacity per line to 25-50% of heritage
3. RAPID DEPLOYMENT	Reduce deployment time by up to 50%
4. SUPPLY CHAIN EFFICIENT	Reduce shipping distances by 30-80%
5. COST COMPETITIVE	Reduce cost gap with competing substrates by 50-75%
6. LOWER CAPITAL INTENSITY	Reduce capital intensity up to 40%
7. CONVENIENT	Reduce product weight[1] up to 30%
8. SUSTAINABLE	Reduce GHG emissions by up to 95%

Source: OI 2021 Capital Markets Day presentation

- Cheaper, smaller unit of incremental capacity, more flexible, better for the environment… if it works

INVESTMENT PROCESS

Key Economic Variables – MAGMA Growth Investment



Source: OI 2021 Capital Markets Day presentation

- Incremental development, full benefits still 2-3 years out
- Supply chain problems caused some delays, currently on track for Gen 2 with a Gen 3 pilot line by mid-2024
- $630M+ investment, expected $110M incremental pre-tax profit or mid-teens IRR
- Range of outcomes from ~ -$3/sh to +$2/sh in NPV, with Base Case of ~ + $1

INVESTMENT PROCESS

Security Research and Valuation

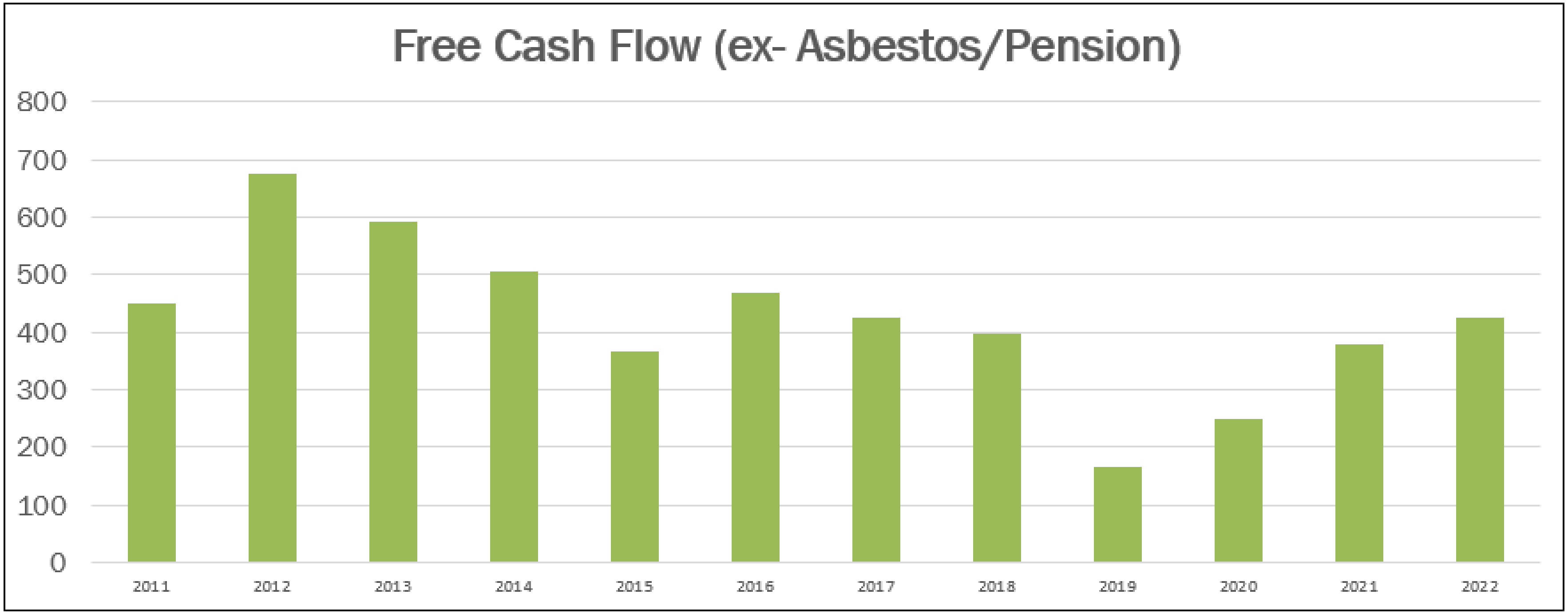
Step 3 **Financial Modeling**

Use the analysis from Steps 1 and 2 to model the company's income statement, balance sheet and cash flow statement, and create 3 scenarios:

- *Worst case*, where each key economic variable has its *worst* likely outcome
- *Base case*, where each key economic variable has its *most* likely outcome
- *Best case*, where each key economic variable has its *best* likely outcome

INVESTMENT PROCESS

Financial Modeling



Source: Company reports, my analysis

- Past financials distorted by historical asbestos payments (now gone) and severely underfunded pension (now close to fully funded)
- 10-year average FCF = ~ $400M or 12% FCF yield

INVESTMENT PROCESS

Financial Modeling

O-I GLASS INC (OI US) Model & Value Estimate	Worst	Base	Best	2019	LT Avg	LTM
Sales	**6,587**	**7,132**	**7,484**	**6,691**	**6,111**	**6,995**
Europe	2,791	3,027	3,179	2,387	2,726	2,968
Americas	3,663	3,973	4,172	3,622	3,314	3,895
Asia Pacific				634		
Other	132	132	132	48	71	132
EBITDA	**1,028**	**1,310**	**1,524**	**1,260**	**1,233**	**1,341**
EBITDA (%)	15.6%	18.4%	20.4%	18.8%	20.2%	19.2%
Europe	502	666	795	453	488	726
% Sales	**18.0%**	**22.0%**	**25.0%**	19.0%	17.9%	24.5%
Americas	696	854	960	804	713	756
% Sales	**19.0%**	**21.5%**	**23.0%**	22.2%	21.5%	19.4%
Corporate & Other	(170)	(210)	(230)	(86)	(89)	(217)
% Sales	-2.6%	-2.9%	-3.1%	-1.3%	-1.5%	
Depreciation	379	410	430	390	374	355
% Sales	5.8%	5.8%	5.8%	5.8%	6.1%	5.1%
EBITA	**650**	**900**	**1,094**	**870**	**858**	**986**
EBITA (%)	9.9%	12.6%	14.6%	**13.0%**	**14.0%**	14.1%
Interest Expense	272	272	272	239		
Tax Rate	23.0%	23.0%	23.0%	25.7%	23.3%	
Minority Interests	20	40	50			43
Net Income	**271**	**444**	**583**	**469**		
Shares	159.1	159.1	159.1	159.0		
EPS	**$1.70**	**$2.79**	**$3.66**	**$2.95**		

INVESTMENT PROCESS

Security Research and Valuation

Step 4 **Valuation**

- Estimate the range of intrinsic values for the business using Discounted Cash Flow (DCF) analysis
- Perform sanity checks on each part of the range by checking other valuation metrics, such as normalized P/E, EV/EBITA, Price to Book (P/B) ratios and Sum of the Parts analysis

INVESTMENT PROCESS

Valuation

O-I GLASS INC (OI US) Model & Value Estimate					
	Worst	**Base**	**Best**	**2019**	**LT Avg**
EPS	**$1.70**	**$2.79**	**$3.66**	**$2.95**	
Organic Sales Growth	**-1.0%**	**2.0%**	**3.9%**	**0.2%**	**0.2%**
Europe	**-1.0%**	**2.0%**	**4.0%**	1.1%	0.0%
Americas	**-1.0%**	**2.0%**	**4.0%**	0.0%	-1.5%
Forecast Period Growth	**-2.0%**	**3.0%**	**6.9%**		
Debt	4,567	4,567	4,567	5,016	
Debt/EBITDA	**4.4x**	**3.5x**	**3.0x**	**4.0x**	**3.7x**
Equity	1,887	1,887	1,887	1,528	
Intangibles	2,134	2,134	2,134	2,075	
Tangible Equity	(247)	(247)	(247)	(547)	
Tangible Capital	4,320	4,320	4,320	4,469	
Invested Capital	6,454	6,454	6,454	6,544	
ROITC	**11.6%**	**16.0%**	**19.5%**	**14.5%**	
ROIC	**7.8%**	**10.7%**	**13.1%**	**9.9%**	
Other Assets/Sh	($1.07)	($1.07)	($1.07)		
Net Cash	$0	$0	$0		
Unfunded Pensions	($170)	($170)	($170)		
Excess Debt first claim on FCF	$0	$0	$0		
DCF Value	**$14**	**$34**	**$64**		
Price	$21.44	$21.44	$21.44		
Price % Value	**158%**	**63%**	**34%**		
Expected Return	**-37%**	**59%**	**198%**		
Implied P/E on Normalized EPS	8.6x	12.6x	17.7x		
Current P/E on Normalized EPS	13.2x	8.1x	6.1x	7.6x	
Implied EV/EBITA	12.2x	12.4x	14.5x		
Current EV/EBITA	14.1x	10.2x	8.4x	10.5x	
6/13/2023					

INVESTMENT PROCESS

Valuation – Sanity Checks

OI Sum-of-the-Parts Analysis

		Tax Rate	"Cap Rate" (1)	Value	Implied EV/EBITDA
Segment Sales (2022)	6,713				
Europe	2,878				
North America	1,956				
Latin America	1,879				
Segment EBITDA (2022)	1,390				
Europe	640				
North America	186				
Latin America	564				
Maintenance CapEx % Sales					
Europe	5.4%				
North America	4.6%				
Latin America	6.6%				
Maintenance CapEx	369				
Europe	154				
North America	90				
Latin America	125				
Segment EBITDA less Maintenance CapEx	**1,021**				
Europe	**486**	**23.0%**	**7.5%**	**4,989**	**7.8x**
North America	**96**	**23.0%**	**8.0%**	**923**	**5.0x**
Latin America	**439**	**23.0%**	**5.5%**	**6,148**	**10.9x**
Unallocated Corporate Costs	**(210)**	**23.0%**	**7.5%**	**(2,156)**	**10.3x**
OI Enterprise Value Estimate				**9,904**	**7.9x**
Net Debt				4,567	
Underfunded Pension Amount (NPV)				170	
OI Equity Value Estimate				5,167	
# of shares				159	
OI Value per Share				**$32.48**	
Current Price				**$21.44**	
Price % Value				**66%**	
Expected Return to Value				**51%**	

Source: Company reports and my estimates; Company stopped providing North America vs. Latin America break-out starting in 2018

(1) "Cap Rate" is defined as after-tax firm free cash flow divided by firm value

INVESTMENT PROCESS

Valuation – Sanity Checks

- Stock is at ~ 7x 2023 EPS and at ~ 8x normalized, mid-cycle EPS despite evidence of a modestly growing business
- Free Cash Flow yield of ~ 12% based on 10-year average FCF ex asbestos payments and excess pension contributions
- Trading at ~ 6x EV/EBITDA

INVESTMENT PROCESS

Valuation – Catalysts

Possible Catalysts on the Horizon:

- MAGMA working out and providing incremental profits
- Company beginning meaningful share buybacks once MAGMA investment and de-leveraging is completed, possibly in 2024-2025 timeframe

INVESTMENT PROCESS

Valuation – Sensitivity Analysis

Base Case Sensitivity to Assumption Changes:

- 1% decrease in sales growth rate: -6% decline in Base Case Value
- 1% decrease in EBITDA margin: -13% decline in Base Case Value
- MAGMA completely fails: -11%

<u>Conclusion</u>: Given the current price/value gap, there is more than sufficient margin of safety to be somewhat wrong and still do well on this investment

INVESTMENT PROCESS

Risks

Possible Risks:

- Business is over-earning due to tight supply/demand by more than I estimate
- MAGMA fails
- Glass packaging loses share to plastic or aluminum
- Management does large acquisitions rather than share buybacks

INVESTMENT PROCESS

Security Research and Valuation

Step 5 **Behavioral Checklist**

- Ask a series of questions to guard against behavioral biases before finalizing the analysis
- Checklist includes questions such as:
  - Have the most recent developments – positive or negative – colored the analysis of the company's prospects disproportionately to their long-term significance?
  - If the markets closed and I couldn't sell this security for five years, would I be comfortable owning it?
  - Do I have emotions – positive or negative – towards this investment?

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