# EDISON

QuickView

# Card Factory

Retail

28 September 2017

## Unbending

**Card Factory is a deep value retailer, offering a core product at 99p that retails for twice that at high street competitors. Despite the wide price gap, management is adamant that it does not need to raise prices to maintain profitability, with a range of actions in progress to optimise both top line and cost structure. The share price has fallen steeply, but this could present an opportunity as there are a number of potential catalysts.**

### Interim results: Coming to terms with cost pressure

Card Factory, while market leader, is coming to terms with higher costs. PBT is down 5% at £26.3m. Footfall declines have been compensated by higher average spend as it expands its non-card range, to leave a creditable 3% like-for-like sales growth. But gross margins have been hit by currency, down 1.3 percentage points at 27.0%. And after the National Living Wage, wage costs rose 10.7% against revenue up only 6.1%. This new cost structure is unlikely to reverse anytime soon.

### Standing firm against price increases

Despite cost pressure, management is resistant to price rises, choosing to retain its deep value appeal. Its core price point is 99p, which gives it 'clear blue water' against high street competitors, though less against supermarkets and online players. Management believes that there are sufficient opportunities to be addressed, both on sales and costs, to make the price option unnecessary.

### The fightback: A range of actions

The sales strategy is aimed at increasing the range that customers will buy, including non-card gifts. The estate is growing, with 30 openings in H1 taking it to 895 and with an encouraging boost from retail parks. Online remains small, though growing c 30%, with opportunity further out. And management is mining efficiencies such as rent and rate cuts, streamlining internal tasks, and LED lighting. It is also refining supply chain management including some vertical integration, and EPOS will soon be in all stores, raising visibility on customer behaviour.

### Valuation: Depressed but not without catalysts

The shares, down 21% post the results, trade at c 22% P/E discount to WH Smith, adjusted to January 2018. That appears to reflect slowing earnings growth adequately. Catalysts to share price recovery could be above-trend sales growth, from mix if not directly on price, advances in online share, or a boost from larger stores on retail parks. In addition, given management has signalled that the special dividend is subject to review, further cash distributions would likely be positive.

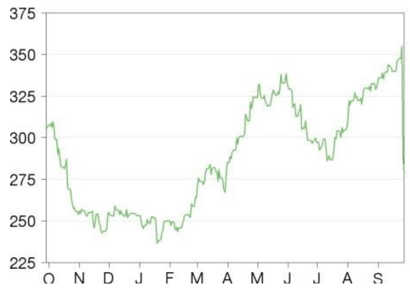
**Consensus estimates**

| Year end | Revenue (£m) | PBT (£m) | EPS (p) | DPS (p) | P/E (x) | Yield (%) |
|---|---|---|---|---|---|---|
| 01/16 | 381.6 | 82.0 | 19.1 | 23.5 | 14.6 | 8.4 |
| 01/17 | 398.2 | 85.1 | 19.8 | 24.1 | 14.1 | 8.7 |
| 01/18e | 425.3 | 83.2 | 19.4 | 24.3 | 14.4 | 8.7 |
| 01/19e | 451.5 | 86.7 | 20.3 | 9.9 | 13.7 | 3.6 |

Source: Card Factory (underlying historic), Bloomberg (forecast: recent consensus)

| | |
|---|---|
| Price | 278.5p |
| Market cap | £951m |

**Share price graph**




**Share details**

| | |
|---|---|
| Code | CARD |
| Listing | LSE |
| Shares in issue | 341.5m |

**Business description**

Card Factory is the UK's leading specialist retailer of greeting cards and related gifting items. It operates from 895 stores across the UK, and has an established online presence. Its key focus is to produce a wide range of quality cards and products at exceptional value.

**Bull**

- Market leader.
- Cash productive.
- Deep value with price potential in reserve.

**Bear**

- A discretionary purchase.
- Not yet addressing online competition.
- Cost structure suffers from weak sterling.

**Analysts**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