EDISON

Walker Greenbank

H119 results

H1 dividend and full year guidance unchanged

Care & household goods

Following H119 results, our full-year earnings estimates look attainable and are unchanged. Group strategy has been clearly stated, although a change in management may give rise to some shift of emphasis within Brands. Walker Greenbank's share price is up from September lows, but has not really shown any appreciable recovery in a longer-term context and currently sits c 20% below our projected year-end NAV. The prospective dividend yield – heavily weighted towards final DPS – is now 5%.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
01/17	92.4	10.4	12.9	3.6	6.4	4.3
01/18	108.8	12.5	14.4	4.4	5.8	5.3
01/19e	108.4	9.5	10.8	4.4	7.7	5.3
01/20e	109.8	9.6	10.9	4.4	7.6	5.3

Note: *PBT and EPS (fully diluted) are normalised, excluding exceptional items and LTIP charges.

Lower Brands profitability

A weaker UK market had been well trailed, but good performances from licensing activities and manufactured product for some UK and export customers served to substantially mitigate group revenue pressures in H1. Nevertheless, a lower Brands contribution led to c 22% lower y-o-y group adjusted EBIT in the period. Despite this, the company delivered better operating and free cash inflows than seen in H1 last year and net debt reduced to just £3.4m at the period-end. The 0.69p first-half dividend was unchanged from the prior year. An unexpected change in management was announced alongside the interim results, with non-executive director Chris Rogers now assuming an interim executive chairman role. The search for a new CEO is underway.

Management changes, estimates unchanged

Some modest improvement to UK trading was noted for the first nine weeks of H219, and our PBT, EPS and DPS estimates are all unchanged. (The newly adopted IFRS 15 standard increases revenue modestly, with no material net benefit to the bottom line.) Change in the senior management team may result in tweaks in the execution of group strategy, possibly including more individual brand plans based on market segment requirements. Ahead of that, we expect to see a continuation of the already visible sales drive to develop international markets, licensing activity and product category extensions.

Valuation: Multiple reasons for interest

In a tough trading year, Walker Greenbank's share price hit a low of 64p in September before picking up to current levels. Announced brand licence agreements should help to underpin the small EBIT improvement required in the second half to reach our full-year estimates, which are unchanged as is management guidance. An FY19 P/E 7.7x, EV/EBITDA (adjusted for pensions cash) 4.9x, a prospective 5% dividend yield covered 2.5x by earnings and a projected 92p year-end NAV per share all provide interest for investors, in our view.

18 October 2018

Price	**83.0p**
Market cap	**£59m**

Net debt (£m) at end-July 2018	3.4
Shares in issue	70.9m
Free float	92%
Code	WGB
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	27.7	(24.2)	(63.2)
Rel (local)	32.9	(17.9)	(60.9)
52-week high/low		226.5p	64.0p

Business description

Walker Greenbank is a luxury interior furnishings group combining specialist design skills with high-quality upstream UK manufacturing facilities. Leading brands include Harlequin, Sanderson, Morris & Co, Scion, Anthology, Zoffany and Clarke & Clarke. FY18 revenue: UK 58%, International 39% and Licence income 3%.

Next events

H119 DPS 0.69p ex dividend	26 October 2018
H119 DPS to be paid	23 November 2018

Analyst

Toby Thorrington +44 (0)20 3077 5721

industrials@edisongroup.com

Edison profile page

Walker Greenbank is a research client of Edison Investment Research Limited

H119 results overview

Walker Greenbank saw a modest headline sales decline in H119 but a more significant profit impact, which arose in the Brands division. A positive cash flow performance in the period reinforced the company's strong balance sheet funding position. The H1 dividend was unchanged despite the earnings reduction and – with unchanged PBT and earnings estimates, which provide cover over 2x – we expect the dividend to be held for the year as a whole also.

Exhibit 1: Walker Greenbank interim splits

Year-end January (£m)	H118	H119	% change y-o-y	% change y-o-y
			Reported H119	CER H119
Group revenue	**55.5**	**54.7**	**-1.5%**	**N/A**
Brands	46.4	44.6	-3.9%	-3.3%
UK	24.6	23.1	-5.9%	-5.9%
International	20.4	19.5	-4.3%	-2.9%
Licence income	1.5	2.0	35.4%	37.4%
Manufacturing – gross*	16.1	16.3	1.4%	N/A
UK	7.3	7.5	3.0%	3.0%
International	1.8	2.6	41.5%	N/A
Intercompany*	(7.0)	(6.2)		
Group operating profit	**5.6**	**4.4**	**-22.4%**	
Brands	6.1	4.8	-21.4%	
Manufacturing	0.5	0.6	28.7%	
Central items**	(1.0)	(1.1)		

Source: Edison Investment Research, Walker Greenbank data. Note: H118 restated for IFRS 15. *Manufacturing – gross includes intercompany transfers to Brands, which is netted out on consolidation. **Loss of profits figures included in central items were as follows: H118, £1.1m, H119 zero.

Note: the company adopted the IFRS 15 reporting standard – revenue recognition in H119; overall, there was a slight improvement in restated H118 EBIT. The inclusion of charged carriage costs within revenue now – rather than netted off distribution costs previously – increases annual revenues by c £2m, we estimate, with a modestly dilutive impact on reported margins.

Brands

Internationally recognised heritage and contemporary, premium and mid-market, wall covering and furnishing brands (Sanderson, Morris & Co, Harlequin, Zoffany, Scion, Anthology, Clarke & Clarke, Studio G).

Progress in the US and in licensing activity were the highlights of first-half trading, although this was offset by softer product sales in other markets, leaving divisional revenue down by 3.3% overall in local currency (slightly more in sterling terms), with a sharper profit decline.

The UK accounted for just over half of **product sales** (at 54%) in H119 and, as previously noted, trading conditions here were challenging during the period, resulting in a 5.9% revenue reduction. Generally weak demand has been experienced across a broad range of high-street retail names and with flat to slightly lower residential transaction trends also, subdued activity in the housing market is an unhelpful backdrop for renovation/improvement sector spending. UK GDP is still expanding, albeit slowly, and with tourism numbers remaining healthy, we would expect the commercial/contract sector to have been relatively resilient for Walker Greenbank. International product sales have been identified as offering superior growth rates to the UK and steps are being taken to capitalise on these opportunities. The US is an obvious example of success; Walker Greenbank already has a direct salesforce here and the opening of a second showroom towards the end of 2017 contributed to local revenue growth of +5.8%. Elsewhere, the migration from distributor-led to a direct presence in Russia and Germany in the first half will have caused some short-term sales disruption (eg western and eastern European regional sales -5.8% and -10.4%, respectively). Other smaller international markets were mixed and possibly more influenced by commercial order patterns. For product sales overall, at **individual brand level**, Clarke & Clarke/Studio G performed well in the first six months (revenue +7.8%), which we believe reflects its positioning at the more affordable end of Wlaker Greenbank's target markets. In contrast, the heritage brand groups, collectively marketed under the Style Library umbrella, saw worldwide revenue declines of between 7 and 10%.

Licensing

Licensing currently accounts for less than 5% of Brand divisional sales but contributes well to profitability, owing to a favourable drop-through net of costs compared to product sales. Reported revenue rose by over £0.5m (c 35%) in H119. Walker Greenbank has been steadily building a base of multi-year agreements largely in the soft furnishings category (eg bedding, blinds) but was also successful in signing new seasonal deals in the apparel and accessory categories for Sanderson designs (Radley, Uniqlo) and those of Wm Morris (H&M). As previously announced, the H&M contract is the largest individual licence agreement signed by the company to date and is expected to be delivered during the second half of the year. Overall, just over half of licensing revenue was generated in overseas markets and local currency growth was slightly ahead of the rate of headline progress.

Despite a more favourable contribution from licensing activities, divisional profitability fell by over 20% overall in H119. We suggest that some of the discrete (eg showroom and sales) costs associated with establishing a new direct presence in Russia and Germany will have contributed to this outturn, although we expect this effect to weaken as sales build in these countries. Otherwise, lower volumes of (most likely higher-margin) heritage brands will have been the primary driver of lower profitability, in our view. Responding to market challenges, Walker Greenbank is to place an increasing focus on its existing strategy (to expand international sales, licensing and product category extensions), possibly developing more brand-specific initiatives in each case.

Manufacturing

Two locations, Anstey (wallcoverings) and Standfast & Barracks (fabrics), which produce high-end furnishings with third party output now larger than that servicing the group Brands division.

Divisional gross sales grew modestly overall in H119, the net result of expanding third-party revenues (+10.7% y-o-y) largely offset by lower internal Brand requirements (-10.6%), and operating profitability rose by c £140k to c £0.64m.

We consider that the **internal Brands** performance is largely consistent with the H119 heritage Brands revenue trend mentioned earlier and amplified, we believe, by some inventory reduction in that division. (The Clarke & Clarke brand has historically not been a significant user of group manufacturing capacity in its supply chain and so its positive sale momentum brought little benefit to this division.) **Third-party** sales were clearly firmer, more so in international/export markets, which grew by 41.5% (£0.75m) compared to the larger UK customer segment (+3%). As already noted, the UK market is experiencing lower overall demand, so we attribute the 3% third-party sales increase to market share gains, although no particular customers were highlighted. Faster growth in export markets is a stated strategic aim and the manufacturing division's performance in the first half of the year indicates that this is being achieved.

Walker Greenbank's two manufacturing facilities delivered contrasting performances in H119, with Anstey delivering wallcovering revenue growth to third parties in excess of 20%, while Standfast & Barracks (S&B) revenues were broadly flat y-o-y – check in the period, chiefly due to softer UK sales. (Both operations experienced significantly reduced internal sales to the Brands division.) Adding more detail to the divisional export performance noted above, both product categories grew overseas sales strongly in the first six months to become almost 16% of total divisional (or 25% of net, third-party) sales. At S&B, additional digital printing capability has supported export growth, while new in-house paint tinting and distribution will have aided Anstey's top-line growth, although not necessarily in export markets.

Net debt at low levels and heading lower from FY20

Group net debt stood at £3.4m at the end of September, £1.9m lower compared to the position at the beginning of the year, including c £0.1m favourable translation of overseas cash balances.

At £4.2m, operating cash flow was £2.5m better than the prior year, despite a £1.6m reduction in EBITDA y-o-y. The main component of this underlying y-o-y improvement was a much lower working capital outflow at £1.1m (versus £4.1m in H118); all three line items contributed to this outturn with inventory reductions and a smaller receivables outflow characterising the trading performance, while a smaller payables outflow also reflected some lower central cost elements. Otherwise, the c £1m pension scheme contribution was similar to the prior year, while there was a c £0.7m insurance receipt (relating to the Anstey fire) compared to a small net timing outflow in the prior year (concluding an earlier flood-related loss of profits claim at S&B).

Working further down the cash flow statement, interest costs were similar to the prior year while cash tax payments were lower (combined outflow of £0.7m). Capex on tangible assets was also down y-o-y (at £1.1m including a digital pigment printer, a new process for S&B) slightly below the depreciation charge in the period) and capex on intangible assets was similar to H118 (at £0.5m, being largely collection design costs). Note that Walker Greenbank received £1.8m insurance proceeds for replacing equipment at S&B in the prior year that did not recur in H119. The company makes all of its annual cash dividend payments (ie the prior year final and current year interim) in the second half of its trading year, so there were no such outflows in H1, as in the prior year.

Cash flow outlook

We expect to see a small EBITDA improvement in the second half compared to the first and a similar operating cash flow performance. On substantially unchanged estimates and allowing for slightly higher tax and capex outflows in the second half, we estimate £0.7m free cash flow generation in H2. The payment of declared dividends, totalling £3.1m, results in our projected year-end net debt position of £5.2m, similar to that reported at the end of FY18.

Compared to our £13m FY19 EBITDA estimate, balance sheet funding is set conservatively, in our view. (The impact of IFRS 16 leases with regard to operating lease commitments is currently being assessed.) For the record, Walker Greenbank has a small-term loan, a £12.5m multi-currency RCF and, additionally, a £10m accordion facility, which all run to December 2020.

The company clearly has headroom to make acquisitions should suitable opportunities arise (the last being Clarke & Clarke in October 2016). This may or may not influence future decisions regarding dividend payments. Our current estimates indicate a subdued earnings recovery beyond FY19 and, while dividend cover is more than two times covered in our model, free cash flow cover is 1.5x or less over our estimate horizon. We retain our existing expectation for an unchanged dividend payout in the current year and the two that follow, and will continue to monitor this assumption in the context of any changes to prospective earnings and cash flow profiles. On this basis, we expect Walker Greenbank to generate net cash at or above £1m in both FY20 and FY21, with net debt trending down accordingly.

Revenues nudged up, profit expectations unchanged

As noted earlier, IFRS 15 (and specifically the inclusion of charged carriage costs as revenue) increases our previous Brands revenue estimates by c £2m pa, which is mostly reflected at group level also, save for a minor reduction to our Manufacturing revenue expectations by FY21. There are no substantive changes to our profit estimates and – given that previous guidance for FY19 company PBT norm is intact – we sit at the lower end of that £9.5–10m indicated range.

Exhibit 2: Financial summary

£m	2013	2014	2015	2016	2017	2018	2019e	2020e	2021e
January	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS									
Revenue	75.7	78.4	83.4	87.8	92.4	108.8	108.4	109.8	112.4
Cost of Sales	(30.2)	(30.3)	(32.7)	(35.9)	(36.2)	(43.3)	(42.3)	(42.8)	(43.9)
Gross Profit	45.5	48.1	50.7	52.0	56.2	65.5	66.1	66.9	68.6
EBITDA	8.6	9.7	10.7	11.8	13.4	15.9	13.0	13.3	14.2
Operating Profit (before GW, except. & LTIP)	6.6	7.5	8.3	9.1	10.6	12.8	9.8	10.0	10.8
Operating Profit (before GW and except.) - reported	5.8	6.5	7.3	8.2	9.8	12.4	9.2	9.4	10.2
Net Interest	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.3)	(0.3)	(0.3)	(0.3)
Intangible Amortisation - acquired	0	0	0	0	(0.3)	(1.0)	(1.0)	(1.0)	(1.0)
Pension net finance charge	(0.7)	(0.9)	(0.8)	(0.7)	(0.5)	(0.6)	(0.6)	(0.6)	(0.6)
Exceptionals	0	0	0	0	(1.8)	2.3	0.5	0.0	0.0
Other	0	0	0	0	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)	6.4	7.3	8.1	8.9	10.4	12.5	9.5	9.6	10.4
Profit Before Tax (FRS 3)	4.9	5.5	6.3	7.3	7.0	12.8	7.8	7.4	8.2
Tax	(1.0)	(0.5)	(1.2)	(1.5)	(1.6)	(1.0)	(1.9)	(1.9)	(2.1)
Profit After Tax (norm)	5.4	6.6	6.9	7.5	8.6	11.5	7.6	7.7	8.4
Profit After Tax (FRS 3)	4.0	5.0	5.1	5.9	5.4	11.8	5.9	5.5	6.1
Average Number of Shares Outstanding (m)	57.5	58.5	59.3	60.0	62.7	70.4	70.7	70.7	70.7
EPS - normalised (p) FD	9.4	10.7	11.2	11.6	12.9	14.4	10.8	10.9	11.8
EPS - FRS 3 (p)	6.9	8.6	8.6	9.8	8.6	16.7	8.3	7.8	8.7
Dividend per share (p)	1.5	1.9	2.3	2.9	3.6	4.4	4.4	4.4	4.4
Gross Margin (%)	60.1	61.3	60.8	59.2	60.8	60.2	61.0	61.0	61.0
EBITDA Margin (%)	11.4	12.4	12.8	13.4	14.6	14.6	12.0	12.1	12.6
Operating Margin (before GW and except.) (%)	7.7	8.3	8.8	9.3	10.7	11.4	8.5	8.5	9.1
BALANCE SHEET									
Fixed Assets	18.5	21.1	21.5	18.9	47.5	47.7	47.1	46.3	45.4
Intangible Assets	6.7	7.3	7.2	7.1	31.6	31.8	30.6	29.5	28.4
Tangible Assets	9.8	11.7	12.7	11.7	15.8	16.0	16.5	16.8	17.1
Investments	2.0	2.2	1.6	0.1	0.0	0.0	0.0	0.0	0.0
Current Assets	32.6	35.3	37.1	40.3	51.3	51.9	54.4	56.1	58.6
Stocks	16.8	18.4	22.0	18.1	30.3	29.4	30.7	31.1	31.9
Debtors	12.8	13.9	14.1	19.3	19.5	21.2	21.9	22.1	22.4
Cash	2.9	2.8	1.0	2.9	1.5	1.3	1.8	2.9	4.3
Other	0.1	0.2	0.0	0.0					
Current Liabilities	(17.3)	(19.4)	(20.7)	(19.4)	(34.8)	(28.9)	(29.3)	(29.9)	(30.7)
Creditors	(16.9)	(19.0)	(20.3)	(19.0)	(28.0)	(22.4)	(22.3)	(22.9)	(23.7)
Short term borrowings	(0.4)	(0.4)	(0.4)	(0.4)	(6.8)	(6.6)	(7.0)	(7.0)	(7.0)
Long Term Liabilities	(9.6)	(10.2)	(10.9)	(4.5)	(12.7)	(9.1)	(7.2)	(5.1)	(2.8)
Long term borrowings	(1.4)	(0.9)	(0.6)	(0.2)	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	(8.2)	(9.2)	(10.4)	(4.3)	(12.7)	(9.1)	(7.2)	(5.1)	(2.8)
Net Assets	24.2	26.9	26.9	35.3	51.3	61.6	65.0	67.5	70.5
CASH FLOW									
Operating Cash Flow	6.0	6.2	3.5	7.1	12.4	7.0	8.7	10.0	10.4
Net Interest	(0.2)	(0.2)	(0.2)	(0.1)	(0.2)	(0.2)	(0.3)	(0.3)	(0.3)
Tax	(0.0)	(0.0)	(0.0)	(0.6)	(2.3)	(2.2)	(1.9)	(1.9)	(2.1)
Capex	(3.1)	(4.7)	(3.2)	(2.5)	(6.7)	(3.5)	(3.5)	(3.5)	(3.5)
Acquisitions/disposals	0.0	0.0	0.0	0.0	(27.1)	0.0	0.0	0.0	0.0
Financing	(0.1)	(0.0)	(0.4)	(0.1)	18.3	1.8	0.0	0.0	0.0
Dividends	(0.7)	(0.9)	(1.1)	(1.4)	(1.8)	(2.7)	(3.1)	(3.1)	(3.1)
Net Cash Flow	1.8	0.3	(1.5)	2.3	(7.4)	0.1	(0.1)	1.1	1.4
Opening net debt/(cash)	0.7	(1.2)	(1.5)	(0.0)	(2.3)	5.3	5.3	5.2	4.0
HP finance leases initiated	0.0	0.0	0.0	0.0	(0.0)	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	(0.2)	(0.1)	0.1	0.0	0.0
Closing net debt/(cash)	(1.2)	(1.5)	(0.0)	(2.3)	5.3	5.3	5.2	4.0	2.6

Source: Company, Edison Investment Research

Edison is an investment research and advisory company, with offices in North America, Europe, the Middle East and AsiaPac. The heart of Edison is our world-renowned equity research platform and deep multi-sector expertise. At Edison Investment Research, our research is widely read by international investors, advisers and stakeholders. Edison Advisors leverages our core research platform to provide differentiated services including investor relations and strategic consulting. Edison is authorised and regulated by the Financial Conduct Authority. Edison Investment Research (NZ) Limited (Edison NZ) is the New Zealand subsidiary of Edison. Edison NZ is registered on the New Zealand Financial Service Providers Register (FSP number 247505) and is registered to provide wholesale and/or generic financial adviser services only. Edison Investment Research Inc (Edison US) is the US subsidiary of Edison and is regulated by the Securities and Exchange Commission. Edison Investment Research Pty Limited (Edison Aus) [46085869] is the Australian subsidiary of Edison. Edison Germany is a branch entity of Edison Investment Research Limited [4794244]. www.edisongroup.com

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
295 Madison Avenue, 18th Floor
10017, New York
US

Sydney +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia