EDISON

4imprint Group

Interim results

Watching and waiting for the US to unlock

Media

4imprint's first half trading was heavily affected by the commercial repercussions of the COVID-19 pandemic as it spread across the US. With uncertainty over the speed and extent of the reopening of the US economy, projections for the remainder of the year (and for FY21) are more tentative than usual. Despite the difficult trading circumstances, 4imprint retains a strong, cash positive balance sheet, and has low fixed costs and capital requirements. We believe that it retains its long-term attractions in a large, fragmented market and should rebuild quickly as the economy recovers.

Year end	Revenue ($m)	PBT* ($m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/18	738.4	46.1	129.4	70.0	20.8	2.6
12/19	860.8	55.6	157.2	84.0**	17.2	3.1
12/20e	535.0	0.5	0.3	0.0	N/A	N/A
12/21e	600.0	15.0	40.6	20.0	65.6	0.7

Note: *PBT and EPS are normalised, excluding exceptional items. **84c declared, 25c paid.

Coping in a harsh trading environment

It is unsurprising that branded promotional products have not been top-of-mind for corporate America recently. 4imprint's H120 revenues were down 34% on H119 and we have made a further cautionary cut to our FY20 revenue forecast to $535m from $550m. Our FY21 revenue number is unchanged, but we have taken a more cautious view on margins. The first two months of FY20 were strong, with order intake up 13%, but at the nadir in April, orders were more than 80% below prior year. 4imprint retained its full workforce, working from home wherever possible. This has had a clear impact on operating profit, to a little over break-even in H120, from $19.4m in H119. However, customer relationships have been nurtured and average order value increased by 6%. New customers made up 27% of H120 orders (H119: 29%). Some competitors have had more resilient sales, but many have pivoted to supplying unbranded personal protective equipment.

Managing the marketing spend

The key to 4imprint's historical success is the careful and intricate management of the marketing spend, which is managed to grow the revenues while maintaining a broadly stable operating margin. This period has obviously presented a different set of priorities and marketing spend was reined in by 40% to $47.2m, of which just $9.5m was in Q2, implying revenue per marketing dollar in H1 of $5.64, a little ahead of recent levels. The emphasis has shifted further to brand promotion, which should help drive further market share gains as the trading environment improves.

Valuation: Strong fundamentals and many unknowns

With so much uncertainty regarding how and at what speed the US economy will continue to recover our earnings forecasts are tentative and valuation judgements based on them are subjective. 4imprint has a market-leading position, a low fixed cost base and limited capital requirements, attractive cash flow characteristics and a cash positive balance sheet, all of which justify its premium rating. 4imprint trades on an FY19 EV/EBITDA of 12.0x, compared to marketing services stocks on 7.2x.

11 September 2020

Price	**2,055p**
Market cap	**£578m**
	$1.31/£
Net cash ($m) at 30 June 2020	37.5
Shares in issue	28.1m
Free float	98.2%
Code	FOUR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(17.2)	(15.5)	(28.3)
Rel (local)	(16.6)	(11.8)	(14.7)
52-week high/low		3,500p	1,320p

Business description

4imprint is the leading direct marketer of promotional products in the US, Canada, the UK and Ireland. In FY19, 97% of revenues were generated in the US and Canada.

Next events

Q3 trading update	Early November
Year-end update	Early January 2021

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Edison profile page

4imprint Group is a research client of Edison Investment Research Limited

Investment case

Interrupted impressive organic growth record

4imprint presents a unique investment case: a UK-listed company, with British and US management, run out of the US and with 97% of revenues generated in the US. It is a distributor of promotional products across the spectrum of enterprises in North America, with a large range of product across categories from pens to apparel. Up until the onset of the pandemic, it had a very impressive financial record, with revenue growth for the five years from FY13 through to FY19 at a CAGR of 17.2% (10-year CAGR of 15.0%). For FY20, our updated modelling suggests a 38% drop in revenue over the prior year, reflecting the severe impact that the lockdowns have had across the US economy.

Sizeable and fragmented target market

4imprint operates in a large and diverse market. The Advertising Specialty Institute (ASI), an industry body, estimated the value of the US promotional products distribution market in 2019 at US$25.8bn. 4imprint is the largest distributor, yet has an estimated market share of less than 3%. The market reportedly grew at around 4.5% for FY19, with a 10-year CAGR of 5.0%, but is currently estimated to retrench by 35% in 2020. However, this figure includes some distributors switching to supplying PPE. 4imprint has hitherto consistently grown faster than the market, building share through its reputation for quality, reliability and customer service. There are no direct comparators, as the other large players have differentiated business models, described below.

Marketing mix shifted to reflect circumstances

Understanding 4imprint's marketing approach is central to understanding the company. Its strong long-term record stems from a data-driven approach to understanding its customers and meeting (and anticipating) their requirements. This has been just as true over the pandemic period as in 'normal' trading. The marketing uses data to drive what products are presented to which audiences, when and via what channel. The meld of automation and personalisation has been very effective in delivering top line growth historically. It uses a range of marketing techniques to drive both customer acquisition and customer retention, complemented with TV and radio campaigns to drive brand awareness. Under the current market conditions, the mix has been quickly adapted to reflect how customers are working, with the overall spend heavily reduced. Marketing effectiveness ($1 revenue earned relative to $1 spent) increased in H120 at $5.64, from $5.12 in H119 (FY19: $5.58).

Inherent strong cash flow characteristics

4imprint's cash positive balance sheet has afforded it a substantial cushion against the sharp downturn in revenues. The business's cash requirements are modest, as it is primarily a marketing and distribution business, with minimal need to invest in large stock positions or substantial pieces of capital equipment. Historically, significant cash was absorbed by a legacy pension scheme funding requirement (mostly in the UK) and a $9.14m lump-sum contribution was paid in May 2020, as previously agreed with the trustees. The objective is to fund the scheme to be 'buy-out' ready within five years.

Forecasts and valuation

We reduced our forecasts in June as the scale of the downturn began to look more quantifiable and we have now made a further 3% reduction to our FY20 revenue forecast, based on a month-by-month scenario outlined in the financial section below. Our FY21 revenue figure is unchanged at this juncture, implying a 12% year-on-year revenue improvement, which is well below the 18% CAGR achieved (organically) through FY11-19. However, it is clear that the recovery is unlikely to follow a straight-line trajectory. We have assumed that FY21 operating costs revert to nearer FY19 levels and that marketing costs run at a similar percentage of revenue year-on-year, although this is the line with the greatest potential flex. On our modelled 38% FY20 year-on-year revenue reduction, the group still generates positive operating cash flow and would end the year with a net cash balance of $22.5m. The main component of the projected FY20 negative free cash flow is the pension contribution. We expect the dividend to be reinstated for FY21.

Exhibit 1: Summary forecast changes

	Revenue ($m)			EPS (c)			PBT ($m)			EBITDA ($m)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2019	861		N/A	157.2	-	N/A	55.6	-	N/A	59.1	-	N/A
2020e	550	535	-3	20.5	0.3	-99	8.8	0.5	-94	13.7	3.9	-72
2021e	600	600	u/c	73.9	40.6	-45	28.0	15.0	-46	32.8	18.8	-43

Source: Company accounts, Edison Investment Research

Our FY20 revenue forecast reduces by $15m, translating to an $10m reduction in EBITDA and an $8m reduction at the pre-tax level. Despite the significant downgrade, which is exacerbated by the operating leverage, we expect the company to remain profitable in the current year.

The degree of uncertainty over the short-term financial prospects makes it difficult to judge relative valuation, particularly as the main peer set of marketing services companies have little in common geographically or commercially. We therefore also compare against a couple of US distributors. On historic EV/EBITDA, 4imprint trades on 12.0x, compared with marketing services stocks on 7.2x and the relevant distributors on 7.3x. For FY21e, the premium is greater at 38.3x versus 6.2x and 7.0x for the two respective peer sets.

Company description: Direct marketing of promotional products

4imprint's business model is remarkably straightforward. It supplies customised, promotional products to customers across North America (97% of revenues) and the UK and Ireland (3% of revenues). Trading over the last six months has been atypical due to the coronavirus pandemic, which has had a significant impact on the way North American businesses function. 4imprint's reaction has been to protect its people through moving to remote working wherever possible and to continue to market to and deliver to its existing and potential customers, subject to the necessary operating constraints. The marketing approach has been rapidly rescaled and reconfigured to reflect the circumstances and this flexibility will continue as and when the US economy reopens and recovers, which may not be on a smooth trajectory.

Despite the dramatic changes in the operating environment, 4imprint's ethos is unchanged. Management is protective of the group's reputation for 'best-in-class' customer service and of its partnership approach to dealing with its suppliers. In both aspects, the brand's positioning has undoubtedly helped to give a degree (obviously unquantifiable) of resilience against the worst of the market impacts. The scale of the operation is large, running at around 1.3m orders a year, but all are individually customised and of great importance to the customer. The market is highly fragmented; there are an estimated 23,000 distributors in North America alone. It is, however, substantial, estimated by industry body ASI at $25.8bn in 2019. 4imprint's growth has consistently outstripped the market, with a revenue CAGR of 14.0% for the period FY11–20e, compared to an estimated market growth of 4.8%. This premium growth is being delivered through the group's sophisticated direct marketing operation, based on data and covering online and offline approaches to recruit new customers and to drive return visits. Marketing spend is managed with a view to driving the top line while broadly maintaining operating margin. How the spend has been tailored to suit the changed circumstances is described in more detail below.

Customised, promotional products

Exhibit 2: Sample 4imprint products

Source: 4imprint

Exhibit 3: Sample 4imprint apparel

Source: 4imprint

Promotional products are used by businesses to increase the profile of their services, products or events, and also to motivate staff within their own operations. The product range offered by 4imprint is extensive, from the basic, such as pens, bags and drinkware, through to higher priced items such as apparel, business gifts and full displays for trade shows. All are customised with the name and/or logo of the organisation doing the promotion. 4imprint has over 5,000 products that can be customised and shipped in less than 24 hours (order today, ship tomorrow) and over 600 exclusive lines. Overall, the group lists around 50,000 SKUs, taking into account different colourways, etc. The average order quantity is over 300 items.

The immediacy of the relationships with both customers and suppliers allows for trends to be quickly identified and addressed. 4imprint only carries a small amount of inventory, principally the own-branded Crossland apparel. The general method of working is on a 'drop-ship' basis, whereby the supplier holds the inventory, prints the product and ships it directly to the customer. This gives 4imprint the ability to offer a far higher number of product lines, without any of the associated stock risk. It does require a high degree of trust and co-operation between the group and its supplier base, which it cements through a collaborative/partnership-based approach and prompt payment. The closeness of these relationships has held the group in good stead with the onset and development of the COVID-19 pandemic. A supplier operating at lower than usual levels will prefer to work with those they know and trust, in the knowledge that they will be paid – and on time.

As at the end of December 2019, 4imprint was holding $11.5m of finished goods and goods for resale (which includes goods in transit), compared with FY19 revenues of $860.8m, and up on $9.8m from the prior year (versus $738m of sales in that year). At the half-year, this figure was $8.6m, which is greater as a proportion of sales than prior year (3.2% from 2.9%), but necessary to ensure smooth fulfilment of customer orders when logistics have been more challenging.

The top categories of product in 2019 were:

Exhibit 4: Top product categories 2019

Rank	Category	Rank	Category
1	Apparel	6	Technology (power banks, Bluetooth speakers etc)
2	Bags	7	Outdoor & Leisure
3	Drinkware	8	Tradeshows & Signage
4	Writing (pens etc)	9	Auto, home & tools
5	Stationery	10	Wellness & Safety

Source: 4imprint

Some other distributors of promotional products have switched their product bias as the pandemic spread, with a move into unbranded PPE. While 4imprint has added some COVID-19 specific lines, these have been items such as hand sanitiser and branded face masks, so within the existing product sphere.

While it is easy to envisage a high degree of automation with an online business model, part of the strength of the business is the management of the combination of digital and analogue. This applies both to the marketing and the operational side, where day-to-day activities involve a far higher element of handholding for customers for whom this type of buying is not central to their normal working practices. Customer service personnel talk to customers over the phone to guide them through the process – albeit that much of this has been done remotely over recent weeks, rather than at the main office in Oshkosh, Wisconsin.

4imprint employs around 1,200 people. This is usually supplemented with temporary employees according to the demand cycle across the year, although the figure for FY20 may well be quite different, depending on how the remainder of the year develops. Around 650 (normally) work at the main office, with the balance employed at the distribution centre nearby, also in Oshkosh, Wisconsin. Over 300 are employed in a customer-facing capacity. During the pandemic, roles that can be fulfilled through home working have been and the majority of office-based staff remain working from home. The distribution centre was shut for several weeks, then reopened at reduced throughput and with social distancing in operation. The embroidery facility is also now back in action.

Within the main office, there are some specialist teams: a team focused on inbound enquiries from Canada, including French speakers; an Education team, focused on K-12, colleges and universities, and on licensing; Federal, state and local government; Spanish speakers; and a small team specifically dealing with claims and credits. Supplier faults/errors and delivery issues are dealt with by this team, and the overall rate of orders needing attention of this type runs at less than 2%.

The personal approach is a crucial element of the differentiation over an order from an online platform, such as Amazon. A team member taking an inbound call has access to that customer's order history and digital artwork and can walk the customer through the options and process, or talk through those with an inbound enquiry from a new potential customer, building the level of trust needed to drive longer-term, repeat business.

Having been based in Oshkosh since the early 1990s, 4imprint is a well-established local employer and cultivates its reputation as a preferred employer through offering benefits such as training, onsite medical and dental provision (company-funded), holiday pay and pensions. Staff retention is very good, with turnover in low single digits.

Orders are processed, customised, then despatched, mostly direct from the supplier. The large distribution facility is located in an industrial zone on the outskirts of Oshkosh. An idea of the scale is shown in the video below.

The distribution centre has three key roles: 'Blue Box' marketing, sample pick & pack and embroidery to customise apparel and bags etc. 4imprint is well-known for these Blue Boxes, which are a core element of the marketing, designed to drive customer retention. The contents of the boxes are tailored according to the relevant data, with catalogues and relevant samples enclosed. This programme was suspended while much of the North American business community has been working remotely and has now resumed at a reduced level.

Embroidered apparel is the area where 4imprint's proportion of revenue is lower than the distributor market and is therefore an area of focus in driving the top line. It has a particularly high perceived value and is often used as an element of staff motivation, in addition to the promotional benefit. It obviously sells through at higher price points and boosts basket size. The embroidery side of the 4imprint's offering differs to its other products due to the degree of customisation that must be carried out before despatch. Management has evaluated the business and commercial dynamics of in-housing as opposed to external sourcing. The key issues swaying the argument to an internal solution principally surround scalability, product quality and speed. Unless these can all align, the risk to client satisfaction – and hence quality, repeat business – is too high. To give the capacity to increase apparel in the overall business mix, the embroidery facility was extended over the last year and direct to garment printing was added just before lockdown, at a cost of $2.3m. Bespoke digital printing is also carried out at the facility for display materials and where transfer printing is preferred or technically superior to embroidery for fabrics and bags.

Exhibit 5: Video of the distribution centre

Source: 4imprint

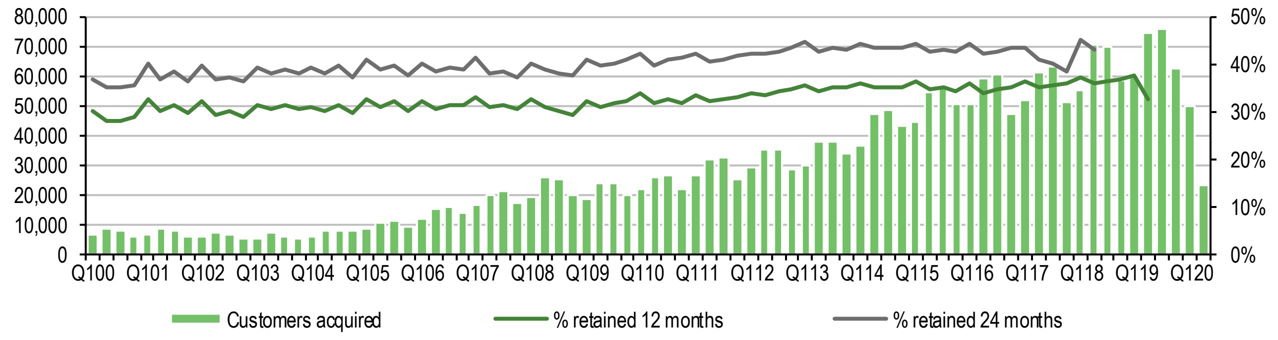
The UK and Ireland business broadly replicates that in North America, but on a far smaller scale and without the embroidery facility.

Reactive and adaptive marketing drives the top line

4imprint has many years of experience honing what does and does not work when it comes to encouraging existing customers to buy and how to recruit new business customers. Management monitors marketing effectiveness through KPIs such as the number of customers acquired and the percentage of those customers retained after 12 and after 24 months. Customer acquisition has historically been more heavily weighted to Q2 and Q3 on an increasing trend across the last decade, with between 32% and 38% ordering again within the subsequent 12 months and between 38% and 45% re-ordering before two years have passed. Obviously, the situation for the current year is far from normal circumstances and the steady growth that has been seen in previous years has been interrupted. What is interesting – and encouraging – is that customer recruitment, although diminished, has not completely dried up. This is testament to the efficacy of the management of the marketing activity and, in particular, of the TV campaign to boost brand awareness.

The group uses a wide range of marketing techniques (some of which have been less relevant in recent months where workplaces have been far emptier than normal). These include 'traditional' printed catalogues, SEM, email, quantitative analytics, Blue Box physical samples (used for customer retention) and, more recently, television and radio campaigns aimed at boosting brand awareness. The management of the marketing mix is sophisticated and is based on the data derived from each marketing exercise, which is fed back into the planning. This systemic management of the marketing effort is a vital part of the group's IP and is key to how the group has been able to build its market share through understanding customers' needs and buying patterns. It has also facilitated the flexibility needed in speedily adapting the mix as the pandemic has disrupted working patterns across North America.

Exhibit 6: Customer acquisition and retention



Source: 4imprint

The main changes in the mix as a result over the last six months have been a significant reduction in catalogues (little point in them sitting on desks of people who are not in their normal workplace) with direct mail halted between late March and June. The Blue Box scheme was suspended for the same reason between May and mid-June. More recently, the group has been trialling a limited resumption delivering these to the home offices of the relevant individuals, entirely on an 'opt-in' basis. Catalogues may look to be a 20th century technique, but they are proven and still very effective in a B2B context and suit the nature of the businesses that form the core customer constituency, likely sitting on the desk of the targeted individual. It is therefore likely that they will be resumed but may not in future form as large a part of the mix. Photographic work has been done in house in studios at the head office, with models all being from the workforce – again this has been temporarily curtailed but will resume as conditions ease. Sourcing this element in house has obvious cost benefits but also adds to the authenticity of the branding.

In FY18, 4imprint added linear TV to the marketing mix to promote the group's brand awareness rather than to directly drive sales. The original experimentation and investment (an incremental $7m) proved even more effective than had been anticipated and now forms a core part of the marketing mix. It drives an increased proportion of direct traffic to the website, as opposed to traffic delivered via search/Google, and in inbound interest over the phone. Unprompted and prompted brand awareness also rose by a greater extent than originally anticipated, with a further double-digit improvement year-on-year in H120.

With the onset of the pandemic, the creative element of these ads was tweaked, with two new campaigns addressing potential and existing customers. Costs for TV campaigns dipped considerably initially and have now firmed up again, albeit lower now than a year ago.

Investment in supplier relationships pays off

The customer landscape is looked at in the section below, but it is easy to overlook the importance of the supplier relationships in the business model. 4imprint guards its corporate integrity closely and this extends to its supply chain. Ethical standards on employment and sourcing back through the chain are high and the potential reputational impact of any lowering or breach of these standards on either 4imprint or its clients is considerable. The group's general approach is that of partnership. Given its industry positioning as market leader, it will tend to be the supplier's largest customer, but it also endeavours to be a favoured customer through good communication and prompt payment. This attitude has stood the group in strong stead over the last six months, initially with difficulties in shipments from China and then as the logistics of distribution In North America became more complex. With a rapidly shifting product mix and a production environment with novel challenges, solid communication and trust have been essential. Where other distributors may be looking to stretch terms of trade, and supply of goods may be constrained if the logistics have been more challenging, the element of trust may be the crucial deciding factor on who to deal with. Being paid on time also helps considerably.

Just as there is ongoing consolidation within the distributors, there has been a mirroring process happening within the supply base, with the bigger suppliers getting bigger and private equity funding having moved into the sector. This trend may well accelerate post pandemic, particularly if the smaller players lack the funding to support the necessary working capital. As 4imprint's business has scaled up, it has had to manage its supplier relationships to continue to meet customer expectations on quality and on expedited delivery schedules. This has necessitated gravitating to suppliers also of greater scale, where key factors, such as regulatory requirements, product safety and documented provenance, are easier to manage.

There is a natural limit on supplier concentration, given the sheer number of SKUs being offered across the various catalogues and online. While the recent weeks and months have been far from typical in their trading patterns, in general terms management estimates that the 10 largest suppliers account for around half of the overall group volume. Roughly one-third (and growing) of the total supplier base supplies multiple product lines, a further third are supplying apparel and the balance have a particular product speciality.

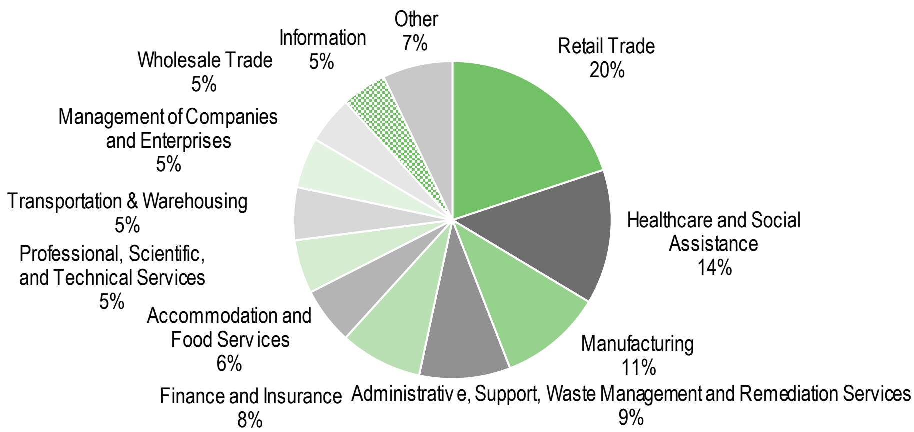
There is a core team of senior merchandisers negotiating larger contracts and conducting social/ compliance audits, with around 25 further team members in support. Goods are designed and produced overseas and shipped to the US for decoration or else sourced domestically.

Supplier prices are normally published and set on an annual basis.

Promotional goods landscape

The latest US government statistics show there were just under 6m enterprises earning below $1m in revenues in 2017 (latest year available) and 26.5k reporting revenues of over $1m. More recent figures for Q119 show 692k enterprises that employed between 10 and 1,000 workers. 4imprint identifies its target customer base as those employing more than 10 people and generating over $1m in revenue, so this measure is a reasonable proxy. The split by business sector is shown below.

Exhibit 7: Key US employment sectors for smaller firms 2017



Source: US Gov NAICS

The size of the US promotional products market is estimated at $23bn by the industry body, PPAI ($25bn including Canada). Management estimates that around one-third of the total market is accounted for by corporate programmes, namely contractual relationships with large corporations. Given the overall scale of the promotional products sector, 4imprint is able to afford to sidestep this corporate programme segment of the market, which would be significantly more capital intensive and contractual in nature. This leaves around two-thirds of the market truly addressable, allowing for considerable further growth before any market share constraints might emerge.

This is a competitive landscape (PPAI estimates around 30k distributors), but the participants are predominantly small and locally active. Over the last few years, 4imprint's growth has moved it up the relative 'league table' and it now has the largest sales of all US promotional product distributors. However, it still accounts for below 3% of the estimated market.

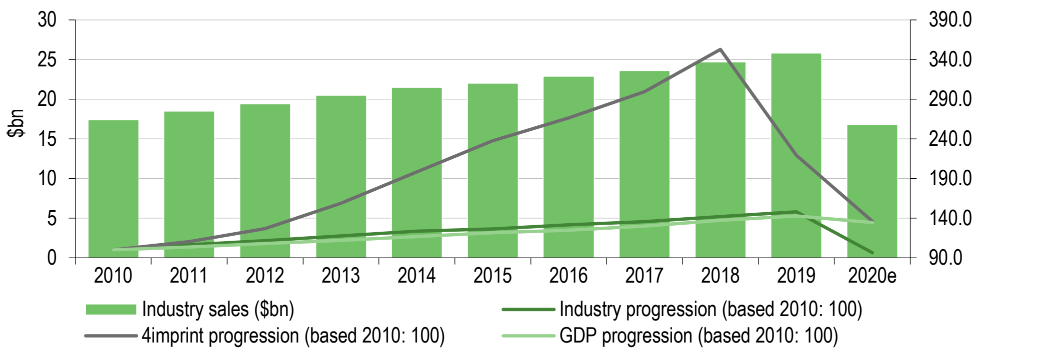
Apparel accounted for around 38% of industry sales in 2019, the same proportion as the prior year. Although it is the largest of 4imprint's segments, we estimate the comparative proportion to be a little over 20%, allowing for plenty of room for growth to match. 4imprint's largest categories are shown above in Exhibit 4.

The second placed firm is HALO Branded Solutions (FY19 revenues: $787m, owned by TPG Growth), which overtook Staples Promotional Products in 2019 and acquired Axis Promotions in January 2020 on undisclosed terms. Axis was itself a top 30 distributor in 2018 with revenues of $53.7m. Staples (privately owned), with estimated FY19 revenues of $602m, has a markedly different business model based on regional field salesforces travelling around the client pool. It is particularly heavily weighted to corporate programmes.

Proforma (FY19 sales: $501m) has a franchise-based business model based on printing, design and brand promotion, while BDA (FY sales: $493m) has a strong franchise in licensed sports affiliated merchandise.

Altitude Group is not considered a direct competitor as it is a SaaS and platform business within the sector, as opposed to a distributor.

Exhibit 8: The 10-year record and FY20e projection of industry, 4imprint and US GDP growth



Source: ASI, US CBO, Company accounts, Edison Investment Research

Amazon has been cited as a potential threat to the business model. While Amazon is underestimated at any competitor's peril, we do not believe a significant proportion of this type of trade will be transferring. As explained above, 4imprint's operation involves a meaningful amount of interaction with the client to make sure that the design and specification are as required. For distributors selling through the Amazon Marketplace, the commission charged can vary from 15–25% of the sale price. As volumes are modest, due to the personalisation, this proposition is not likely to be that attractive to the core supplier base.

While there are few public figures yet on the coronavirus impact on the sector, the ASI is forecasting a 35% fall in agglomerated revenues for FY20 over prior year. Industry surveys are indicating that sales in the healthcare/wellbeing segment will be up 28% year-on-year, but that is the only vertical with forecast growth. Trade shows and sporting events are expected to deliver less than half prior year sales. Neither observation is surprising in the circumstances. Many distributors have clearly pivoted to supplying PPE, with over half reporting to the PPAI that this category represents over 30% of their sales.

Management

CEO Kevin Lyons-Tarr has been with the business since 1991 and is based in Oshkosh, Wisconsin. He has performed a number of roles within the group, including CIO and COO, and became president of the Direct Marketing business in 2004. He was appointed as an executive director in 2012 and then CEO in March 2015. David Seekings, the group CFO (KPMG-trained), is also a long-standing employee, having joined as group financial controller in 1996. He moved from the UK to Oshkosh in 2000 to take up the role of CFO of 4imprint Direct Marketing and was appointed overall group CFO in March 2015, remaining in the US. They are both based (physically) at the centre of the principal office in Oshkosh from where the direct marketing is carried out.

Sensitivities

As has been highlighted by the recent experience, the key sensitivity for 4imprint is the health (or otherwise) of the economy, particularly that of corporate entities across North America. Its particular sweet spot is small and medium-sized commercial enterprises with between 20 and 500 employees. These firms are large enough to be considering marketing their organisations, but not so large as to have the capacity to source directly. As such, the normal economic cyclicality is limited, with some counter-cyclical elements as businesses may be more likely to drive differentiation and bolster their market positioning. Prolonged or deeper economic weakness has a greater deleterious impact, as has been the case over the last few months.

- Marketing efficacy. 4imprint has a strong record of translating its marketing spending into revenue growth through the application of data analysis to its various promotional advertising and marketing drivers. The range of options it uses – and its openness to try new approaches – should enable it to continue to focus its spend on the most effective methods.
- Currency. Although the group earns 97% of its revenues in US dollars, it carries its head office costs, pension scheme commitments and pays its dividend in sterling. It reports in US dollars, so a stronger dollar has a positive impact.
- Competitive risks. As outlined in the section above on the promotional goods landscape, there are both large national and localised and regional competitors. However, there are no other direct marketers in these product categories anywhere near the scale of 4imprint. With a focus on quality and service, the competitive risk from predatory pricing is relatively limited. The close and direct relationships to both customers and suppliers should enable the group to continue to have a good sense of market dynamics.
- Supplier consolidation/concentration/reputational risks. 4imprint has been going through a process over recent years in migrating its supplier base upscale, with more coherent disciplines on sourcing, which should mitigate the reputational risks, although it would never be possible to eliminate these entirely.
- Data security. While the US market is not subject to the GDPR, the reputational risks through any mishandling of data could be considerable and would undermine the relationship of trust that the group has built both with customers and suppliers.

- Single site distribution. The bulk of 4imprint's sales volume is shipped directly from the suppliers. For its own products and for the apparel/embroidery, the group operates from its large distribution centre on the edge of Oshkosh.
- Dependence on courier services (UPS is the main courier used). Rising postal costs for catalogues have sometimes been an issue (USPS prices for packages rose by 79% over 2012–18) but are an unavoidable cost of business, borne by the client.
- Tariffs. The vacillation over tariffs has been a complication of the business model under the Trump administration. The initial imposition at 10% was largely absorbed within the supply chain. The current average tariff is 19.3%, having scaled back from the peak of 25% in June 2019 but the categories of goods subject to tariffs is not necessarily logical or consistent. Up to one-third of products were potentially affected, particularly in bags/totes and caps. The impact of tariffs has broadly been managed between the suppliers (who used up existing stocks first) and the distributors through changes in specifications, with relatively modest impact, if any, on customers.
- For a long period, the group's historical pension arrangements were material to the financial outcome. With the work done over previous periods to move the scheme's liabilities off the balance sheet, and the $9.14m one-off contribution made in H120, this no longer represents a particular sensitivity to the financial model. The plan is for the scheme to be funded at a level sufficient to facilitate a buyout within five years.

Valuation

For a company operating on a 'mature' basis, we would normally assess the valuation relative to other quoted businesses with similar operating models. We would then sense check this valuation via a discounted cash flow analysis. The issue for 4imprint is that there are not any genuine peers to measure it against. For context, therefore, we have looked at the multiples of other smaller/medium-sized marketing services companies and those of a smaller group of US B2B distributors, although they operate in different market segments with greatly differing dynamics.

Marketing service groups context

The UK small- and mid-cap marketing services groups self-evidently have business models substantially different from 4imprint and none have anything like the consistent performance record. They are nevertheless listed in the same sector and provide a particular backdrop.

Exhibit 9: Marketing service companies' multiples

	Price (p)	Perf ytd (%)	P/E last (x)	P/E 1FY (x)	P/E 2FY (x)	Hist EV/sales last (x)	EV/ EBITDA last (x)	EV/ EBITDA 1FY (x)	EV/ EBITDA 2FY (x)	Div yield last (x)	EBITDA margin last (%)	EBITDA margin 1FY (%)
M&C Saatchi	61	(50.8)	2.6	5.4	5.4	0.4	3.2	3.2	3.0	18.0	13.3	12.7
Mission Group	60.5	(22.2)	6.8	153.8	8.0	0.9	4.5	33.0	6.5	1.3	19.3	3.4
Kin + Carta	68.9	(30.8)	7.5	10.7	8.5	1.0	7.9	8.0	7.0	2.8	13.1	14.6
Next Fifteen Communications	487	(9.5)	14.0	14.8	12.0	2.0	8.9	9.4	8.4	0.5	22.9	20.6
Altitude	15.75	(67.2)	N/A	26.3	N/A	0.5	N/A	4.8	N/A	0.0	N/A	10.5
Pebble Group	106	(23.7)	37.7	N/A	N/A	1.6	11.3	N/A	N/A	0.0	14.2	N/A
Average		**(34.0)**	**13.7**	**42.2**	**8.5**	**1.1**	**7.2**	**11.7**	**6.2**	**3.8**	**16.6**	**12.4**
4imprint	2020	(39.1)	16.8	N/A	65.2	0.8	12.0	186.7	38.3	3.2	6.9	0.7

Source: Refinitiv, Edison Investment Research. Note: Prices at 3 September 2020.

4imprint has historically traded at a premium to these stocks, reflecting its financial record, strong balance sheet and high levels of cash conversion. The lower EBITDA margin for 4imprint is simply a reflection of its different business model as a distributor, with those peers shown in the table primarily 'people' businesses. The impact of COVID-19 on marketing budgets has not been uniform and some marketing services groups have had a resilient financial performance – certainly a lot less affected than looked likely at the start of Q220.

US distributor context

Again, we provide this comparison with more than a degree of caution, given the disparity of operations. Those we have picked out have some relevancy: Veritiv, as it supplies B2B print, publishing and packaging services; and Core-Mark Holdings, which distributes and markets consumer goods. Essendant, a B2B supplier and distributor of workplace products, was bought by Staples (completed Q119) on 0.2x historic sales, 10.3x adjusted EBITDA.

Exhibit 10: US distributors' multiples

	Price (US$)	Perf ytd (%)	P/E last (x)	P/E 1FY (x)	P/E 2FY (x)	Hist EV/sales last (x)	EV/ EBITDA last (x)	EV/ EBITDA 1FY (x)	EV/ EBITDA 2FY (x)	Div yield last (x)	EBITDA margin last (%)	EBITDA margin 1FY (%)
Veritiv	17.76	(9.7)	-	-	16.9	0.1	5.4	5.7	5.4	0.0	2.0	2.4
Core-Mark	33.85	24.5	20.0	22.0	17.8	0.1	9.2	9.8	8.6	0.0	1.1	1.1
Average		**7.4**	**20.0**	**22.0**	**17.3**	**0.1**	**7.3**	**7.7**	**7.0**	**0.0**	**1.6**	**1.7**
4imprint	28.20	(39.1)	16.8	N/A	65.2	0.8	12.0	186.7	38.3	3.2	6.9	0.7

Source: Refinitiv, Edison Investment Research. Note: Prices at 3 September 2020.

The volatility of earnings over the COVID-19 disruption makes comparisons with such a small sample unhelpful. However, 4imprint's valuation is clearly at a premium to these distributors.

DCF the more relevant technique

Given the issues with the peer-based approach and given the group's financial characteristics – in particular the element of repeat business and the management towards a maintained operating margin – a DCF would normally be the more justifiable valuation technique. We would caution that the degree of uncertainty over the financial performance for the balance of FY20 and through FY21 makes this a less reliable indicator of value than has historically been the case.

In Exhibit 11, below, we show a range of terminal growth rates and WACCs, predicated on the projections contained in the financial summary in Exhibit 17. Beyond the explicit forecast period, the assumption is for revenue growth of 8%, which is below that achieved historically (FY11-19: CAGR 17.8%). With the extent of the subjectivity in the short-term forecasts, we emphasise this is illustrative rather than indicative of value.

Exhibit 11: DCF under varying terminal growth and WACC assumptions

		Terminal growth rate				
		1.00%	**2.00%**	**3.00%**	**4.00%**	**5.00%**
WACC	12.00%	1,189	1,260	1,349	1,463	1,616
	11.00%	1,295	1,387	1,506	1,665	1,886
	10.00%	1,247	1,551	1,716	1,947	2,293
	9.00%	1,598	1,770	2,010	2,370	2,970
	8.00%	1,826	2,076	2,451	3,076	4,326
	7.00%	2,146	2,536	3,187	4,488	8,392
	6.00%	2,626	3,303	4,659	8,725	-
	5.00%	3,426	4,838	9,076	-	-

Source: Edison Investment Research

Financials

In our note published in June, we made a first attempt at drawing up a trading scenario outlook for the remainder of the year. Now we have the actual figures for the first six months, we have revisited our assumptions but retained the methodology of estimating the relative weighting of the individual months, allocating the historic revenues between the months on that basis and then assuming by how much the year-on-year monthly revenues have retrenched. Our H1 modelling suggested revenue of $216m and the outturn was better, at $266m. However, with some resurgence of hotspots of the pandemic and renewed state lockdowns, we are now being more cautious on the pace of recovery in H220. Obviously, there is a great deal of subjectivity in the assumptions made across H220 and different inputs might produce quite different conclusions.

Similarly, for FY21e, there are a wide range of plausible scenarios. We have assumed a fair degree of recovery in the economy, but still leave it well short of the levels achieved in FY19.

Exhibit 12: Working assumptions for FY20e revenue forecast

	Assumed monthly revenue weighting %	Implied FY19 revenue $m	FY20 monthly revenue vs FY19 revenue	Assumed FY20 revenue $m	Half-yearly $m	% change
H1 actual		405			266	-34.3
Jul	10	89	0.50	44		
Aug	7	62	0.50	31		
Sep	10	92	0.60	55		
Oct	10	89	0.62	55		
Nov	8	71	0.65	46		
Dec	6	53	0.70	37	269	-39.5
FY20e		**861**		**269**	**535**	**-37.9**

Source: Edison Investment Research

This has the following impact on the financial performance.

Exhibit 13: Summary changes

	Revenue ($m)			EPS (c)			PBT ($m)			EBITDA ($m)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2019	861		N/A	157.2	-	N/A	55.6	-	N/A	59.1	-	N/A
2020e	550	535	-3	20.5	0.3	-99	8.8	0.5	-94	13.7	3.9	-72
2021e	600	600	u/c	73.9	40.6	-45	28.0	15.0	-46	32.8	18.8	-43

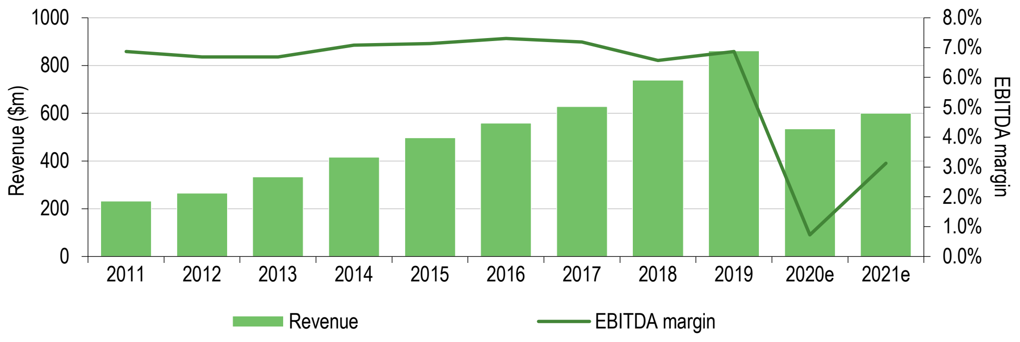
Source: Company accounts, Edison Investment Research

In percentage terms, the current year downgrade looks alarming but is distorted by being so close to breakeven. We do expect the company to continue to be profitable in the current year. The revenue forecast reduces by $15m, translating to an $10m reduction in EBITDA and an $8m reduction at the pre-tax level.

Our tentative forecasts for FY21 are also revised down from those published previously, although imply a 12% recovery in revenues rather than the 9% we had factored in before. This is well below the historic levels of growth (see below), partly to reflect the opportunity that the group should have to build market share in a market where less financially secure competitors may struggle to rebuild, or even survive. We have assumed administrative and sales costs revert to around FY19 levels, with marketing costs increasing broadly in line with year-on-year revenue growth. This latter is a variable cost within management's control, and the quantum and type of spend will depend on market conditions at the time.

FY20: Interrupted long-term growth

Exhibit 14: Growth record and forecasts



Source: Company accounts, Edison Investment Research

Until this juncture, 4imprint has had a very impressive growth record, with a revenue CAGR of 17.8% for FY11–19. As explained above, growth is driven through the marketing effort, with the rate of spend managed to deliver a reasonably stable margin. EBITDA margin was in the range of 6.6% to 7.3% between 2011 and 2019.

Obviously, FY20 cannot be viewed in the same light as previous periods and for now, we err on the side of caution over the degree of recovery that can be achieved in FY20e. On first view, it may seem as if the modelling for the full year is exceptionally harsh. However, the first two months of H120 were good, continuing the trend of previous periods, with revenues ahead by 16%. In contrast, revenues for March through to June were down by 54% as the effects of lockdowns took hold. The overall result for H120 was therefore a 34% decline in revenues, with underlying operating profit reduced to just ahead of breakeven, as shown in the table below.

Exhibit 15: Last three-year summary H1 results

	H118 ($m)	H119 ($m)	% change	H120 ($m)	% change
Orders received (new customers) -'000s	208	225	+8	126	-44
Orders received (existing customers) – '000s	475	553	+16	344	-38
Total orders received – '000s	683	778	+14	470	-40
Revenue	348.3	405.1	+16	265.8	-34
Gross profit	112.9	131.7	+17	77.3	-41
Gross margin	32.4%	32.5%		29.1%	
Marketing costs	(68.0)	(79.2)	+16	(47.2)	-40
As % revenue	19.5%	19.5%		17.7%	
Selling costs	(13.6)	(15.3)	+12	(15.2)	-1
As % revenue	3.9%	3.8%		5.7%	
Admin and central costs	(14.7)	(17.2)	+17	(14.4)	-17
As % revenue	4.2%	4.3%		5.4%	
Share option related charges	(0.3)	(0.5)	+59	(0.4)	-17
Underlying operating profit	16.3	19.4	+19	0.1	-99
Underlying operating margin	4.7%	4.8%		0.0%	

Source: Company accounts

The achieved gross margin is normally stable, but there was some compression in this reporting period. Roughly half of this reduction reflected the closure of the group's main Oshkosh distribution centre for several weeks, with the employees affected retained on full pay. The balance can be attributed to the changed mix of business, with fewer, but larger orders attracting higher discounts and lower supplier rebates reflecting the reduced volumes. This shift in gross margin should therefore not be a structural change and we expect it to revert closer to historic levels as the top line recovers.

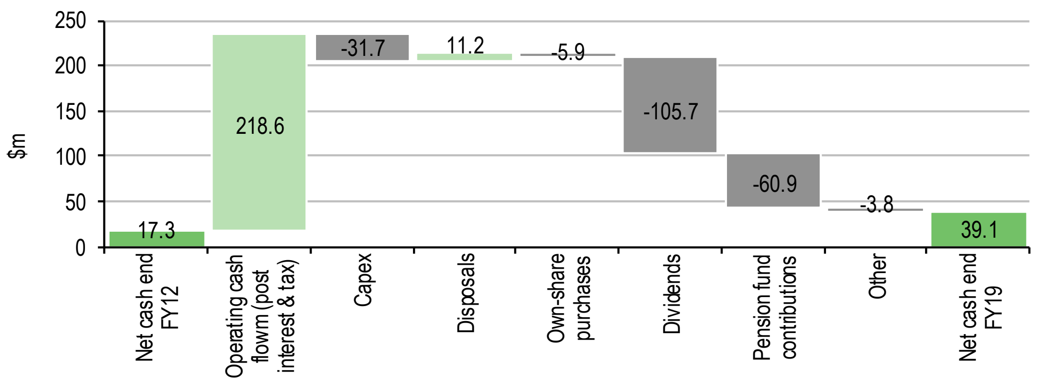
Selling costs (mainly payroll) were broadly flat, as the group retained its workforce in full, while admin and central costs benefited from the receipt of $3.5m of job retention credits under the US CARES Act. Marketing is the biggest variable cost – and normally the largest element of cost by far. Marketing spend in Q1, mostly spent before the lockdowns, was $37.7m. For Q220, it was $9.5m, down from $41.1m in Q219.

Historically strong cash flows

4imprint has strong inherent cash flow characteristics, with very modest requirement for capital spending or an absorption of working capital. Below we show the cumulative cash flows and uses over the last reported seven years. Over this period, the group reported adjusted operating profit of $262.5m, generating a post interest, post tax operating cash flow of $219m. This period covered an expansion programme at the distribution centre in Oshkosh, extending the floor space from 100,000 ft^2 to 215,000 ft^2. Another 85,000 ft^2 has since been added to increase the capacity in embroidery.

Capital spend in H120 was $3.25m, spent in the early weeks of the year on facilities for direct-to-garment printing, increasing the range of product finished internally, with the benefits of closer quality control and speed of turnaround of orders. Minimal capital spend is expected for the remainder of the year. Importantly, operating cash flow was positive in H120, despite the heavy impact on profitability of the lower revenues. There is typically a seasonal first half inflow to working capital, helping in this instance to deliver $8.9m of operating cash flow from $0.1m of underlying operating profit.

Exhibit 16: FY13-FY19 cash generation and uses



Source: Company accounts, Edison Investment Research

The largest source of cash outflow over this period were dividends, followed by the pension scheme payments. If we extend the period covered through H120, the sum paid towards the pension scheme is $10.91m higher, including a special contribution of $9.14m that was agreed with the trustees prior to the onset of the pandemic. This relates to a legacy defined benefit scheme in the UK that has been closed for several years. The scheme deficit is now reduced to $3.5m and continuing contributions are designed to achieve funding on a buyout basis by mid-FY24.

Payment of the final dividend for FY19 was cancelled in April 2020 in light of the pandemic and no interim dividend for H120 has been proposed. Management will look to reinstate dividends when it is sensible to do so.

Cash resource gives resilience and opportunity

4imprint is run with a net cash-positive balance sheet, giving a buffer that enables the group to invest in marketing and growth through the downwards and the upwards phases of any economic cycle. In this COVID-19 crisis, it has protected the business and its employees from the need to make short-term decisions that might damage future growth prospects. There is no debt on the balance sheet, although the group does have a $20.0m working capital facility in place with JP Morgan, running to the end May 2022 and a £1m UK overdraft facility.

Cash at the end of the half year was $37.5m, vs $41.1m at end FY19, and our modelled scenario shows this decreasing to $22.9m by the year-end (reflecting the seasonal reversal of the working capital) before starting to rebuild through FY21.

Exhibit 17: Financial summary

$000s	2018	2019	2020e	2021e
Year end 31 December	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	738,418	860,844	535,000	600,000
Cost of Sales	(500,531)	(585,543)	(379,437)	(410,813)
Gross Profit	237,887	275,301	155,564	189,187
EBITDA	48,507	59,144	3,875	18,775
Operating Profit (before amort. and except).	45,862	54,860	475	14,975
Intangible Amortisation	0	0	0	0
Operating Profit (after amort. and before except.)	45,862	54,860	475	14,975
Operating Profit	44,322	53,620	(625)	13,775
Net Interest	227	751	25	25
Net pension finance charge	(403)	(378)	(378)	(378)
Profit Before Tax (norm)	46,089	55,611	500	15,000
Profit Before Tax (IFRS)	44,146	53,993	(578)	13,822
Tax	(8,952)	(11,276)	(21)	(2,865)
Profit After Tax (norm)	36,734	44,335	79	11,735
Profit After Tax (IFRS)	35,194	42,717	(599)	10,957
Discontinued businesses	(100)	0	0	0
Net income (norm)	36,360	44,203	78	11,388
Net income (IFRS)	35,094	42,717	(1,399)	10,157
Average Number of Shares Outstanding (m)	28.0	28.0	28.0	28.0
EPS - normalised (c)	129.4	157.2	0.3	40.6
EPS - (IFRS) (c)	125.6	152.4	(2.1)	39.1
Dividend per share (c)	70.0	84.0	0.0	20.0
Gross Margin (%)	32.2	32.0	29.1	31.5
EBITDA Margin (%)	6.6	6.9	0.7	3.1
Operating Margin (before GW and except.) (%)	6.2	6.4	0.1	2.5
BALANCE SHEET				
Fixed Assets	25,732	31,844	30,577	30,077
Intangible Assets	0	0	0	0
Other intangible assets	1,084	1,152	1,152	1,152
Tangible Assets	19,012	24,369	24,687	24,587
Right of use assets	0	1,985	400	0
Deferred tax assets	5,636	4,338	4,338	4,338
Current Assets	84,234	105,631	61,690	70,653
Stocks	9,878	11,456	7,476	8,384
Debtors	46,872	53,039	31,315	35,119
Cash	27,484	41,136	22,900	27,150
Other	0	0	0	0
Current Liabilities	(50,752)	(60,839)	(39,957)	(44,363)
Creditors	(50,752)	(59,209)	(39,557)	(44,363)
Short term / lease borrowings	0	(1,630)	(400)	0
Long Term Liabilities	(15,947)	(13,688)	(1,348)	(968)
Long term borrowings	0	(415)	0	0
Other long term liabilities (including pension)	(15,947)	(13,273)	(1,348)	(968)
Net Assets	43,267	62,948	50,962	55,399
CASH FLOW				
Operating Cash Flow	45,583	57,796	600	20,700
Net Interest	227	751	25	25
Tax	(7,844)	(10,318)	(141)	(3,212)
Capex	(2,855)	(8,178)	(3,718)	(3,700)
Acquisitions/disposals	0	0	0	0
Pension contributions	(3,932)	(3,593)	(12,700)	(3,500)
Financing	(465)	(2,567)	900	(2,200)
Dividends	(32,984)	(20,659)	0	(1,853)
Other	0	(1,687)	(1,622)	(1,622)
Net Cash Flow	(2,270)	11,545	(16,656)	4,638
Opening net debt/(cash)	(30,767)	(27,484)	(39,091)	(22,500)
Net impact of disposals etc	0	0	0	0
Other	(1,013)	62	65	12
Closing net debt/(cash)	(27,484)	(39,091)	(22,500)	(27,150)

Source: Company accounts, Edison Investment Research

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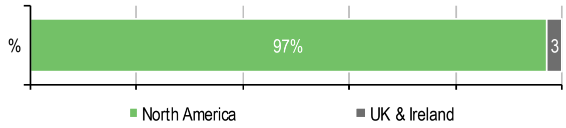
Revenue by geography



Management team

CEO: Kevin Lyons-Tarr

Kevin joined the business in 1991, acting in various capacities including CIO and COO, before being appointed president of the Direct Marketing business in 2004. He was appointed as an executive director in 2012 and as CEO in March 2015.

CFO: David Seekings

David is a chartered accountant (KPMG) and joined 4imprint in 1996 as group financial controller. He relocated to the US in 2000 as CFO of the Direct Marketing business and was appointed as group CFO in 2015.

Non-exec Chairman: Paul Moody

Paul joined the board in February 2016 and was appointed chairman in December the same year. He is also non-executive chairman of Card Factory and a non-exec at Pets at Home. He spent 17 years at Britvic, the last eight as CEO.

Principal shareholders	(%)
BlackRock Inc	9.86
Standard Life Aberdeen	9.68
Montanaro Asset Management	6.04
Majedie Investments	5.22
JP Morgan Chase & Co	5.07
Invesco	4.21
Kames Capital	3.82
Canaccord Genuity Group Inc	3.76
M&G	3.19

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