EDISON

IG Design Group

Party time

Final results

Care & household goods

Another strong set of results from IG Design Group show the positive impact of its strategy of investment and innovation in design and delivery. Last year's acquisition of Lang in the US has added product and customers, while the European operations are gaining additional benefit from the growth of their clients. A particularly strong cash performance has moved the balance sheet cash positive at the year-end, well ahead of schedule. The dividend has been raised from 2.5p in FY16 to a proposed 4.5p, with further rises on the cards underpinned by our raised FY18 and new FY19 estimates.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/16	237.0	11.1	13.5	2.5	25.4	0.7
03/17	311.0	17.1	18.8	4.5	18.2	1.3
03/18e	325.0	20.0	20.5	5.5	16.7	1.6
03/19e	335.0	22.5	22.9	6.5	15.0	1.9

Note: *PBT and EPS (fully diluted) are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Europe and the US in the performance vanguard

With external sales up 31% (organic growth of 11% plus 8% from acquisition and 12% currency benefit) and EBIT up 51% (21% organic), this has clearly been a strong year. While the Lang acquisition has clearly allowed a step change in the scale of the US sales and profits (38% of FY17 revenues), the performance of the underlying business there was remarkably strong. Revenues were up 26.6% (at constant currency) on a stable margin of 6.4%, facilitated by the prior year's investment in additional converting equipment. In Europe, revenue growth of 13.4% is in part a reflection of the strong client performance as the likes of Aldi, Lidl and Carrefour build their market share. IG Design's gifting offering has built particularly well as those customers have concentrated their supplier bases – now accounting for 25% of geographic revenues and a larger proportion of profits.

Capital allocation: investment, bolt-ons, dividend

The significantly strengthened balance sheet – cash positive at the year-end – opens up management's options on capital allocation, with funding growth in the business through continuing investment in best-of-class manufacturing remaining the priority. Bolt-on acquisitions are on the wish list where they add adjacent product or add to customer reach. The large increase in the proposed dividend was ahead of our forecast of 4.0p and our projections allow for further progress here.

Valuation: Underpinned by cash generation

The near-doubling of the share price over the last 12 months recognises the group's transformation into a confident, global, design-led, efficient partnership supplier to retail channels. However, a reverse DCF shows that the current share price assumes that either medium-term growth retrenches to around 1.4% or that EBITDA margins remain broadly static. Neither of these scenarios fits with our view of current prospects. The strong cash flow generation and large step-up in dividend reinforce the positive outlook.

27 June 2017

Price	**342.5p**
Market cap	**£215m**
	$1.27/£
Net cash (£m) at end March 2017	3.0
Shares in issue	62.6m
Free float	54%
Code	IGR
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	4.4	12.3	128.3
Rel (local)	5.9	10.1	87.7
52-week high/low		361.5p	145.0p

Business description

IG Design Group is one of the world's leading designers, innovators and manufacturers of gift packaging and greetings, social expression giftware, stationery and creative play products.

Next events

AGM	31 August 2017
Interim results	28 November 2017

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Edison profile page

IG Design Group is a research client of Edison Investment Research Limited

Investment summary

Company description: Design-led manufacturer and supplier

IG Design Group designs, manufactures and sources product in the celebrations, stationery and creative play and gifting product categories. The UK is the group's core manufacturing base, with additional manufacturing facilities in China, the US and the Netherlands. The UK, US, Australia and other European countries are the key trading areas. Management has steered the group to a year-end net cash position despite a major investment programme to upgrade manufacturing facilities. Markets are highly competitive, so optimising manufacturing efficiency while providing exemplary customer service and compliance are prerequisites. IG Design is the third largest global supplier of gift packaging (after American Greetings and Hallmark). Just under half of product is sold under the group's own proprietary generic brands (including Tom Smith in crackers, Lang in calendars and Kids Create in creative play) or brands that it has licensed from Disney, Universal and others. It supplies products at all pricing levels and has a particularly strong position in the value sector in Europe and the US.

Valuation: Starting to reflect opportunity

The share price is now starting to look forward to the global market opportunities rather than reflecting the earlier history. Having nearly doubled over the last year, the share price may now show less forward momentum. The valuation now stands at a premium to other home and lifestyle brands (the nearest peers) on both EV/EBITDA and P/E. The dividend, having been restored in FY15, was increased well ahead of earnings as it moves towards a target cover of 3.0x. The implied progression is obviously well ahead of the market.

Financials: Forecasts raised again

- The results were ahead of the year-end trading update, which itself indicated outperformance against earlier expectations.
- We have raised our FY18 PBT forecast by 11% to give 17% growth, with new FY19 estimates indicating a further 13% in that year. EPS is up 6% on our previous forecast, giving FY18e growth of 13%, followed by 12%. These are based on top line growth of 5% followed by 3%.
- Our forecast as revised at the year-end update showed net debt down to £1.2m at the balance sheet date. The actual figure was cash positive at £3.0m. Despite a continuing programme of investment in manufacturing, people and systems, we envisage net cash of £6.5m at end FY18; and £10m at end FY19. There is good scope, therefore, for further dividend progression.
- M&A activity remains on the agenda, but only where synergies are obvious and provide the group with adjacent categories or incremental channels.

Sensitivities: Currency, competition, seasonality

The US dollar and the euro are important group currencies, with raw material costs predominantly in local currency, US dollars and in renminbi for goods sourced in China, benefiting from weaker sterling. Underlying consumer demand remains key and customers are relentless in their pursuit of value, with deflation remaining an issue at the commodity end of the scale. Underlying markets are broadly stable, but longstanding trading relationships help visibility. Small acquisitions can extend the customer reach and the scope of the product offering. Raw material, freight and energy costs are key inputs. While growth is targeted at everyday product, Christmas product is inherently of importance.

Company description: Celebrations, stationery & creative play and gifting

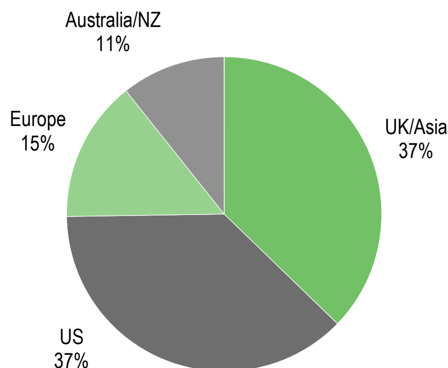
From its origins as a manufacturer of gift wrap, through being a manufacturer of gift packaging product, IG Design Group now has a broad product range within the categories of:

- celebrations – primarily gift packaging and greetings products (75% of FY17 revenues);
- stationery and creative play (15% of revenues); and
- design-led giftware (10% of revenues).

The company is known in its markets simply as The Design Group, while retaining the ticker IGR from its historic name of International Greetings, having relaunched with new branding in summer 2016. This branding highlights the core competence of the group in design and innovation, which is leveraged across a broadening range of product categories. The exposure to seasonal product (eg for Christmas, or Valentine's day), which was a distinct characteristic of the group, has been managed by management's focusing on growing the 'everyday' categories, which accounted for 43% of FY17 revenues.

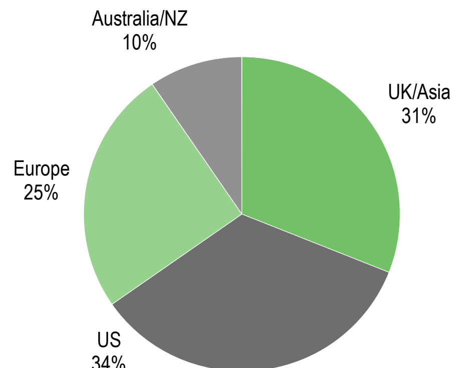
The business is genuinely global, with manufacturing operations in China, the Netherlands, the UK and the US and a JV in Australia. Revenues and operating profits by geography are shown below, but this masks the true spread of the business as the UK/Asia segment includes the sourcing activities for goods sold into different territories. Turnover by destination paints a slightly different picture, with the UK a lower proportion at 27% and the US higher at 43%, boosted by a part-year of Lang, acquired during FY17.

Exhibit 1: FY17 revenue by geography



Source: IG Design Group accounts

Exhibit 2: FY17 operating profit by geography



Source: IG Design Group accounts

The scale of the business is important to grasp. In the year just reported, IG Design traded with more than 10,000 customers across the world (up from 5,400 in the prior year, reflecting Lang joining the group), with group products on sale in more than 200,000 retail outlets in 80 countries. Management estimates that the global gift packaging and greetings market is valued at around £15bn at retail prices and that it is the third largest player (after American Greetings and Hallmark, both US companies). In FY17, IG Design sold almost 1bn metres of gift wrap and nearly 1 billion stickers. Lang added £14m of sales in calendars, which are a common gifting item in the US market and are reported in the Gifting segment. Across the group, over half a billion items were either manufactured or sourced in FY17, 46% of which were either carrying IG Design's own brands or licences. This implies a unit price of approximately 61p at trade price, with retail values being roughly 2.5-3x that level.

Around 10% of sales are in the upscale market segments and this acts as a spur to innovation and creativity. However, the real impetus behind top line growth has been the growth in the market of the value retailers in both Europe and North America. There is an exceptionally broad range of retail

customers, from the mass-market brands in the US such as Costco, Target and Walmart, through the major traditional multiple grocers and the discounters in the UK, the discount/dollar stores, regional retailers and drugstores, as well as niche and upscale retailer groups and online retailers. Some of these trading relationships have lasted over 20 years and the group was recently one of only three global suppliers to be awarded 'No one tries harder for customers' status by Tesco. The largest customer represents 8% of sales.

Licensed product across the group makes up around 12% of group revenues, but concentrated on a relatively narrow and focused portfolio. This principally consists of a mix of perennial properties, such as *Peppa Pig* and classic Disney characters, with some 'hotter' additional licences such as *Frozen* and *Star Wars*. The retail segment has become increasingly risk averse in its stock decisions, but many of the Disney or Universal properties have the momentum to drive sales even in dull markets. Lang has added some strong US sports-based licences, such as NFL and the NBA.

The group manufactures around 39% of the product that it sells (by value) and has a broad supplier base, with a heavy bias to China and the Far East. This proportion was diluted in the reporting year by the acquisition of Lang, which sources its entire product range. IG Design employed an average of just over 2,100 people in FY17, 77% of whom worked in production and distribution, principally in China, the UK (the two largest manufacturing geographies), the Netherlands and the US. Common IT infrastructure is facilitating the use of the main design studios across the group's global manufacturing and sourcing, as well as providing the more obvious benefits in sales and CRM.

Exhibit 3: FY17 activity by region

£m	UK & Asia	y-o-y growth	Americas	y-o-y growth	Europe	y-o-y growth	Australia	y-o-y growth	TOTAL	y-o-y growth
Celebrations	85.6	4%	82.5	52%	33.4	36%	30.5	32%	234.2	26%
Stationery & Creative Play	22.8	4%	21.2	91%	0.9	-11%	2.7	-36%	48.2	25%
Gifting	5.7	4%	14.1		11.4	34%	0.3	-40%	31.8	117%
Total	117.0	4%	117.8	81%	45.7	34%	33.6	20%	311.0	31%

Source: IG Design Group accounts, Edison Investment Research

Diversification driving growth opportunities

IGR originated as a gift wrap printing company established in Wales in the late 1970s by Anders Hedlund (whose family interests still account for 38% of the group's equity). It expanded through the 1990s to include other seasonally related products, selling predominantly to UK wholesalers. It floated on AIM in 1996, at which point sales were around 90% UK, 90% in buyers' own-brand and 90% oriented to the Christmas season, with a buy-and-build strategy. A number of acquisitions followed, but when markets softened in 2007 the group was compromised, with the balance sheet significantly stretched, with gearing at 168% at end FY09. A new FD specialising in restructuring and control implementation was appointed and in January 2009 Paul Fineman was appointed group CEO, having joined the group in 2007 with the acquisition of Anker (a UK-based supplier of stationery and children's activity kits). Paul initially focused on instilling commercial disciplines, having had many years of experience in the industry, joining his family firm, Anker, after college. Anthony Lawrinson took over as CFO in October 2011, joining from Reliance Security Group, with prior experience in a range of sectors including O2 and Hickson International.

Tight financial management ("it's not profit until it's cash") has seen gearing first brought under control then actively managed down, at a notably faster pace than we had anticipated. This discipline has given the executive team the comparative freedom to be able to make operational decisions (particularly the significant capital investment across its key manufacturing facilities) in the interests of building the group's future rather than simply focusing on paying back the debt.

Strong design disciplines, efficient manufacturing supporting low cost and a commitment to supply-chain compliance underlie the group's client relationships, which are increasingly more like a strategic partnership in nature, particularly as retailers contract their supplier lists.

These principles are being extended through adjacent categories. Partyware has been added in recent years and forms part of the Celebrations (about 5% of divisional sales). In the current financial year, there will be an increased sales effort on retail collateral, also known as not-for-sale consumables (also known as bags). Primarily targeting the fashion and beauty segments, where visual and tactile attributes are of greater importance, the group has already built around a 7% market share with product being shipped in from its Chinese manufacturing operations. Management estimates that the value of this sector is around £130m, with recyclable paper bags with integral twisted-paper handles an attractive proposition from quality and compliance perspectives. In FY18, IG Design will start to manufacture for this segment in its UK facilities.

Elsewhere the group is benefiting from the growth of its customers across Europe, as retailers such as Aldi grow in Eastern Europe. There is also benefit from bricks-and-mortar retailers growing their online channels (and, to a lesser extent, vice versa).

Sensitivities

Currency: the group's larger currency risk is on purchases, with the main exposure being to the US dollar and the Chinese renminbi. Around half of group sales are of items bought or manufactured in Asia and mostly paid for either in US$ or renminbi. On sales, key currencies are sterling, the US$ and the euro, and IGR hedges against expected future sales for which there are firm commitments. The group's credit facilities are in part US dollar denominated (see Exhibit 12, below).

The group's financial performance is subject to a number of sensitivities, most particularly **underlying consumer demand**, itself a factor of economic confidence. This will obviously vary across the economies in which the group operates and we assume little fundamental growth in markets. Given that people are unlikely to stop wanting to give each other presents or have parties, having attractive designs, and products that are widely available and sensibly priced is crucial to maximising market share. High service standards need to be (at least) maintained to protect share in a competitive marketplace, while innovation and design skills help to retain retailer interest and also help recoup margin lost through a deflationary trading environment.

The group has a very **broad spread of customers**, so concentration of revenue is not a particular issue. The largest customer on a group-wide basis accounts for just over 8% of group sales. Small acquisitions can broaden the customer reach. Online competition has had limited impact on the market to date, taking an estimated 3-4% share in developed markets, with online retailers being customers in their own right for gift-wrapped shipments. As described elsewhere, the market is heavily populated and highly competitive. Expansion into the retail collateral market gives another income stream and can be extended or used to maximise manufacturing efficiency.

Licence management: IGR has longstanding formal relationships with key brand owners including Disney, historically an important entry ticket to obtaining other key licences. Licences for Universal Studios and *Star Wars* (now Disney-owned) were added in 2015 and have performed strongly. Lang has now added key sports brand licences. Rates vary by player and generally have minimum guarantees attached. The US business is more driven by generic brands.

Seasonality: while there are other smaller peaks during the year, Christmas is the key selling period and a poor season would have a notable impact on the financial outturn. Working capital climbs from July, peaking in November, before falling sharply in December and January as seasonal debtors settle their accounts. The group's intention is to continue aiming to increase the proportion of everyday product to partially offset the effect. Substantial Christmas business does give a clear benefit of visibility, allowing for efficient scheduling of work through the factories.

As for all manufacturers, **raw material and energy costs** are a perennial concern, with paper the largest element of cost, followed by labour. Continuous improvements to the efficiency of

manufacturing will help to offset inflationary input costs. Moving to more modern machinery also lowers the environmental impact, particularly the transition away from solvents to water-based inks.

Possible changes to **US tax rates** could have a material effect on net earnings. Any import **tariffs** imposed would have industry-wide impacts. The possible implications of Brexit on UK international trade are also not yet possible to quantify.

The group's pension schemes are all defined contribution and there are no especial issues here.

Valuation

There is no one obvious valuation methodology for IG Design. Therefore, we continue to look at it from three perspectives: peer comparison, a DCF basis and underlying asset value. None of these provides a definitive valuation, but in combination they give a context for the pricing of the stock.

One quoted direct peer

There are no directly comparable quoted peers in the UK and the overall competition is highly fragmented. The most substantial international operators are:

- American Greetings Corporation, which was quoted on NYSE until being taken private by the Weiss family in 2013. It generated revenues of around $1.8bn in FY17 (vs $1.9bn in the year to February 2016, which was down 5.5% on 2015). It now aggregates its reporting of social expression products, but the implied value of its gift packaging and party goods segment sales is around $337m, representing a little under 20% of group net sales.
- Hallmark Cards, a privately owned US company with 2016 revenues of $4.0bn (up 8% on the prior year). Over recent years, Hallmark has rationalised its manufacturing base and has three operations: Hallmark Greetings, Hallmark Home & Gifts and Hallmark Retail.
- CSS Industries, a quoted US firm but on a smaller scale, with annual sales to March 2017 of $322m, up 2% on prior year, with a bias to Christmas product (approximately 30% of revenue). There are no publicly available forecasts. 30% of FY17 sales were to Walmart; 10% to Target.

Exhibit 4: Peer group valuations

	EV/sales (x)		EV/EBITDA (x)		P/E (x)	
	2016	2017	2016	2017	2016	2017
Lifetime Brands	0.6	0.1	7.7	-	12.6	12.0
JAKKS	0.5	-	7.8	-	14.8	
Party City	0.3	0.3	5.7	5.0	17.2	12.1
CSS	1.6	1.5	10.2	8.9	13.6	12.5
Duni	1.5	1.4	10.0	10.1	15.6	14.9
Average	0.9	0.8	8.3	8.0	14.8	12.9
IGR (annualised)	0.9	0.7	13.1	10.2	23.6	17.9

Source: Bloomberg, Edison Investment Research. Note: Prices as at 22 June 2017.

Given that there is no direct peer group, we have cast our net a little wider and looked at three other US-based manufacturers and distributors of relatively low-ticket consumer goods/gifts: Party City (supply and retail of party goods, Halloween merchandise); Lifetime Brands (kitchen gadgets); JAKKS Pacific (toys, consumer licensed products); Duni (Sweden-based table top, B2B and B2C supplies); and CSS (see above). Following the strong share price performance of the last year, IGR is now trading at around par with these comparators on historic EV/revenue, and has moved to a premium on both an EV/EBITDA and a P/E basis for historic and current years.

DCF

Running a DCF has some relevance in industries that are long established and still growing, albeit at a modest underlying rate, but comes with the usual provisos regarding the sensitivity of the model to the underlying assumptions. Rather than varying the WACC assumptions, we have instead shown the implied share price under various operating margin and medium-term growth rate assumptions, these being the factors that investors are most likely to take differing views on. The calculations are done using a WACC of 9% and a terminal growth rate of 1.5%. On an EBITDA margin of 8% (our forecast for FY18) and on a modest 2% medium-term growth rate assumption, the implied share price is 360p, 5% ahead of the current price.

Exhibit 5: DCF under varying medium-term growth and EBITDA margin assumptions

		Medium-term growth rate				
		0.00%	1.00%	2.00%	3.00%	4.00%
EBITDA margin	5.00%	184.0	203.6	228.6	261.6	307.3
	6.00%	218.0	241.9	272.5	312.8	368.7
	7.00%	251.9	280.3	316.4	364.0	430.1
	8.00%	285.9	318.6	360.2	415.2	491.5
	9.00%	319.9	356.9	404.1	466.4	552.9
	10.00%	353.9	395.3	448.0	517.7	614.2
	11.00%	387.8	433.6	491.9	568.9	675.6
Margin implied by current price		9.5%	8.5%	7.5%	6.5%	5.5%

Source: Edison Investment Research

Asset and yield backing

On the basis of the balance sheet as at the end of March 2017, the value of the net assets attributable to the owners of the parent company was worth 144p per share, or 138p after minorities, giving asset backing of 44% of the current share price. With the return to dividend payments in 2015, direct returns to shareholders have been climbing the list of capital allocation priorities. Management's intention gradually to move the dividend cover back to around 2.5x makes yield also relevant to the valuation argument.

Financials

Exhibit 6: Upgrades to forecasts

	EPS (p)			PBT (£m)			EBITDA (£m)		
	Old	New	% change	Old	New	% change	Old	New	% change
2017	17.5	18.8	+7	16.0	17.1	+7	21.5	20.7	-3
2018e	19.3	20.5	+6	18.1	20.0	+11	24.0	26.0	+8
2019e	-	22.9	N/A	-	22.5	N/A	-	28.5	N/A

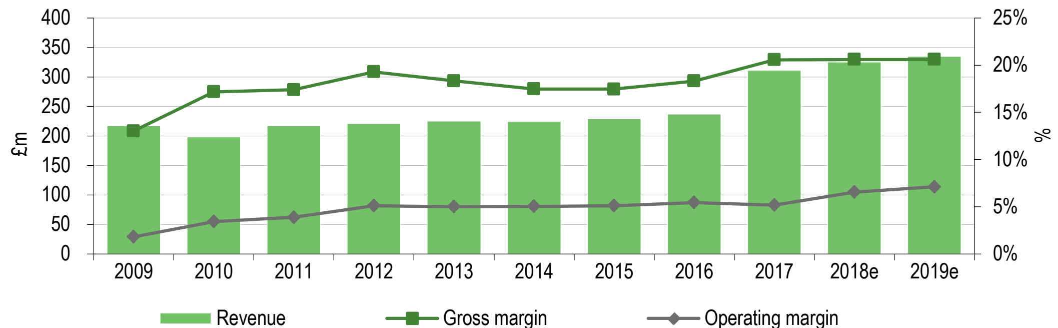
Source: IG Design Group accounts, Edison Investment Research. Note: FY17 new = actual.

We have revisited our forecasts in light of the FY17 figures, with an upward revision on the expected gross and operating margins. The moves in foreign exchange had a positive impact on the published results, but this should not overshadow the good progress made on an organic basis, or the benefits starting to accrue from the Lang acquisition. On a mechanistic basis, sterling weakness prompts a translational benefit on earnings, with a partial offset on more expensive sourcing of product from Asia priced in US dollars and of raw material prices, particularly paper.

The FY17 figures show a strong performance at revenue, gross margin, profit, earnings and cash levels. Top line growth of 31% was flattered by the acquisition and by currency, but stripping both of these factors out, organic sales growth was still 11%, particularly impressive given that the group operates in mature markets where there is little underlying growth. The contribution at the top line from FX was 12%, with the Lang purchase partway through the year adding another 8%. Gross margins rose again to 20.6% (FY16: 18.3%, FY15: 17.5%), ahead of the previous target of 20%.

Much of this is to do with mix. Lang, not being a manufacturer, operates at a high gross margin (although a lower operating margin) and there was also some benefit to gross margin from FX. The investment over the years in efficiency across the manufacturing and converting operations has helped, as has the move away from commodity product and the growth in Design Group own brands and licensed product, as opposed to customer bespoke work.

Exhibit 7: Long-term earnings and margin record and forecasts



Source: IG Design Group accounts, Edison Investment Research

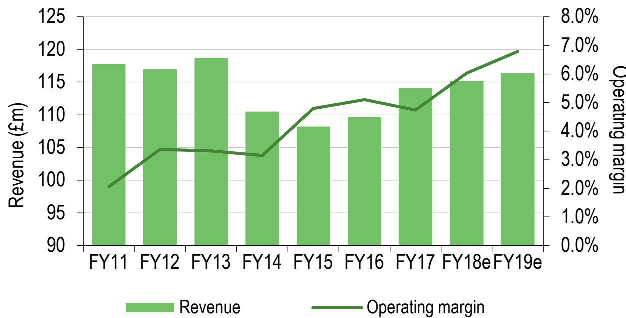
In terms of overheads, the increase again outstripped the growth in sales, with the additional investment in Lang and in people and the sales function to push forward with the growth opportunities. FX also had an impact, as did performance-related pay following the strong FY16. EBIT margin is targeted to move to 7% and our model shows it picking up from 5.2% in FY17 to 6.6% in FY18e and to around the target level in FY19e.

Exceptional charges in the year just reported of £1.0m relate to Lang's acquisition and subsequent restructuring, with our model allowing for a further charge of £0.2m in the current year. Finance costs in FY17 were significantly below the prior year, but it should be noted that this partly related to the reversal of the impact of some FX contracts being marked to market. The underlying interest cost (and associated charges) fell from £2.2m in FY16 to £1.9m in FY17 as the levels of average balance sheet debt diminished. Our numbers show a further step down in this underlying level to £1.5m in both FY18e and FY19e.

While the group was predominantly a manufacturer of commodity product, principally gift wrap, it was difficult to envisage top-line growth and the investment case centred around (i) manufacturing efficiency to combat deflationary pricing pressures and (ii) taking market share from those that could not or would not invest in their businesses to meet best practice and reduce unit cost. It is now the case that its model is predicated on top-line growth through those gains in market share and through changes in the mix, increasing the level of value add and leveraging the design and procurement skills at the heart of the group. The greatest opportunity here continues to be in the US. That top-line growth should be amplified in the operating profit line by the continuing investment in efficiency and greater contribution from newer product lines. With a reducing interest line, the adjusted pre-tax growth is well supported.

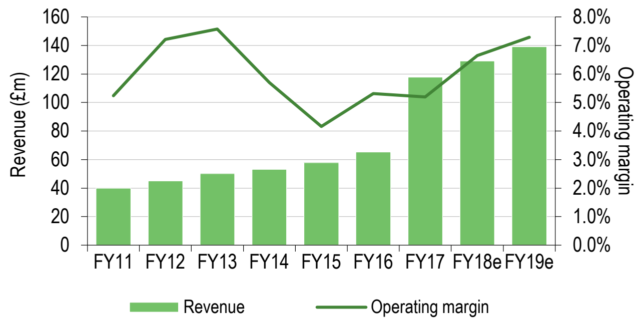
The regional charts below show the financial picture more clearly. In the UK, there was sales growth of 4.0%, still very respectable in a consumer market lacking in confidence. The profitability figure would have been higher but for a reorganisation of the three underlying businesses (Anker, the Welsh operations and Scoop) under a single management team headed by group MD Lance Burn, which affected the achieved margin in the year. Our modelling shows this recovering in FY18e and pushing ahead in FY19e.

Exhibit 8: UK/Asia revenue and operating margin



Source: IG Design Group accounts, Edison Investment Research

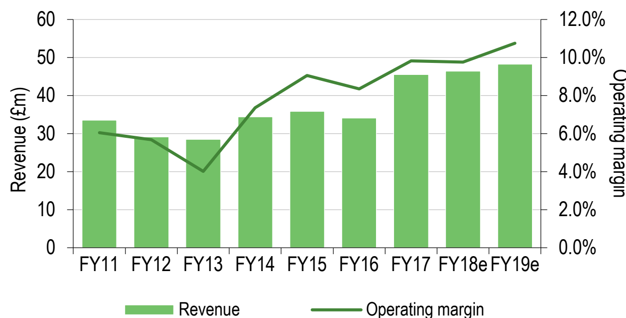
Exhibit 9: North America revenue and operating margin



Source: IG Design Group accounts, Edison Investment Research

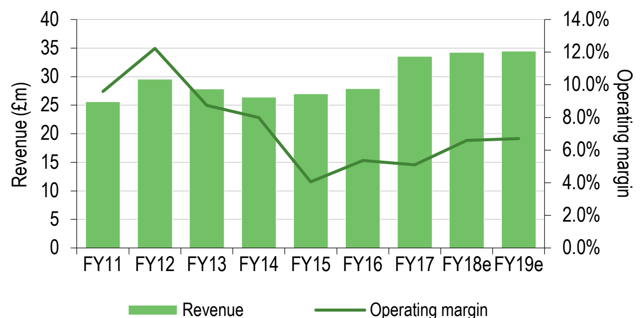
North America is now the largest geographic segment at 49% of group revenues, having overtaken UK/Asia on organic growth alone, with clear water provided by the inclusion of Lang. Organic revenue growth of 27% reflects the first full year of the additional converting equipment that has allowed for a more proactive sales stance. The underlying operating margin was unchanged at 6.4%, with the dilution on a segmental level stemming from the inclusion of Lang, on an operating margin of 3.3%. With its different business model (entirely outsourced range), it is unlikely to be able to match the best margins in the group, but structurally should be able to move toward the 7-8% range, allowing for the FY18e and FY19e margin expansion shown in the chart above.

Exhibit 10: Europe revenue and operating margin



Source: IG Design Group accounts, Edison Investment Research

Exhibit 11: Australia revenue and operating margin



Source: IG Design Group accounts, Edison Investment Research

While there were clear prior indications of the growth potential in the US, the achievement in Europe is perhaps more impressive. Revenue increased by 13.4% (at constant currency), driven by the success of the group's customers in building their own market share, which in turn led to larger volume runs. The group's gifting offer has also now really taken off with these customers, as they consolidate their own supplier bases, with IG Design Group's scale clearly advantageous. Gifting now represents around half of the Europe divisional sales and nearly half of profits. Looking ahead, volumes should be steadier in the current year, with the commissioning of a further press boosting production in FY19. Margins appreciated from 9.8% to 10.8% FY17 over FY16, despite currency headwinds.

While on the face of it, the Australian performance looks less compelling (business 50% owned), there has been some upheaval over the last reporting periods as the group has reoriented its business away from the commoditised Christmas market. A new CEO was appointed in April 2017, with the original JV partner and co-owner retiring. He will be non-exec chairman and will retain his shareholding. As previously reported, the group has won a major three-year contract for 'everyday' cards and there has been some upfront cost relating to this, which has affected margins in the short term.

Underlying growth in earnings per share was 38%, of which 13% was organic, with 5% attributable to Lang and 20% to FX. Tax rates are set to rise as losses have now all been recognised and US profits should start to build more strongly. Across the group, the reported rate for FY17 was 24.2% (a blend from a low 20% in the UK to 35.1% in the US). The expected rate for FY18 is 28%, although cash tax should continue to be shielded for a while.

Year-end net cash positive

As recently as FY10, net debt at the year-end exceeded shareholders' funds at £48.9m vs £42.6m. Our earlier forecast for the end FY17 was for the group to have reduced the strike date net debt to £1.2m and even this ambitious target has been outstripped.

The group has an average leverage target, rather than a year-end calculation, to take account of the peaks and troughs of the working capital cycle (March represents a low for the year, with the peak typically in October/November). The target level of 2.5x EBITDA has been exceeded (at 2.3x) in the year just reported, having been set as a goal for FY19. Management's view is that this is an appropriate ongoing level for the business, meaning that there is capacity for acquisitions/bolt-ons as well as to meet potential capex requirements. The share price improvement over the last 18 months means that equity can now be more sensibly included as an element of a deal, as was the case with Lang (where the company raised £5.0m net at a price of 175p). There is also a clear understanding that now IGR has moved well beyond the 'repair' phase, rewarding shareholders through dividends is higher up the agenda. Increases in payout levels are envisaged towards cover of 2.5x, revised from 3.0x this time last year.

Capex in the year just reported was a little under £5.0m (around the same level as depreciation) and we have pencilled in spend of £10.0m in the current year and £7.5m the following year. The main project currently being undertaken is for an additional high-speed, high-definition press in the Netherlands, at a cost of around €3.0m. With the incremental conversion put into the US, the investment case for additional printing there is currently less compelling when the balance of currency and shipping costs are taken into consideration. This position can obviously change. The other investment ongoing is in upgrading US IT systems, in particular the addition of a new ERP system.

Comfortable balance sheet facilities

The group has made huge strides over the last few years in repairing a balance sheet that had been overstretched by the historical acquisition programme. This has been achieved despite continuing investment in capacity and manufacturing facilities of £25.6m over FY10-17, which is testament to the inherent cash generation of the business and the focus on tight working capital management.

There have been a few tweaks to the financing arrangements, with the Revolving Credit Facility now running to 2020 (was 2019), the ending of a higher coupon HP agreement and the expansion of the US invoice financing from $50m to $75m to take account of Lang and of the Asian facility from $12m to $18m.

Exhibit 12: Financing arrangements

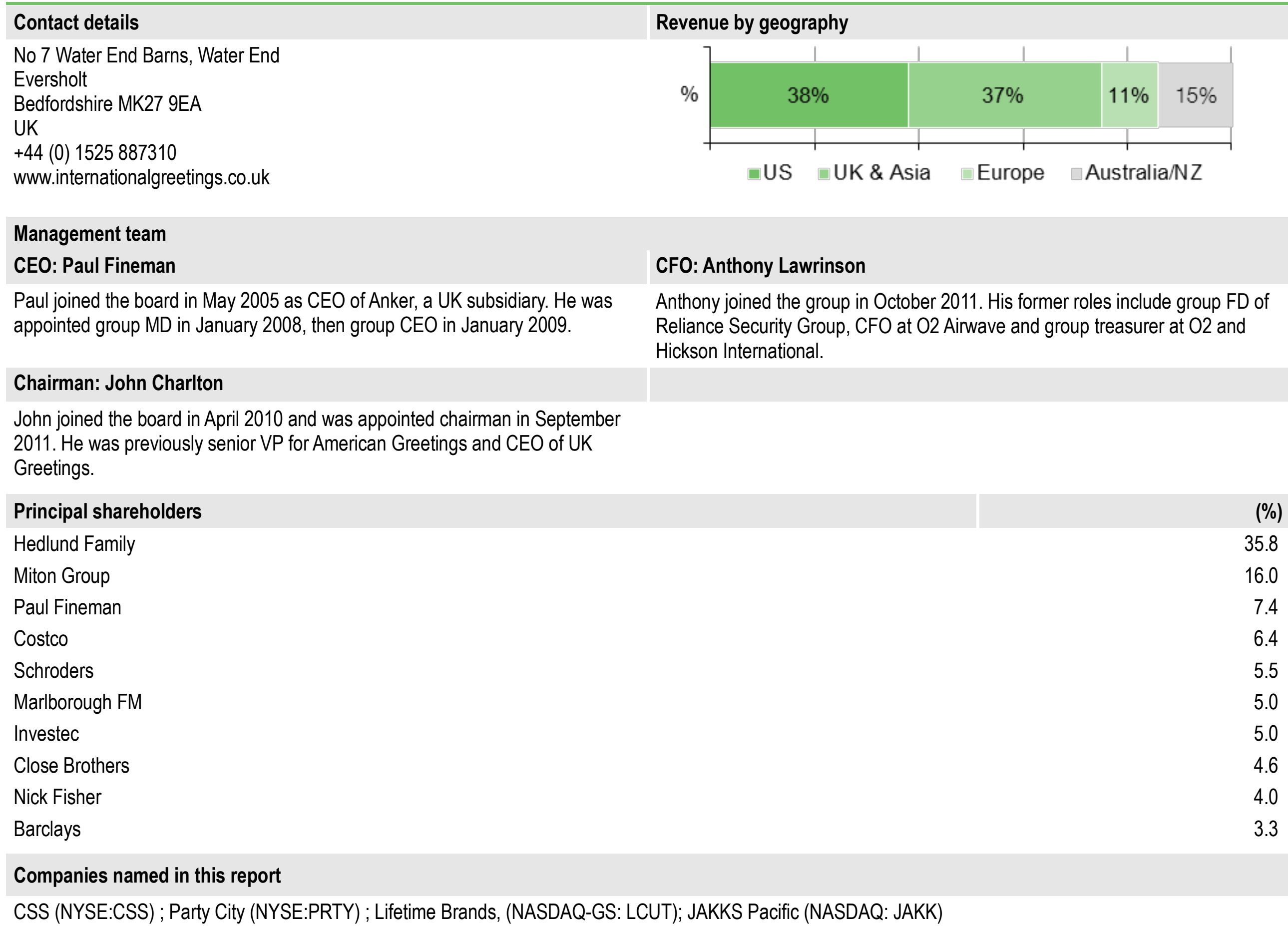
Lender	Due	Facility (£m/$m)	Margin	Covenant
HSBC				
■ RCF & O/D	2020	18	0.95%	Leverage
■ Working cap RCF	Annual	40	1.40%	Stock and unfunded debtors
■ Invoice financing UK/Europe	2019	50	1.10%	Receivables
■ Invoice financing US (US$)	2019	75	1.10%	Receivables
■ Invoice financing Asia (US$)	2019	18	1.30%	Receivables
Westpac	Annual	A$10m	2.52%	

Source: IG Design Group accounts

Exhibit 13: Financial summary

	2015	2016	2017	2018e	2019e
Year end 31 March	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	229,025	236,950	310,992	325,000	335,000
Cost of Sales	(189,048)	(193,552)	(247,059)	(258,050)	(265,990)
Gross Profit	39,977	43,398	63,934	66,950	69,010
EBITDA	16,227	16,505	20,662	26,000	28,500
Operating Profit (before amort and except)	11,692	12,909	16,091	21,500	24,000
Intangible Amortisation	(428)	(285)	(798)	(825)	(825)
Exceptionals	(1,235)	0	(1,037)	(200)	0
Share-based payments	(623)	(908)	(2,216)	(1,800)	(1,500)
Operating Profit	9,406	11,716	12,040	18,675	21,675
Net Interest	(2,726)	(2,763)	(1,229)	(1,500)	(1,500)
Profit Before Tax (norm)	9,589	11,054	17,078	20,000	22,500
Profit Before Tax (FRS 3)	7,303	9,861	13,027	18,975	21,675
Tax	(1,346)	(2,219)	(2,719)	(5,202)	(6,135)
Profit After Tax (norm)	8,243	8,835	12,143	14,798	16,365
Profit After Tax (FRS 3)	5,957	7,642	10,308	13,773	15,540
Average Number of Shares Outstanding (m)	58.1	59.3	61.5	62.6	62.6
EPS - normalised (p)	12.3	13.9	19.6	21.3	23.9
EPS - normalised fully diluted (p)	11.8	13.5	18.8	20.5	22.9
EPS - (IFRS) (p)	9.7	12.2	15.7	20.9	23.7
Dividend per share (p)	1.0	2.5	4.5	5.5	6.5
Gross Margin (%)	17.5	18.3	20.6	20.6	20.6
EBITDA Margin (%)	7.1	7.0	6.6	8.0	8.5
Operating Margin (before GW and except.) (%)	5.1	5.4	5.2	6.6	7.2
BALANCE SHEET					
Fixed Assets	65,688	66,722	71,686	76,361	78,536
Intangible Assets	31,692	32,236	33,681	32,856	32,031
Tangible Assets	33,996	34,486	38,005	43,505	46,505
Investments	0	0	0	0	0
Current Assets	71,312	75,791	83,063	88,071	92,397
Stocks	46,162	46,006	49,475	50,669	51,184
Debtors	22,304	21,405	29,929	30,652	30,963
Cash	2,846	8,380	3,659	6,750	10,250
Other	0	0	0	0	0
Current Liabilities	(45,722)	(48,331)	(60,338)	(61,377)	(62,066)
Creditors	(39,982)	(42,765)	(59,622)	(61,127)	(61,816)
Short term borrowings	(5,740)	(5,566)	(716)	(250)	(250)
Long Term Liabilities	(28,694)	(22,810)	(4,361)	(4,356)	(4,356)
Long term borrowings	(26,479)	(20,297)	26	0	0
Other long term liabilities	(2,215)	(2,513)	(4,387)	(4,356)	(4,356)
Net Assets	62,584	71,372	90,050	98,699	104,511
CASH FLOW					
Operating Cash Flow	17,851	20,744	31,527	23,500	23,800
Net Interest	(2,775)	(1,961)	(1,867)	(1,500)	(1,500)
Tax	(1,263)	(1,797)	(2,003)	(4,160)	(6,068)
Capex	(2,100)	(3,191)	(4,959)	(10,000)	(7,500)
Acquisitions/disposals	(1,451)	0	(2,699)	0	0
Financing/Other	(1,347)	74	5,086	0	0
Dividends	(829)	(1,032)	(3,001)	(3,926)	(4,577)
Net Cash Flow	8,086	12,837	22,084	3,914	4,155
Opening net debt/(cash)	36,947	29,373	17,483	(2,969)	(6,500)
HP finance leases initiated	0	0	0	0	0
Other	(512)	(947)	(1,632)	(383)	(655)
Closing net debt/(cash)	29,373	17,483	(2,969)	(6,500)	(10,000)

Source: IG Design Group accounts, Edison Investment Research



Contact details	Revenue by geography
No 7 Water End Barns, Water End Eversholt Bedfordshire MK27 9EA UK +44 (0) 1525 887310 www.internationalgreetings.co.uk	% US 38%; UK & Asia 37%; Europe 11%; Australia/NZ 15%

Management team

CEO: Paul Fineman	CFO: Anthony Lawrinson
Paul joined the board in May 2005 as CEO of Anker, a UK subsidiary. He was appointed group MD in January 2008, then group CEO in January 2009.	Anthony joined the group in October 2011. His former roles include group FD of Reliance Security Group, CFO at O2 Airwave and group treasurer at O2 and Hickson International.
Chairman: John Charlton	
John joined the board in April 2010 and was appointed chairman in September 2011. He was previously senior VP for American Greetings and CEO of UK Greetings.	

Principal shareholders	(%)
Hedlund Family	35.8
Miton Group	16.0
Paul Fineman	7.4
Costco	6.4
Schroders	5.5
Marlborough FM	5.0
Investec	5.0
Close Brothers	4.6
Nick Fisher	4.0
Barclays	3.3

Companies named in this report

CSS (NYSE:CSS) ; Party City (NYSE:PRTY) ; Lifetime Brands, (NASDAQ-GS: LCUT); JAKKS Pacific (NASDAQ: JAKK)

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