EDISON

Findel

Christmas trading update

Christmas trading - incremental strength

Retail

Increased trading strength in the late Christmas period marks Findel out as one of the winners in a very mixed retail landscape. The combination of a serious and wide-ranging value offer, with responsible consumer credit support, appeals to the substantial consumer cohort that is managing household finances. The company is clear of terrestrial retail issues, while online ordering has hit a new high of 78% this Christmas. We upgrade our underlying IFRS9 adjusted earnings forecasts, and our updated valuation of 348p now shows 74% headroom above the share price.

Year end	Revenue (£m)	EBITDA (£m)	PBT* (£m)	EPS* (p)	P/E (x)	EV/EBITDA (x)
03/17**	457.0	40.8	22.2	20.4	9.8	6.1
03/18	479.0	46.6	26.8	25.9	7.7	5.3
03/19e	506.6	49.8	27.0	26.3	7.6	5.0
03/20e	539.9	53.8	29.2	28.2	7.1	4.6

Note: *PBT and EPS are normalised, excl intangible amortisation, exceptional items and share-based payments. **53 weeks, restated. Historical results are not restated for IFRS9.

Even stronger late Christmas trading

The retail business, renamed Studio, traded strongly over the 15 weeks to the end of December. Product sales grew 13.6% year-on-year, an improved rate against 12% for the 10 weeks previously reported. Online ordering has hit a new peak of 78% of orders, and margins continue in a range 125–175bp ahead of the prior year. Financial services growth was comparable, to produce 13.7% total revenue growth for Studio. The new calendar year has started well, helped by mild weather.

Education: Turnaround progress continues

In a quiet period for schools spend, Q3 core revenue grew 3.8%. Reflecting its investments both in margin and order channels, the division continues to see underlying growth in its customer base, with a significant swing to online ordering.

Forecast: Upgrade driven by Studio performance

We upgrade our underlying PBT forecasts (adjusted for IFRS9) by 3.8% for FY19 and 3.5% for FY20, reflecting the higher level of product sales in Studio. Separately, we are rebasing our forecast to reflect IFRS9, the current accounting standard on financial instruments, which Findel is adopting in FY19. Prior years are not restated, but on a pro forma basis, comparable FY19e PBT growth is 10.7%. On revenue up 5.8%, this shows a meaningful positive operational gearing effect.

Valuation: Weak share price leaves 74% upside

Since interim results on 28 November, the share price has declined by 11%, which appears to us unjustified given that trading has been increasingly strong, while the balance sheet has improved. There is little overall change to our valuation. Our DCF valuation increases 2% to 418p, although our peer comparison reduces from 319p to 278p reflecting weakness elsewhere in the retail sector. These produce a blended valuation of 348p (previously 360p), which nevertheless represents a 74% premium to the share price.

25 January 2019

Price	**200p**
Market cap	**£173m**

Core net debt (£m) at 31 December 2018	c 54
Shares in issue	86.4m
Free float	69%
Code	FDL
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(1.0)	(21.6)	0.0
Rel (local)	(3.8)	(20.3)	11.8
52-week high/low		302.0p	172.2p

Business description

Findel is a multi-channel retailer operating across the business-to-consumer and business-to-business market places. It is a market leader in the home shopping and educational supplies sectors in the UK.

Next events

Trading update	April 2019

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Edison profile page

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Christmas trading: Further strengthening

Findel's total revenue grew 10.9% in Q3 and 6.9% year to date.

Studio: Excellent late finish

The retail business, now renamed Studio rather than Express Gifts, traded strongly over the 15 weeks to the end of December (the period was extended to include the last two weeks of September to achieve a proper comparison, given the earlier phasing of marketing activity in 2018). Product sales grew 13.6% year-on-year, comparing well against 12% for the 10 weeks reported at the time of the interim results. This appears to reflect continuation of the general later trend to Christmas, combined with more short-term ordering from the increasingly online customer base. Demand has been well spread across product ranges, with toys and personalised nightwear popular as Christmas gifts.

Online ordering increased in value by 25% and has hit a new peak of 78% of orders, against 72% at the same stage last year, with orders from mobiles showing relatively high frequency at lower order value. We understand that gross margins continue to be in the guided range of 125–175bp ahead of the prior year. After a margin decline of 50bp in H1, if achieved for the full year this implies that second-half margins would be 270–350bp higher, representing good momentum.

The company is also seeing a later phasing of Christmas orders, probably as a result of improvements in fulfilment across the online market generally.

Financial services growth was comparable, to produce 13.7% total revenue growth for Studio.

The new calendar year has started well, with mild weather contributing to relative strength in homewares and garden products.

Education: Progress continues

The Christmas period, including school holidays, is a quiet period for educational spend. However, core revenue, excluding the discontinued Sainsbury's retail scheme, grew by 3.8% in the quarter, against underlying growth of 0.8% in the first half. In fundamental terms, the business continues to see promising growth in its customer base as well as a significant swing to online ordering, reflecting its investments both in margin and order channels.

Balance sheet: Approaching 1x leverage

As a result of stronger trading performance and better working capital management, core net debt at end December improved beyond management's previous expectations to c £54m against £76.7m at December 2017. We forecast March 2019 core net debt of £58.5m (FY18: £73.8m) which, with FY19 EBITDA forecast at £49.8m, represents leverage of 1.2x.

Forecast: Performance upgrade, accounting change

We upgrade our PBT forecasts (adjusted for IFRS9) by 3.8% for FY19 and 3.5% for FY20, reflecting the higher level of product sales in Studio. Separately, we are rebasing our forecast to reflect IFRS9, the current accounting standard on financial instruments, which Findel is adopting in FY19. Prior years will not be restated, but on a pro forma basis, FY18 PBT would be £24.4m, giving comparable FY19e PBT growth of 10.7%. On revenue up 5.8%, this shows a meaningfully positive operational gearing effect.

Accounting change: IFRS9 on bad debt provisions

The adoption of IFRS9 reflects a more cautious approach to bad debt provisioning, resulting in a £2.5m increase in our forecast provision for FY19. The effects of our forecast upgrade and the accounting restatement on our PBT forecasts are as follows:

Exhibit 1: Effect of accounting change and performance upgrade on PBT

£m	FY19e	FY20e
Previous forecast	28.5	30.9
IFRS9 accounting change	(2.5)	(2.7)
Rebased previous forecast	26.0	28.2
Upgrade	1.0	1.0
New forecast	27.0	29.2
Upgrade vs IFRS9 adjusted previous forecast (%)	3.8%	3.5%

Source: Edison Investment Research

Given that external economic assumptions form an input into the IFRS9 provisioning process, Findel has had to take a position on the economic outlook that includes a wide range of possible outcomes on Brexit. Management has made relatively cautious assumptions, but has not taken a worst-case approach, such as might be triggered by a no-deal exit.

The net effect of the changes drives lower EPS, PBT and EBITDA forecasts:

Exhibit 2: Net changes to forecasts

	EPS (p)			PBT (£m)			EBITDA (£m)		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
03/19e	27.7	26.3	-5.0%	28.5	27.0	-5.2%	51.3	49.8	-2.9%
03/20e	29.8	28.2	-5.3%	30.9	29.2	-5.6%	55.5	53.8	-3.1%

Source: Edison Investment Research

Valuation: 74% headroom

There is little overall change to our valuation. With the short-term upgrade to our forecasts we increase our DCF valuation from 401p to 418p. However, further de-rating in the sector means that our peer comparison reduces from 319p to 278p. These produce a blended valuation of 348p, 3% lower than our previous 360p. That now represents a 74% premium to the share price, which has declined recently without underlying cause, we believe.

Exhibit 3: Financial summary

£'000s	2017	2018	2019e	2020e
Year end 31March	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	457,030	478,959	506,558	539,858
Cost of Sales	(269,182)	(280,230)	(301,540)	(320,530)
Gross Profit	187,848	198,729	205,018	219,328
EBITDA	40,786	46,569	49,795	53,816
Operating Profit (before amort. and except.)	33,300	38,146	40,934	44,855
Intangible Amortisation	(1,959)	(1,996)	(2,552)	(2,387)
Operating profit pre exc post intang amortisation	31,341	36,150	38,381	42,468
Exceptionals	(82,152)	0	0	0
Other/share based payments	(191)	(199)	(1,000)	(1,000)
Operating Profit	(51,002)	35,951	37,381	41,468
Net Interest	(8,920)	(9,130)	(10,345)	(12,244)
Derivatives, other	556	(4,701)	0	0
Profit Before Tax (norm)	22,230	26,821	27,036	29,225
Profit Before Tax (FRS 3)	(59,366)	22,120	27,036	29,225
Tax	1,659	2,081	(5,338)	(5,845)
Profit After Tax (norm)	17,617	22,397	22,697	24,380
Profit After Tax (FRS 3)	(57,707)	24,201	21,697	23,380
Average Number of Shares Outstanding (m)	86.3	86.3	86.3	86.3
EPS - normalised (p)	20.4	25.9	26.3	28.2
EPS - normalised and fully diluted (p)	20.4	25.9	26.3	28.2
EPS - (IFRS) (p)	(66.8)	28.0	25.1	27.1
Dividend per share (p)	0.0	0.0	0.0	0.0
Gross Margin (%)	41.1	41.5	40.5	40.6
EBITDA Margin (%)	8.9	9.7	9.8	10.0
Operating Margin (before GW and except.) (%)	7.3	8.0	8.1	8.3
BALANCE SHEET				
Fixed Assets	79,012	81,687	84,288	84,940
Intangible Assets	26,185	25,175	28,947	28,560
Tangible Assets	44,417	47,596	46,489	47,528
Investments	8,410	8,916	8,852	8,852
Current Assets	301,265	311,918	339,383	364,813
Stocks	57,108	54,180	57,194	70,567
Debtors	212,648	231,037	246,567	260,124
Cash	29,173	26,244	35,299	33,800
Other	2,336	457	322	322
Current Liabilities	(91,789)	(81,190)	(85,140)	(91,829)
Creditors	(91,244)	(80,618)	(84,622)	(91,311)
Short term borrowings	(545)	(572)	(518)	(518)
Long Term Liabilities	(271,785)	(273,170)	(276,172)	(273,672)
Long term borrowings	(253,603)	(258,001)	(264,192)	(264,192)
Other long term liabilities	(18,182)	(15,169)	(11,980)	(9,480)
Net Assets	16,703	39,245	62,359	84,252
CASH FLOW				
Operating Cash Flow	12,281	11,439	28,259	28,769
Net Interest	(9,103)	(8,365)	(10,716)	(12,424)
Tax	148	581	(1,984)	(5,845)
Capex	(11,724)	(10,595)	(12,357)	(12,000)
Acquisitions/disposals	1,168	(450)	0	0
Financing	0	0	0	0
Dividends	0	0	0	0
Net Cash Flow	(7,230)	(7,390)	3,201	(1,499)
Opening net debt/(cash)	216,682	224,974	232,329	229,411
HP finance leases initiated	0	0	(283)	0
Other	(1,062)	35	(0)	(0)
Closing net debt/(cash)	224,974	232,329	229,411	230,910

Source: Company data, Edison Investment Research. Note: Historical results are not restated for IFRS9.

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