EDISON

Walker Greenbank

Strategy refreshed, key estimates unchanged

Strategy update & H120 results

Care & household goods

A narrower focus on core business strengths driven with greater operational intensity is an appealing proposition under a revised strategy and new senior management team. More detail will emerge here, but an intention to regain revenue momentum will be a clear marker to watch. H120 results were in line with pre-close comments and our earnings estimates are unchanged at this stage. They – and we suspect the company valuation – have yet to fully factor in renewed strategic impetus.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
01/18**	112.2	12.3	14.1	4.4	5.3	5.9
01/19	113.3	9.1	10.2	3.2	7.2	4.4
01/20e	109.8	7.4	8.3	2.5	8.9	3.4
01/21e	112.8	7.8	9.1	2.7	8.2	3.6

Note: *PBT and EPS (fully diluted) are normalised, excluding exceptional items and LTIP charges. **Restated for IFRS 15.

New strategy built around core strengths

The new management team has outlined an updated corporate strategy which seeks to capitalise on the existing key group strengths. We summarise this approach as greater individual brand intensity and differentiation focused on core products (fabric, wallpaper and paint) supported by an enhanced supply chain and talent pool capability. The UK, US and a northern Europe bloc are the key revenue territories; all three areas already have some direct sales representation and all are tasked with growth. Explicit financial targets are still to be revealed externally, but this approach appears to us to be a logical and coherent way to create internally generated growth and business momentum without waiting for market conditions – in the UK in particular – to become more favourable.

H120 ahead, lower full year expectation unchanged

H120 revenues grew modestly y-o-y, but both divisions delivered a more significant uplift in operating profitability with a better sales mix despite weak UK market conditions. Adjusted EPS rose by 17.1% in the first half but, without the significant H219 apparel licence income recurring, our unchanged earnings estimates – underpinned by some cost reduction actions – continue to anticipate a lower full year outturn y-o-y. Consequently, the H1 dividend was rebased referencing a stated commitment to a 30% payout ratio. The period-end balance sheet was in good shape with a small increase in net funds (to £0.9m).

Valuation: P/Es sub 10x, NAV discount widens

From the half year period end to the results announcement, the company's share price slid gently downwards; post results gains have now retraced such that it sits c 15% below its level at the start of the year. On our unchanged earnings estimates, the company's P/E rating has settled for now below 10x sitting at 8.9x for the current year, declining to 8.1x by FY22. The equivalent EV/EBITDA multiples (adjusted for pensions cash) are 5.4x and 4.8x respectively. Other valuation metrics include a prospective FY20 dividend yield of 3.4% and a 21% discount to the reported end-July NAV.

9 December 2019

Price	**74.0p**
Market cap	**£53m**

Net cash (£m) at end July 2019 (excludes IFRS 16 lease liabilities £8.7m)	0.9
Shares in issue	70.9m
Free float	92%
Code	WGB
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(9.9)	(11.6)	(9.4)
Rel (local)	(9.0)	(12.1)	(17.2)
52-week high/low		92.0p	56.2p

Business description

Walker Greenbank is a luxury interior furnishings group combining specialist design skills with high-quality upstream UK manufacturing facilities. Leading brands include Harlequin, Sanderson, Morris & Co, Scion, Anthology, Zoffany and Clarke & Clarke. FY19 revenue was split UK 53%, international 41% and licence income 6%.

Next events

FY20 ends	January 2020

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Investment summary

Description

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Valuation: Single-digit P/E multiples and NAV discount

Conventional multiples in our expected trough year for earnings are a current year P/E of 8.9x and EV/EBITDA (adjusted for pensions cash) of 5.4x. We currently anticipate a c 5% EPS CAGR over our following two estimate years, at the end of which these multiples reduce to 8.1x and 4.8x respectively. Dividends are expected to follow the same profile as earnings and our current year projected yield is 3.4%. We note that Walker Greenbank's share price sits at a 21% discount to its last published NAV as at the end of July. On a P/E basis, the company is valued below Colefax Group (on a P/E basis) but higher in EV/EBITDA terms and at the lower end of the range for other selected adjacent home furnishings companies listed in London.

Financials: Trough earnings in FY20 and cash positive

Tough UK trading conditions have affected financial performance since FY18; we anticipate that FY20 will be the trough year for earnings with some recovery in the following two years assisted by cost savings with dividends following a similar pattern. Our expectations have been stable since they were re-set at the end of the prior year and not materially changed after the H120 results announcement (which showed a small y-o-y increase in group revenue, together with more significant profit improvement in both divisions). The company was in a modest net funds position at the end of H120 (excluding IFRS 16 lease liabilities of £8.7m) and we expect this to improve further, rising to £5-6m (excluding IFRS 16 lease liabilities) by the end of FY22. We should add that the new management team is beginning to implement an updated strategy; although specific financial targets have not yet been revealed, there is a clear aim of achieving broader sales growth and, we assume, improved profitability. Consequently, there may be upside to our earnings outlook, which we will revisit when the financial means and metrics are shared externally. Our only balance sheet comment here is to note that group net assets of c £67m attribute a relatively small carrying value to some of the long-established and well-known brands in the Walker Greenbank portfolio.

Sensitivities: Market segmentation, FX and vertical integration

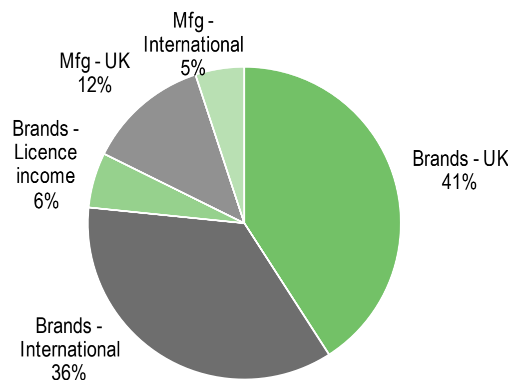
Housing transactions tend to correlate with home improvement/RMI spending, although they may be less key for Walker Greenbank's premium and luxury subsegment products and their target demographic. Commercial/contract markets – to which the company only has relatively small exposure – tend to have natural renovation cycles as well as newbuild opportunities. Differentiated positioning for the company's brands suggests that end-demand drivers are diverse and are, of course, influenced by prevailing fashions. As an exporter (of finished products) and an importer (of some substrate materials and finished items), sterling weakness is beneficial to earnings in the former case – especially against the US dollar – and a headwind in the latter. As a vertically integrated business, Brands sales volumes directly affect utilisation levels of in-house manufacturing facilities, which also service third-party customers.

Company Description: Premium brand owner

Walker Greenbank is a UK-based owner of a portfolio of luxury interior furnishing brands, which it supplies into domestic and overseas markets in the form of premium wallpaper and fabrics, and through licence agreements. In its two main categories, products are supplied both from two in-house UK printing facilities and also via third-party fabric sourcing. A unique heritage brand archive and the range of high-quality UK print manufacturing capabilities are significant differentiators in the markets in which Walker Greenbank operates.

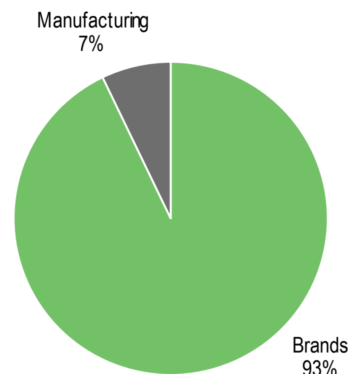
The company reports under a two-divisional structure. Its **Brands** portfolio includes leading traditional names Morris & Co, Sanderson and Zoffany at the luxury end of the market and the more contemporary/premium Harlequin, Scion and Clarke & Clarke. Driven by in-house design teams, the company supplies wallpapers and fabrics under these brands into the UK – just over half of revenue – and international markets. Through licensing agreements with third parties, these brands also migrate into other product categories including core non-apparel lines (eg bedding, gift items) and also periodically apparel again in both domestic and international markets. The **Manufacturing** division comprises two facilities at Anstey (Loughborough, wallpaper) and Standfast & Barracks (Lancaster, fabric), each with a variety of printing capabilities by technique and substrate material. They are the only scale UK providers of high-quality print services in these product areas, which support both in-house Brands sales and third-party customers. Revenues in both divisions in any one year comprise new collection launches and re-prints of popular existing ones.

Exhibit 1: FY19 group revenue split (£113.3m*)



Source: Company. Note: *External revenue – after c £13m of Manufacturing sales to Brands was eliminated on consolidation.

Exhibit 2: FY19 group EBIT split (£11.6m*)



Source: Company. Note: *Before £1.2m group central costs.

The US and northern Europe are the leading overseas markets served and Walker Greenbank has a direct showroom presence in New York, Chicago, Paris, Amsterdam, Moscow as well as Dubai. Other markets including Japan are serviced through a combination of distribution and agency arrangements, depending on scale.

The management team has undergone a transformation in the last 18 months including the recruitment of Lisa Montague (ex-Loewe, Aspinal of London and Mulberry Group), who joined in March, becoming CEO on 10 April). There are three non-executive board members, two of whom were appointed in April and November last year, with Dianne Thompson joining in February 2019 before becoming chair in April. Mike Gant (CFO since 2014) completes the board, providing continuity amid the above changes. As flagged earlier in the year, a refreshed strategy was introduced with the interim results. With a new executive team and other senior hires in process, the messaging was understandably high level at this stage. We look into some of the implications in the following sections, but summarise the direction here as one pursuing sharper individual brand strategies and greater international concentration.

Strategy update: Brand-centric growth plan

Management has set out a clear direction of travel with regard to a refreshed group strategy, and this represents a proactive approach, in our view, in the context of a core UK market which is continuing to labour. We summarise the approach as a logical focus on the company's core strengths – brands, products, customers and regional markets – supported by people investment.

Walker Greenbank's quality **brands** are positioned towards the upper end of their markets, ranging from 'accessible premium' (Clarke & Clarke) to luxury (Zoffany). At the heart of the updated strategy is an increased emphasis on the individuality of each brand and, as part of this process, there is to be a degree of repositioning as shown in Exhibit 3. To us, this appears to be a clearer delineation with three different subsegments in two categories:

- Luxury/heritage/traditional – Zoffany, Morris & Co, Sanderson.
- Premium/contemporary – Harlequin, Clarke & Clarke, Scion.

Exhibit 3: Walker Greenbank dynamic brand positioning overview

Source: Company

The **brand repositioning** process is naturally a gradual one, evolving existing collections/archives via both discontinuations and the progressive addition of new ones. On this subject, the stated intention is to reduce the absolute number of new launches but implicitly give them enhanced marketing support. Return on investment metrics are to be applied as part of this process from the design stage and we will revisit this as the body of new launches builds. Given that design teams are already brand focused (and supporting service infrastructure including manufacturing, finance and HR is well established), our sense is that the primary changes will be seen in sales, marketing and distribution, with more tailored campaigns and channel intensity at individual brand level.

Walker Greenbank remains a B2B/trade business and its **marketing strategies** will vary by brand/channel. For example, Zoffany targets interior designers/specifiers, while other customers include leading department stores, specialist independent retailers and, in the case of fabrics, finished goods manufacturers. Clearly, with the above brand repositioning taking place, some refinement and strengthening of customer relationships is to be expected. At the same time, brand profiles are to be raised with core end-consumer groups including increased use of digital marketing campaigns to stimulate product pull-through and engagement with partner trade customers. This dual-pronged approach is not revolutionary, but we believe it represents a step up

for the Walker Greenbank brands and is complementary to the other initiatives taking place around the group.

This approach most obviously applies in the UK, the largest single country market. Along with the US and a northern European country bloc (including Russia), these territories account for c 80% of annual sales. Walker Greenbank already has a direct presence in several of these countries but also uses local partners (eg Kravet Inc in the US). It remains to be seen exactly how overseas sales, marketing and distribution develops in these areas which have been designated as core growth drivers; we would imagine that investment in more direct sales staff will progressively occur with other measures put in place appropriate for the scale of ambition from current levels. To quantify this, the company is targeting a doubling of international sales in these markets (ie an increase of £30m+), although no timeline was provided.

The existing **product focus** on fabrics, wallcoverings and paint has been reaffirmed and range extensions – which had been under consideration – will continue to be addressed predominantly through licence agreements. The proposed broadening of co-ordinated paint ranges across all brands (currently only Sanderson and Zoffany do this) should serve to reinforce individual brand propositions and we note that management is targeting growth in all three product groups. With regard to licensing activities, we do not detect any material change in approach at this stage. Growth in core (non-apparel) licence areas is an ongoing aspiration – and other opportunities may periodically arise – but growth in core product areas appears to be the priority for now.

Walker Greenbank's in-house **manufacturing** capability provides an important underpin to the company's control over and consistent delivery of quality products. An inferred reduction in SKUs over time should bring some manufacturing benefits (eg reduced variants, tooling requirements, fewer changeovers). The review process underway extends beyond this to a full supply chain audit – including CSR considerations – with the aim of developing closer relationships and reduced lead times with selected partners. Further investment in the higher-growth digital printing segment is under consideration (especially at Anstey, where the proportion of wallpaper sales is low at 12% but rising rapidly), as are the incorporation of additional processes on a standalone basis and in conjunction with existing techniques to maintain a broad and innovative offer to customers.

The group board changes and updated corporate strategy are being accompanied by **investment in personnel** through other senior management hires and the development of internal talent. A new global commercial director was appointed in August, a group marketing & digital director has started in November and a group operations director is to follow in January (as announced on 24 October, along with a senior US hire). In the context of our high-level strategy outline above, they – along with the existing CFO and creative director – are likely to be among the key enablers in its execution.

Understandably, given that the senior management team is in the process of coming together and settling in, specific **financial targets** and the fine detail are still to be made explicit externally at this stage. That said, the three-year plan as outlined to date does contain some specific objectives against which we can benchmark progress:

- FY21– assemble leadership team, differentiate brands;
- FY22 – UK sales growth, accelerate US sales growth; and
- FY23 – all brands growing, UK/US/Europe growing.

We should add that y-o-y progress in core Licence income in the next two years is also a corporate aim. There are a lot of moving parts in Walker Greenbank's comprehensive strategy update and they will take time to be brought fully into alignment in our view. We believe that it signifies that organic growth is being prioritised although, with an ungeared balance sheet, the company is in a position to make bolt-on acquisitions – most likely in brands – at the appropriate time.

H120 results overview

Walker Greenbank reported a small y-o-y increase in group revenue in H120, together with more significant profit improvement in both divisions. This chiefly reflected progress with heritage brands and associated manufacturing benefits. Consistent with the end-FY19 position, the interim dividend was rebased, with an expectation that the full year payout will be maintained at the prior year level (ie 30%). The company improved its balance sheet net cash position slightly to £0.9m at the period end (and IFRS 16 lease liabilities of £8.7m).

Exhibit 4: Walker Greenbank interim & divisional splits

£m	H119*	H219	2019	H120***	Headline	CER
					% change y-o-y	
					H120	H120
Group Revenue	**54.7**	**58.6**	**113.3**	**55.9**	**2.3%**	**N/A**
Brands	44.6	48.6	**93.3**	46.3	3.8%	0.8%
UK	23.1	23.2	**46.3**	22.2	-4.0%	-4.0%
International	19.5	21.0	**40.5**	20.9	7.2%	4.8%
Licence income	2.0	4.5	**6.5**	3.2	60.0%	60.0%
Manufacturing – gross**	16.3	16.6	**32.9**	17.1	5.1%	N/A
UK	7.5	6.8	**14.3**	6.6	-12.0%	-12.0%
International	2.6	3.2	**5.7**	3.0	16.6%	N/A
Inter company	(6.2)	(6.7)	**(12.9)**	(7.6)	21.0%	
Group Operating Profit	**4.1**	**6.0**	**10.0**	**4.9**	**18.7%**	
Brands	4.7	6.1	**10.8**	5.6	19.8%	
Manufacturing	0.6	0.2	**0.8**	1.0	87.0%	
Central items****	(1.1)	(0.5)	**(1.6)**	(1.8)	57.1%	

Source: Edison Investment Research, Walker Greenbank data. Note: *Minor reallocation of costs from central to divisions versus original H119 report. **Manufacturing – gross includes intercompany transfers to Brands, which is netted out on consolidation. ***Reported under IFRS 16 for the first time – c £0.1m of lease finance costs now included in the net finance cost line. ****Includes pension administration costs.

Brands: Mixed individual performances, profit progress

Divisional revenues increased by almost 4% in the first half with a stronger uplift in profitability, as reflected in the 140bp EBIT margin increase to 12.1%.

UK product sales declined by 4% y-o-y in contrast with 7.2% higher international revenue over the same period. As noted at the pre-close stage, UK market conditions remain challenging and individual brand performance was certainly mixed. The jointly reported Sanderson/Morris & Co brands continue to be the standout portfolio performer with an 8% y-o-y revenue increase. Continuing popularity of the core collections supplemented by ongoing momentum from the launch of Pure Morris a couple of years ago appears to be sustaining this market outperformance. The more contemporary Clarke & Clarke saw greater progress, with sales almost one-fifth higher than seen in H118; this was substantially attributable to supply chain disruption in the prior year (and higher unit value agency sales in this period versus distributor sales previously), which ultimately resulted in a new US distributor agreement with Kravet Inc (a leading trade home furnishings supplier, as announced on 1 July). Pull-through from the relatively new group Chicago show room (opened in October 2017) and reduced UK domestic discounting are also likely to have contributed to this outturn, in our view.

In contrast, Harlequin (and its sub brands) and Zoffany both saw continuing top-line pressure (revenues down 11% and 15% respectively). Momentum was weak during FY19 and there has been no discernible bottoming out/reversal of this in evidence during the first half. Zoffany is positioned as a luxury brand and perhaps its performance reflects weakness seen in the upper end of the London residential market. Harlequin is a more contemporary brand and has been in a broadly similar price category as Sanderson/Morris. To complete the revenue picture, core non-apparel licensing income rose by c 12% and was supplemented by some apparel income and an

IFRS 15-related recognition of guaranteed minimum income under a renewed agreement with an existing licensee. In total, licence income was £1.2m higher at £3.2m in H120.

Even without all aspects firing, the Brands division as a whole delivered £0.9m (c 20%) EBIT progress, equivalent to a 160bp increase in EBIT margin (to 12.1%). Breaking this down, the largest contributor was Licensing, where a substantial proportion of the £1.2m revenue uplift dropped through to the bottom line. The remainder from the Brands portfolio included initial benefits from cost to serve savings and a small y-o-y improvement from the adoption of IFRS 16 for the first time.

Manufacturing: Benefits of vertical integration

Increases in export sales to third parties and internal Brands more than compensated for weak UK domestic market demand, leaving the combined total revenue from the two printing companies 5.1% above H118. There was also a good margin recovery from a low base (+220bp to 6.1%), reflecting both higher activity levels and improved sales mix.

The gross divisional revenue increase was the net product of a 4.7% decline in sales to third parties overall, more than offset by a c 21% rise in throughput to support proprietary Brands sales. Within the third-party mix, the domestic component reduced by 12% in contrast with export sales, which rose by 16.6%, a similar profile to the Brands division (domestic lower, international ahead y-o-y, albeit within a narrower range of variation).

In this context, the Manufacturing division's internal sales performance was clearly substantially better than its external equivalent. Given market conditions, this is unlikely to be explained simply by preferential capacity allocation as overall utilisation rates are not a constraining factor in our view. There can be other timing issues – such as collection launches and larger orders – but as they were not flagged by management, we assume they were not material in the first half. Sterling weakness appeared to be beneficial for export sales, while demand for digitally printed products was also relatively firm. This was particularly the case at Anstey, where gross sales were broadly flat – against a slightly tougher H119 comparator, given a degree of catch-up following a machine fire at the end of FY18 – with an increased proportion of internal revenues. Standfast & Barracks grew total revenues by c 13% and we believe that its third-party sales were up c 5% y-o-y, with overall growth therefore driven primarily by internal sales volumes.

Central items increase: to complete the commentary on Exhibit 4, we note that the 'Eliminations and unallocated cost' line rose significantly in the period (+£0.7m to £1.8m). We believe that this was attributable to higher unrealised FX losses, professional and legal fees and some external fees incurred as part of the strategy review. Finally, not shown in Exhibit 4 but apart from amortisation of acquired intangibles (which were unchanged y-o-y at c £0.5m), the primary non-underlying items were reorganisation costs at Clarke & Clarke (£0.7m), partly offset by a reduced tail of insurance proceeds receipts (£0.1m credit versus c £0.7m in H118).

Net funds position expected to grow

Walker Greenbank ended H120 in a £0.9m net funds position (excluding IFRS 16 leases), a £0.5m uplift from the year end. The adoption of IFRS 16 for the first time has a small impact on the cash flow presentation and therefore y-o-y comparability, but no difference at the net level. In the following commentary, we have separated the underlying and IFRS 16 effects.

Core EBITDA was c £6.6m, mainly driven by the higher EBIT contribution noted earlier, plus a small uplift in depreciation following recent investment in digital printing equipment. Non-trading cash items totalled £1.7m; the larger component related to pension deficit recovery payments of £0.9m and exceptionals of £0.8m, which largely corresponds to the Clarke & Clarke reorganisation referred to above. (In H119, net non-trading cash outflows were £0.7m after taking into account £0.7m insurance proceeds arising from a machine fire at Anstey at the end of FY18.)

First half working capital absorption was somewhat higher than in the prior year (ie £3m versus £1.1m in H119) for two primary reasons. Firstly, the IFRS 15-related accelerated licence income recognition noted earlier carries an accrual for future periods, which we believe represented the lion's share of a £2.5m payables outflow. In addition, c £0.8m additional inventory investment was made in H1 as a buffer against Brexit uncertainties; historically, the majority of Walker Greenbank's inventory position has been held as finished goods. Taking into account all of the above effects, underlying pre-IFRS 16 operating cash inflow for the period was £2.2m (against £4.2m in the prior year).

There were no other major items of note in core cash flow movements. The presence of a bank interest charge – despite a net funds position at the start and end of H1 – reflects facility fees and the monthly working capital cycle, while a slightly lower tax payment is consistent with the profit profile. Capital investment in the form of physical assets, including a new (ie the third) digital printer at Anstey, and new collection development totalled £1.2m versus the equivalent £1.8m depreciation and internal amortisation charge. Lastly, as in previous years, no dividend cash payment was made in the first half year. At the net level, underlying free cash flow was a modestly positive £0.3m.

IFRS 16 effects: as described in the footnote to Exhibit 4, IFRS 16 requires companies to split out the 'depreciation' and 'financing' elements of significant leases. In Walker Greenbank's case, the latter element was £117k; this represented a small boost to reported EBIT offset by an equivalent amount in total net interest affecting the presentation and prior year comparability of both the P&L and cash flows. In addition, the cash flow statement now shows the capital repayment of leases made in each trading period and these amounted to £1.3m in H120. At the end of this period, the company had £8.7m lease liabilities on its balance sheet (split £2.6m short, £6.1m long).

Cash flow outlook: during H1, banking arrangements were renewed with a £12.5m RCF now running to 2024 with a reduced £5m accordion facility (previously £10m) also. We project underlying free cash flow to be in the £3–4m range in each of our forecast years which, after dividends and IFRS 16 effects, nets down to c £1–2m net cash inflow pa.

Regarding IFRS 16 lease exposure, we currently model for this to decline naturally, but future asset financing decisions (eg leasehold property, including break/extension decisions and capital equipment) will clearly influence the actual profile. Lastly, we note that retirement benefit obligations on the balance sheet declined significantly (from £9.7m at the end of FY19 – when the present value of funded obligations was c £77m – to £5.2m six months on). We have not modelled any reduction in the c £2m annual deficit recovery cash payments over our estimate horizon and the next triennial valuation is due in 2021.

Estimates effectively unchanged

We have not factored in any immediate benefit from the newly refreshed strategy pending further financial detail/targets and we expect the initial implementation phase to bed in progressively over the remainder of FY20 as the senior team comes together. The company has reminded us of an expected £1m savings from the Clarke & Clarke warehouse consolidation in the current financial year, although some of the £2m annualised benefit (already in our estimates) could also be absorbed by senior management hires. Given that H120 profitability was ahead of the prior year, we should point out that the absence of significant one-off apparel licence income seen in FY19 is the primary driver behind our expected reduction in FY20 earnings.

Management flagged unchanged expectations for FY20. Following the H120 results, we made a small net revenue increase in the Brands division and factored in stronger Manufacturing EBIT based on the first half rebound. The latter element is partly offset by a higher expected central cost run rate. The net result is that our PBT, EPS and – given a 30% fixed payout ratio in the near term – DPS are effectively unchanged.

Sensitivities

Walker Greenbank's portfolio of brands largely addresses the mid- and upper premium end of its markets. It has an integrated business model with substantially all of its Brands wallpaper revenues and around half of its Brands fabric sales being printed in-house.

Market drivers: in residential which accounts for the majority of revenues, spending on home improvements is associated with housing transactions and, therefore, seen as cyclical. Walker Greenbank's products are in the premium and luxury subsegments and end-customer homeowner behaviour in this demographic may be less dependent on transactions as the key driver. Commercial/contract markets such as the hospitality sectors (representing no more than 10% of sales) tend to have natural renovation cycles with opportunities across single units, multiple/chain locations as well as newbuild situations. We should add that differentiated positioning for Walker Greenbank's brands indicates that end-demand drivers are diverse and are, of course, influenced by prevailing fashions and appetite for heritage patterns and new collections. Walker Greenbank is a B2B business and consequently reliant to a great extent on its own direct customers for end-customer engagement. Marketing support, stock availability and service levels are all critical elements behind maintaining a network of interior designers/specifiers in commercial, department stores (eg John Lewis), specialist furnishings retailers and trade distributors, which could have local, regional or national coverage. Enhancements in these areas, along with an increased digital/online presence, are part of the updated strategy. In some cases, customers include UK product competitors that require high-quality design and printing and/or local UK manufacture to support their own sales. In international markets, changes to local partners (eg in the US and Germany) have periodically caused some disruption to sales during transition periods.

Currency exposure: as well as around half of sales, the majority of expensed inventory items (accounting for c 80% of cost of goods sold; with COGS typically in the 35–40% of sales range) are sourced outside the UK. Hence, sterling weakness is helpful for exports from a UK manufacturing perspective but also provides a cost headwind for input and other costs. The US dollar and euro are the most important cross rates against sterling from a revenue perspective, while euros are the main ex-UK imported goods currency. Broadly speaking, currency exposures (costs and revenues) tend to balance out providing a natural hedge.

Operational gearing: as a vertically integrated business, sales volume pull-through directly affects utilisation levels of the two in-house printing facilities. In each of these locations, Walker Greenbank operates a number of different machines and processes and throughput can be influenced by equipment age and workflow (eg number of changeovers), so production planning is a key discipline. In-house production permits control over product quality and brand reputation, which are both significant competitive strengths, as is scale UK capacity. Events that disrupted production in the past (ie a factory flooding, machine fire) highlight challenges in sourcing substitute products, although the company had appropriate business insurance cover in place in these cases.

Repositioning brands: the strategy to reposition some of the existing brands (see page 4) represents both opportunities (clearer delineation, more focused brand identities and marketing to drive sales) and risks to some extent (channel partner/end-customer acceptance, competitive positions). As part of this process, launching fewer new collections with the intention for them to have more significant impacts places a greater onus on successful design/manufacturing/marketing collaboration in order to achieve this. Deepening and embedding the discipline of return on investment analysis across SKUs looks like a logical enabler here.

Pensions: the group currently makes c £2m pa pension cash recovery payments to its defined benefit schemes, with end-FY19 stated liabilities of £77m. These are material items in the context of the current market cap and profitability levels. That said, with an unstressed balance sheet and an end-July accounting deficit of c £5m, we consider these obligations to be manageable.

Valuation

Walker Greenbank is an established, vertically integrated and leading supplier of branded interior furnishing fabrics and wallcoverings to its domestic UK and international customers. Revenues are generated from internally printed and sourced finished goods materials with smaller proportions from complementary tinted paints and licence income (from finished goods manufactured under partner licence agreements). The company was in a modest net funds position at the end of both FY19 and H120 (which included IFRS 16 leases of £8.7m for the first time).

A combination of soft UK markets and a stronger FY19 licence income comparator (from a significant one-off apparel agreement in that year) means that we expect FY20 profitability and earnings to be down y-o-y. Conventional earnings and cash multiples perhaps reflect this earnings dip with a current year P/E of 8.9x and EV/EBITDA (adjusted for pensions cash[1]) of 5.4x. We consider that FY20 is likely to be the trough earnings year; we currently anticipate a c 5% EPS CAGR over our following two estimate years, noting that FY22e is still below prior year reported levels. On this basis, the P/E and EV/EBITDA multiples (as above) have reduced to 8.1x and 4.8x respectively. For income investors – given a stated 30% payout policy – dividends are expected to follow the same profile as earnings, and the current year expected yield is 3.4%.

At the end of H120, net assets were c £67m, equivalent to c 94p per share. This figure includes £30m of intangible fixed assets, of which we estimate around three-quarters related to Clarke & Clarke (acquired in October 2016); excluding some capitalised software costs, only c £6m therefore concerns the existing Brands portfolio carrying value, which generated c 80% of FY19 revenue. So, in acknowledging a c 14% discount in Walker Greenbank's share price currently to the last published NAV, we suggest that the NAV itself understates the value of its main Brands on the company's balance sheet.

No true peers: as a supplier of branded fabrics and wallpaper, Colefax Group is the closest UK quoted comparator (although there are significant differentiators, not least a larger US/lower UK revenue split, no manufacturing and shareholder structure), which trades on a c 30% P/E premium and lower EV/EBITDA, we believe. Looking at other adjacent companies, Exhibit 5 also includes flooring businesses Headlam (distributor) and Victoria (hybrid manufacturer/distributor). Other quoted product companies with RMI exposure tend to be oriented to building materials and/or more mid/mass-market products. We have also included home furnishings retailer Dunelm Group. Walker Greenbank trades at the bottom end of the P/E range versus these three selected companies.

Exhibit 5: Selected UK quoted home furnishings and apparel suppliers

Company	Year End	Price p	Market Cap (£m)	P/E (x) FY1	P/E (x) FY2	EV/EBITDA (x) FY1	EV/EBITDA (x) FY2	Dividend yield (%) FY1
Colefax Group PLC	Apr	430	39	11.3	11.2	3.7	4.0	1.3
Headlam Group PLC	Dec	468	397	12.3	11.7	7.7	7.3	5.4
Victoria PLC	Mar	398	499	10.0	9.0	7.1	6.5	0.0
Dunelm Group PLC	Jun	1024	2071	19.5	18.6	11.6	11.6	3.4
Burberry Group PLC	Mar	2100	8587	24.0	21.6	13.2	11.9	2.1
Superdry PLC	Apr	504	414	12.6	10.5	4.6	4.0	2.6

Source: Refinitiv data, consensus earnings. Note: Prices as at 6 December 2019.

Apparel insight? Walker Greenbank has limited exposure to apparel markets currently (and historically only through licence agreements). For interest, we looked at ratings for the internationally known, quoted premium brands Burberry and Superdry. Divergent valuations (consensus P/Es above 20x and EV/EBITDA in low double digits for Burberry versus low double digit P/Es and EV/EBITDA of 4-5x for Superdry) perhaps do illustrate that the market can attach widely different valuations to brand owners that are in or out of favour.

[1] We deduct annual pension deficit cash recovery payments of c £2m from historic and our expected EBITDA as the denominator in this calculation, as we consider it to be inaccessible in managing group operations.

Financials

With management expectations and guidance unchanged for the current year, our headline estimates were not materially altered following the H120 results announcement and now incorporate IFRS 16 effects for the first time. Earnings dipped in FY19 and, on our estimates, are expected to trough in the current year c 40% below FY18 levels. On a company-defined basis (ie adding back P&L LTIP costs), we project a gradual earnings recovery from FY21 onwards. The refreshed strategic approach is to be implemented gradually over the next two years or so and no new financial goals have been revealed at this stage. Hence the nature of earnings and cash flow development could vary from our projections depending on actual strategic steps taken, eg there could be greater P&L investment through Brand marketing and/or overseas presence with an associated uplift in revenue growth. We will continue to refine our model as the strategy unfolds.

P&L: product revenues are chiefly generated in the UK (c 57%), US (16%) and northern European countries (12%). Over our three-year estimate horizon, we expect UK Brands sales to remain below FY19 levels but show a modest pick-up from FY20 lows, International to show steady underlying growth and broadly match domestic sales by FY22 with a similar geographic profile for Manufacturing third-party sales also. (Licensing, reported under Brands, should see growth in core income, after stripping out an exceptional one-off apparel deal in FY19.) The net result of these top-line drivers is a three-year revenue CAGR in the 1–2% range and we have assumed a flat 63.5% gross margin (in line with H120, raised partly by accounting changes). After the step down in earnings in our existing FY20 estimates (partly current UK market conditions, partly the exceptional FY19 licence effect referenced above), we expect EPS to increase by 4–5% pa in the following two years. DPS should follow a similar pattern, given guidance for a 30% payout ratio.

Cash flow: from the end-H120 £0.9m positive net funds position, we anticipate further cash accretion, building to £5-6m by the end of FY22 (excluding IFRS 16 leases). This incorporates a small working capital absorption when sales growth returns – though no further inventory investment is anticipated by management – and c £3m pa capex, modestly below the equivalent depreciation/amortisation charge. With respect to non-trading items, we have factored in a 5% annual uplift in pension cash contributions (from c £2m in FY19). As referenced earlier, IFRS 16 has no net impact on our cash flow projections but does now distinguish between the asset depreciation and financing components of leases and reports them separately. After the above effects, we expect to see underlying annual free cash flows in the £3–4m range, netting down to c £1–2m group cash inflow after IFRS 16 effects in each of our estimate years. In the near term, we expect the strategic focus to be on developing existing brands but, having added to the portfolio in the past (most recently through the Clarke & Clarke acquisition in FY17), growth through M&A may be revisited at some point. As stated in our H120 results review, Walker Greenbank's banking facilities extend to 2024.

Balance sheet: at the end of H120, group net assets stood at c £67m. Just under half of this related to intangibles (c £16m goodwill, c £14m other, including brands, design archives, customer relationships) and Clarke & Clarke represents a substantial proportion of the total. Owned tangible fixed assets account for a further c £15m of long-term assets. (IFRS 16 had a marginally positive impact on group net assets.) Within working capital, trade creditors have historically tracked just above their trade debtor equivalents, while inventory (at 200+ days, dominated by finished goods, compared to annual COGS) looks optically on the high side. Manufacturing process efficiency and the need to service international markets undoubtedly influence this position. Lastly, we should mention retirement benefit obligations with a balance sheet deficit of £5.2m at the end of H120. This was down from £9.7m six months earlier (driven by net actuarial gains) at which time the present value of gross scheme obligations was c £77m.

Exhibit 6: Financial summary

£'ms	2013	2014	2015	2016	2017	2018	2018R	2019	2020e	2021e	2022e
January y/e	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS											
Revenue	75.7	78.4	83.4	87.8	92.4	108.8	112.2	113.3	109.8	112.8	115.5
Cost of Sales	(30.2)	(30.3)	(32.7)	(35.9)	(36.2)	(43.3)	(44.0)	(45.3)	(40.1)	(41.2)	(42.1)
Gross Profit	45.5	48.1	50.7	52.0	56.2	65.5	68.2	68.0	69.7	71.7	73.3
EBITDA (pre IFRS16)	8.6	9.7	10.7	11.8	13.4	15.5	15.7	12.9	11.6	12.0	12.2
Op Profit (before GW, except. & LTIP)	6.6	7.5	8.3	9.1	10.6	12.4	12.6	9.4	7.9	8.3	8.3
Op Profit (before GW and except.) – rptd	5.8	6.5	7.3	8.2	9.8	12.0	12.2	10.0	7.9	7.7	7.7
Net Interest	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.3)	(0.3)	(0.3)	(0.5)	(0.5)	(0.4)
Intangible Amort - acquired	0	0	0	0	(0.3)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Pension net finance charge	(0.7)	(0.9)	(0.8)	(0.7)	(0.5)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
Exceptionals	0	0	0	0	(1.8)	2.3	2.3	(2.2)	(1.0)	0.0	0.0
Other	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)	6.4	7.3	8.1	8.9	10.4	12.1	12.3	9.1	7.4	7.8	7.9
Profit Before Tax (statutory)	4.9	5.5	6.3	7.3	7.0	12.8	13.0	6.3	5.2	6.0	6.1
Tax	(1.0)	(0.5)	(1.2)	(1.5)	(1.6)	(1.0)	(1.1)	(1.2)	(1.3)	(1.4)	(1.4)
Profit After Tax (norm)	5.4	6.6	6.9	7.5	8.6	11.1	10.0	7.3	6.1	6.4	6.5
Profit After Tax (statutory)	4.0	5.0	5.1	5.9	5.4	11.8	11.9	5.1	3.9	4.6	4.7
Average Number of Shares Outstanding (m)	57.5	58.5	59.3	60.0	62.7	70.4	70.4	71.0	71.0	71.0	71.0
EPS - normalised (p) FD	9.4	10.7	11.2	11.6	12.9	13.9	14.1	10.2	8.3	9.1	9.2
EPS - statutory (p)	6.9	8.6	8.6	9.8	8.6	16.7	16.9	7.2	5.5	6.5	6.6
Dividend per share (p)	1.5	1.9	2.3	2.9	3.6	4.4	4.4	3.2	2.5	2.7	2.8
Gross Margin (%)	60.1	61.3	60.8	59.2	60.8	60.2	60.8	60.0	63.5	63.5	63.5
EBITDA Margin (%)	11.4	12.4	12.8	13.4	14.6	14.2	14.0	11.4	10.6	10.7	10.6
Op Margin (before GW and except.) (%)	7.7	8.3	8.8	9.3	10.7	11.0	10.9	8.8	7.2	6.8	6.7
BALANCE SHEET											
Fixed Assets	18.5	21.1	21.5	18.9	47.5	47.7	47.7	46.0	51.8	47.2	42.6
Intangible Assets	6.7	7.3	7.2	7.1	31.6	31.8	31.8	30.8	29.6	28.4	27.2
Tangible Assets	9.8	11.7	12.7	11.7	15.8	16.0	16.0	15.2	22.2	18.8	15.4
Investments	2.0	2.2	1.6	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current Assets	32.6	35.3	37.1	40.3	51.3	51.9	52.1	49.3	49.8	53.4	56.9
Stocks	16.8	18.4	22.0	18.1	30.3	29.4	29.5	28.0	28.5	29.3	30.0
Debtors	12.8	13.9	14.1	19.3	19.5	21.2	21.3	18.9	18.0	18.8	19.5
Cash	2.9	2.8	1.0	2.9	1.5	1.3	1.3	2.4	3.3	5.3	7.3
Other	0.1	0.2	0.0	0.0							
Current Liabilities	(17.3)	(19.4)	(20.7)	(19.4)	(34.8)	(28.9)	(28.9)	(23.8)	(25.5)	(26.8)	(26.5)
Creditors	(16.9)	(19.0)	(20.3)	(19.0)	(28.0)	(22.4)	(22.4)	(21.8)	(24.0)	(25.2)	(25.0)
Short term borrowings	(0.4)	(0.4)	(0.4)	(0.4)	(6.8)	(6.6)	(6.6)	(2.0)	(1.5)	(1.5)	(1.5)
Long Term Liabilities	(9.6)	(10.2)	(10.9)	(4.5)	(12.7)	(9.1)	(9.1)	(10.6)	(10.2)	(5.2)	(1.5)
Long term borrowings	(1.4)	(0.9)	(0.6)	(0.2)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	(8.2)	(9.2)	(10.4)	(4.3)	(12.7)	(9.1)	(9.1)	(10.6)	(10.2)	(5.2)	(1.5)
Net Assets	24.2	26.9	26.9	35.3	51.3	61.6	61.8	60.9	65.9	68.7	71.4
CASH FLOW											
Operating Cash Flow	6.0	6.2	3.5	7.1	12.4	7.0	7.0	12.6	10.8	11.2	11.3
Net Interest	(0.2)	(0.2)	(0.2)	(0.1)	(0.2)	(0.2)	(0.2)	(0.3)	(0.5)	(0.4)	(0.4)
Tax	(0.0)	(0.0)	(0.0)	(0.6)	(2.3)	(2.2)	(2.2)	(0.8)	(1.3)	(1.4)	(1.4)
Capex	(3.1)	(4.7)	(3.2)	(2.5)	(6.7)	(3.5)	(3.5)	(2.8)	(3.0)	(3.0)	(3.0)
Acquisitions/disposals	0.0	0.0	0.0	0.0	(27.1)	0.0	0.0	0.0	0.0	0.0	0.0
Financing	(0.1)	(0.0)	(0.4)	(0.1)	18.3	1.8	1.8	0.0	0.0	0.0	0.0
Dividends	(0.7)	(0.9)	(1.1)	(1.4)	(1.8)	(2.7)	(2.7)	(3.1)	(2.2)	(1.8)	(1.9)
Net Cash Flow	1.8	0.3	(1.5)	2.3	(7.4)	0.1	0.1	5.7	3.9	4.6	4.6
Opening net debt/(cash)	0.7	(1.2)	(1.5)	(0.0)	(2.3)	5.3	5.3	5.3	(0.4)	(1.8)	(3.8)
Net finance leases	0.0	0.0	0.0	0.0	(0.0)	0.0	0.0	0.0	(2.6)	(2.6)	(2.6)
Other	0.0	0.0	0.0	0.0	(0.2)	(0.1)	(0.1)	0.0	0.1	0.0	0.0
Closing net debt/(cash)	(1.2)	(1.5)	(0.0)	(2.3)	5.3	5.3	5.3	(0.4)	(1.8)	(3.8)	(5.8)
Lease finance (IFRS16)									7.3	4.4	1.9

Source: Walker Greenbank, Edison Investment Research. Note: 2018 results restated for IFRS 15 'Revenue from Contracts with Customers'; the primary P&L effects were to reclassify some marketing materials/services as net other income and carriage recoveries to revenue and, as they were previously netted out of distribution costs, increase this cost line. From FY20 onwards (ie the three estimate years, figures are presented on an IFRS 16 basis).

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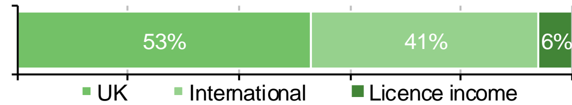
Revenue by geography (FY19)



Management team

Chief executive: Lisa Montague

Experienced luxury goods executive who became CEO in April 2019. Previous roles in UK and international brand-based businesses with manufacturing and multi-channel distribution at Loewe (part of LVMH), Aspinal of London and Mulberry Group.

Chief financial officer: Mike Gant

Chartered management accountant, with an MBA from Nottingham Business School, who joined the board in 2014. He has brought a breadth of international, financial and brand experience from previous roles with Bass, Marstons, Geest, Constellation Brands and Britvic.

Chair: Dianne Thompson

Chairman since April 2019, having joined as a NED two months earlier. Current NED at Next plc. Previously CEO of Camelot Group (2000–14) with other management experience at Signet Group, Sandvik and ICI Paints.

Principal shareholders	(%)
Octopus Investments Limited	12.0
Schroders	8.1
Fidelity Worldwide Investments	6.2
Ennismore Fund Mgt	5.6
Investec Group	5.3
Revera Asset Mgt	4.4
Killik & Co	4.3
Charles Stanley Group	4.3

Companies named in this report

Burberry Group, Colefax Group, Dunelm Group, Headlam Group, Victoria plc, Superdry

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