International Greetings

Full year results

The whole package

Personal & household goods

International Greetings (IGR) has delivered results a little ahead of market expectations despite the drags of currency translation and bad weather in the US in Q114. The investments made in manufacturing efficiency should now start to show in margins. Alongside reduced interest costs and a lower tax charge, this should drive earnings in spite of the lack of growth in underlying markets. The improved balance sheet gives IGR the flexibility to make further bolt-on acquisitions without compromising commitments on leverage. The rating, while improved, remains at a substantial discount.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/13	225.2	7.8	8.7	0.0	8.6	N/A
03/14	224.5	8.1	9.0	0.0	8.3	N/A
03/15e	222.4	8.4	9.3	0.0	8.1	N/A
03/16e	228.1	9.5	11.0	1.0	6.8	1.3

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Best-in-class manufacturing

The delivery of the Welsh project gives IGR state-of-the-art, efficient manufacturing compliant with demanding clients' environmental requirements. With high-volume, low-ticket items differentiation is increasingly important, as well as buoying gross margin. With earlier investment in China and the Netherlands, only the smaller US manufacturing facilities remain as a possible further upgrade project. Benefits from the FY14 programme will be felt in full in FY16, when we expect returns to lift the profits off the plateau without the push of top-line growth. Further out, there will be limited potential for more overhead reductions and growth will more likely stem from increased product categories, new sales channels and geographic territories.

Currency limits top-line progress

Adverse currency movements, particularly in the US$ and AU$, have limited the scope for top-line progress in the current financial year and our forecasts have been adjusted accordingly. There is some natural hedge with elements of interest and tax being in US dollars, along with an element of costs. Net debt reduced by more than we had originally expected, but some of this was down to the timing of payments. Given the recent bolt-on acquisition of Enper in The Netherlands for €1.9m, we would expect that next step change improvement will be in FY16.

Valuation: Still plenty to go for

The share price has more than doubled over the last year, having retreated on the news of the Welsh investment programme delaying the debt reduction. As the project moved towards completion, both on time and on budget, the benefits have become more obvious and debt concerns have receded. However, the share price still stands at a discount to its peer group, its DCF-derived valuation and the group's underlying NAV. These measures justify a valuation range of 92p to 105p, over 20% higher than the current level. With the full financial benefits of the capex likely to be reflected in FY16 figures, closure of the valuation gap may be gradual.

2 July 2014

Price	**75p**
Market cap	**£43m**

Net debt (£m) at FY14	36.9
Shares in issue	57.9m
Free float	50.4%
Code	IGR
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(1.3)	3.5	127.3
Rel (local)	(0.3)	2.1	109.0
52-week high/low		82.5p	29.0p

Business description

International Greetings 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	15 September 2014
Half year results	3 December 2014

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International Greetings is a research client of Edison Investment Research Limited

Investment summary

Company description: Social stationery supplier

IGR is a leading global supplier of social expressions stationery and gift packaging, with gift wrap the biggest component. Its activities cover the supply chain from design, marketing, manufacture or sourcing and sale of products for both the Christmas and everyday markets, encompassing trade/generic and customer own-brand. Around 15% of product bears character or other licensing. The UK is the core manufacturing base of the group, but it has other manufacturing facilities in China, the Netherlands and the US, with the UK, US, Australia and other European countries being important trading areas. The group has moved well beyond the stage of repairing the business from the legacy of a balance sheet overburdened by an earlier buy-and-build strategy, with the debt considerably reduced. The next phase of debt reduction has been deferred by the substantial investment programme in upgrading the manufacturing facilities, with the full support of the group's banks. Markets are and will remain highly competitive, so optimising manufacturing efficiency while providing exemplary customer service are prerequisites to running a profitable business. Top-line growth is more dependent on increasing the addressable market.

Valuation: Discount to peers, DCF and assets

We have looked at the value of the group on three bases and all suggest a higher valuation than that currently accorded by the market. We can justify a valuation range of 92-105p, implying a minimum upside potential of over 20% from current levels. With the negative currency impact on the current year financial outcome and the full benefits of the investment programme likely to be in FY16, it may be that the closure of the valuation gap will be a gradual process rather than a short-term correction.

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. Underlying consumer demand is a constant issue and the marked retrenchment of US GDP of 2.9% in Q114 (primarily reflecting the abnormally severe weather) was unhelpful. There is little growth in underlying markets, but longstanding trading relationships help visibility. Small acquisitions, such as that of Enper, can extend the customer reach. Raw material, freight and energy costs are key inputs. In a highly competitive and international market, deflation will remain an issue at the commodity end of the scale. This indicates the necessity for optimising manufacturing efficiency and procurement, while protecting market share through ensuring exemplary customer service and innovative design. While growth is targeted at everyday product, Christmas product is of key importance.

Financials: Breaking out of the plateau

Our forecasts are adjusted for currency and mix, with new numbers for FY16 that demonstrate the return on investment in the manufacturing base kicking in more strongly. With the reducing capex requirement, we also expect the balance sheet to make a further step improvement, paving the way for the company to pay dividends to ordinary shareholders.

Exhibit 1: Summary revisions to forecasts

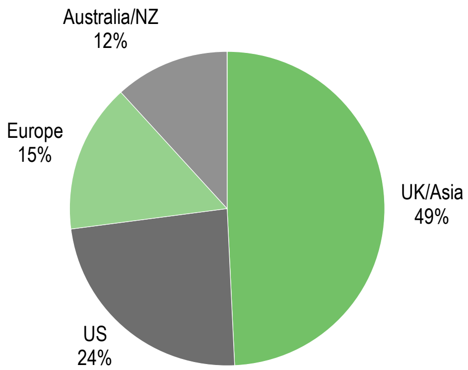
Year end	EPS (p)			PBT (£m)			EBITDA (£m)		
March	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2014	8.7	9.0	+3	7.8	8.1	+4	15.1	16.3	+8
2015e	9.9	9.3	-6	8.9	8.4	-6	15.8	16.6	+5
2016e	-	11.0	N/A	-	9.5	N/A	-	17.7	N/A

Source: International Greetings, Edison Investment Research. Note: For 2014, 'new' = actual.

Company description: The whole package

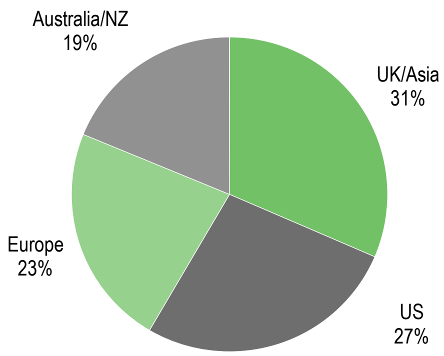
IGR is a global supplier of social stationery across a range of categories, principally gift packaging (which constitutes the bulk of sales), greetings and stationery (70% of group revenues) and creative play products (30%). Its core strengths are in design, manufacturing and sourcing, giving its customers (multiple retailers) a one-stop shop option. Over recent years, the focus has been on growing volumes with the value and discount sectors, principally in the UK and US, where the group's increasing operational efficiency can be leveraged to best effect. With a range of products on offer, the group can supply on a 'good, better, best' basis. It has a broad range of customers, the largest of which represents 8% of sales. IGR has manufacturing facilities in the UK, China, the Netherlands and the US and its major trading geographies are shown below. The Asian figures are reported within a larger UK/Asian category as this covers procurement activities, which it would be misleading to separate out. By destination, the UK remains the largest market at 33% of revenues, closely followed by the US at 31%, Europe at 21%, Australia/New Zealand at 12% and the rest of the World at 3%. On average, the group employs over 1,800 people, principally in China, the UK (the two largest manufacturing geographies), the Netherlands and the US.

Exhibit 2: Revenue by geography FY14



Source: International Greetings

Exhibit 3: Operating profit by geography FY14



Source: International Greetings

Social expressions stationery supplier

IGR originated as a gift-wrap printing company established by Anders Hedlund (whose family interests still account for 41% of the group's equity) in Wales in the late 1970s. By the 1990s, the group had expanded to include other seasonally related products, selling predominantly to UK wholesalers. The strategy then shifted toward supplying the major UK retailers, as they moved to an aggressive market share grab of the national purse. The group also made its first major overseas move, buying a US-based manufacturer of ribbons and bows. The group floated on AIM in 1996, at which point sales were around 90% in the UK, 90% in buyers' own-brand and 90% oriented to the Christmas season, with a buy-and-build strategy.

A number of acquisitions expanded the group's sales base, but it lacked the internal disciplines and structures necessary to support the larger top-line and the weaknesses were exposed when markets softened in 2007. The balance sheet had become significantly overstrained, with gearing reaching 168% at end FY09. A new finance director 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). Since taking up the role, Paul has focused on instilling commercial disciplines on a group that had been expanded somewhat opportunistically. He has many years of experience in the industry, having joined 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 has seen the gearing situation first brought under control then actively managed down. The result is that the group has strong support from its banking network and has been able to make operational decisions (including the investment programme) that have been in the interests of building the group’s future rather than simply focusing on paying back the debt, which had reduced to a net figure of £36.9m at the year end just passed.

Licensed product across the group makes up around 15% of group revenues, but has recently been concentrated down to a narrower and more focused portfolio, principally in perennial properties. This reflects the shift in attitudes within the retail segment, which has become increasingly risk averse.

Global supplier in a fragmented market

IGR is now a major global supplier of social stationery, selling to over 80 countries, with over half of group revenues earned outside the UK. It operates within a highly fragmented market and has built a more even balance of business between everyday and Christmas sales, and between manufactured and sourced product (FY14: 56% outsourced, 44% manufactured). The group has been undertaking a significant investment programme, first in China where the factory was relocated two years ago to provide both more capacity and greater efficiency, with a higher degree of automation, followed by the upgrading of the manufacturing facilities in Hoomark in The Netherlands in H113. The Hoomark gift-wrap printing presses were upgraded to high-speed, high-definition, double-width, flexographic presses using water-based inks, with considerably faster run times, quicker turnaround between runs and greatly reduced wastage – a precursor to the similar exercise recently carried out in Wales, providing a useful route map for the larger project.

The management team has handled these substantial projects on time and on budget, with the revamped Welsh facility recently reopened by HM The Queen. IGR holds Royal Warrants for crackers and now gift wrap, a valuable marketing advantage internationally, particularly in the US.

Good, better, best

IGR supplies a wide product range within the social expressions stationery and creative play SKUs, predominantly low ticket items that give some degree of recession-resilience. It has generic, licensed and customer-bespoke items, designed by its studio in Wales and manufactured or sourced to web-disseminated specification, enabling the group to produce wherever it makes economic sense to do so. It has a large customer base, with a strong presence in the value sector, in particular the dollar stores in North America, as a result of a proactive sales focus over the last few years. However, it also has significant upscale business, some of which is within the well-known **Tom Smith** branding. The group has long-term relationships, maintained by delivering well-designed products and paying close attention to customer service as well as to product quality. The majority of the customer base has traded with the group for more than 10 years. For many customers, the integrity and environmental impact of the supply chain has become a key issue. By switching away from solvent-based printing to water-based inks and by paying close attention to its own supply chain, particularly for outsourced product, IGR is pushing itself up the preferred supplier lists.

The US customer base includes Costco, Walmart, Dollar Tree and Dollar General; the UK customer base includes all the major grocers, WH Smith, Wilkinson and Poundland; and in Europe IKEA, Auchan, Aldi, Netto and Carrefour, with IGR products sold in over 100k outlets worldwide.

Delivering earnings growth from improving quality of business

The management strategy is designed to deliver increasing shareholder value, specifically through growth in earnings per share, through:

- Investing in efficient manufacturing – evidenced by the spend in upgrading/improving facilities in China, the Netherlands, Wales and the US. With the bulk of this programme complete, there are fewer opportunities in future years for overhead reduction.
- Diversifying by geography, with further penetration of the substantial US market key to achieving top-line growth.
- Broadening the product range across the full social expressions category, which gives customers the 'easy' ordering option, but which is crucially dependent on having a mutually trusting relationship. However, this is not just a function of having the relevant product lines, but having good design that resonates with the ultimate consumers, continuing innovation to maintain consumer interest (and to manage input costs through product re-engineering) and scrupulous attention to customer service. Partyware is a possible adjacent product category, often with the same buyers as the existing range.
- Bolt-on and/or infill acquisitions, such as that of Enper, with complementary customer bases.
- Increasing the proportion of everyday product, to reduce seasonality and ease working capital surges, as well as managing the physical implications of warehousing and freight usage.
- Growing branded product, principally IGR brands, but also licensed brands where satisfactory terms can be achieved. This can de-risk the stock position and also has margin advantages.
- Developing new channels to market.
- Driving down debt to give greater management flexibility.

Investment continues

With the positive handling of the debt position, the group has been able to be more proactive about its growth strategy. Management has also been able to take decisions in the longer-term interests of the group, such as the investment that has been made in upgrading the manufacturing facilities. While this has delayed the pay-down of the outstanding debt, the returns from improved efficiency are already helping margins, as well as giving greater environmental reassurance to the customer base. The group's bankers have been very supportive of the investment programme and terms have been adjusted to the group's advantage (a profile of the debt is given in Exhibit 7, page 10).

The US manufacturing facility is now the only one that has not benefited from a significant investment programme and the business case for doing so is currently being examined. Were it to proceed, the likely cost would be in the region of $3-4m, with payback within three years.

The group recently announced that it had acquired the trade and assets of Enper, a manufacturer of gift wrap in The Netherlands, for €1.9m. This was to some extent an opportunistic move, with Enper having around €5m of revenues and finding itself struggling to maintain both sales and margin. This gives IGR a good opportunity to maximise the synergies, albeit that their realisation is affected by the inherent seasonality of the business. Management has indicated cash payback in three to four years.

A large, flat and fragmented market

There are limited statistics available on the specific market segments in which IGR is involved. According to the latest Marketline report, the global wrapping and paper packaging market was worth US$233.4bn in 2012, having grown at 8.1% CAGR between 2008 and 2012. Volumes actually declined marginally over that period, with growth coming through pricing and adding value.

The vast majority of the market is in categories other than gift wrap, particularly food and beverage packaging. A similar level of growth is expected from 2012-17, building the overall value to US$348.0bn.

The greeting card market is more easily defined. The National Greetings Card Association (US) values the market at US$7-8bn; 6.5bn cards at an average price of c US$1.15. Everyday cards make up 67%, with Christmas the largest 'occasion' (25%). In the UK, the Greetings Card Association's 2013 report, covering value and volume figures for single cards on the main sending occasions in 2012, sizes the market at £1.4bn (flat on 2011 and 2010), with everyday cards at a value of £1.1bn and an average retail price of £1.42. On average, people in the UK send 31 cards per year, 85% of which are purchased by women. Wholesale value is typically around 40% of the retail value.

The market segment in which IGR participates is grouped together as 'social expressions' stationery, which it estimates to have a global value around £3bn, giving it around 7% market share. The market is characterised by a large number of predominately small players, together with a handful of more substantial companies such as Hallmark and American Greetings, making for an intensively competitive trading environment. There are estimated to be around 3,000 greeting card publishers in the US alone. While design is the most obvious distinction (and what draws most participants to the industry in the first place), success or failure is more likely to depend on a supplier's commerciality – customer service, payment terms, and other concessions to the retail customer market such as marketing support or category management under long-term agreements.

Online is emerging mostly as an alternative route to market, although there are online-only suppliers such as Moonpig (taken over by PE-owned online photo specialist Photobox in July 2011 for £120m; 3.1x sales). WHSmith brand Funky Pigeon, bought in 2010, is reported to be continuing to perform well and is being used both as a limited retail format and as an online brand. The key attractions from a customer perspective are convenience and the ability to personalise, and this has contributed to the online segment growing to 3-4% of the greeting card market.

Cost is the key driver to delivering acceptable returns in commoditised markets, which means good sourcing and continuing product engineering, both areas in which IGR has underlying strengths.

Sensitivities

Currency. The group's larger currency risk is on purchases, with the main exposure being to the US dollar and the Chinese renminbi. On sales, key currencies are sterling, the US dollar and the euro, and it hedges against expected future sales for which there are firm commitments. With around half revenues generated outside the UK, there is a translation exposure, which can be exacerbated or favourably influenced by currency movements around peak seasonality.

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 have assumed little fundamental growth in markets. Given that people are unlikely to stop wanting to give each other presents, having attractive design, widely available and at the right price is crucial to maximising market share. High service standards need to be (at least) maintained to protect share in a competitive marketplace, while innovation 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 an especial issue. The largest customer on a group-wide basis accounts for around 8% of group sales, a number that will be diluted as exposure to the dollar store sector in the US widens the trading base further. Small acquisitions, such as that of Enper, can broaden the customer reach. Online competition has been around for a few years but has had a limited impact on the market to date, taking an estimated 4% share in developed markets. As described elsewhere, the market is heavily populated and highly competitive.

Licence management. IGR has longstanding formal relationships with key brand owners including Disney, historically an important entry ticket to obtaining other key licences. The group has recently been more discerning in which licences it takes and favours the perennial properties. However, it has agreed licences for Despicable Me and for Frozen, which have been very successful more recent franchises. Rates vary by player and generally have minimum guarantees attached.

Seasonality. While there are other smaller peaks during the year, Christmas is the group's key selling period and a poor Christmas would have a notable impact in the financial outturn. As described in the financials section, working capital tends to climb from July, peaking in September/October. The group's corporate intention is to work at increasing the proportion of everyday product to partially offset the effect. The benefit of having substantial Christmas business is the visibility it affords, 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.

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 IGR. We have therefore looked at it from three perspectives: in comparison with the two of its peers for which numbers are available, on a DCF basis and on the value of the underlying assets. None of these methods provides a definitive valuation, but in combination they give a context for the pricing of the stock.

Narrow international peer group

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

- Hallmark Cards, a privately owned US company with 2013 revenues of $3.9bn (down 2% on each of the two prior years). The decrease reflected the North American comparable business retreating 4%, but with growth in the Crayola branded product. Hallmark has been rationalising its manufacturing base and has gone from three to two production facilities in the US. It has also announced that it intends to close its greeting card and gift-wrap manufacturing in Bradford, UK, transferring the business to other printers, including Hallmark's own specialty production centre in Leavenworth, Kansas.
- American Greetings Corporation, which was quoted on NYSE until being taken private by the Weiss family in August 2013 after a protracted battle. The group had revenues of $2.0bn in 2013, up 5.4% on prior, growth that primarily reflected the full year benefit of its purchase of Clinton Cards in the UK. Its last 10-k refers to higher sales of greetings cards but higher sales of gift packaging and party goods. Due to the Weiss family's position, the take out price of around 0.5x EV/TTM revenues and just under 7x EV/2013 EBITDA is not necessarily a good proxy for the inherent value of the business.
- CSS Industries, again a US firm but still quoted and on a smaller scale, with historic sales of $320m, down 12% year-on-year. There are no publicly available forecasts for CSS.

IGR's pricing is at a small discount to CSS on EV/sales, larger on P/E, but at a larger discount to the American Greetings take-out price, which had little if anything in the way of control premium. Using the average of CSS and American Greetings' take-out price would give an EV/sales figure of 0.47x and EV/EBITDA of 6.0x, implying a share price for IGR of around 105p.

Exhibit 4: IGR and CSS summary valuation metrics

	Price	Market cap	EV/sales	EV/EBITDA	P/E	P/E 1	P/E 2	P/CF
IGR	76p	£44m	0.36	5.0	8.4	8.1	6.9	31.6
CSS	$25.86	$240m	0.44	5.1	13.1			4.0
American Greetings	$19.00		0.49	6.9				
Average CSS/AGR			0.47	6.0	13.1			4.0

Source: CSS accounts, Edison Investment Research. Note: AGR at take-out price. Prices as at 29 June 2014.

DCF

Running a DCF has some relevance in industries that are long established and still growing but at a modest underlying rate, but comes with usual provisos regarding the sensitivity of the model to the underlying assumptions. Taking a terminal growth rate of 1%, the market is currently attributing a very high WACC of 15.6%. A 1% terminal growth rate and a 13% WACC give an equivalent share price of 103p, 36% higher than the current market valuation and in line with the value derived from the peer comparison.

Exhibit 5: DCF under varying terminal growth and WACC assumptions

		Terminal growth rate				
		-2%	-1%	0%	1%	2%
WACC	16%	68.6	69.5	70.6	71.9	73.3
	15%	76.4	77.6	79.0	80.6	82.5
	14%	85.3	86.9	88.7	90.7	93.1
	13%	95.5	97.5	99.8	102.6	105.8
	12%	107.3	109.9	112.9	116.5	120.8
	11%	121.0	124.4	128.5	133.3	139.3
	10%	137.1	141.7	147.2	153.9	162.3
Break-even WACC		15.1%	15.3%	15.4%	15.6%	15.8%

Source: Edison Investment Research

Asset-based valuation

On the basis of the balance sheet as at the end of March 2014, the value of the net assets attributable to the owners of the parent company was worth 99p per share, or 92p after minorities.

We therefore can justify a valuation range of 92-105p, implying good upside potential of over 20%.

Financials

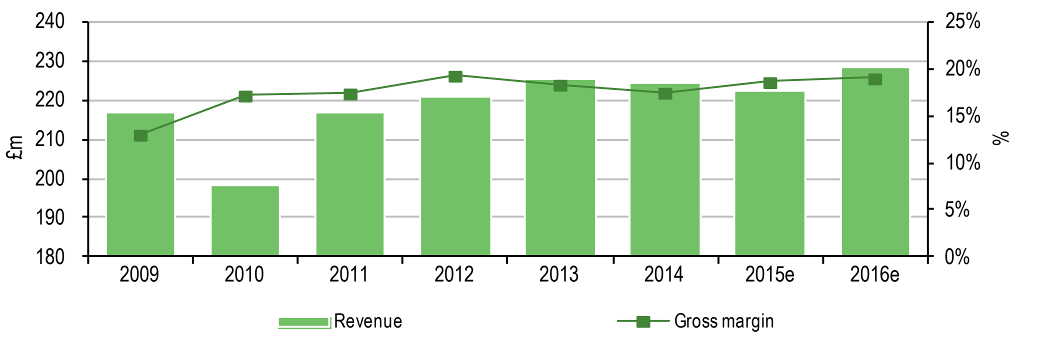
We have made some adjustments to our forecasts in light of the full year numbers, summarised above in Exhibit 1, page 2. The largest element of the adjustments reflects the movements in currency, with the impact particularly for US dollar earnings, where we are assuming an average rate for the year of US$1.70/£, against an average rate for FY14 of US$1.59/£, with the euro in at €1.25/£ (FY14: €1.19/£). This external change will make it very difficult for the revenue numbers to move ahead in the current year against the prior year, despite the additional revenue from Enper. We are now forecasting a slight reduction, which also reflects the disposal (to management) of the non-licensed segment of Alligator Books. The larger, licensed segment has been retained and will be developed. The disposal netted an immediate cash inflow of £0.6m, with a further opportunity of phased payments totalling up to £0.5m to be received by the end of January 2015.

There is little, if any, growth in the underlying markets, backed up by the available industry statistics quoted above. The key to growing the top line is therefore down to the twin strategies of increasing market share in existing product categories and extending into contiguous product areas. Our model assumes a little of the former, buoyed by the recent Enper acquisition, but, as yet, none of the latter.

The reduction in gross margin in the previous year reflected the lower contribution from the Australian JV, which had previously generated unsustainably high margins. Gross margin is also subject to variation according to how great a proportion of goods are shipped FOB. It may well be worth some sacrifice at the gross margin level to achieve an improved net margin, or at least reduce the exposure to variable freight rates. Sea freight rates, which have historically had an impact on profitability, have been comparatively stable against previous years.

Overall, we are expecting that the investments made in manufacturing efficiency should enable the gross margin to edge ahead. Internal targets are for gross margin to reach 20% by end FY16, but we have taken a slightly more cautious view. We are therefore looking at modest progress in FY15 on EBITDA of 2%, which comes through to a 4.5% increase at the pre-tax level and 3% at EPS after a slight upwards adjustment in the expected tax rate. The group still has unrecognised gross tax assets of £1.5m in the UK and US$10.6m in the US.

Exhibit 6: Revenue and gross margin record and projections



Source: International Greetings, Edison Investment Research

The group's internal targets point to 10% CAGR in fully diluted earnings per share over the period 2013-16. Our model currently slightly undershoots this, but is based on a relatively conservative scenario on the top line.

Exceptional items for FY14 totalled £2.3m, of which £1.5m was non-cash (accelerated depreciation and amortisation). Edison's model strips out the effect of the LTIP on our normalised earnings figure, equivalent to around £0.1m in FY14 but likely to run at around £0.4m for FY15 and FY16. We also adjust for the intangible amortisation in our definition, which is the key divergence from the company's own presentation of the figures.

Strong year for cash flow

The seasonality of the business affects the cash profile across the year, with around 30% of annual sales achieved in August and September. The emphasis over the last few years has been on increasing the proportion of everyday product in the mix, as well as attempts to persuade customers to order earlier to try to manage peak production and storage capacity. This is having some impact on evening out the peaks and troughs of working capital requirements across the year, but it is unrealistic to expect that the inherent seasonality in working capital requirement will change significantly.

Working capital decreased from £35.4m at end March 2013 to £32.3m, but this primarily reflects the translation effect of stock held in the overseas operations (£2.5m) and the underlying working capital position was therefore little changed on the year. Following a year when there had been a working capital outflow, the operational cash flow is obviously much stronger, explaining why the bulge in net capital expenditure has not led to a surge in the net indebtedness. The statutory definition of capital expenditure demanded by the auditors at £5.09m excludes the related finance leases of £3.24m. Netting the total off against the grant of £1.05m gives a more realistic capex figure for the year of £7.28m.

One-off factors (see below) mean that the cash flow will be less flattered in the current financial year. However, our model assumes that there is no further asset realisation of surplus property assets following the Welsh project. Part of the Hirwaun site in Wales is now subject to a five-year call option from a power company seeking planning permission to build a power station, for which it would pay £2.4m in consideration for premiums totalling £0.5m. Full realisation of the excess property portfolio has the potential to raise in excess of £5m.

Improving balance sheet

Net debt at the end of March is at the lowest point in the annual cycle and the amount owing followed a similar pattern through the year as the prior year, reflecting the naturally inherent cyclicality of the business. Earlier in the year, we had expected the group to end the year with a higher net debt figure due to the investment made in the Welsh manufacturing facilities. In fact, the year-end figure of £36.9m was slightly flattered by early receipt of the Welsh Development Agency grant towards the improvements, as well as some redundancy and decommissioning costs being pushed out to FY15. The final 10% of the project cost also falls into what is now the current financial year. This implies that the level of reduction in FY15 will be much less significant and our model derives a year-end figure of £36m, with a more meaningful paying down of debt in the following year to £28m by March 2016. The average level of debt across the year was around £68m, peaking at end October at just over £95m.

The capital funding arrangements of the Welsh project were obviously put in place following extensive negotiations with the group's bankers, which actually resulted in improvements in certain terms, as illustrated below.

Exhibit 7: Funding facilities as at June 2014

Lender	Due	Facility, £m	Margin	Margin in prior year	Covenant/notes
HSBC					
– Medium-term loan	2016	32	2.95% - 3.35%	2.95%-3.35% u/c	Interest cover; debt cover; cash flow cover; leverage
– Asset-backed lending	2016	36	2.05%	2.25%	
– HP agreement	2021	3	3.95% fixed	3.95% fixed	
– RCF and overdraft	Annual	6.5-21	2.65% - 3.0%	3.20% - 3.50%	Reduced max facility from £34m
Sun Trust					
– Asset-backed lending	2017	18	2.25%	2.50%	Debt service cover, extended from 2014 and increased from £16m
ING					
– Mortgage	2028	6	1.50%	1.5% u/c	Debt service cover
– Asset-backed lending	2017	8	1.50%	1.5%	Extended from 2014
– Finance Lease	2019	2	4.75% fixed	4.75%	
– Overdraft	Annual	2	2.00%	2.00%	
Westpac					
– Overdraft	Annual	6	0.85%	0.85%	Interest cover; capital ratio
Total		**119.5-134**			

Source: International Greetings

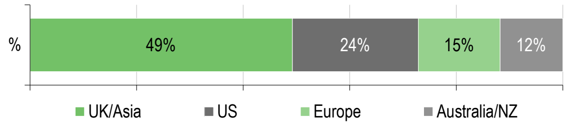
The stated target is to reduce the debt level to twice EBITDA. For the year just reported this figure was 2.3x (FY13: 2.8x). For FY15 and FY16, this would be 2.2x and 1.6x respectively based on our forecast model. Management has historically indicated that the payment of dividends to ordinary shareholders would be considered once this ratio went below two times. We are therefore now forecasting that a modest dividend is declared in respect of the financial year to March 2016.

Exhibit 8: Financial summary

£'000s	2012	2013	2014	2015e	2016e
Year end 31 March	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	220,755	225,211	224,462	222,362	228,099
Cost of Sales	(178,190)	(183,941)	(185,244)	(181,003)	(184,760)
Gross Profit	42,565	41,270	39,218	41,359	43,339
EBITDA	15,010	15,047	16,270	16,570	17,693
Operating Profit (before amort and except)	11,257	11,240	11,238	11,520	12,643
Intangible Amortisation	(534)	(494)	(576)	(576)	(576)
Exceptionals	(3,918)	(1,603)	(2,298)	(1,100)	0
Share-based payments	0	(22)	(82)	(400)	(400)
Operating Profit	6,805	9,121	8,282	9,444	11,667
Net Interest	(3,635)	(3,466)	(3,177)	(3,100)	(3,100)
Profit Before Tax (norm)	7,622	7,774	8,061	8,420	9,543
Profit Before Tax (FRS 3)	3,170	5,655	5,187	6,744	8,967
Tax	(1,753)	(1,601)	(1,459)	(1,787)	(2,242)
Profit After Tax (norm)	5,869	6,173	6,602	6,633	7,301
Profit After Tax (FRS 3)	1,417	4,054	3,728	4,957	6,725
Average Number of Shares Outstanding (m)	54.2	56.2	57.5	57.9	57.9
EPS - normalised (p)	8.2	9.3	9.3	9.6	11.3
EPS - normalised fully diluted (p)	7.6	8.7	9.0	9.3	11.0
EPS - (IFRS) (p)	0.3	6.0	5.2	7.4	10.5
Dividend per share (p)	0.0	0.0	0.0	0.0	1.0
Gross Margin (%)	19.3	18.3	17.5	18.6	19.0
EBITDA Margin (%)	6.8	6.7	7.2	7.5	7.8
Operating Margin (before GW and except.) (%)	5.1	5.0	5.0	5.2	5.5
BALANCE SHEET					
Fixed Assets	69,089	67,038	67,664	68,253	70,238
Intangible Assets	32,916	32,795	31,950	33,734	34,350
Tangible Assets	36,173	34,243	35,714	34,519	35,888
Investments	0	0	0	0	0
Current Assets	66,738	75,700	76,261	74,012	75,486
Stocks	42,628	50,114	48,460	48,007	50,476
Debtors	20,942	23,285	19,690	19,506	20,509
Cash	3,168	2,301	8,111	6,500	4,500
Other	0	0	0	0	0
Current Liabilities	(46,328)	(52,693)	(51,965)	(49,273)	(45,331)
Creditors	(34,985)	(39,273)	(39,139)	(38,773)	(38,831)
Short term borrowings	(11,343)	(13,420)	(12,826)	(10,500)	(6,500)
Long Term Liabilities	(36,951)	(33,473)	(34,799)	(36,356)	(32,356)
Long term borrowings	(33,679)	(31,019)	(32,232)	(32,000)	(28,000)
Other long term liabilities	(3,272)	(2,454)	(2,567)	(4,356)	(4,356)
Net Assets	52,548	56,572	57,161	56,637	68,037
CASH FLOW					
Operating Cash Flow	12,340	7,533	13,724	13,200	15,450
Net Interest	(3,491)	(3,285)	(3,221)	(3,100)	(3,100)
Tax	(1,131)	(937)	(60)	(1,623)	(2,014)
Capex	(3,764)	(1,705)	(5,291)	(3,500)	(3,500)
Acquisitions/disposals	(111)	0	140	(1,900)	0
Financing	146	159	1,225	(1,200)	(40)
Dividends	(918)	(968)	(1,014)	(750)	(791)
Net Cash Flow	3,071	797	5,503	1,127	6,004
Opening net debt/(cash)	44,599	41,854	42,138	36,947	36,000
HP finance leases initiated	49	(1,649)	296	0	0
Other	(375)	568	(608)	(180)	(4)
Closing net debt/(cash)	41,854	42,138	36,947	36,000	30,000

Source: Company accounts, Edison Investment Research

EDISON

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	

CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS 12-16e	9.7%	ROCE 15e	10.7%	Gearing 15e	63.6%	Litigation/regulatory	○
EPS 14-16e	10.6%	Avg ROCE 12-16e	10.5%	Interest cover 15e	3.7x	Pensions	○
EBITDA 12-16e	4.2%	ROE 15e	10.7%	CA/CL 15e	1.5x	Currency	◖
EBITDA 14-16e	4.3%	Gross margin 15e	18.6%	Stock days 15e	79	Stock overhang	◖
Sales 12-16e	0.8%	Operating margin 15e	5.2%	Debtor days 15e	32	Interest rates	◖
Sales 14-16e	0.8%	Gr mgn / Op mgn 15e	3.6x	Creditor days 15e	60	Oil/commodity prices	◖

Management team

CEO: Paul Fineman

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.

CFO: Anthony Lawrinson

Anthony joined the group in October 2011. His former roles included group FD of Reliance Security Group, CFO at O2 Airwave and group treasurer at O2 plc 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	40.69
Miton Group	16.25
Paul Fineman	7.62
A Scott	3.84

Companies named in this report

CSS (NYSE:CSS)