EDISON

International Greetings

Interim results

Playing its cards right

Personal & household goods

International Greetings (IGR) is one year into a three-year plan to grow profits, pay down debt and drive up earnings per share and is, to date, on track. H115 results were broadly in line, despite currency headwinds on the top line, with earnings already starting to benefit from the capital investment programme, reduced interest costs and a lower tax charge. Our FY15 and FY16 numbers are unchanged. Although net debt at the half year was up, our year-end forecast remains £36m, which is tantalisingly close to the 2x leverage level indicated as a prerequisite to paying a dividend.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/13	225.2	7.8	8.7	0.0	8.3	0.0
03/14	224.5	8.1	9.0	0.0	8.0	0.0
03/15e	222.4	8.4	9.3	0.0	7.7	0.0
03/16e	228.1	9.5	11.0	1.0	6.5	1.4

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

Global investment producing returns

The Chinese facility has produced 74m crackers in the 2014 season, well ahead of earlier productivity estimates. The investments in manufacturing in the Netherlands and, more recently, in Wales, are enabling efficiency gains that make producing to the exacting standards of retailers from Lidl to Waitrose – at competitive pricing – achievable. The market is polarising into three strands: Value, Mass and Upscale, and IGR is able to serve them all, with a strong design ethos and fully compliant manufacturing and sourcing helping to differentiate the offer. The interim report showed a particular uptick in performance from the licensed product (15% sales), with *Frozen* and *Despicable Me* both achieving good market traction. The overall market is unlikely to show much growth, but there is good potential for IGR to generate additional revenues from growing market share, particularly in the US.

Dividend creeps closer

While net debt crept up to £89.9m at the half year (H114: £84.8m), the cut-off date is at the peak ahead of the Christmas selling season and trade debtors reflect later call-off of stock than last year. The purchase of the assets of Dutch wrap manufacturer Enper (€1.9m) in H1 also pushed the total figure ahead. This profile makes us comfortable with maintaining our end-March forecast of £36m, which is 2.2x our forecast EBITDA. For FY15, the leverage reduces to 1.7x, below the 2.0x target level that management has indicated is needed to consider a dividend.

Valuation: Deep discount persists

The returns from the capital investment are set to come through more strongly from FY16, with underlying earnings per share set to grow well ahead, helped by a low tax charge. However, the share price still stands at a discount to its quoted peer (NYSE: CSS), its DCF-derived valuation and the group's underlying NAV. These measures justify a valuation range of 96p to 100p, well above the current level.

4 December 2014

Price	**72p**
Market cap	**£42m**

Net debt (£m) at Sept 2014	89.9
Shares in issue	57.9m
Free float	50.8%
Code	IGR
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	2.1	(1.4)	15.2
Rel (local)	(1.1)	0.8	11.9
52-week high/low		86p	59p

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 event

Trading update	End January 2015

Analysts

Fiona Orford-Williams +44 (0)20 3077 5739

Jane Anscombe +44 (0)20 3077 5740

media@edisongroup.com

Edison profile page

International Greetings is a research client of Edison Investment Research Limited

Interims: Gross margins down, PBT margins up

While on the face of the revenue account first-half revenues and gross margin are both down, the former is primarily due to currency, with further impact from difficult Australian markets (12% of sales), and the gross margin reflecting (geographic) mix. Adjusting for currency, sales edged ahead 0.3%. The setback in the Australian joint venture cost half a percent on gross margin after client bankruptcy (with no cash impact as trading terms had been significantly tightened) and sales were replaced with lower-margin business. The balance of the difference on gross margin was from increased FOB and trading with the major dollar stores in the US.

Tight control of costs and the impact of manufacturing efficiencies, particularly in the UK, meant that EBITDA margin increased slightly from 6.9% to 7% and the effect was stronger at the pre-tax level as the interest burden started to fall. The improved terms of the banking facility (outlined in our July Outlook) allow for more flexibility to utilise asset-backed lending at more advantageous rates.

China, Europe manufacturing strong

The Chinese manufacturing results have been ahead of expectations, with delivery of the Christmas peak volume in October/November ahead of budget. The ability to supply consistent quality product from factories that meet clients' increasingly exacting standards on environmental and ethical pre-requirements is an important differentiator. Added value and licensed product is also increasing in the mix. Wage inflation in China is running at around 15%, but there is more the group can do in terms of automation. Freight rates have been falling with capacity coming into the market.

UK & Asia overall (this category covers the procurement activities, which it would be misleading to separate out from UK revenues) had softer sales in the first half, although this partly reflects the disposal of the non-licensed segment of Alligator Books earlier in the year. Operating margins (pre management charges) moved ahead from 6.7% to 7.5% as the first investment benefits started to come through, with further progress pencilled in for FY16 with a full year of the Welsh manufacturing upgrade.

The European operations have gained from the earlier investment in manufacturing production, with first results from the purchase of the assets and customer lists of Enper in the first half. Business has been particularly strong with the major discount retailers as they take market share across Europe. Operating margins moved ahead sharply from 6.2% to 7.7%, with further incremental gains possible.

North America has greatest upside potential

Pushing market share in the US is key to achieving top-line growth for the group. Although the business has been functioning satisfactorily, and growing its top line, it has undoubtedly been affected by the illness and sad death of its CEO, Rich Eckman, in June. An appointment is expected shortly that should enable this business to resume its earlier momentum and rebuild and grow margins. The dollar majors continue to grow their market share and reach. IGR should be able to profit from their expansion, as well as that of Walmart, into Canada and Latin and South American markets.

Exhibit 1: 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	222,231	228,100
Cost of Sales	(178,190)	(183,941)	(185,244)	(183,563)	(187,042)
Gross Profit	42,565	41,270	39,218	38,668	41,058
EBITDA	15,010	15,047	16,270	16,470	17,593
Operating Profit (before amort and except)	11,257	11,240	11,238	11,420	12,543
Intangible Amortisation	(534)	(494)	(576)	(576)	(576)
Exceptionals	(3,918)	(1,603)	(2,298)	(1,400)	0
Share-based payments	0	(22)	(82)	(350)	(350)
Operating Profit	6,805	9,121	8,282	9,094	11,617
Net Interest	(3,635)	(3,466)	(3,177)	(3,000)	(3,000)
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	6,444	8,967
Tax	(1,753)	(1,601)	(1,459)	(1,708)	(2,242)
Profit After Tax (norm)	5,869	6,173	6,602	6,712	7,301
Profit After Tax (FRS 3)	1,417	4,054	3,728	4,736	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	7.1	10.5
Dividend per share (p)	0.0	0.0	0.0	0.0	1.0
Gross Margin (%)	19.3	18.3	17.5	17.4	18.0
EBITDA Margin (%)	6.8	6.7	7.2	7.4	7.7
Operating Margin (before GW and except.) (%)	5.1	5.0	5.0	5.1	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	74,985	76,551
Stocks	42,628	50,114	48,460	48,698	51,234
Debtors	20,942	23,285	19,690	19,787	20,817
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)	(48,699)	(44,780)
Creditors	(34,985)	(39,273)	(39,139)	(38,199)	(38,280)
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	58,183	69,653
CASH FLOW					
Operating Cash Flow	12,340	7,533	13,724	12,700	14,500
Net Interest	(3,491)	(3,285)	(3,221)	(3,000)	(3,000)
Tax	(1,131)	(937)	(60)	(1,583)	(1,975)
Capex	(3,764)	(1,705)	(5,291)	(3,000)	(2,500)
Acquisitions/disposals	(111)	0	140	(1,451)	0
Financing/Other	146	159	1,225	(1,200)	(40)
Dividends	(918)	(968)	(1,014)	(829)	(791)
Net Cash Flow	3,071	797	5,503	1,637	6,194
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)	(690)	(194)
Closing net debt/(cash)	41,854	42,138	36,947	36,000	30,000

Source: Company accounts, Edison Investment Research

Frankfurt +49 (0)69 78 8076 960	**London** +44 (0)20 3077 5700	**New York** +1 646 653 7026	**Sydney** +61 (0)2 9258 1161	**Wellington** +64 (0)48 948 555
Schumannstrasse 34b	280 High Holborn	245 Park Avenue, 39th Floor	Level 25, Aurora Place	Level 15, 171 Featherston St
60325 Frankfurt	London, WC1V 7EE	10167, New York	88 Phillip St, Sydney	Wellington 6011
Germany	United Kingdom	US	NSW 2000, Australia	New Zealand