EDISON

Walker Greenbank

FY18 results

Accentuating the positives

Care & household goods

There were a number of headwinds and tailwinds in FY18, in which good growth was delivered, but lower earnings expectations have dominated sentiment. Walker Greenbank has some strong and unique market positions and is becoming increasingly active in broadening its revenue mix into faster-growing segments. Success here and greater stability in UK demand will translate to rating expansion in our view.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
01/17	92.4	10.4	12.9	3.6	9.4	3.0
01/18	108.8	12.5	14.4	4.4	8.4	3.6
01/19e	111.0	12.8	14.4	4.6	8.4	3.8
01/20e	114.4	13.3	15.0	4.9	8.1	4.0

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

Good step forward despite UK challenges

FY18 ended on a weaker UK trading note but Walker Greenbank still delivered good overall growth from the enlarged business and demonstrated manufacturing stability after previous disruption. At the group level, adjusted PBT (excluding LTIP charges and non-trading items) rose by +20.2% to £12.5m in FY18 and, in the event, was slightly better than our reduced year end estimates. On the same basis fully diluted EPS increased by 11.7%, while full-year DPS was 21.1% higher than the prior year. Net debt was unchanged at £5.3m at the year end and equivalent to just 0.3x reported FY18 EBITDA.

Estimates down, growth initiatives visible

Revisiting estimates, we have put through further profit and earnings reductions (in the 5% to 11% range for FY19 and FY20) substantially due to UK Brands expectations. We are also adopting more conservative dividend growth expectations, representing a CAGR of 5% over our forecast horizon. More positively, we are encouraged by a more explicit and driven international growth strategy and other initiatives (including technology investment, complementary line extensions and increasing licensing activity), which clearly represent faster revenue growth opportunities. Given the balance sheet position, group progress could conceivably also be enhanced by acquisitions.

Valuation: Low earnings multiples

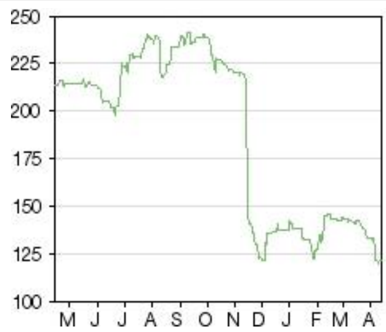
Walker Greenbank's share price has settled towards the lower end of a 120–145p trading range seen since the 15 November update. On our revised estimates, the FY19 P/E and EV/EBITDA (adjusted for pension cash contributions) are now just 8.4x and 6.2x respectively. We acknowledge that earnings growth expectations have been lowered and are comparatively modest but dividend growth prospects are somewhat better, leading to income attractions. Financial risk remains very low and the rating seems to attribute little value to the company's unique brand portfolio and manufacturing proposition in our view.

13 April 2018

Price	**121p**
Market cap	**£86m**

Net debt (£m) at end January 2018	5.3
Shares in issue	70.9m
Free float	92%
Code	WGB
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(14.6)	(12.6)	(42.9)
Rel (local)	(14.8)	(6.7)	(42.6)
52-week high/low		241.5p	120.0p

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. FY18 revenue: UK 58%, International 39% and Licence income 3%

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Edison profile page

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FY18 results overview

Walker Greenbank delivered significant y-o-y progress in revenue (+17.7%) and operating profit (+25.8%) in FY18. A full-year contribution from Clarke & Clarke was the single largest contributor to this outturn with both positive and negative aspects to trading performance seen in other ongoing operations, including a previously noted weakening UK market backdrop. While the group's modest net debt position was unchanged over the year, underlying cash and balance sheet characteristics remain strong in our view. We consider an increasing emphasis on international markets and developing complementary revenue streams to be a logical strategy without waiting for returning confidence among UK consumers.

Exhibit 1: Walker Greenbank divisional and interim splits

£m Jan Y/E	H1	H2	2017	H1	H2	2018	H118	FY18	FY18
							Actual	Actual	CER
								y-o-y % change	
Group revenue	**41.8**	**50.5**	**92.4**	**54.3**	**54.5**	**108.8**	**29.7%**	**17.7%**	
Brands	33.8	42.8	**76.6**	45.2	45.2	**90.4**	33.4%	**17.9%**	**16.2%**
UK	18.8	23.8	**42.5**	23.5	24.9	**48.4**	25.1%	**13.9%**	**13.9%**
Overseas	14.0	17.6	**31.6**	20.3	18.5	**38.9**	45.6%	**23.2%**	**18.9%**
Licensing	1.1	1.5	**2.6**	1.3	1.8	**3.1**	21.1%	**21.5%**	**21.6%**
Manufacturing – gross*	15.0	17.1	**32.0**	16.1	17.3	**33.4**	7.5%	**4.2%**	
UK	6.2	6.0	**12.2**	7.3	7.1	**14.4**	17.4%	**18.0%**	
Overseas	1.8	1.7	**3.5**	1.8	2.1	**3.9**	1.6%	**12.6%**	
Inter company*	-7.0	-9.3	**-16.3**	-7.0	-8.0	**-15.0**	0.1%	**-8.0%**	
Group operating profit	3.6	6.3	**9.8**	5.5	6.9	**12.4**	55.2%	**25.8%**	
Brands	3.6	5.6	**9.2**	6.0	6.6	**12.6**	65.7%	**36.4%**	
Manufacturing	0.2	0.9	**1.0**	0.5	1.4	**1.9**	184.5%	**89.3%**	
Central items**	-0.2	-0.2	**-0.4**	-1.0	-1.2	**-2.2**			

Source: Edison Investment Research, Walker Greenbank data. Note: *Manufacturing – gross includes intercompany transfers to Brands which is netted out on consolidation. **Loss of profits figures included in central items were as follows: £1.6m / H117, £2.8m / FY17 and £1.1m / H118, £1.1m / FY18 (ie zero in H218).

Brands: Internationally recognised heritage and contemporary, premium and mid-market, wall covering and furnishing brands (Sanderson, Morris & Co, Harlequin, Zoffany, Scion, Anthology, Clarke & Clarke, Studio G).

Total Brands revenue increased by 17.9% on a reported basis in FY18, comprising a modest reduction in product sales, a 21.5% uplift in licence income and the full-year contribution effect of Clarke & Clarke (vs 18 weeks in the prior year). FX translation had a small positive overall influence on overseas revenue growth.

At individual brand level, **Clarke & Clarke** achieved a high single-digit percentage improvement in underlying revenues (full year basis) and saw a comparatively high level of new collection launch activity in the year. This included nine for Clarke & Clarke and 10 for its Studio G sub-brand, the latter representing entry into the US market for the first time, which should gather momentum in FY19. This said, based on current market conditions, management considers that the stretch earnout targets established on acquisition are now unlikely to be achieved and the associated provisions were reversed as a non-trading item in FY18 results. Nevertheless, we consider it likely that underlying profitability has been improved under Walker Greenback's ownership with return on capital in the low double-digit to mid-teen percentage range. **Sanderson** also grew sales in FY18 driven by a strong H1 performance while **Harlequin** (incorporating Scion and Anthology) and **Zoffany** both saw modest revenue declines in the year. We acknowledge that all three of these Brand groups experienced a weaker sales pull-through in H2, while noting also that FX translation effects provided a modest headwind in overseas markets in the second six months of the year.

Regionally, Brands' **UK** revenues accounted for c £50m of the £90.4m reported (both including licence income). Product sales, including C&C, rose by almost 14% and we estimate that the other brands' sales together were modestly down y-o-y. The latter group are now collectively marketed under the Style Library umbrella and the UK sales team was re-oriented in the year to reflect this, though it is probably too early to measure the impact of this. **Internationally**, 12 other countries outside the UK generated sales in excess of £0.5m and Walker Greenbank now has a direct presence (ie sales representation and showroom) in six of these.

- **US** brand sales (£12.7m) increased by +19.8% y-o-y in constant currency with positive contributions from all brands (Harlequin +6.3%, Sanderson/Morris +6.6%, Zoffany +1.8%) and implicitly a material uplift from C&C also. A relative stronger US dollar boosted reported sales by c 3%. Opening a Chicago showroom (adding to one in New York) and launching new C&C/Studio G collections supported progress in FY18 and annualised benefits should flow through from FY19 onwards.
- **Western European** brand sales (£11.7m) were lower in underlying, constant currency terms (we estimate by c 5%; Harlequin -8.9%, Sanderson/Morris -2.4%, Zoffany -5.2%) but a positive C&C effect resulted in +15% local currency growth overall, supplemented by a c 6% positive FX translation tailwind. The division has showrooms in Amsterdam and Paris and is expected to add another in Germany during FY19.
- **Rest of the World** brand sales (£14.5m) rose 21.9% in constant currency, +23.9% reported. No particular brand performances were highlighted but more detail on the larger regional sales blocs in the year were provided: the Far East (£4.1m), Eastern Europe (£3.0m), Scandinavia (£2.8m) and the Middle East (£2.0m). There is already direct showroom presence in the first and last of these blocs (ie China and Dubai) and a Moscow one opened in February 2018. These markets are possibly more oriented to the commercial/contract segments and consequently may show more lumpy/non-linear progress.

Apart from the largest 12 countries (each over £0.5m revenue), Walker Greenbank sells into 70+ others variously through local distributor/agents and, subject to scale, dedicated agents. There is a clear emphasis on faster progression through these development stages and increasing the number of direct sales territories. While acknowledging an increased level of local opex to support this, the associated uplift in contribution margin through this channel is significant.

Licensing income (£3.1m) is seen as a way of developing complementary revenue streams from strong brand portfolio IP in adjacent segments, which also enhances the marketing visibility of these brands (chiefly Sanderson, Morris & Co, Harlequin and Scion). In FY18, licence revenues rose by nearly 22%, driven by new licensee agreements signed in the last two years. Current licensee products include soft furnishings (eg bedding, blinds, flooring), gift items (eg stationery, cosmetics cases) and apparel/fashion is understood to be gaining interest. Walker Greenbank has a dedicated resource focus on the management and further development of these revenue streams which, by their nature, attract very high contribution margins. Strong double-digit growth is anticipated by management again in FY19. Moreover, £5m revenue has been set as a three-year aspiration from FY18.

Manufacturing: Two locations, Anstey (wallcoverings) and Standfast & Barracks (fabrics), which produce high-end furnishings with output split broadly equally between the group Brands division and third parties.

Overall, a solid year for manufacturing activities, confirming full recovery of operational performance at Standfast & Barracks (following flood disruption at the end of FY16/beginning of FY17) with progress at Anstey also, despite a machine fire affecting one of six lines at the year end.

Gross manufacturing revenues rose by 4.2% y-o-y and both Anstey (£18m, +6.5%) and S&B (£15.4m, +2.0%) contributed to this outturn. Behind the headline figure, third-party sales rose c 17% (to £18.4m) while internal sales to support Brand activities were 8% lower (at £15m). Both movements were influenced by flood-affected comparators, which restricted sales to third parties in FY17 and led to higher carried Brands inventory at the end of that year; this perhaps took longer to work down than originally anticipated. Interestingly, UK third-party sales (of £14.4m) showed good double digit progress in both half years while International (£3.9m) was even stronger in H2 after a fairly flat H1 performance. Both Anstey and S&B grew revenues in both UK and export markets over the year as a whole.

Putting y-o-y comparatives to one side, both manufacturing operations appear to have seen fairly stable activity levels across the year. There was new collection launch activity among Walker Greenbank's own premium Brands – which requires pattern book and pipeline inventory build ahead of launch – and we believe that S&B had good success in winning new third-party work in the year. Similarly, after a fairly quiet H1 in this regard for Anstey, momentum improved in H2. This is a positive marker for re-print activity in future periods. (Note that while Clarke & Clarke did have significant new launch activity in FY18, there is a greater degree of external sourcing compared to the premium Brands and, therefore, the associated impact on group manufacturing was relatively modest.) In the absence of the previously reported embossing machine fire damage, it is clear that the underlying Anstey performance would have been stronger. We understand this line has been completely repaired and is fully operational now. Also at Anstey, the change of paint supplier and establishment of in-house tinting capability (matching Sanderson and Zoffany colour palettes) has created a platform for additional growth; from a base of c £2m, a revenue target of c £15m per year in five years' time has been set. Other growth initiatives include the trialling of a third digital printing line with innovative ink technology at S&B that potentially brings benefits in the finishing process and access to other markets.

At the operating profit level, Manufacturing achieved a reported margin of 5.8%. Note that the final flood-related loss of profit insurance payment (£1.1m) was booked to central items in H1; it is not possible to determine what proportion of this applied specifically to Manufacturing. In the absence of such receipts going forward, the reported margin will provide a better representation of the underlying profitability generated in this division.

Modest debt position maintained, positive cash flow prospects

Net debt stood at £5.3m at the end of FY18, in line with the positions at the end of H118 and 12 months earlier. At £2.8m, free cash flow (FCF) was around half of the prior year level, and this was substantially all applied to increased cash dividend payments (reflecting both underlying DPS growth and increased shares in issue following the acquisition of Clarke & Clarke in FY17). We now look at some of the component parts of this underlying FCF performance.

As discussed earlier, the full year inclusion of Clarke & Clarke had a positive effect on group profitability and EBITDA rose by £2.6m y-o-y to £15.9m. In contrast to this, working capital items collectively saw the c £2m FY17 inflow switch round to a £5m outflow in FY18 and all of this variance occurred in H2. There was undoubtedly some distortion to the normal working capital cycle in FY17 arising from the end FY16 flood impact on underlying business activity so the comparison is probably not an entirely fair one. Looking at FY18 in isolation, outflows in receivables (from an increase in international and new collection launch activity) and payables (from sourcing changes on shorter terms) were the chief influences on working capital movement within the year. Overall, this outflow was slightly lower than we had anticipated due to a better inventory performance. Non-trading operating cash outflow was £3.8m, as follows:

- pension cash contributions £1.9m, consistent with expected annual increase
- insurance P&L net cash effect £0.3m, as seen in H118
- other £1.6m, the major items being restructuring/reorganisation costs (substantially seen in H1) and Anstey fire-related costs. The latter cash cost (c £0.7m) is likely to reverse in FY19 with the expected receipt of associated insurance proceeds.

Taken together, these items led to an FY18 group operating cash inflow of £7m and, as discussed, working capital movements were the chief difference between this and the prior year £12.4m inflow.

Elsewhere, net interest cash costs rose slightly (reflecting higher average net debt, being the full year Clarke & Clarke acquisition effect) while cash tax was in line with the prior year (and modestly below the underlying P&L charge); the combined outflow was £2.5m here. Gross fixed capex of £2.6m just exceeded depreciation prior to the receipt of £1.8m equipment related flood insurance proceeds, as reported in H1. Lastly, we note that intangible capex of £0.9m was similar to the prior year.

Cash flow outlook: we anticipate some working capital investment to support overseas growth but on a much more modest extent than seen in FY18. Additionally, total capex should continue to run ahead of depreciation and amortisation (of internal intangibles) for the same reason. Nevertheless, we project FCF of c £6m in FY19, rising thereafter, being sufficient to fund dividend growth and, in the absence of acquisitions, be in a modest net funds position by the end of FY20.

Reduced UK expectations

UK consumer confidence and spending weakness has been a broad theme over the last 12 months or so, and subdued repair, maintain and improvement (RMI) activity for longer, and Walker Greenbank has not been immune to this. We have trimmed our group revenue expectations chiefly in UK Brands and, with above-average margins, this feeds into lower profit estimates as shown in Exhibit 1. Our international expectations are little changed at this stage; with greater focus and resource being applied to further developing markets outside the UK, this may prove to be conservative.

Exhibit 2: Walker Greenbank revised estimates

	EPS, fully diluted, normalised (p)			PBT, normalised (£m)			EBITDA (£m)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2018	14.0	14.4	+3.4%	12.4	12.5	+6.2%	16.1	15.9	(1.4%)
2019e	15.6	14.4	(7.3%)	13.9	12.8	(5.7%)	17.8	16.2	(8.8%)
2020e	16.8	15.0	(10.7%)	14.9	13.3	(8.5%)	19.0	16.8	(11.7%)
2021e	N/A	15.8	N/A	N/A	14.1	N/A	N/A	17.5	N/A

Source: Edison Investment Research. Note: 2017 old = estimate, New = actual.

We have elected to lower our expected rate of dividend growth to 5% per year; maintaining cover of c 3.x on our estimates.

Exhibit 3: Financial summary

£m	2013	2014	2015	2016	2017	2018	2019e	2020e	2021e
January	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS									
Revenue	75.7	78.4	83.4	87.8	92.4	108.8	111.0	114.4	118.7
Cost of Sales	(30.2)	(30.3)	(32.7)	(35.9)	(36.2)	(43.3)	(43.7)	(45.1)	(46.8)
Gross Profit	45.5	48.1	50.7	52.0	56.2	65.5	67.3	69.3	71.9
EBITDA	8.6	9.7	10.7	11.8	13.4	15.9	16.2	16.8	17.5
Operating Profit (before GW, except. & LTIP)	6.6	7.5	8.3	9.1	10.6	12.8	13.1	13.5	14.1
Operating Profit (before GW and except.) - reported	5.8	6.5	7.3	8.2	9.8	12.4	12.5	12.9	13.5
Net Interest	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.3)	(0.3)	(0.1)	(0.0)
Intangible Amortisation - acquired	0	0	0	0	(0.3)	(1.0)	(1.0)	(1.0)	(1.0)
Pension net finance charge	(0.7)	(0.9)	(0.8)	(0.7)	(0.5)	(0.6)	(0.6)	(0.6)	(0.6)
Exceptionals	0	0	0	0	(1.8)	2.3	0.0	0.0	0.0
Other	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	12.5	12.8	13.3	14.1
Profit Before Tax (FRS 3)	4.9	5.5	6.3	7.3	7.0	12.8	10.6	11.1	11.9
Tax	(1.0)	(0.5)	(1.2)	(1.5)	(1.6)	(1.0)	(2.6)	(2.7)	(2.9)
Profit After Tax (norm)	5.4	6.6	6.9	7.5	8.6	11.5	10.2	10.6	11.2
Profit After Tax (FRS 3)	4.0	5.0	5.1	5.9	5.4	11.8	8.0	8.4	9.0
Average Number of Shares Outstanding (m)	57.5	58.5	59.3	60.0	62.7	70.4	70.7	70.7	70.7
EPS - normalised (p) FD	9.4	10.7	11.2	11.6	12.9	14.4	14.4	15.0	15.8
EPS - FRS 3 (p)	6.9	8.6	8.6	9.8	8.6	16.7	11.3	11.9	12.7
Dividend per share (p)	1.5	1.9	2.3	2.9	3.6	4.4	4.6	4.9	5.1
Gross Margin (%)	60.1	61.3	60.8	59.2	60.8	60.2	60.6	60.6	60.6
EBITDA Margin (%)	11.4	12.4	12.8	13.4	14.6	14.6	14.6	14.6	14.7
Operating Margin (before GW and except.) (%)	7.7	8.3	8.8	9.3	10.7	11.4	11.2	11.3	11.4
BALANCE SHEET									
Fixed Assets	18.5	21.1	21.5	18.9	47.5	47.7	47.6	46.8	45.9
Intangible Assets	6.7	7.3	7.2	7.1	31.6	31.8	30.6	29.5	28.4
Tangible Assets	9.8	11.7	12.7	11.7	15.8	16.0	16.9	17.3	17.5
Investments	2.0	2.2	1.6	0.1	0.0	0.0	0.0	0.0	0.0
Current Assets	32.6	35.3	37.1	40.3	51.3	51.9	53.5	54.4	59.6
Stocks	16.8	18.4	22.0	18.1	30.3	29.4	30.2	31.1	32.3
Debtors	12.8	13.9	14.1	19.3	19.5	21.2	22.0	22.5	23.1
Cash	2.9	2.8	1.0	2.9	1.5	1.3	1.3	0.8	4.3
Other	0.1	0.2	0.0	0.0					
Current Liabilities	(17.3)	(19.4)	(20.7)	(19.4)	(34.8)	(28.9)	(27.4)	(24.6)	(25.6)
Creditors	(16.9)	(19.0)	(20.3)	(19.0)	(28.0)	(22.4)	(23.7)	(24.6)	(25.6)
Short term borrowings	(0.4)	(0.4)	(0.4)	(0.4)	(6.8)	(6.6)	(3.7)	0.0	0.0
Long Term Liabilities	(9.6)	(10.2)	(10.9)	(4.5)	(12.7)	(9.1)	(7.1)	(5.0)	(2.8)
Long term borrowings	(1.4)	(0.9)	(0.6)	(0.2)	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)	(7.1)	(5.0)	(2.8)
Net Assets	24.2	26.9	26.9	35.3	51.3	61.6	66.5	71.5	77.0
CASH FLOW									
Operating Cash Flow	6.0	6.2	3.5	7.1	12.4	7.0	12.7	12.9	13.3
Net Interest	(0.2)	(0.2)	(0.2)	(0.1)	(0.2)	(0.2)	(0.2)	(0.1)	0.0
Tax	(0.0)	(0.0)	(0.0)	(0.6)	(2.3)	(2.2)	(2.6)	(2.7)	(2.9)
Capex	(3.1)	(4.7)	(3.2)	(2.5)	(6.7)	(3.5)	(4.0)	(3.5)	(3.5)
Acquisitions/disposals	0.0	0.0	0.0	0.0	(27.1)	0.0	0.0	0.0	0.0
Financing	(0.1)	(0.0)	(0.4)	(0.1)	18.3	1.8	0.0	0.0	0.0
Dividends	(0.7)	(0.9)	(1.1)	(1.4)	(1.8)	(2.7)	(3.1)	(3.4)	(3.5)
Net Cash Flow	1.8	0.3	(1.5)	2.3	(7.4)	0.1	2.8	3.3	3.5
Opening net debt/(cash)	0.7	(1.2)	(1.5)	(0.0)	(2.3)	5.3	5.3	2.4	(0.8)
HP finance leases initiated	0.0	0.0	0.0	0.0	(0.0)	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	(0.2)	(0.1)	0.0	0.0	0.0
Closing net debt/(cash)	(1.2)	(1.5)	(0.0)	(2.3)	5.3	5.3	2.4	(0.8)	(4.3)

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