Investors' Chronicle | Alpha

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Alpha small company research

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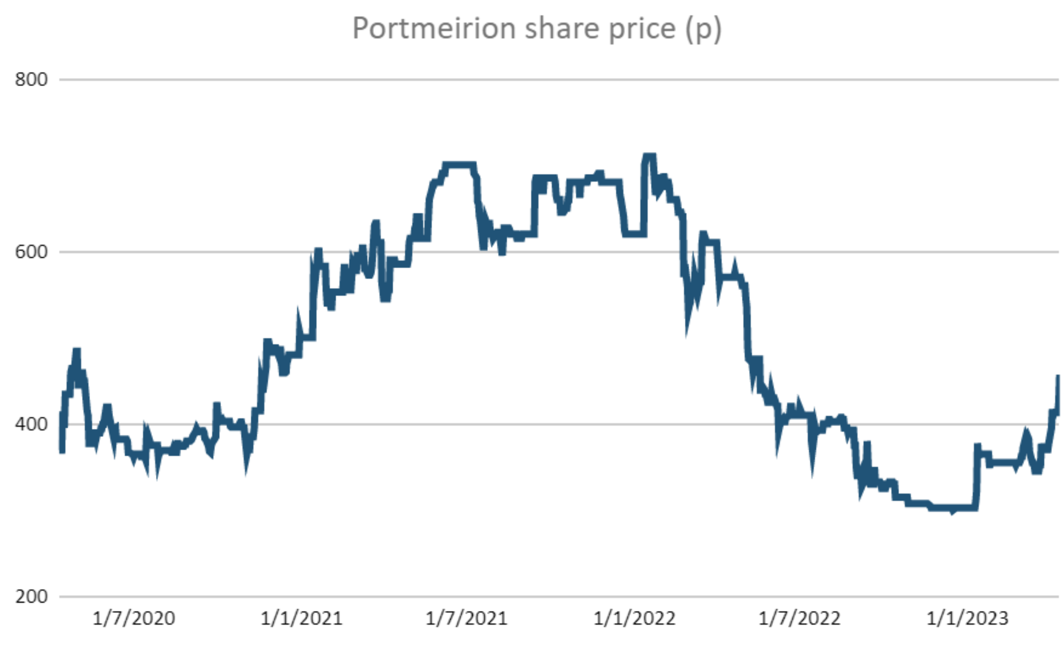
Dine out on a Royal investment for The Coronation

Business is booming in global markets for a ceramic manufacturer and designer of some of the world's most iconic brands, a trend that looks set fair to continue.

Simon Thompson's view:

'Forecast to deliver 35 per cent earnings growth over a two-year period, leading British ceramics maker **Portmeirion Group (PMP)** is still priced at a current year forward PE ratio of just nine. The growth trajectory is being driven by self-help measures aimed at improving profitability, the launch of new products and ongoing geographic expansion into overseas territories. For good measure, cash generation could almost wipe out net debt next year, transferring more of the economic value in the entity from debt holders to shareholders. A 2024 prospective dividend yield of 4.6 per cent adds to the attraction.'



Source: Refinitiv

Bull points

1. Geographic diversification and robust overseas growth.
2. Increasing online penetration.
3. Healthy order book and pipeline of product launches.
4. Automation is driving cost efficiencies and improved profitability.
5. Pricing power.
6. Energy costs are hedged until 2024.
7. Synergy benefits from AromaWorks acquisition.
8. Strong balance sheet and stock normalisation to cut borrowings.
9. Progressive dividend policy.
10. Supply chain pressures and global shipping costs are easing.

Bear points

1. UK market weakness due to cost-of-living crisis.
2. Home fragrance division was loss-making in 2022.
3. Seasonal weighting to the second half of the year.
4. Working capital build in 2022.

Portmeirion Group (PMP)	
Ticker	PMP
Current price	457p
Bid-offer spread	450p - 464p
Target price	700p
Market cap	£64mn
52 week high	582.60p
52 week low	290.25p
Net debt	£10.1mn (31 December 2022)
Net asset value	£66.7mn (31 December 2022)
Shares in issue	14mn
Financial year end	31 December
Next event	annual meeting on 23 May 2023
Website	portmeiriongroup.com

Source: London Stock Exchange, company preliminary results

Established in 1960, Stoke-on-Trent-based **Portmeirion Group (Aim:PMP)** is a leading British ceramics manufacturer and retailer of six unique and established homeware and fragrance brands: Portmeirion, Spode, Wax Lyrical, Royal Worcester, Pimpernel and Nambé. The brands have over 750 years of collective heritage and enduring global appeal, generating increasing levels of sales to consumers across more than 80 countries in the world. In fact, international sales now account for 75 per cent of group revenue.

The well-established portfolio of brands has certainly stood the test of time, as highlighted by a record sales performance in 2022 when group revenue increased 5 per cent to £110mn, a fifth above 2019 pre-Covid levels. Moreover, profitability is recovering after taking a hit during the pandemic. Operating profit margin expanded from 7.2 to 7.8 per cent last year and there are reasons to believe that profitability can be further improved, driven by self-help measures such as greater automation in production (see section: 'Improving profitability key to driving profits higher').

The margin expansion combined with conservative looking sales growth forecasts are the reasons why analysts expect the group's pre-tax profit to rise 40 per cent over the next two financial years, a possibility that is not embedded in the current rating with the shares currently rated on lowly forward price/earnings (PE) ratios of 8.9 (2023) and 7.2 (2024).

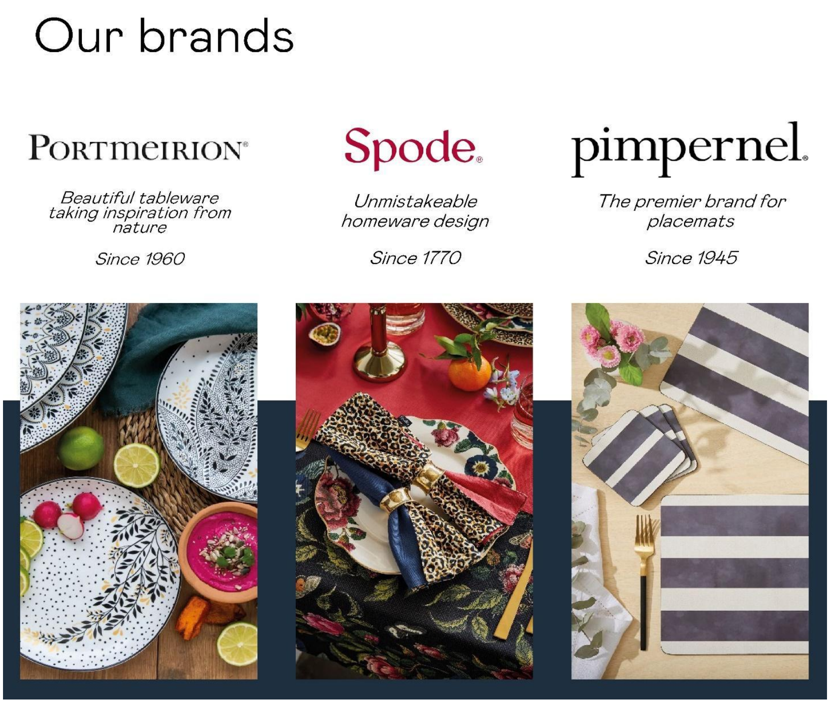
Portmeirion Group earnings estimates

Year end 30 Apr	Rev	Adj Ebitda	Adj PBT	Adj EPS	DPS	PE ratio	Div yield	Net cash/(debt)
2021A	£106mn	£11.9mn	£7.2mn	38.7p	13.0p	11.8	2.9%	£0.7mn
2022A	£111mn	£13.2mn	£8.0mn	46.5p	15.5p	9.8	3.4%	-£10.1mn
2023E	£113mn	£14.7mn	£9.1mn	51.4p	17.5p	8.9	3.8%	-£4.2mn
2024E	£120mn	£16.8mn	£11.2mn	62.8p	21.0p	7.2	4.6%	-£1.2mn
2025E	£125mn	£17.8mn	£12.5mn	69.7p	24.0p	6.5	5.3%	£0.9mn

Source: Company data, Shore Capital estimates (23 March 2023)

There should be upside to these estimates, a point that house broker Shore Capital makes in its recent initiation note, pointing out that "adjusted pre-tax profit forecasts may well prove conservative given the potential for upside to both our sales and margin assumptions." I concur especially as a raft of product launches has potential for the group to over deliver on revenue. For instance, the Portmeirion brand has produced a range of tableware including plates, mugs and teapots to mark the Coronation of His Majesty King Charles III, providing both collectors and Royalists the opportunity to add to their collections.

It's also worth noting that although annual sales are 60 per cent weighted to the second half and have a seasonal bias to the last few months of the year, which ordinarily would increase earnings risk, the festive period is the group's most reliable period of the year in terms of forecasting sales. That's because large numbers of repeat customers return each year to place orders to add to their collections.



Source: Portmeirion Group

Portmeirion experienced another strong seasonal Christmas and Thanksgiving trading period in 2022 – particularly in the US, now its largest sales market and one that represents 40 per cent of total turnover. The ceramic maker's Spode Christmas Tree range, first launched in 1938, remains a top US Christmas tableware range and continues to grow in popularity, driven by new product launches and increased online exposure through retailer websites and own e-commerce channels.

Source: Portmeirion Group

It's not the only product range that has longevity and long-running customer repeat purchases. Portmeirion Botanic Garden was launched 51 years ago by Susan Williams-Ellis, a designer and illustrator who started selling pottery in the gift shop in Portmeirion, a tourist village in North Wales which was created by her father, Sir Clough Williams-Ellis. It continues to sell well today. Together the two ranges account for 40 per cent of the group's annual sales and are two of the most successful global tableware ranges, providing a reliable base of sales each year.

Portmeirion Group timeline

2022	50th anniversary of Portmeirion Botanic Garden range
2021	Launch of new Sophie Conran for Portmeirion collection inspired by nature.
2020	250th anniversary of iconic Spode brand.

	Equity raise in June 2020 raised net proceeds of £11.2mn to accelerate online channel sales growth; extend Wax Lyrical product lines; build a more significant presence in Canada; and invest in UK manufacturing efficiencies.
	Acquired remaining 50 per cent of share capital in Portmeirion Canada Inc. for £0.5mn in August 2020 to leverage US sales and online infrastructure and grow presence in the Canadian market.
	Board strengthened in August 2020 with the appointment of Jacqui Gale as Chief Commercial Officer, Bill Robedee as President North America and a new Non-executive Director, Clare Askem.
2019	Completed $12mn acquisition of Nambé a US based premium homewares business
	New UK manufactured ranges launched – Portmeirion Botanic Garden Harmony, Portmeirion Atrium and Spode Kingsley.
	Relaunch of UK websites to further drive online sales.
2018	Tenth consecutive year of record group revenue.
	Portmeirion UK and Wax Lyrical achieved Investors in People Gold accreditation.
2017	Completed integration of Wax Lyrical business, including the launch of over 200 home fragrance products under the existing Portmeirion Group brands.
	Senior management team strengthened with the appointments of Mike Raybould as Group Finance Director, Mick Knapper as Operations Director, Moira MacDonald as Company Secretary and Andrew Andrea as a Non-executive Director.
2016	Completed £17.5mn acquisition of Wax Lyrical, the UK's largest manufacturer of home fragrances.
	Received the Queen's Award for Enterprise in the category of International Trade, which recognises the company's continuous growth in overseas sales and outstanding achievement in international trade over the last six years.
	Celebrated the 200th anniversary of Blue Italian range.
2013	Completed £3.9mn purchase of long leasehold interest in warehouse and offices in July 2013.
	Launch of US website in July 2013 following revamp of UK website earlier in the year.
	Excellence in Housewares Award for new Sophie Conran for Portmeirion cookware range.
2011	Received Queen's Award for Enterprise in the category of International Trade.
2010	Portmeirion celebrates its 50th anniversary.

2009	Acquisition of the Spode and Royal Worcester brands.
2006	Acquisition of the Pimpernel brands.
2004	Transfers to the Alternative Investment Market of London Stock Exchange.
1990	Former partnership of Portmeirion Group USA became a wholly owned subsidiary.
1988	Portmeirion Group listed on London Stock Exchange.
1986	Partnership established to distribute Portmeirion products in the US.
1972	Launch of Botanic Garden range.
1960	Susan Williams-Ellis founded the brand.

Source: Company data

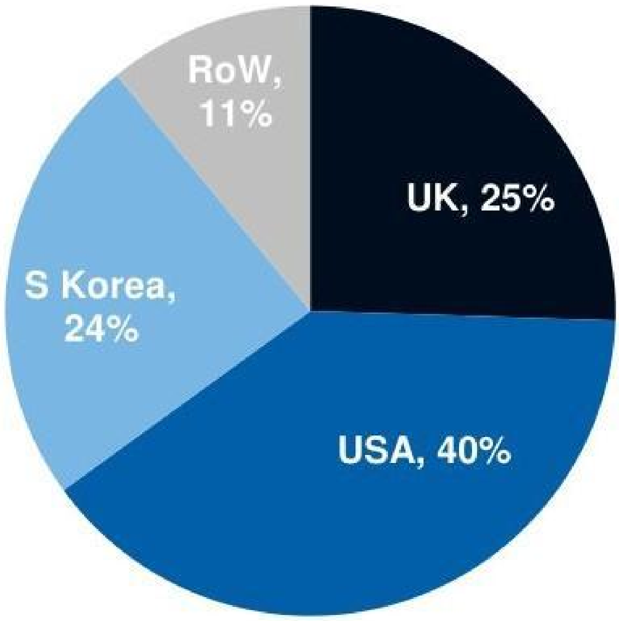
The group also has a growing portfolio of contemporary product ranges, including Sophie Conran for Portmeirion, and an exciting roadmap of new products. The well-established management team is focused on growing both their heritage range sales footprint and boosting contemporary market share through new product development, increasing online sales channel penetration and developing new geographical markets. These initiatives align with a capital-light self-funded growth strategy focused on building a wider customer base and growing the brands through:

- Building and growing international sales markets
- Developing online sales channels in core markets
- Designing and launching new product to broaden appeal and take market share
- Leveraging brands and extensive product ranges

Geographic expansion

Portmeirion's products are sold in more than 80 countries with its three core markets – UK, US and South Korea – accounting for 89 per cent of group sales. A segmental breakdown by region highlights where the growth is coming from.

Revenue split by geography for FY22A



Source: Company Data

In 2022, sales into South Korea surged from £18.7mn to £26.7mn (24 per cent of group total) after management took action to stabilise and maintain sales at previous historical levels. That's because sales in this important overseas market had been impacted by high levels of product re-shipped from other markets, so management took considerable steps in the second half of 2019 and throughout 2020 to reduce the incidence of this parallel shipping of its core Portmeirion Botanic Garden tableware ranges and allowing overstocking in the market to subside.

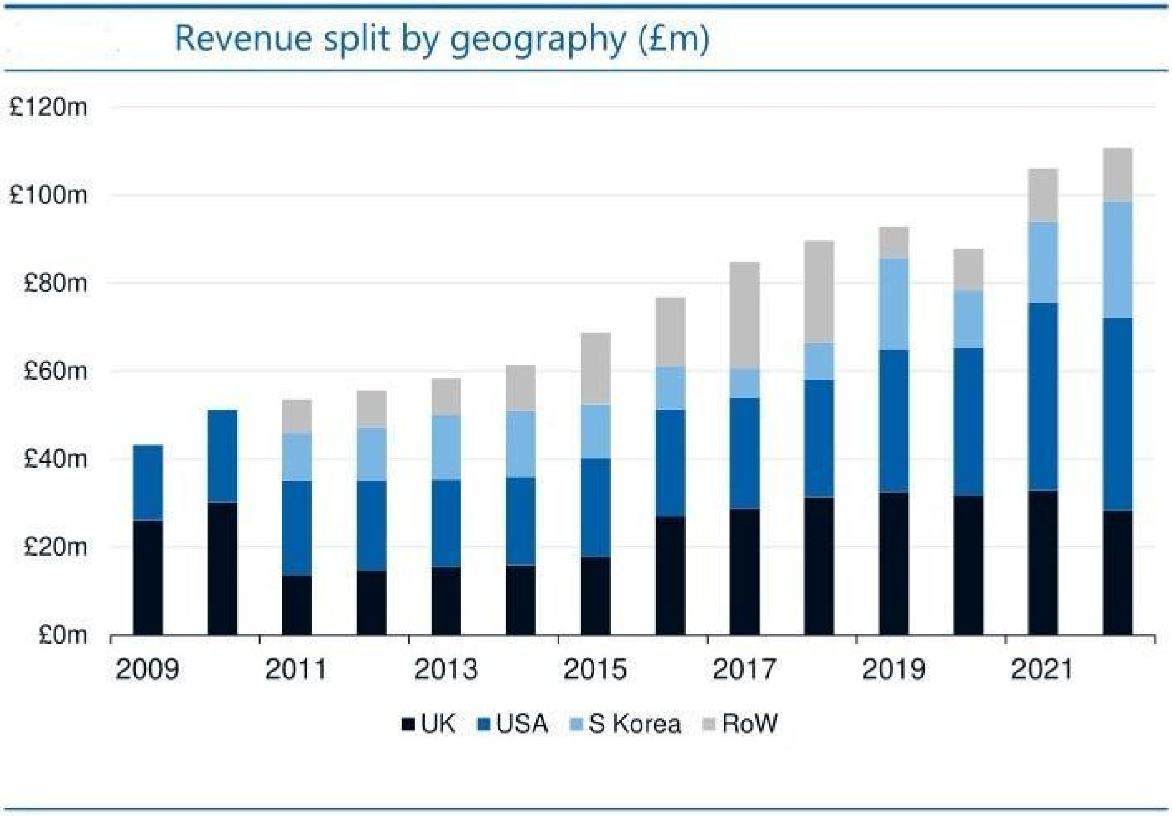
Trading in South Korea also benefited from the group's strategy of increasing online channel exposure as well as the sale of new and different ranges outside of its core Botanic Garden range such as home fragrance and more contemporary ranges. That said, Portmeirion Botanic Garden remains hugely popular in the country, ranking as one of the top 'online search terms' in the tableware category.

Sales by country	2022 £m	2021 £m	2019 £m	2022 v 2021 Change	2022 v 2019 Change
US	**43.8**	42.5	32.5	3%	35%
UK	**28.3**	32.9	32.6	-14%	-13%
South Korea	**26.7**	18.7	20.8	43%	28%
Canada	**5.2**	4.2	1.0	23%	420%
Europe	**2.6**	2.8	3.2	-7%	-19%
Australia	**1.2**	1.3	0.6	-8%	100%
China/Far East	**1.2**	0.6	0.1	100%	1100%
Middle East	**0.6**	0.8	0.8	-25%	-25%
Russia/Eastern Europe	**0.2**	0.9	0.5	-78%	-60%
Other	**1.0**	1.3	0.7	-23%	43%
Total	**110.8**	106.0	92.8	5%	19%

Source: Portmeirion Group corporate results presentation (23 March 2023)

Although last year's sales in the US edged up only three per cent to £43.8mn they are still more than a third ahead of pre-Covid levels, highlighting the push to diversify the sales mix internationally. The gains in both South Korea and the US more than offset weakness in the home market – UK revenue declined 14 per cent from £32.9mn to £28.3mn – which felt the full impact of the cost-of-living crisis on discretionary consumer spending.

Another key take is the ongoing growth in Rest of World sales markets. In 2022, revenue increased 6 per cent to £12.1mn and is now 81 per cent higher than in 2019, excluding Russia and Eastern Europe. Sales in Canada rose 23 per cent to £5.2mn, reflecting the ongoing benefits from the August 2020 buy-out of the group's joint venture partner in the territory. The acquisition secured control over the selling and distribution process in this market, the rights to key licence distribution agreements, and enabled Portmeirion to leverage synergies with its North American team.



Source: Company Data

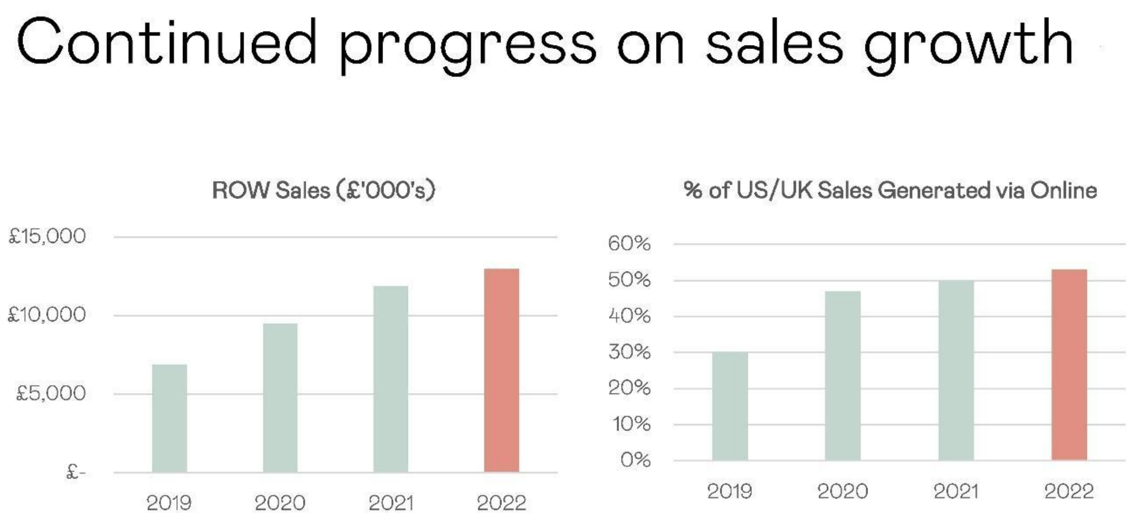
The appointment of new distributor partners in China and Malaysia is paying off, too. Sales in the region doubled to £1.2mn last year, albeit from a low base. The directors see a significant opportunity to grow the contribution from its Rest of World sales markets over the next three to five years.

Online expansion

Another key part of management's growth strategy is to increase online penetration in Portmeirion's core markets, thus enabling its businesses to reach more potential customers on more occasions.

In the UK and US markets, which account for almost three-quarters of group sales, the business continues to build long-term direct to consumer relationships through its own e-commerce sites. In the UK, new websites were launched last year that will improve the customer experience, conversion and the ability of Portmeirion to retarget customers for future purchases.

In 2022, the group's own e-commerce sales represented 14 per cent of total sales in the UK, or two-thirds higher than pre-Covid levels. Sales through all online channels in the UK and the US represented 51 per cent of total sales in the two major regions, up from 30 per cent in 2019.



Source: Portmeirion Group corporate presentation (23 March 2023)

It's worth flagging that making Christmas ranges more widely available on retailer websites was a key reason for the "excellent sell through across the 2022 seasonal holidays". This in turn provides strong momentum and encouragement for increased retailer buying activity for 2023.

Source: Portmeirion Group corporate presentation (23 March 2023)

New product launches

The directors are also focused on widening the appeal with their existing customer base and taking market share. Sales from new product launches and extensions to existing ranges currently account for more than 10 per cent of group sales. A strong roadmap of new launches for the next 18 months supports the ambition to grow share.

For instance, product launch extensions to the group's core heritage ranges (Portmeirion Botanic Garden and Spode Christmas Tree) are benefiting from significant repeat purchasing as consumers add to their collection. Over the next 12 to 18 months, an exciting portfolio of contemporary tableware, giftware and home fragrance launches include new lines for well-established ranges: Sophie Conran for Portmeirion, Royal Worcester Wrendale Designs and Sara Miller London.

Leveraging brands

As noted earlier, 40 per cent of group revenue is derived from key heritage ranges, Portmeirion Botanic Garden and Spode Christmas Tree, which continue to sell well. In 2022, the Portmeirion and Spode brands reported single-digit sales growth to £46mn and £21.4mn, respectively, their combined contribution accounting for 61 per cent of group revenue.

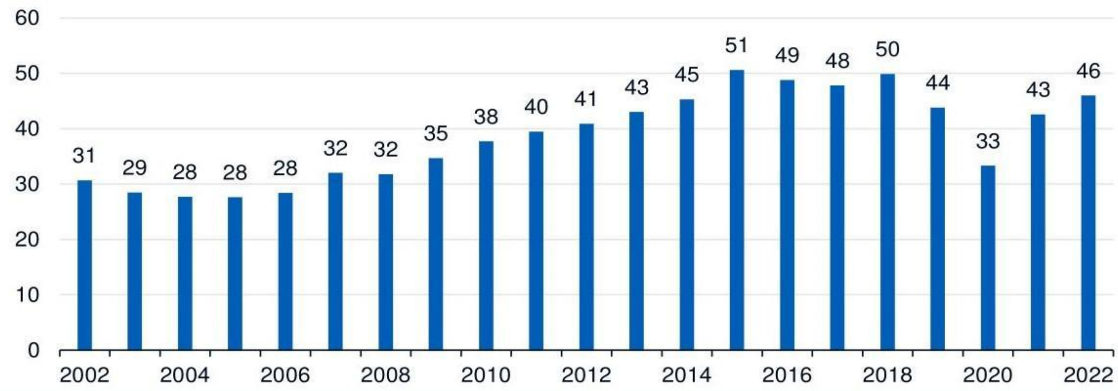
Sales by brand	2022 £m	2021 £m	2019 £m	2022 v 2021 Change	2022 v 2019 Change
Portmeirion	**46.0**	42.6	43.8	8%	5%
Spode	**21.4**	20.5	15.4	4%	39%
Royal Worcester	**6.7**	7.5	6.3	-11%	6%
Pimpernel	**5.7**	5.9	4.7	-3	21%
Nambe	**17.4**	15.3	7.8	13%	123%
Wax Lyrical*	**11.3**	12.2	14.6	-7%	-23%
Other**	**2.3**	2.0	0.2	15%	1050%
Total	**110.8**	106.0	92.8	5%	19%

(*Wax Lyrical includes sales of AromaWorks acquired August 2022).
(**Other includes hand sanitiser which is excluded from Wax Lyrical).

Source: Portmeirion Group corporate results presentation (23 March 2023)

House broker Shore Capital estimates that the group's Portmeirion brand delivered a record performance buoyed by South Korean sales after adjusting for around £4mn of Pimpernel sales which contributed to the previous record revenue performance in 2015. There should be scope to break new highs, driven by expansion into new geographies.

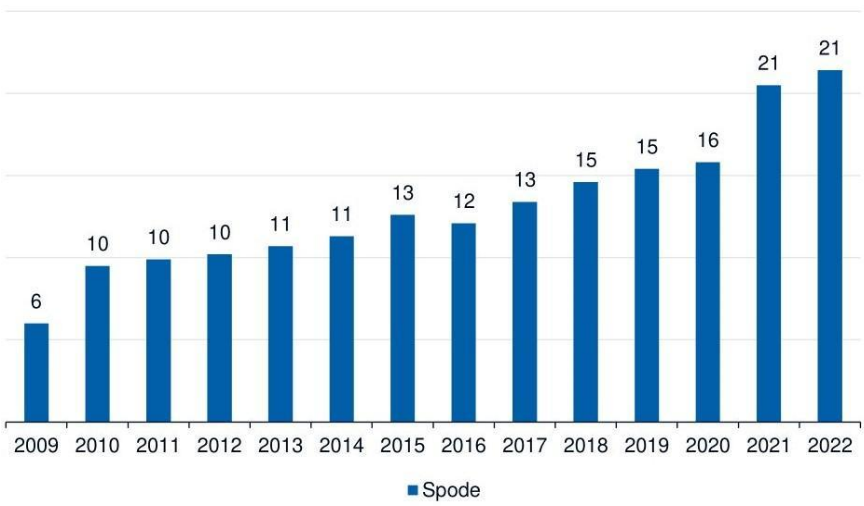
Portmeirion sales (£m)



Source: Shore Capital Company data

Spode, a company that was established in 1770 and merged with Royal Worcester in 2006, before both companies were acquired by Portmeirion from the administrators for £3.2mn in 2009, continues to deliver robust growth under the group's ownership. In the 13-year period, Spode's annual sales have more than doubled, an impressive performance and one that management are building on with the launch of a new range of products later this month, having entered a new collaboration with Kit Kemp Design Studio for an initial period of five years.

Spode sales (£m)



Source: Company Data; Shore Capital Markets

Established in 1751, Royal Worcester has performed well under Portmeirion's ownership, too, lifting annual sales from £4mn in 2010 to a high of £7.5mn in 2021, driven by its two major collections, Wrendale and Serendipity.

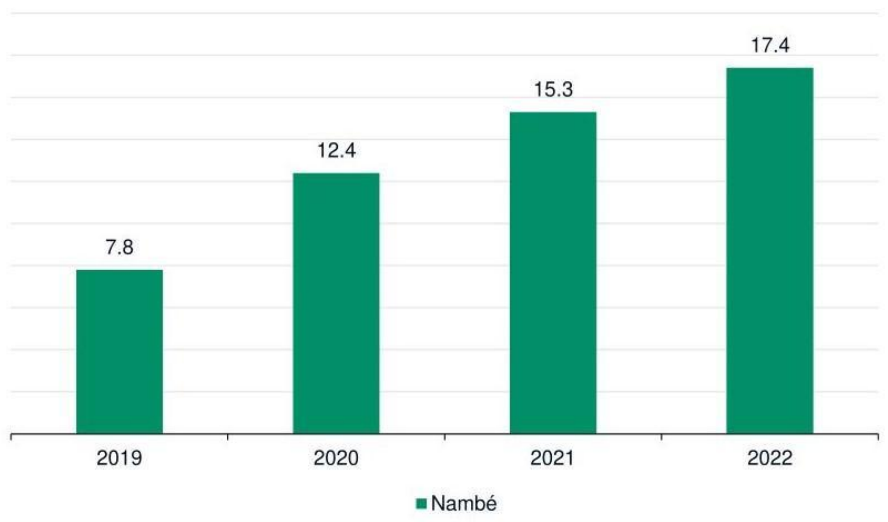
Source: Company Data; Shore Capital Markets

However, last year's stand-out performance came from Nambé, a company that designs, sources and retails homeware products. Portmeirion acquired the business for $12mn in 2019 to provide additional scale in its key US market and to diversify into new homeware product categories. Nambé's management team remained in place which strengthened the group's US-based team, and Portmeirion has leveraged the brand by selling through its existing sales channels and global sales infrastructure. It is also utilising the expertise of Nambé's design consultants across other brands, so generating cost savings.

Nambé has more than doubled sales since acquisition in 2019

Revenue from the Nambé brand surged 13 per cent to £17.4mn last year and is now materially above 2019 pre-acquisition sales levels despite disruption to sales markets from Covid. There should be more growth to come as Portmeirion continues to expand product ranges and sales distribution channels as well as establishing the brand outside of its core US market.

Nambé sales since acquisition (£m)

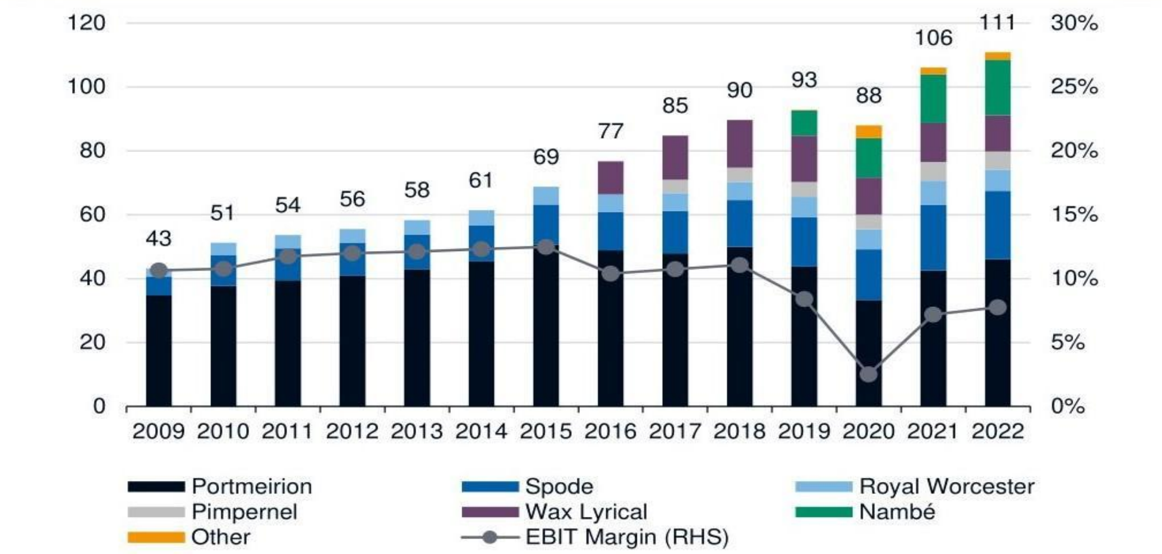


Source: Company Data

Portmeirion's underlying pre-tax profit increased 11 per cent to £8mn in 2022, or 8 per cent above the group's pre-Covid 2019 pre-tax profit of £7.4mn. However, this was delivered on record annual revenue of £110.8mn, or 19 per cent higher than the revenue reported in 2019. So, although 2022 operating profit of £8.7mn was £1mn higher than in 2021 as margin expanded from 7.2 to 7.8 per cent, it is still shy of the 8.4 per cent margin reported pre-Covid in 2019 and well below the 12.5 per cent record peak margin achieved in 2015. Getting the group operating margin back to that 12.5 per cent level is a key management objective.

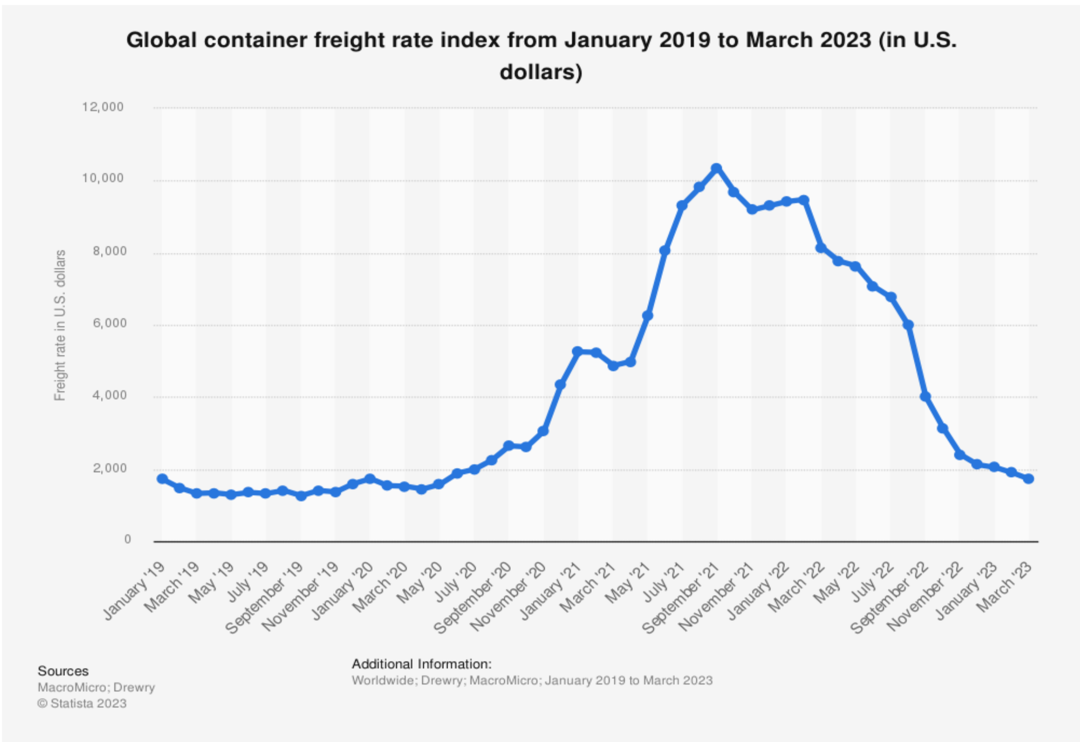
Of course, the pandemic created huge supply chain issues and the ensuing disruption led to a spike in freight costs, both of which have held back margins. Around 38 per cent of group sales are generated from the two UK factories (Lake District and Stoke-on-Trent) with the balance of products sourced from suppliers around the world. This exposes Portmeirion to increased cost of shipping containers as product from its six global brands is shipped mainly from distribution centres in the UK, US and Canada. The inflationary environment has extended to a whole host of other input costs including energy, a major component for a ceramic manufacturer.

Record sales each year since FY09A, bar FY20A (£m)



Source: Company Data; Shore Capital Markets

Bearing this in mind, Portmeirion has energy hedges in place until the first quarter of 2024, so should be well placed to benefit from the collapse in wholesale energy prices since last summer. The directors also report signs of global supply chain disruption starting to ease, while shipping container rates have plunged back to a three-year low and are now back to pre-pandemic levels. In other words, these major cost headwinds are now turning into tailwinds, a positive for improving operating margins.



Ongoing productivity improvements at the group's Stoke-on-Trent ceramic factory over the past two years are also positive for group profitability in a positive sales cycle. An accelerated four-year capital investment programme has seen investment in automation reduce manual handling and increase the number of pieces produced per labour hour. Average payback on project investment is three years or less, which combined with leveraging the factory's spare capacity means that as sales grow operating margins will ramp up.

Importantly, Portmeirion has pricing power – gross margin edged up from 40.3 to 40.5 per cent in 2022 – so has been able to pass on price rises to customers despite facing cost headwinds last year. This factor combined with factory productivity gains, and the strength and depth of its supply chain experience in managing high input cost inflation, has been key to delivering last year's improved operating profit margin in an inflationary environment.

Embracing the retail shift online is helping, too. Investment in direct to consumer fulfilment capabilities at each of the three distribution centres supports the growth in e-commerce as has building relationships with distributors and retailers who share a similar approach to digital growth.

A return to profit in the group's underperforming home fragrance division, trading as Wax Lyrical, should also help boost group operating margin.

Time to Wax Lyrical about a turnround

Source: Company Data; Shore Capital Markets

In 2016, Portmeirion acquired Wax Lyrical for £17.5mn, a price reflecting the £2.1mn pre-tax profit on revenue of £13.8mn that the scented candles and reed diffuser company reported the prior year. It appeared a good strategic fit, but the business has struggled to deliver a meaningful return on that investment in recent years. Although not disclosed by the directors, Shore Capital believe the business was loss-making in both 2021 and 2022, materially impacted by the closure of much of its customer base during Covid lockdowns.

Concentrated in physical retail, the nature of the product meant there was a much lower transition to online sales channels than with the group's core tableware businesses. Wax Lyrical's revenue declined seven per cent to £11.3mn last year and ended the year 23 per cent below pre-Covid levels. Due to cost reduction initiatives, profit contribution was £0.5mn better than in 2021, albeit a small undisclosed pre-tax loss was still incurred.

So, to improve factory utilisation, Portmeirion purchased the brand and certain assets of AromaWorks London out of administration in August 2022, paying £0.44mn in cash. AromaWorks is a manufacturer of a range of home fragrance products using essential oils in the adjacent health and wellbeing category with a retailer customer base in the UK and US. All its customers were retained including Waitrose, Holland and Barrett, and Champneys.

Portmeirion has since closed the AromaWorks factory and migrated the manufacturing of its product lines to existing capacity at Wax Lyrical's factory in Cumbria. This will drive better recovery of fixed overheads and, together with commercial product initiatives to leverage the enlarged joint customer base, is forecast by the directors to return Wax Lyrical to profitability in 2023. Furthermore, it's reasonable to expect the home fragrance category to show some sales recovery over the next few years as cost of living pressures ease, so removing a drag on the group operating margin.

Sound financials

As noted earlier, Portmeirion's ability to keep cost of sales in check in an inflationary environment coupled with a keen eye on general operating costs meant that the group delivered £2.1mn additional gross profit in 2022. Around half of the increase in gross profit dropped through to adjusted operating profit which rose 14 per cent from £7.6mn to £8.7mn on almost 5 per cent higher revenue of £110.8mn.

However, the 11 per cent increase in pre-tax profit lagged the growth in operating profit due to higher finance costs, up from £0.58mn to £0.96mn. The higher debt servicing costs – net interest payments increased 90 per cent to £0.69mn – reflected a £10.3mn working capital outflow due to a £9.9mn net increase in inventory which resulted in closing net debt (pre-IFRS 16 lease liabilities) of £10.1mn, reversing a £0.7mn net cash position 12 months earlier.

About two-thirds of the increase in net working capital was caused by foreign currency retranslation and supply chain cost increases, mainly container freight rates and material increases. The remainder was early purchasing for additional stock of key lines, which meant the group exited the year with a higher stock balance. The build-up of inventory should not be a concern given that it is focused on the stronger brands such as Nambé and Spode, both of which are showing good ongoing demand.

	2022 £m	2021 £m	2019 £m	2022 v 2021 Change	2022 v 2019 Change
Revenue	**110.8**	106.0	92.8	5%	19%
Headline* profit before tax	**8.0**	7.2	7.4	11%	8%
Headline* operating profit margin	**7.8%**	7.2%	8.4%	+0.6%	-0.6%
Headline* EPS	**46.59p**	38.85p	56.32p	20%	-17%
Dividends	**15.50p**	13.00p	8.00p	19%	94%
Net cash/(debt)	**(10.1)**	0.7	(12.3)	-10.8	+2.2

*Headline numbers exclude exceptional items; acquisition and restructuring costs.

Source: Portmeirion Group corporate results presentation (23 March 2023)

With improving supply chains, the directors expect stock balances to reduce during 2023 and end this year broadly in line with 2021 volumes, hence why joint house broker Shore Capital is pencilling in year-end net debt (pre-IFRS 16 lease liabilities) of £4.2mn, down from net borrowings of £10.1mn in 2022. Analysts at joint broking house Singer Capital Markets see even greater scope for debt reduction, forecasting net debt of £3.8mn at the year-end. This forecast is based on inventory levels falling back from £41.1mn to £36.7mn, so not quite returning to the 2021 position of £29.2mn due to higher cost of sales (namely price).

Singer Capital Markets' projection of a reduction in net debt is underpinned by forecast 2023 free cash flow of £8.5mn (61p per share) which factors in net capital expenditure of £4mn, net interest payments of £0.8mn and corporation tax of £2.1mn, all of which are deducted from projected operating cash flow of £15.4mn. Given the robust cash generation and improving profitability – Shore Capital and Singer Capital Markets predict group operating profit will increase this year from £8.7mn to £9.9mn and £10.5mn, respectively; implying at least one percentage point increase in operating profit margin to a range 8.8 to 9.2 per cent – then it is reasonable to expect another sharp hike in the pay-out.

	2022 £m	2021 £m	2019 £m	2022 v 2021 Change	2022 v 2019 Change
Non-current assets	**40.7**	36.9	35.1	10%	16%
Inventory	**41.1**	29.2	26.6	41%	55%
Trade & other receivables	**20.7**	19.9	19.5	4%	6%
Cash	**1.7**	7.6	1.2	-78%	42%
Total current assets	**63.5**	56.7	47.3	12%	34%
Trade and other payables	**-26.0**	-25.7	-20.4	1%	27%
Borrowings	**-11.8**	-6.9	-13.5	71%	-13%
Pension scheme	**0.3**	0.9	-0.4	-67%	-175%
Net assets	**66.7**	61.9	48.1	8%	39%

Source: Portmeirion Group corporate results presentation (23 March 2023)

So, having raised the annual dividend per share by 19 per cent to 15.5p in 2022, the broking houses are expecting the board to hike the 2023 pay-out per share to 17.2p (Singer Capital Markets) and 17.5p (Shore Capital), the dividend covered almost three times by their respective earnings per share (EPS) estimates (51.7p and 51.4p) and more than three times by Singer Capital Markets' free cash flow per share forecast.

On this basis, the shares are rated on a modest forward PE ratio of 8.9 and offer a current year prospective dividend yield of 3.8 per cent. That's a low rating for a group that is projected to deliver almost 11 per cent EPS growth in 2023 and one that both house brokers believe is well set to drive up EPS by more than 20 per cent to around 62p in 2024. They have reason to publish such high growth estimates as improving profitability in a positive sales cycle means that an even greater proportion of incremental gross profit earned is converted into operating profit.

Group financials

Income statement (£m, unless otherwise stated)					
Year-end December	FY21A	FY22A	FY23F	FY24F	FY25F
Revenues	**106.0**	**110.8**	**112.5**	**120.1**	**125.4**
% increase	20.7	4.5	1.5	6.7	4.4
Cost of sales	(63.3)	(66.0)	(66.4)	(70.3)	(72.7)
% group revenues	59.7	59.5	59.0	58.5	58.0
% increase	12.6	4.3	0.6	5.8	3.5
Gross profit	42.7	44.8	46.1	49.8	52.7
% group revenues	40.3	40.5	41.0	41.5	42.0
Operating expenses	(35.1)	(36.2)	(36.2)	(37.8)	(39.6)
% group revenues	33.1	32.6	32.2	31.5	31.6
Exceptional/non-recurring items	(1.2)	(1.0)	-	-	-
Share-based payments	-	-	-	-	-
Operating profit (Pre-x +SBP)	**7.6**	**8.7**	**9.9**	**12.0**	**13.1**
% group revenues	7.2	7.8	8.8	10.0	10.4
Operating profit	6.4	7.6	9.9	12.0	13.1
% group revenues	6.0	6.9	8.8	10.0	10.4
Net financial items	(0.0)	(0.7)	(0.8)	(0.8)	(0.6)
Net interest % net debt	9.2	4.0	7.6	10.6	11.0
PBT	6.0	7.0	9.1	11.2	12.5
% group revenues	5.6	6.3	8.1	9.3	9.9
PBT (Pre-x + SBP)	**7.2**	**8.0**	**9.1**	**11.2**	**12.5**
Tax	(2.7)	(1.4)	(2.1)	(2.6)	(2.9)
% Pre-exceptional PBT	-	21.5	22.5	23.0	23.0
Total tax charge	(1.9)	(1.6)	(2.1)	(2.6)	(2.9)
Net profit	3.2	5.6	7.1	8.6	9.6
% group revenues	3.1	5.0	6.3	7.2	7.7
Net profit (Pre-x + SBP)	5.3	6.4	7.1	8.6	9.6
% group revenues	5.0	5.8	6.3	7.2	7.7
RoE	8.6	9.6	9.9	11.1	11.4
Diluted shares in issue (ex-c0.2m in Treasury) (m)	13.8	13.8	13.8	13.8	13.8
Basic EPS (p)	23.5	40.3	51.4	62.8	69.7
% increase	-490.2	71.8	27.3	22.2	11.1
Adjusted diluted EPS (p)	**38.7**	**46.5**	**51.4**	**62.8**	**69.7**
% increase	681.2	20.2	10.4	22.2	11.1

Source: Company Data; Shore Capital Markets

It's also worth flagging Portmeirion's rock solid and well-funded balance sheet. Last year's closing net debt of £10.1mn was well within the group's £27.5mn combined credit facilities with Lloyds Bank, which include a £10mn revolving credit facility and £10mn term loan facility, both of which don't mature until 2025. Net debt equates to only 15 per cent of shareholders' funds, so balance sheet gearing is comfortable.

Also, net asset value of £66.7mn (476p) is above the current market capitalisation of £64mn, even though property, plant and equipment accounts for more than a quarter of book value and the group pension scheme ended 2022 in a small accounting surplus. Based on current year profit estimates (post share-based payments), the group is forecast to deliver a post-tax return on average equity of almost 10 per cent, a return on investment that suggests the shares really shouldn't be trading on a single-digit earnings multiple and priced below book value.

Peer group comparison

Portmeirion is undervalued on a peer group comparison basis, too. The shares are trading on forward PE multiples of 8.9 (2023) and 7.2 (2024), half that of larger peer **Churchill China (CHH),** even though the smaller group is expected to deliver 35 per cent aggregate EPS growth over the two-year forecast period. That's more than the 30 per cent EPS growth forecast for Churchill China in the same period.

Furthermore, Portmeirion's operating margin is expected to rise from 7.8 per cent to 10 per cent by 2024, marginally below the 10.8 per cent margin Churchill earned last year. Historically, the 12-month forward ratings gap between the two companies on a PE ratio basis averaged 3.5 points pre-Covid pandemic, highlighting the scope for the current eight point forward discount for both the 2023 and 2024 financial years to narrow materially. Portmeirion is also priced on a 42 per cent discount to Churchill China on a multiple of its enterprise valuation to 12-month forward Ebitda – earnings before interest, taxation, depreciation and amortisation – and offers a prospective dividend yield almost one percentage point higher.

Portmeirion peer group comparison

Company	Price	Market Cap	2023 PE	2024 PE	EV 2023	EV/ EBITDA	Divi yield (NTM)
Portmeirion	455p	£64.0mn	8.9	7.2	£74.1mn	5.0	3.8%
Churchill China	1,240p	£136.4mn	16.7	15.1	£120.9mn	8.7	3.0%
Sanderson Design	131.5p	£94.0mn	9.2	9.3	£77.4mn	4.1	2.7%
Colefax	755p	£54.6mn	9.9	11.6	£35.6mn	2.2	NA

Source: Portmeirion Group (Shore Capital estimates - 23 March 2023); Churchill China (FactSet); Sanderson Design (Progressive Equity Research -30 March 2023); Colefax (Peel Hunt - 23 January 2023)

Portmeirion's shares are rated on a ratings discount on a PE ratio basis to **Sanderson Design (SDG)** and **Colefax (CFX)**, both companies are international designers and distributors of furnishing fabrics & wallpapers so operate in the same consumer discretionary space. The discount looks anomalous given that Sanderson Design's earnings are forecast to be flat over the next two years, and analysts at Peel Hunt predict a fall in Colefax's earnings in the next financial year to 30 April 2024.

So, although Portmeirion enjoys a higher rating on an enterprise valuation to 12-month forward Ebitda basis, which highlights the fact that it has net debt currently while the other two companies have a net cash position, this is more than justified given its more attractive earnings growth profile. Indeed, if Portmeirion achieves Shore Capital's £16.8mn Ebitda forecast for 2024 and pays down net debt to £1.2mn, then its enterprise valuation to Ebitda multiple could tumble to 3.9, below that of Sanderson Group. It's not a case that its rivals are overvalued, but Portmeirion is significantly undervalued.

Management team

Portmeirion's chief executive **Mike Raybould** is a qualified Chartered Accountant who was previously finance director. In his current role he is responsible for formulating the group's objectives, strategy and overseeing operations. Before joining the group in 2017, he was the Chief Financial Officer of the Europe, Middle East and Africa (EMEA) Floorcare Division of Hong Kong Stock Exchange-listed, Techtronic Industries Company.

Finance director and Chartered Accountant **David Sproston** is responsible for all aspects of financial control. He previously held the same role at Portmeirion Group UK Limited, the group's main trading subsidiary, having joined from Deloitte in 2008.

Operations director **Mick Knapper** is responsible for sourcing, production, information systems and logistics functions. Knapper joined the group in 1998 and has been a board member of Portmeirion Group UK Limited since 2011.

Global sales director **Bill Robedee** is responsible for growing key sales markets in the UK, US and Canada and heads up the Portmeirion North America division. Before joining Nambé as chief executive in 2014, Robedee was chief legal officer at Lenox Holdings Inc. and General Counsel at Waterford Wedgwood Royal Doulton.

Non-executive chairman **Dick Steele** leads the board and is a Fellow of the Institute of Chartered Accountants in England and Wales and a member of the Institute of Taxation, adding to the financial experience of the board.

The group has three non-executive directors: Andrew Andrea, Angela Luger and Clare Askem.

Andrew Andrea, a qualified Chartered Accountant, has a wealth of experience gained in financial and commercial roles across diverse businesses including hospitality and retailing. He is currently chief executive of Marston's, having previously held the roles of chief financial officer and corporate development officer.

Angela Luger contributes general management experience with a retail, digital and customer focus. Luger is chair of The Paint Shed Holdings and non-executive director of retailers ScS

Group and New Look Retail Holdings Limited. Her previous executive positions include roles as chief executive of N Brown and The Original Factory Shop.

Clare Askem has a wealth of experience in business change and digital transformation. She holds non-executive director positions at The Law Debenture Corporation and IG Design Group and previously held executive roles at retail group's Sainsbury's (including Managing Director of Habitat), Home Retail Group and Dixons.

Portmeirion releases its annual accounts for the 2022 financial year on Friday, 14 April 2023, but in the prior year the board of directors were paid total remuneration of £2mn, a reasonable sum in relation to the £7.2mn pre-tax profit made by the group that year and the £1.82mn cash cost of the dividend. As the directors hold small shareholdings, share incentive plans and bonuses are more material financially to them, a strong motivation to hit margin targets that could lift group profits significantly and reward all shareholders with a higher share price and stock market rating.

Major shareholders

The share register lacks an institutional following with only Investec Wealth & Investment and Charles Stanley holding disclosable stakes above the 3 per cent limit. In fact, the top six shareholders only hold 35 per cent of the 14mn shares in issue.

However, this means that retail investors are the price setters in the market, something that is likely to work in their favour in the coming year as investors targeting lowly-rated below the radar companies latch onto the heady earnings growth Portmeirion is likely to deliver. Also, the bid-offer spread is around two per cent at the current price, albeit to build up a position you may need to execute several bargains to get the best price.

Portmeirion Group significant shareholders

Shareholder	Number of shares held	Percentage
Trustees of Caroline Fulbright Settlement	1.44mn	10.27%
AB Traction	1.055mn	7.54%
Investec Wealth & Investment	0.69mn	4.99%
Shahrzad Farhadi	0.63mn	4.52%
Kamrouz Farhadi	0.56mn	4.02%
Charles Stanley Group	0.54mn	3.89%

Source: Portmeirion Group

Target price

On any basis, the shares are significantly undervalued on forward PE ratios of 8.9 (2023) and 7.2 (2024), a bargain basement rating for a company that is predicted to deliver 35 per cent EPS growth over the two-year forecast period and one that is expected to deliver a healthy post-tax return on equity of around 10 per cent this year. The prospective dividend yields of 3.8 per cent and 4.6 per cent are attractive, too.

Furthermore, equity analysts at Shore Capital view their estimates as conservative, so there is the prospect of earnings upgrades materialising to support a re-rating that now seems under way with the shares now breaking out from a base formation. From a technical perspective a move through 520p to 530p, a previous level of support, would open the door to a run up to last year's high of 720p.

Singer Capital Markets has a target of 600p which equates to less than 10 times the broker's EPS estimate of 62.3p for 2024. That not only looks achievable, but beatable. A more realistic fair valuation is 700p a share to value the equity at £98mn and the group on an enterprise valuation of £100mn, equating to six times Ebitda forecasts for 2024, a rating 25 per cent below that of Churchill China. My 700p a share fair valuation is also based on a re-rating to a 2024 PE ratio of 11, still a 27 per cent discount to closest rival Churchill China. Buy.

Risk assessment

Economic environment. The Covid-19 pandemic disrupted the group's sales markets and operations around the world, led to closures of non-essential retail in some of its major markets, and accelerated the shift to online and omnichannel retail.

The group sells into more than 80 countries, although the majority of sales are concentrated into three key markets.

To mitigate risk, management maintains close relationships with key customers and suppliers to identify any signs of financial difficulties to prevent or limit any potential losses. The concentration of credit risk is limited due to the customer base being large and unrelated, and provisioning for doubtful debts is modest as a result. Customer orders and sales trends are constantly reviewed to enable early action to be taken in the event of declining sales. Also, the group continues to invest in online and digital capabilities and capacity to provide an increasingly direct to consumer element for product fulfilment.

Competitors. The group faces strong competition in most of the major markets in which it operates. The risk is managed by ensuring that high quality and innovative products are brought to market, maintaining strong relationships with key customers and ensuring the group is aware of local market conditions, trends and industry-specific issues and initiatives. This enables management to identify and address any specific matters within the group's overall business strategy. Portmeirion continues to invest in its strong brands and new product development to provide a point of difference, whilst working closely with key customers to provide a reliable and timely service.

Suppliers. The group's purchasing activities could expose it to over reliance on certain key suppliers or markets. The impact of Covid-19 on supply chains created inflationary cost increases and disruption through additional lead times. To mitigate risk, Portmeirion manufactures and sources products from a range of suppliers to reduce the impact of inflation or disruption in any market or supplier and ensures that key raw materials are available from more than one source to ensure continuity and competitive pricing. Suppliers are carefully selected to ensure a sufficient breadth in supply base.

Financial risk. This is wide-ranging and covers capital management, credit risk, currency risk and liquidity risk. The risks presented in these areas include the failure to achieve business goals, potential financial loss caused by default, reduction in profit due to currency fluctuations, and insufficient funds to continue trading.

Exposure to foreign currency risk arises from net investments in and cash flows from overseas subsidiaries. The policy in managing this risk is to maintain appropriate levels of net assets in the overseas companies and utilise foreign currency forward contracts. The most significant risk of exposure to foreign currency arises from the US dollar sales made by Portmeirion UK to Portmeirion North America. However, the net exposure to US dollar cash flows is not significant. That's because the group has a policy of having an average rate option in US dollars in place to manage the risk arising from the retranslation of profit made in the US, and after the year-end it places a forward contract for US dollars.

Portmeirion maintains a low level of balance sheet gearing and retains material headroom within current borrowings facilities, so there are no liquidity issues.

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