



Card Factory (CARD-LSE): £1.08

Market Cap: £372mm

Enterprise Value: £406mm

EV/EBITDA: 4

P/E: 7.6

Rating: Buy

Upside: 50%

12-month perf (%): -3.3%

30-Day Average Daily Volume: 1mm

Date: 5/1/2024

Company Background

Card Factory, a prominent UK retailer specializing in greeting cards and various celebration essentials (balloons, party supplies, picture frames, stuffed toys, etc.), has built a solid brand reputation based on its unmatched combination of value, quality, and selection. While competitors may rival Card Factory on one or two of these aspects, surpassing it in all three remains unlikely. Positioned to yield high returns on capital for the foreseeable future, Card Factory stands out in an ostensibly stagnant greeting card market. Despite general market assumptions of a declining sector, Card Factory is not only increasing its market share in greeting cards but also expanding in the growing segment of celebration essentials and gifts. Trading at merely ~7.5x EV-to-normalized-free-cash-flow, the market undervalues Card Factory, misjudging its strengthening position. We anticipate a low teens growth in free cash flow over the next five years, with cash generation surpassing the current enterprise value. We see a potential upside for the company of comfortably over 50%.

Opportunities

- **Market misperceptions**

Market participants view Card Factory's business model as in decline given the broader volume declines of cards. Despite small declines in UK card volumes, Card Factory has witnessed an increase in revenue from card sales. We do not view the slight volume decline as detrimental given the company continues to show evidence it can expand market share in cards and use this dominant market position to offer additional complementary products.

- **Non-card growth**

The most significant growth potential lies in non-card products. The new management is strategically reducing the floor space dedicated to greeting cards to increase the visibility and accessibility of gifts and other products. Currently, only 17% of Card Factory's customers purchase gifts along with their cards, while the industry average stands at about 70%. This indicates a substantial opportunity to boost sales through better store layout and presentation, which management is currently executing on.

Valuation

We believe that Card Factory will be able to grow revenues by ~7% in the intermediary period and we estimate normalized free cash flow of ~£62mm for FY 2025. Given Card Factory's operating leverage, non-variable expenses will grow sub-linearly, and we estimate FCFF growth at low teens for the intermediary period. Applying a range of discount rates to future cash flows and netting out net debt, we arrive at an intrinsic value of the equity at £565mm, signifying greater than 50% upside from current levels.

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