

## **Business Model and Operations**

4imprint is a leading direct marketer of promotional products in North America, the UK and Ireland. The customers of 4imprint can promote their brands, increase their presence in the target region by direct marketing products and raise brand awareness among the target audience with the help of the specially designed products with their logo and message. These products can be used for sales and marketing campaigns, recruitment or recognition services; to celebrate important events; and for any other purpose that helps the customer reach its goal. The portfolio contains apparel, bags, drinkware, writing, stationery, technology, outdoor and leisure, trade show and signage, auto, home and tools, wellness and safety products. 4imprint also has its 'own label' brands. *Crossland* as an apparel brand, *reFresh* as a line of affordable water bottles, and *SuperKid* brand as stickers and temporary tattoos are the main brands that experienced a significant expansion over the last few years.

Orders processes are easy and convenient, allowing the customers to research and purchase products in a simple and secure way. Customers can place an order either online or over the telephone, with the assistance of highly skilled customer service and art teams. Products are generally shipped to the customers by dropshipping method, meaning that there is limited inventory held by 4imprint and products are directly shipped from the suppliers' inventories. 60% of blank products are shipped from China, so it has strategic importance for the company (it comes with its own benefits and risks). 4imprint has 7000 items that are available to order today and ship tomorrow.

With the certain delivery policy, the company claims to process the order for free if it is not shipped on time. Certain value policy emphasizes the competitive and customer-oriented nature of the company that if customers find their order would cost less elsewhere within 30 days of purchase, they will be refunded double the difference. Certain happiness policy makes it possible for customers to return an item if they are not 100% happy with it. The employees are also trained specifically to provide a remarkable customer experience at any time. 4imprint's target customers are mainly organizations with more than 25 employees. There is no single customer that comprises a significant portion of the revenue. Apart from commercial businesses, governments, charitable organizations, religious, educational and other segments are also customers of 4imprint.

The company uses an efficient direct marketing business model. Innovative print and internet-based marketing methods are used to acquire new customers (Blue Box sample mailings, subscription mailings and online advertising). To be a leading direct marketer of promotional products through organic growth is the main goal of 4imprint. The company claims that they have a competitive advantage in the markets they operate in, and this is made possible by the continuous investment in marketing, human capital and technology. The differentiation through excellent customer service, merchandising and supply, efficient processing of individually customized, time-sensitive orders at scale are the company's main focus on operations.

4imprint's direct marketing business model does not require external financing and has a negative cash conversion cycle with very limited working capital requirements. However, the business is exposed to the general business cycle, meaning that any economic downturn would negatively impact the demand for the products. As people are unable to gather for events, meetings and training sessions, or in-office events, which are typical situations where promotional products are used, the demand for promotional products is lower. During COVID-19, 4imprint's sales have been almost perfectly correlated with the lockdown measures. As a result, 960,000 total orders were processed in 2020, as opposed to 1,587,000 orders in 2020. The company, however, maintained the marketing activities during these times, as this helps maintain brand awareness and facilitate faster recovery and market share gain when the crisis passes.

## **Quality of the company and the business**

4imprint relies on acquiring new customers as well as maintaining good relationships with the existing ones. Revenues from new customers consisted of 28% of the revenues in 2020, very similar to 2019, which proves that 4imprint could reach out to new customers even in unprecedented times. The 24-month customer retention rate remained around 43%. The company emphasizes organic growth as the main accelerator of the business and is focusing on the bigger market North America where sales have grown by 17% whereas sales in the UK and Ireland have declined by 10% (small effect on revenues). The industry has grown steadily over the past years and 4imprint has experienced a significantly larger growth than the industry (15% CAGR compared to 4% CAGR of the industry since 2016). However, the company's revenues are down 34% compared to a 19% decrease in the industry in 2020, losing some of its market share.

4imprint had managed to have a stable gross margin, operating margin, and net profit margin between 2016-2019 (around 32%, 6.5%, 4.5% respectively). In 2020, the company couldn't lower its COGS and operational expenses as much as the decrease in revenues, so the operating margin dropped from the peak of 4.96% in 2019 to a mere 0.55% in 2020. A relatively low and stable profit margin necessitates aggressive revenue increase to generate more profit every year, and this is what the company has been pursuing over the past years. With zero debt, current ratio (around 1.7) and quick ratio (around 1.5) have also been stable, signaling that the company can mitigate any liquidity-related issues. Favorable accounts receivable days and account payable days figures are the main driver of the business. Good relationships with suppliers and the customer-centric policy are reflected in these numbers as cash conversion cycle remained negative. It means that vendors are financing their operations with no extra cash needed to be injected into the business by 4imprint. Overall, the growth in sales reflected a significant increase in the cash balance (cash ratio increased from 0.54 to 0.79 between 2016-2020).

ROE and ROIC have been volatile but remained high (67.9% and 64.4% respectively in 2019). ROA has seen a peak of 31.6% in 2019 by increasing steadily over the past years. Although in 2020 these ratios were significantly negatively impacted by COVID-19, 4imprint's liquid structure and aggressive customer acquaintance policy with data-driven marketing strategies helped it to finish the year with a profit. The company's assets-to-equity ratio decreased constantly. To mitigate this de-leveraging issue, high asset turnover is needed to have a favorable ROE ratio. Regular dividends have increased from 52.50 cents to 84 cents per share from 2016 to 2020, growing in line with the total EPS growth (see appendix-1 for above paragraphs).

4imprint has a market-leading position with a low-cost base and constant cash flow generating structure. The company's business requires only limited working capital that helps to keep the healthy cash flow characteristics, definitely putting the company in the list of Buffett-like stocks. However, the strength of future cash flows remains fairly uncertain given that there are still some risks associated with the demand side. Even though the economies reopen, large gatherings might not come back soon, and the companies are expected to minimize discretionary spending to stay on the course. With the "new normal" life, customers may start relying more on alternative methods to promote their brands rather than using mainly tangible products.

On the other side, competition may increase in the coming years if the other competitors have a reach to low-cost suppliers and broader customer base. The company should also increase its market share in embroidered products and focus on scalability, product quality and speed to keep its competitive advantage. There are thousands of small-local similar businesses that can erode the 3% market share of 4imprint. 4imprint's advantage is its large scale with cash-rich basis business structure and good supplier relationships. The flexible business model and trained dynamic team helped them to generate £4.39m operating profit even in 2020. The future of the business depends on how the company will adapt to new trends in the industry and whether they can maintain their leading position in the market.

## Valuation

It is hard to compare 4imprint with other companies as the business model is rather unique. I assumed that the company will not be able to turn back to its previous profit levels next year. I took the net income as roughly £30m for the next year for my multiples valuation analysis. Share price is currently £25.10 with 28m outstanding shares. This means that the future PE ratio is around 23, which can be argued to be a relatively expensive value for 4imprint. If the company can manage to get back to its long-term growth line, this PE ratio can be considered normal. Comparing this PE ratio with the industry PE ratio, we can also conclude that 4imprint is trading with a premium compared to other similar companies. I am also assuming that the company could turn back to its EBITDA of £45m in 2018 (positive assumption). This points out an EV/EBITDA ratio of roughly 14.5, which is way above the industry standards. As the company is traded significantly above average industry ratios, the market seemed to have appreciated this successful business model 4imprint has sustained so far. Keeping the high-risk/high-reward rule in mind, I believe that 4imprint is expensive given that the uncertainties still remain. I also believe that this risk-reward structure does not provide us with a good margin of safety to take long position in this stock. On the other side, high vaccine rollouts in the US could be a big catalyzer for the 4imprint's business model if the firm can sustain its successful marketing campaigns (see Appendix-2).

DCF would be a better approach to determine the value of the business since there are not many similar businesses to compare. Zero debt structure and relatively simple balance sheet and operations make this method more favorable. However, revenue estimates and terminal value figures can change the valuation dramatically and are hard to forecast correctly at these times. I assumed that 4imprint would reach its 2018 sales value in 2021 and continue to grow by 10% in the next 5 years as a base scenario (CAGR is 15% from 2016 to 2020). I took the gross margin as an average of 5 years' gross margin and applied the same technique for determining the marketing costs which consist important part of the operating costs. I applied a similar technique for other assumptions as well. I also used a tax rate of 28% for future valuations as the Biden administration plans to increase the corporate tax rate. I didn't have to calculate measures like WACC and unlevered beta, because the company has no debt and doesn't seem to have in the future. WACC (only equity discount rate) and unlevered beta are taken as 10% and 1.2 respectively. My conservative DCF valuation is reflecting my investment philosophy that always puts 'margin of safety' first (see Appendix-3).

As a result, I found the theoretical share price as £17.05 with my relatively conservative valuation. This represents a 32% decline from the current price of £25.10. To sum up, although 4imprint has strong financials and stable cash flow characteristics, according to both multiples and DCF valuation techniques, the company seems expensive.

## Appendix-1

<b>INCOME STATEMENT ('000s)</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
<b>Revenue</b>	<b>558,223</b>	<b>627,518</b>	<b>738,418</b>	<b>860,844</b>	<b>560,040</b>
COGS	374,128	422,299	502,230	585,524	402,104
<b>Gross Profit</b>	<b>184,095</b>	<b>205,219</b>	<b>236,188</b>	<b>275,320</b>	<b>157,936</b>
Operational Expenses	(145,718)	(162,639)	(190,010)	(220,439)	(152,910)
<i>Marketing Costs</i>	(96,703)	(110,644)	(131,232)	(154,310)	(92,880)
<i>Selling costs</i>	(23,166)	(24,995)	(27,850)	(31,037)	(30,784)
<i>Admin &amp; central costs</i>	(25,849)	(27,000)	(30,928)	(35,092)	(29,246)
<i>Share option related charges</i>	0	(551)	(819)	(949)	(634)
Operating Profit	38,377	42,580	45,359	53,932	4,392
Interest expense&income	(24)	(122)	227	751	(25)
Profit Before Tax	38,353	42,458	45,586	54,683	4,367
Non-operational expenses	(4,202)	(1,799)	(1,440)	(690)	(524)
Tax	(9,672)	(11,734)	(8,952)	(11,276)	(753)
<b>Net Income</b>	<b>24,479</b>	<b>28,925</b>	<b>35,194</b>	<b>42,717</b>	<b>3,090</b>
<b>BALANCE SHEET ('000s)</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
Cash and cash equivalents	21,683	30,767	27,484	41,136	39,766
Inventories	4,179	5,356	9,878	11,456	11,271
Trade and other receivables	39,766	46,309	46,228	52,899	36,799
Current tax debtor	34	472,000	644	140	1,976
<b>Current assets</b>	<b>65,662</b>	<b>82,904</b>	<b>84,234</b>	<b>105,631</b>	<b>89,812</b>
Property, plant and equipment	18,938	18,829	19,012	24,369	24,832
Intangible assets	1,082	1,138	1,084	1,152	1,100
Right-of-use assets	5,030	0	0	1,985	13,065
Deferred tax assets	0	5,912	5,636	4,338	4,272
<b>Non-current assets</b>	<b>25,050</b>	<b>25,879</b>	<b>25,732</b>	<b>31,844</b>	<b>43,269</b>
Lease liabilities	0	0	0	1,630	1,117
Trade and other payables	40,363	47,675	50,252	59,209	49,569
Current tax creditor	0	0	-500	0	-432
Provisions	0	-146	0	0	0
<b>Current liabilities</b>	<b>40,363</b>	<b>47,529</b>	<b>49,752</b>	<b>60,839</b>	<b>50,254</b>
Lease liabilities		0	0	-415	-12,089
Retirement benefit obligations	19,290	18,106	15,016	12,305	3,310
Deferred tax liabilities	1,734	763	931	968	1,193
<b>Non-current liabilities</b>	<b>21,024</b>	<b>18,869</b>	<b>15,947</b>	<b>12,858</b>	<b>-7,586</b>
Share capital	18,842	18,842	18,842	18,842	18,842
Share premium reserve	68,451	68,451	68,451	68,451	68,451
Other reserves	6,420	5,861	5,427	5,254	6,117
Retained earnings	-64,388	-51,061	-49,453	-29,599	-28,039
<b>Shareholder's equity</b>	<b>29,325</b>	<b>42,093</b>	<b>43,267</b>	<b>62,948</b>	<b>65,371</b>
Total Assets	90,712	108,783	109,966	137,475	133,081

Profitability Ratios	2016	2017	2018	2019	2020
Gross Margin	32.98%	32.70%	31.99%	31.98%	28.20%
Operating Margin	6.87%	6.79%	6.14%	6.27%	0.78%
Net Profit Margin	4.39%	4.61%	4.77%	4.96%	0.55%
Liquidity Ratios					
Current Ratio	1.63	1.74	1.69	1.74	1.79
Quick Ratio	1.52	1.62	1.48	1.55	1.52
Cash Ratio	0.54	0.65	0.55	0.68	0.79
Working Capital Ratios					
Accounts Receivable Days	25.65	26.57	22.54	22.12	23.65
Accounts Payable Days	38.84	40.64	36.02	36.40	44.38
Inventory Days	4.02	4.57	7.08	7.04	10.09
Cash Conversion Cycle	-9.17	-9.51	-6.40	-7.24	-10.63
Leverage Ratios					
Debt-Equity Ratio	no debt	no debt	no debt	no debt	no debt
Debt-to-Capital Ratio	no debt	no debt	no debt	no debt	no debt
Equity Multiplier	3.09	2.58	2.54	2.18	2.04
Operating Returns					
Return on Equity (ROE)	83.47%	68.72%	81.34%	67.86%	4.73%
Return on Assets (ROA)	26.96%	26.48%	32.21%	31.62%	2.30%
Return on Invested Capital (ROIC)	79.77%	61.88%	76.99%	63.38%	1.15%
DuPont Identity					
Net Profit Margin	0.044	0.046	0.048	0.050	0.006
Asset Turnover	6.154	5.769	6.715	6.262	4.208
Equity Multiplier	3.093	2.584	2.542	2.184	2.036
ROE	0.83	0.69	0.81	0.68	0.05
Depreciation	2,390	2,510	2,650	2,780	3,430
EBIT	35,987	40,070	42,709	51,152	962
EBITDA	38,377	42,580	45,359	53,932	4,392

## Appendix-2

### Marketing service companies' multiples

	Price (US\$)	Perf ytd (%)	P/E last (x)	P/E 1FY (x)	P/E 2FY (x)	Hist EV/sales last (x)	EV/ EBITDA last (x)	EV/ EBITDA 1FY (x)	EV/ EBITDA 2FY (x)	Div yield last (x)	EBITDA margin last (%)	EBITDA margin 1FY (%)
Veritiv	17.76	(9.7)	-	-	16.9	0.1	5.4	5.7	5.4	0.0	2.0	2.4
Core- Mark	33.85	24.5	20.0	22.0	17.8	0.1	9.2	9.8	8.6	0.0	1.1	1.1
Average		7.4	20.0	22.0	17.3	0.1	7.3	7.7	7.0	0.0	1.6	1.7
4imprint	28.20	(39.1)	16.8	N/A	65.2	0.8	12.0	186.7	38.3	3.2	6.9	0.7

Source: Refinitiv, Edison Investment Research. Note: Prices at 3 September 2020.

### US distributor's multiples

	Price	Perf	P/E	P/E	P/E	Hist	EV/	EV/	EV/	Div	EBITDA	EBITDA
	(p)	ytd	last	1FY	2FY	EV/sales	EBITDA	EBITDA	EBITDA	yield	margin	margin
		(%)	(x)	(x)	(x)	last (x)	last (x)	1FY (x)	2FY (x)	last (x)	last (%)	1FY (%)
M&C Saatchi	61	(50.8)	2.6	5.4	5.4	0.4	3.2	3.2	3.0	18.0	13.3	12.7
Mission Group	60.5	(22.2)	6.8	153.8	8.0	0.9	4.5	33.0	6.5	1.3	19.3	3.4
Kin + Carta	68.9	(30.8)	7.5	10.7	8.5	1.0	7.9	8.0	7.0	2.8	13.1	14.6
Next Fifteen	487	(9.5)	14.0	14.8	12.0	2.0	8.9	9.4	8.4	0.5	22.9	20.6
Communications												
Altitude	15.75	(67.2)	N/A	26.3	N/A	0.5	N/A	4.8	N/A	0.0	N/A	10.5
Pebble Group	106	(23.7)	37.7	N/A	N/A	1.6	11.3	N/A	N/A	0.0	14.2	N/A
<b>Average</b>		<b>(34.0)</b>	<b>13.7</b>	<b>42.2</b>	<b>8.5</b>	<b>1.1</b>	<b>7.2</b>	<b>11.7</b>	<b>6.2</b>	<b>3.8</b>	<b>16.6</b>	<b>12.4</b>
4imprint	2020	(39.1)	16.8	N/A	65.2	0.8	12.0	186.7	38.3	3.2	6.9	0.7

Source: Refinitiv, Edison Investment Research. Note: Prices at 3 September 2020.

### Appendix-3

INCOME STATEMENT ('000s)	2016	2017	2018	2019	2020	2021E	2022E	2023E	2024E	2025E	
Revenue	558,223	627,518	738,418	860,844	560,040	738,418	812,260	893,486	982,834	1,081,118	
COGS	374,128	422,299	502,230	585,524	402,104	516,893	568,582	625,440	687,984	756,782	
Gross Profit	184,095	205,219	236,188	275,320	157,936	221,525	243,678	268,046	294,850	324,335	
Gross Margin	33.0%	32.7%	32.0%	32.0%	28.2%	30.0%	30.0%	30.0%	30.0%	30.0%	
Operational Expenses	(145,718)	(162,639)	(190,010)	(220,439)	(152,910)	(196,134)	(212,370)	(229,576)	(246,724)	(268,859)	
Marketing Costs	(96,703)	(110,644)	(131,232)	(154,310)	(92,880)	(129,223)	(142,145)	(156,360)	(171,996)	(189,196)	
Marketing cost as % of sales	17.3%	17.6%	17.8%	17.9%	16.6%	17.5%	17.5%	17.5%	17.5%	17.5%	
Selling costs	(23,166)	(24,995)	(27,850)	(31,037)	(30,784)	(33,937)	(36,377)	(38,854)	(40,966)	(44,272)	
Admin & central costs	(25,849)	(27,000)	(30,928)	(35,092)	(29,246)	(32,383)	(33,257)	(33,771)	(33,172)	(34,802)	
Share option related charges	0	(551)	(819)	(949)	(634)	(591)	(591)	(591)	(591)	(591)	
Operating Profit	38,377	42,580	45,359	53,932	4,392	25,392	31,308	38,470	48,126	55,476	
Interest expense&income	(24)	(122)	227	751	(25)	161	161	161	161	161	
Profit Before Tax	38,353	42,458	45,586	54,683	4,367	25,553	31,469	38,631	48,287	55,637	
Non-operational expenses	(4,202)	(1,799)	(1,440)	(690)	(524)	(1,731)	(1,731)	(1,731)	(1,731)	(1,731)	
Tax	(9,672)	(11,734)	(8,952)	(11,276)	(753)	(6,670)	(8,327)	(10,332)	(13,036)	(15,094)	
Net Income	24,479	28,925	35,194	42,717	3,090	17,152	21,411	26,568	33,521	38,813	
WORKING CAPITAL ('000s)	2016	2017	2018	2019	2020	2021E	2022E	2023E	2024E	2025E	
Trade and other receivables	39,766	46,309	46,228	52,899	36,799	49,444	54,388	59,827	65,810	72,391	
Days Receivables Outstanding	26.0	26.9	22.9	22.4	24.0	24.4	24.4	24.4	24.4	24.4	
Inventories	4,179	5,356	9,878	11,456	11,271	9,420	10,361	11,398	12,537	13,791	
Days Inventories Outstanding	4.08	4.63	7.18	7.14	10.23	6.7	6.7	6.7	6.7	6.7	
Trade and other payables	40,363	47,675	50,252	59,209	49,569	56,365	62,002	68,202	75,022	82,525	
Days Payables Outstanding	39.38	41.21	36.52	36.91	45.00	39.8	39.8	39.8	39.8	39.8	
Depreciation	2,390	2,510	2,650	2,780	3,430	3,134	3,448	3,793	4,172	4,589	
Depreciation as % of sales	0.43%	0.40%	0.36%	0.32%	0.61%	0.42%	0.42%	0.42%	0.42%	0.42%	
CapEx		2,401	2,833	8,137	3,893	3,554	3,910	4,301	4,731	5,204	
CapEx as % of sales	0.00%	0.38%	0.38%	0.95%	0.70%	0.48%	0.48%	0.48%	0.48%	0.48%	
FREE CASH FLOW ('000s)	2020	2021E	2022E	2023E	2024E	2025E	Unlevered beta				1.2
EBIT*(1-t)	28,070	16,025	20,059	24,967	31,647	36,638	risk-free rate				1.8%
Depreciation	3,430	3,134	3,448	3,793	4,172	4,589	risk premium				5.0%
Change in working capital		3,997	250	275	302	332	WACC (only equity)				10.0%
CapEx		3,554	3,910	4,301	4,731	5,204	Terminal Value				
Free Cash Flow		11,608	19,347	24,185	30,786	35,691	528,191				
Present Value		10,557	17,595	21,994	27,997	32,459	328,562				
Enterprise Value	£439,164.22										
Equity Value (EV+Cash -Debt)	£478,930.22										
Shares Outstanding	28085.5										
Theoretical Share Price	£17.05										
Current Share Price	£25.10										