SANDERSON DESIGN GROUP

CONSUMER DISCRETIONARY

11 November 2021

SDG.L

169p

Market Cap: £120m

SHARE PRICE (p)

12m high/low	234p/61p

Source: LSE Data

KEY DATA	
Net (Debt)/Cash	£10.5m *(at 31/07/21)*
Enterprise value	£109.5m
Index/market	AIM
Next news	FY update - Feb 2022
Shares in Issue (m)	71.0
Chairman	Dame Dianne Thompson
Chief Executive	Lisa Montague
Finance Director	Mike Woodcock

COMPANY DESCRIPTION

Sanderson Design Group is a luxury interior furnishings company, specialising in wallpapers, fabrics and paints.

www.sandersondesign.group

SANDERSON DESIGN GROUP IS A RESEARCH CLIENT OF PROGRESSIVE

ANALYSTS

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Seeking sustained growth…

…in a sustainable fashion

Sanderson Design Group is a leading luxury interior furnishings company, specialising in fabrics, wallpaper and paints, which are sold around the globe. Since the change in leadership in 2019, the group has been following a clearly articulated strategic framework with detailed milestones up to FY24, including its sustainability programme, Live Beautiful. This is with a view to driving sales (and profitability) to close the gap between the undoubted brand equity within its portfolio and the relatively low quantum of realised turnover, which suggests a degree of suboptimal performance. We believe the group is on track to redress this imbalance.

- **A unique business:** SDG is unique, both as the sole UK-listed wallpaper and fabric company with its own in-house manufacturing capabilities, and through its positioning as both a design- and heritage-led company. Its unique and extensive archive is the jewel in the crown of the group's assets, and an incomparable resource to be leveraged into both its own ranges and its licensing activities to third parties. The archive is a source of superior differentiation and sustainable competitive advantage. The planned digitisation of the archive should make a significant contribution to overall business efficiency, contributing eventually to a higher level of profitability.
- **Multiple growth drivers:** The past two years have focused primarily on strengthening the business foundations, rightsizing the cost base and increasing business efficiencies. The group is now shifting its attention to a significant number of growth drivers, all of which are within its gift as self-help actions. These include domestic and international expansion, leveraging its unique archive, increasing brand awareness, extending its licensing agreements and range extension. The group is slated to add homewares alongside its core fabric and wallpaper offering in FY24. The addition of direct to consumer (DTC) activity will expose the group to a new customer demographic, driving incremental sales, as will its concerted move to embrace digital marketing and social media.
- **Valuation:** The share price has risen substantially (by around 6x) from its low point in April 2020. The group has a higher rate of forecast sales growth compared with most of the selected peer group on a two-year view. SDG's shares lag the average and median of our selected comparative company cohort by around 10% on a combined basis.

FYE JAN (£M)	2020	2021	2022E	2023E	2024E
Revenue	111.5	93.8	110.9	117.7	127.0
Adj EBITDA	14.1	13.6	17.0	18.2	19.5
Fully Adj PBT	7.4	7.1	10.6	11.6	12.8
Fully Adj Dil EPS (p)	9.2	7.8	11.8	12.9	14.6
EV/Sales (x)	1.0x	1.2x	1.0x	0.9x	0.9x
EV/EBITDA (x)	7.8x	8.1x	6.4x	6.0x	5.6x
PER (x)	18.4x	21.6x	14.3x	13.1x	11.6x

Source: Company Information and Progressive Equity Research estimates.

Executive Summary and Investment Case

Overview

A luxury interior furnishings company with a portfolio of prestigious brands…

Sanderson Design Group is a luxury interior furnishings company, specialising in wallpapers, fabrics and paints, and spanning the spectrum of heritage and contemporary design. The group's products are sold globally through a portfolio of well-known brands, comprising Sanderson, Morris & Co., Harlequin, Zoffany, Scion, Clarke & Clarke and the recently launched direct to consumer (DTC) brand, Archive by Sanderson Design.

…with a long heritage and a unique archive of wallpaper and fabric samples

The group has a long, significant heritage from both a historical and design perspective, with the iconic Sanderson and Morris & Co brands founded in 1860 and 1861, respectively. This heritage is encapsulated and embodied in the group's unique archive, which contains over 150,000 original samples of wallpapers, fabrics and other artefacts. These provide a rich source of information and inspiration for the group's own designers and underpin the group's lucrative licensing activities.

Addressing performance gap to substantial brand equity with well-defined strategic plan

In our view, while Sanderson Design Group enjoys positive brand equity, the relatively low quantum of turnover suggests a performance gap, and that the brands are performing suboptimally and punching below their weight. This gap can be narrowed by generating greater awareness and creating positive experiences to generate further purchases. We believe the strategy laid out by the group is addressing these issues. Having strengthened the foundations of the business over the past two years, the group should start to reap the rewards of amplifying its brands to generate appropriately higher levels of sales growth and aggregate turnover over the medium term, with traction on brand building often taking around three years to deliver tangible results.

Substantial scope to profitably expand over the longer term

Sanderson Design Group is a unique business, being the only UK-listed wallpaper and fabric company with in-house manufacturing capabilities. We believe the group has substantial scope to profitably expand both its domestic and international market share over the longer term, primarily focusing on its US and Northern Europe target markets.

Valuation sits at 10% discount to compco cohort

The share price has risen substantially (c.6x) from its low point in April 2020 and is around twice as high as its pre-pandemic level in Q1 2020. The group trades at a discount of 10% to the average and median of our selected comparative company (compco) cohort on a combined basis.

Key strengths

Significant key strengths…

SDG benefits from significant strengths across many areas of its business operations, including:

- ***Historical archive:*** The group's extensive, unique archive is the jewel in the crown of its assets. The archive offers an incomparable resource to be leveraged into both its own ranges and its licensing activities. It is a source of both superior differentiation and sustainable competitive advantage.

- ***Leading in-house manufacturing capabilities:*** The vertical integration offered by the Anstey and Standfast facilities and their commitment to leading-edge technologies such as digital printing, alongside more traditional artisanal skills, mitigate some Brexit pressures compared with non-manufacturing competitors, and are increasingly attractive to third-party brands.

- ***Clearly segmented brand portfolio:*** The brand portfolio comprises well-positioned brands offering a range of styles and price points, appealing to a wide range of customers.

- ***End-to-end capabilities:*** With the introduction of DTC brands, the group is starting to develop end-to-end capabilities from design drawing board into the homes of end-consumers.

- ***Brand equity:*** The rich cultural heritage of brands such as Morris & Co and Sanderson commands and underpins high levels of brand equity.

- ***Strong balance sheet and cash-generative:*** The group has a strong balance sheet and is cash-generative, although cash generation will be more muted over the short to medium term due to increased levels of investment capex.

The group is addressing areas of historical weakness, including underinvestment over the past decade. New investment is planned in technology solutions to drive productivity and enhance margins. There also remains more to do in terms of upgrading systems and processes.

Growth drivers

…and growth drivers

We see the following as the main growth drivers, all of which are areas of self-help action:

- ***Leveraging the unique archive:*** Increased leverage of the group's unique and extensive Intellectual Property (IP) in the form of its archive. Digitisation of this source of sustainable competitive advantage will increase accessibility to and facilitate utilisation of this resource, bringing concomitant productivity gains.

- ***Increasing brand awareness:*** An integral part of group strategy is to elevate and promote the individual brands. High-profile media campaigns such as Sanderson's with Maro Itoje and Harlequin's 'Own the Room' campaign are leading the way on this front, complemented by a concerted push in social media and digital advertising.

- ***Domestic expansion:*** Extension of its UK market leadership position through enhanced relationships with retail, contract and interior design customers, driving higher average order values (AOV) over the medium term. The introduction of new DTC brands, such as Archive and the online shop, scionliving.com, will open complementary new channels to a wider market, attracting new customers to the group.

- ***International expansion:*** The main thrust on this front will be the core markets of the USA and Northern Europe. SDG aims to double revenues in North America, compared with the FY20 base when its new strategy was unveiled.

- ***Licensing:*** Leveraging the group's brand equity to build existing licensee relationships and attract new, major partners across a broad range of product categories.

- ***Range extension:*** The group is exploring a third lever to its core fabric and wallpaper ranges in the form of homewares. This is slated as a strategic milestone for FY24.

- ***Increasing business efficiencies:*** These are being sought in many areas to underpin group profitability and margin. Inventory efficiency has been improved through the reduction of annual collections launched and the total number of SKUs. Further infrastructure investment in areas such as digital printing and the new Enterprise Resource Planning (ERP) system at Standfast will improve efficiencies.

Current trend to maximalism helpful

The current trend to maximalism (ie more decorative styles), possibly gaining traction to counter the bleakness of the pandemic and enforced lockdowns, could also benefit the group over the short to medium term.

Forecasts

The following table summarises our key forecasts for the three years to FY24E. Given the exceptional circumstances of the pandemic shaping the commercial performance of FY21, we have also included the figures for FY20.

Summary of key P&L components – FY20-FY24E

	FY20	FY21	FY22E	FY23E	FY24E	3-yr CAGR
Turnover	**111.5**	**93.8**	**110.9**	**117.7**	**127.0**	**10.6%**
Gross profit	68.1	57.0	68.8	73.0	78.7	11.4%
Gross margin (%)	*61.1%*	*60.8%*	*62.0%*	*62.0%*	*62.0%*	
Adjusted EBITDA	**14.1**	**13.6**	**17.0**	**18.2**	**19.5**	**12.9%**
EBITDA margin (%)	*12.7%*	*14.5%*	*15.4%*	*15.4%*	*15.4%*	
Adjusted operating profit	**7.8**	**7.2**	**10.8**	**11.8**	**13.0**	**21.6%**
Operating margin (%)	*7.0%*	*7.7%*	*9.7%*	*10.0%*	*10.3%*	
Adjusted PBT	**7.4**	**7.1**	**10.6**	**11.6**	**12.8**	**21.9%**
Adjusted PBT margin (%)	*6.6%*	*7.5%*	*9.5%*	*9.8%*	*10.1%*	
Adjusted diluted EPS (p)	**9.2**	**7.8**	**11.8**	**12.9**	**14.6**	**23.2%**
Dividend (p)	**0.5**	**0.0**	**3.5**	**3.8**	**4.2**	**n.a.**
Net (debt)/cash - exc lease liabilities	**1.3**	**15.1**	**16.6**	**17.2**	**18.5**	**6.9%**

Source: Sanderson Design Group; Progressive Equity Research

Increasing double-digit three-year CAGR forecasts moving down the P&L account

The column that shows the three-year compound annual growth rate (CAGR) highlights the impressive and increasing double-digit growth figures as one moves down the P&L. Gross, EBITDA, EBIT and PBT margins rise across the period in relation to both the FY21 base year and to FY20. The year-end net cash figure (excluding lease liabilities) delivers a solid CAGR of 6.9% over the period.

Valuation

SDG has superior rate of sales growth to compco group

Our comparative companies (compco) analysis shows that SDG has better turnover growth prospects than the aggregate for our compco group. In contrast to its favourable relative growth outlook, SDG trades at a discount against both the average and median valuation metrics of the group, more so against the average than the median figures, where it is more closely aligned. Taking a simple arithmetic average of the indexed valuations across the two calendar years of consensus forecasts (CY2021E and CY2022E), SDG's valuation is around 18% and 2% lower, respectively, than the average and median for the compco cohort, or 10% lower on a combined basis. The group's valuation is markedly lower when indexed against the best-in-class metrics over this period.

Background and History

A luxury interior furnishings company with…

Sanderson Design Group (SDG) is a luxury interior furnishings company, spanning the spectrum of both heritage and contemporary design. The group's principal activities comprise the design, manufacture and marketing of wallpapers, fabrics and paints. The group also derives licensing income from third parties for the use of its designs on a wide range of products such as bed and bath collections, rugs, blinds, tableware and apparel.

…a prestigious brand portfolio

The group's brand portfolio comprises Sanderson, Morris & Co., Harlequin (now including Anthology), Zoffany, Scion, Clarke & Clarke and Archive by Sanderson Design. The group has a long, significant heritage from both a historical and design perspective, with the iconic Sanderson and Morris & Co brands founded in 1860 and 1861, respectively.

Wallpaper and fabric manufacturing facilities

The group has a substantial UK manufacturing base comprising its Anstey wallpaper factory in Loughborough ('Anstey') and Standfast & Barracks, a fabric printing factory in Lancaster ('Standfast'). Both sites manufacture not only for the company but also for third parties, primarily renowned interiors companies and brands. Standfast & Barracks boasts a proud heritage within its domain, having been established in 1924, with Anstey the result of the integration of several wallpaper businesses stretching back over a century.

Unique archive a rich source of information and design inspiration

The group has several archives across its facilities, housing over 150,000 original samples of wallpapers, fabrics and other artefacts, some of which date from as far back as the 18th century. These provide a rich source of information and inspiration, both for the group's own designers and third-party clients.

Group formed from a number of business combinations

The shape of today's group results from a number of business combinations over many decades. When Morris & Co was dissolved in 1940, Sanderson and Sons bought its wallpaper business and the rights to use the Morris name. The Sanderson business was acquired by Walker Greenbank in 2003. While Walker Greenbank's origins were rooted in the engineering sector, its 1987 acquisition of Wallcoverings International marked a change of direction into the interior furnishings arena. This acquisition brought established wallpaper brands Zoffany and Harlequin into the group, as well as the Anstey Wallpaper Company with its production facility in Leicestershire. In 2000, Walker Greenbank acquired the Standfast & Barracks fabric printing operation, thereby sealing its transformation into an interior furnishings specialist.

Acquired Clarke & Clarke in 2016

As part of a concerted move to extend its offering and customer appeal, in 2012 the group extended its brand portfolio with the launch of the Scion brand. In 2016, the group acquired the British interior design company Clarke & Clarke, founded in 1999 by Lee and Emma Clarke, offering a more accessible mid-market and value pricing proposition for its wallcoverings and fabrics ranges. In September 2021, the group launched a direct to consumer (DTC) brand, Archive by Sanderson Design.

Name change to Sanderson Design Group in 2020 from Walker Greenbank

Until 2020, the group traded as Walker Greenbank plc. The change of name to Sanderson Design Group plc and a simplified corporate structure more directly communicates both the group's longstanding heritage and its core competence of design.

Holders of a Royal Warrant since 1923

Arthur Sanderson & Sons was initially awarded a Royal Warrant of Appointment in 1923, with its current warrant issued in 1955, entitling Sanderson to use the rubric 'By appointment to HM Queen Elizabeth II Suppliers of Wallpapers, Paints and Fabrics'.

Sanderson Design Group has around 610 employees and its products are sold worldwide. It operates its own showrooms in London, New York, Chicago, Paris, Amsterdam and Dubai.

Sanderson Design Group – summary of key events from 2014

Date	Event
2014	
March	Sanderson launches its Anthology contemporary brand and an Emma Bridgwater collection of wallpapers and fabrics.
April	Launch of Style Library website alongside individual brand websites.
2015	
December	Storm Desmond results in flooding of the Standfast & Barracks fabric printing facility in Lancaster, halting production for 16 weeks.
2016	
March	Initial interim insurance payment of £8.0m received for the Standfast & Barracks flooding.
July	Licensing agreement with Indian company, Indo Count, covering bedlinens in the US, Canada and Mexico.
October	Acquistion of Clarke & Clarke, a UK-based designe of interior fabrics and wallcoverings.
2017	
June	Final insurance settlement announced relating to the Standfast & Barracks flooding, with a total of £19.3m received.
July	New showroom opened at the Design Centre Chelsea Harbour for Style Library, the group's initiative to bring together its portfolio of brands, replacing the brands' individual showrooms at the Design Centre. The Style Library initiative included the unification of salesforces, customer services and websites with a view to improving efficiency.
September	Launch of in-house paint tinting/distribution for Zoffany and Sanderson brands, in partnership with US company, PPG.
November	Trading update announces disappointing UK brand sales and consequent lowering of profit expectations for the year.
December	Minor fire at Anstey Wallpaper facility with damage to one of the printing machines.
2018	
April	Company warns poor UK trading environment would adversely impact FY19 results.
July	FY19 adjusted PBT guidance lowered for the year to £9.5m - £10.0m.
September	Licensing agreement for Morris & Co brand with Swedish retailer, H&M, for men's and women's apparel collections.
2019	
March	Appointment of Lisa Montague as CEO.
July	Kravett Inc appointed to distribute the Clarke & Clarke and Studio G brands in the US.
October	New strategy outlined, following review for the Board by Lisa Montague. Further leadership team appointments made.
November	Kravet distribution agreement for Clarke & Clarke and Studio G brands extended to include Canada.
2020	
January	Sanderson collaboration with National Trust for production of a fabric collection, Celebration of the National Trust.
February	Clarke & Clarke collaboration with Tess Daly on the production of her first homeware collection, Tess Daly Home.
March	Scion secures a licensing agreement with NEXT for a range of homeware, nursery and fashion items. Temporary closure of UK factories, along with the group's showrooms in London, Paris and New York, due to the Covid-19 pandemic.
May	Phased re-opening of UK factories announced.
June	Morris & Co collaboration with designer, Ben Pentreath, for a wallpaper and fabric collection - Ben Pentreath's Queen Square Collection for Morris & Co. Standfast & Barracks returns to profit after three years of losses post the 2015 flood.
July	Launch of Harlequin's children's collection, Book of Little Treasures, using a digital design book instead of a physical pattern book for the very first time within the group.
October	Group to change name from Walker Greenbank plc to Sanderson Design Group plc from December 2020, along with simplification of the multi-layered corporate structure of holding companies, trading names, brands and sub-brands.
November	Sanderson, Sanderson Home and Morris & Co brands sign a licensing agreement with NEXT for clothing, homewares and accessories ranges, covering an initial period of two and a half years (5 seasons). Franchise agreement with Design Online to develop and operate an online store for the Scion brand, trading as Scion Living.
2021	
March	Launch of new individual brand websites alongside a refreshed corporate website.
April	Launch of Live Beautiful sustainability strategy. Maro Itoje signed as the new face of Sanderson ahead of the launch of Sanderson's 160th anniversary collection of fabrics and wallpapers, Sanderson One Sixty.
May	Licensing agreement signed with Sangetsu Corporation of Japan for Morris & Co, covering Japan and 14 other East and South East Asian countries as the exclusive licensee for Morris & Co wallpapers, with an initial term of four years.
August	Licensing agreement for Morris & Co with US kitchenware retailer Williams Sonoma, covering a broad range of tableware, workware and kitchen accessories to launch in Autumn 2022. Harlequin launches its Own the Room campaign on TV, with the campaign including an online quiz to help consumers with their colour and design choices.
September	Launch of new direct to consumer (DTC) brand, Archive by Sanderson Design, which reinterprets heritage designs from the group's extensive product archives. As well as through its own website, Archive will be sold through an exclusive retail partnership with Selfridges. Pre-launch of the Simply Morris concept, described as Fresh Maximalism in style, and the second extension of the Morris & Co brand, following the 2016 launch of Morris Pure, the brand's neutral concept.
October	Group announces a new licensing agreement with NEXT for its Morris & Co brand, covering a range of homewares to be launched in early 2022 for an initial three year period.

Source: Sanderson Design Group; Progressive Equity Research

Market Backdrop

Broad market with many potential distribution channels

The prime markets for the group's products in terms of end-use are domestic residences and commercial properties, most notably though not exclusively in the hospitality sector. Combined, these form a very broad market with many potential routes and distribution channels to the end-user or any service provider to the end-user, such as an interior designer for domestic residences or contractors for hotels and restaurants.

Consumer and hospitality sectors affected by the pandemic…

Both areas of end-use have been affected by the pandemic and its various lockdowns, albeit in different ways. The hospitality sector has been badly affected and, while showing signs of recovery with the opening up of economies, there appears still to be caution or reluctance on the part of some consumers to resume pre-pandemic socialising and leisure activities.

…which has also led to increased investment in people's homes

In contrast, the home has become even more central to many families, with the edict of working from home, together with home schooling, meaning families were spending considerably more time within their homes. Combined with savings from not travelling to work and no leisure/holiday spending, this has led to a significant increase in investment in the home, from redecorating to more major refurbishment projects.

Reappraisal of household décor with increased home working

With the potential emergence of a more hybrid way of working for employees who were 'office-based' in the widest sense of the word, involving an element of home working, it is probable that these households will continue to reappraise their household environments and to invest in improvements. This trend should be positive for suppliers of a broad range of home adornment products, including SDG.

Market size

Markets should grow over medium term

The markets for household textiles and wallpaper should continue to grow over the medium term, driven by several factors:

- Global population growth
- Rising number of (smaller) households
- Growth and rising wealth of middle classes in emerging markets
- Increasing urbanisation
- Rising living standards

Definitional issues can throw up a wide range of market size figures

As is often the case with market size statistics, our web-based research into market sizes for the group's two core product categories has thrown up a wide range of figures and projected growth rates. This can sometimes be due to differing market size definitions, which are not always easy to determine in the absence of the full research reports. For example, wallpaper is but one product in a wider range of wallcoverings that can also include wood and metal wall panels, decorative tiles and other products. Some reports appear to be limited to wallpaper but with titles using the term wallcoverings rather than wallpaper, and indeed vice versa. The definitional issue also pertains within the realm of household textiles, which cover many different types of fabrics with many different end-uses.

Wallpaper

Global wallpaper market in 2020 worth around $29bn…

In terms of the global wallpaper market, reports from two different research companies, Industry Research and Mordor Intelligence, both have market sizes and projections of a similar order of magnitude, albeit one uses the term wallpaper and one wallcoverings in reference to their global market sizes and growth projections. Industry Research cites a 2020 global wallpaper market size of $28.9bn, projected to grow by a CAGR of 2.3% to a 2027 market size of $34.0bn. Mordor Intelligence cites a 2020 global wallcoverings market size of $29.7bn, projected to grow with a CAGR of 5.0% to a 2026 market size of $39.4bn. Mordor Intelligence also cites the equivalent figures for the European market: a value of $11.2bn in 2020, forecast to grow to $14.4bn in 2026, with a 4.3% CAGR over the forecast period. This implies the European wallcoverings market accounted for just under 40% of the global market in 2020.

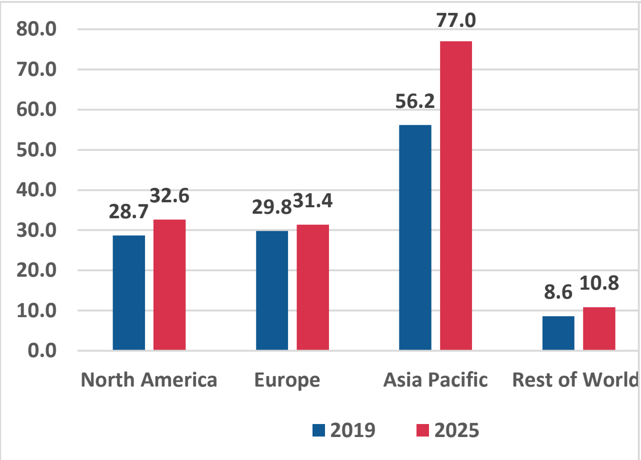
…and projected to grow with low- to mid-single digit CAGR

The principal takeaways from these statistics, in our view, is that the global wallpaper market is of a substantial size with forecast growth rates of low to mid-single digits per annum. This points to a mature rather than high growth market in aggregate, but one within which it is more than likely that certain sub-segments by price/style/material/price point will overperform or underperform the market average.

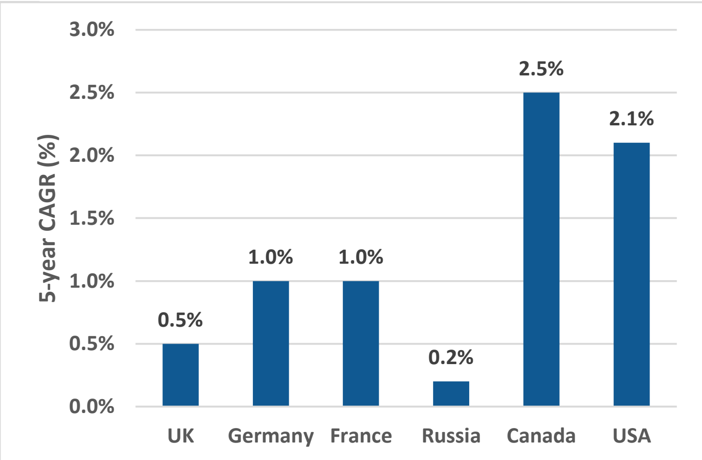
Household textiles

With regard to the global household textiles market, we have referenced a report entitled 'Global Home Textiles Market Outlook' produced by Fibre2Fashion. This has 2019 as its base historical year, with projections for the market in 2025. It is useful in that it also breaks down the global market into four key geographies, as well as giving projections for some of the major individual country markets within the four larger regional geographies, namely North America, Europe, Asia Pacific and Rest of World (RoW).

Global household textiles market ($bn)



Five-year CAGR for selected household textile markets to 2025



Source: Finish2Fashion; Progressive Equity Research

Global household textile market projected to grow with a 4.3% CAGR to 2025…

The two charts above show first the historical and forecast market sizes for the four regional geographies, and second the five-year CAGR for individual countries, where SDG has an active presence. At an aggregate global level, the household textiles market was valued at $123bn in 2019 with a forecast value of $152bn for 2025, reflecting a five-year CAGR of 4.3%. As for the wallpaper market above, the household market is substantial, indeed around 4x larger, and is projected to grow at a solid rate over the medium term.

…with lower rates forecast for Europe and its main markets, including the UK

The forecast CAGR rates for North America and Europe stand at 2.6% and 1.0%, respectively, lagging the global average. The right-hand chart gives the CAGRs for selected European countries and the USA and Canada. In the USA, highlighted by SDG as a market for growth with an ambition to double group sales, the CAGR is 2.1%. This is more than double the projected 1.0% growth rate for France and Germany and four times higher than the 0.5% projected for the UK. For reference, the highest projected growth rates are for India (8.2%) and China (5.9%). The countries with the lowest growth projections are Russia (0.2%) and Japan (0.4%).

Competition

Group positioned in luxury and premium end of market…

The market positioning of the group's brands is concentrated in the luxury and premium segments of both the wallpaper and fabric markets. These segments typically account for a meaningful share of the overall market in value terms, but a significantly smaller share of the market in volume terms, given the high value-added nature of the products.

…with competitors typically smaller, more specialised companies

Producers in these market segments tend therefore to be smaller, more specialised companies rather than massive manufacturing conglomerates. Competition is therefore somewhat fragmented in this market segment. While some of the smaller competitors operate only domestically, the more successful operators have established an international reputation and presence.

Within the UK, SDG is the largest player operating in the upper echelons of these markets and is a supplier of product to many of its branded competitors through its in-house manufacturing facilities. It is also one of the oldest, with its origins dating back to 1860.

Some international companies akin to group with long rich heritage

Outside the UK, there are other long-established specialist companies with their own rich heritage, akin to SDG. In the USA, examples of such competitors would include Thibaut, established in 1886, and Schumacher, established in 1889. In Europe, manufacturers such as the German companies Rasch and Marburg were also established in the 19th century.

Many competitors bear the names of their founders

Many specialist competitors bear the name(s) of their founders. Well-known examples of these include Cole & Son, Colefax and Fowler, Jane Churchill, Osborne & Little, Jim Thompson and Designers Guild.

A better insight into the wide array of specialist companies operating in the wallpaper and fabrics markets (and indeed other homewares markets) can be obtained by looking at the website for the Design Centre, Chelsea Harbour, which showcases over 600 of the world's most prestigious luxury brands in the field of luxury interiors and design. It houses 120 showrooms, including those of SDG's brands.

Sanderson Design Group – Live Beautiful

A deeper dive into the company

In this section we look in more detail at Sanderson Design Group, including its purpose and values, strategy, business model, brand portfolio and customer base. We also highlight the group's commitment to sustainability and its Environmental, Social, Governance (ESG) programme.

Purpose and values

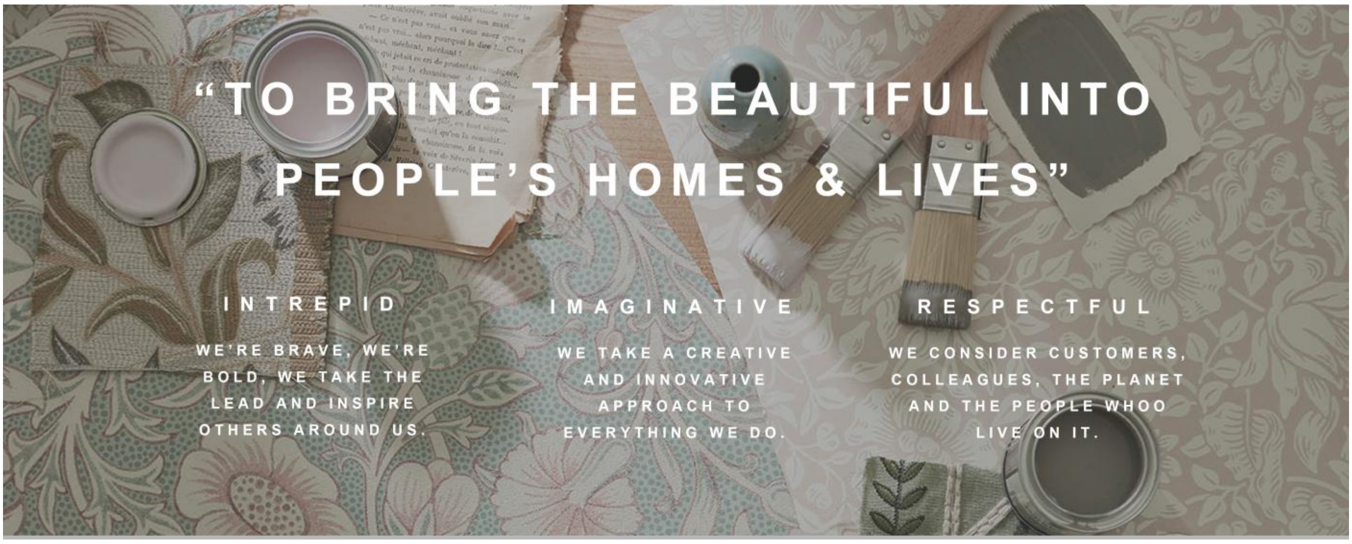
A clear, concise business purpose: "bring the beautiful into people's homes and lives"

SDG has laid a strong foundation for its future with a clearly defined purpose, which states in easily understood terms the objective of the group, or its raison d'etre. It explains what the company does and what it brings to its customers. This purpose or business mission is *"to bring the beautiful into people's homes and lives".*

Core values

In essence this purpose should drive and underpin the day-to-day activity of all employees within the group. While a clear purpose is essential in explaining what a business aims to achieve, this of itself does not establish the *values* it embodies and by which it will accomplish its purpose. The group has determined three core values that will drive its activities, namely being "*intrepid, imaginative and respectful"*, as laid out below.

Sanderson Design Group's business mission and values



Source: Sanderson Design Group

A commitment to sustainability, encapsulated in the Live Beautiful programme

The expanded definitions of these values directly play into the wider activities of the group as a design-led business, notably in a determination to be bold and inspirational through the creativity and innovation of its designs, as captured in the terms 'intrepid' and 'imaginative'. The importance of respect to key stakeholders and the wider environment informs the group's views on sustainability, inclusivity and a range of ESG matters, which are encapsulated in the Live Beautiful programme and strategic framework we will discuss later.

Purpose and values underpinned by core behaviours

Underpinning the purpose and values, the final element of defining how the group operates relates to behaviours, namely how people will conduct themselves within the work environment. The three core behaviours expected of employees are being *agile, accountable and collaborative.*

For such a framework to be effective, it needs to be – and has been – communicated across all functional areas of the group to establish a shared and easily understood modus operandi to the delivery of a common purpose and shared goals.

Strategic framework

Strategic pillars and a milestone timeline/checklist

The group's corporate strategy under CEO Lisa Montague, who took up her position after joining the group in early 2019, was first laid out in a strategic framework, following a review on behalf of the board, at the group's interim results in October 2019. The template presented then, combining strategic pillars and a detailed roadmap and checklist up to (then) FY23 for transparency and accountability, is still in place, albeit with some very minor amendments. The milestone checklist now runs to FY24.

Strengthening foundations for long-term value creation

The rationale and driving force shaping the strategy was one of ***"strengthening the foundations for long-term value creation"***. We would describe the original framework as a 4x4 template. This comprised four strategic pillars – brands, products, geographies and customers – which we view as the key building blocks on and with which to drive the target of long-term value creation. These could be described as predominantly external interfaces with the global marketplace. They were supported by what could be described as internal mechanisms and characteristics to create a more efficient and dynamic business. The original four elements supporting the four strategic pillars were:

- ***People:*** with a view to recruiting, retaining and nurturing talent for the future.
- ***Efficiency, agility, innovation:*** with a view to reducing the number of stockkeeping units (SKUs), delivering more focused collection launches and driving return on investment from design.
- ***Supply chain:*** with the objectives of improving processes and reducing waste and costs.
- ***Financial strategy:*** focusing on tighter management of inventory and cash, while continuing to reduce overheads.

Quantified objectives

The strategy included some key quantified objectives, including the doubling of revenue in the targeted international markets of the USA and Northern Europe. It also included a refocusing of the business on core aspects of the group, most notably its brands, markets and customers, together with investment in its human resource base.

Move away from previous Style Library concept

We would highlight a significant change from the previous strategy, as embodied by The Style Library concept, which was first introduced in 2014 as an initiative to bring together and harness the group's portfolio of brands under a single umbrella brand. This was reinforced in 2017 with the opening of a new showroom at the Design Centre, Chelsea Harbour for Style Library, replacing the brands' individual showrooms at the Design Centre. The Style Library initiative included the unification of salesforces, customer services and websites with a view to improving efficiency.

New strategy restores responsibility and accountability to individual brands

The risk of such a centralising move is that it can constrain the culture, dynamism and identity of individual brands, with smaller brands losing out to larger brands within a single commercial operation, which will always likely focus its efforts on where it sees the bigger commercial opportunities, namely within the larger, more established brands. This may be an oversimplification of the situation, but the new strategy unwound the centralisation of the brands, restoring responsibility and accountability to the individual brands with a view to amplifying the power of each brand, driving brand engagement and optimising brand performance.

The Live Beautiful strategic framework

The following graphic shows the latest iteration of the strategic framework, as taken from the interim results presentation of 13 October 2021. While the four strategic pillars are unchanged, the supporting elements have evolved from two years previously. This includes the consolidation of some elements within the new Financial Health caption and adds the new element: "Planet – inspire our world". The latter incorporates and is shaped by the group's sustainability goals within the Live Beautiful programme introduced in 2020. We look at this in more detail in a later section. The corporate strategy is now embedded within the organisation as the Live Beautiful strategic framework.

The Live Beautiful strategic framework

Source: Sanderson Design Group

Group Leadership Team

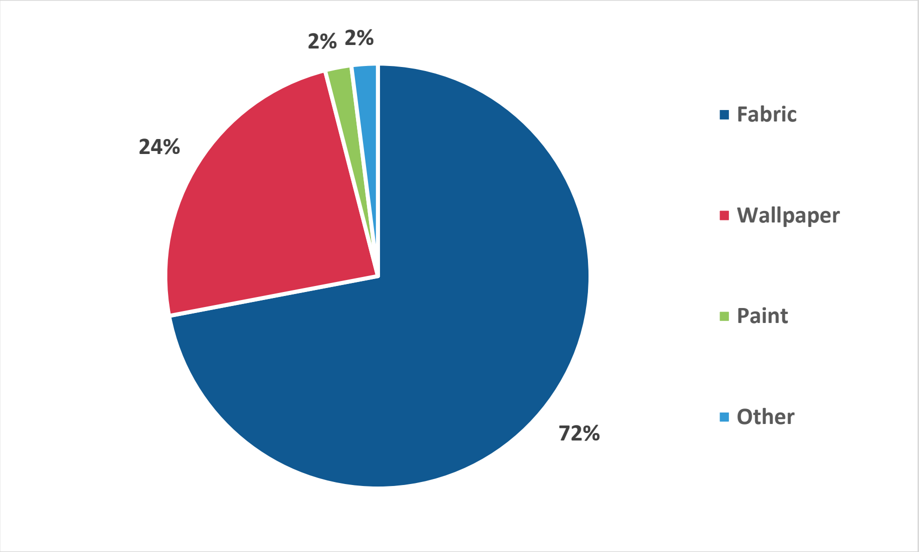
The execution of this framework is led by the Group Leadership Team, comprising seven senior directors, including CEO Lisa Montague, all bar two of whom were not working with the company before 2019. Thus, the new strategy is being led by a new management team.

Product offer

Core offer of fabrics, wallpaper and paints

The group's core product offer comprises fabrics, wallpaper and paint. Its licensing activities see the group's designs applied to a wide range of other products, in addition to the core products. These incremental product categories include bed and bath collections, rugs, blinds, tableware and apparel, though these products will typically be produced and sourced by the licensee and not by the group.

Group product sales mix – H1 FY20



Source: Sanderson Design Group; Progressive Equity Research

Financial reporting focuses on the brand performance, along with manufacturing and licensing, rather than on product sales. For reference, we include the above chart, which shows the product sales mix for the first half of FY20. This was included within the outlining of the new strategy by the incoming CEO, Lisa Montague, accompanied by the message that the focus was to remain on core products with an unchanged product portfolio.

Shift to digital marketing of collections gives faster feedback and reduces costs

Products within the core wallpaper and fabric areas are presented as collections by the individual brands to the trade customer base, historically relying on physical sample and swatch books at the point of sale (POS). While these physical samplers remain important, they will be progressively reduced as the recent introduction of digital books and three dimensional (3D) virtual showroom tours at the Anstey and Standfast manufacturing facilities becomes more important. This shift to digital marketing of the collections has two key benefits. First, customer feedback is more immediately gathered, giving insight into the likely best sellers within collections. Second, given the substantial cost involved in producing wallpaper books, reduced reliance on these has obvious cost-savings benefits. Whether the wallpaper 'catalogues' will eventually no longer be produced remains to be seen. In the parallel world of retailing, it took many years for Argos to have the confidence to cease production of its iconic printed catalogue and rely solely on a digital catalogue instead.

Brand portfolio – a collection of heritage brands

Clearly segmented brand portfolio

The group has a strong brand portfolio, which is segmented with each brand having its own clear market positioning. As outlined above, a key thrust of the strategy defined in 2019 is to focus on the individuality of each brand with a view to amplifying their power and reach, thereby driving brand engagement with trade customers and end-consumers alike. To that end, each brand has its own market, channel, product and communications strategy, with a view to maximising their appeal to specific customer groups within their respective marketplaces.

Key brand characteristics

The following graphic from the company summarises the key characteristics of the core brands, both verbally and graphically. It not only conveys the quintessential essence of each brand, but also shows the differentiated and individual positioning of each. It shows the wide spectrum of styles from classic to contemporary, from bold to more muted colour palettes, and from natural to abstract, thereby appealing to a wide spectrum of styles and tastes. With a high emphasis on design input, reflecting the intrepid and imaginative values of the group, the overall style positioning is more weighted to the maximalist end of the style spectrum rather than the minimalist end, such as is often associated with the Scandinavian look.

Brand portfolio – core positioning characteristic and look

Source: Sanderson Design Group

Luxury brands are Sanderson, Morris & Co and Zoffany

In terms of brand positioning, Zoffany, Sanderson and Morris &Co can clearly be positioned within the luxury and heritage segment for their wallpaper and fabric offerings. Zoffany occupies the most premium position of this trio of brands. The group's other brands can all be considered as premium brands but at more accessible price points, although there is of course some pricing overlap between the brands. The most accessible brands, from a pricing and arguably a style perspective, are Clarke & Clarke and Scion. The following descriptions and graphics give a little more background and visual insight into each brand.

“Luxurious design artfully crafted to the highest standards”

Zoffany

Zoffany embodies luxurious design that has been artfully crafted to the highest standards. With its accomplished aesthetic, Zoffany produces an extensive range of wallpapers, fabrics, trimmings, paint, carpets and furniture, for both contemporary and classic interiors. It is an innovative relationship between past and present, while always striving for the most refined finish, that informs Zoffany’s ethos.

Zoffany – style and design example

Source: Sanderson Design Group

"Combining a timeless British sensibility with hand-drawn patterns"

Sanderson

Founded in 1860, Sanderson is one of the most renowned interiors brands worldwide. The brand was granted a Royal Warrant in 1923 and still supplies fabrics to HM Queen Elizabeth II. Its quintessential style incorporates hand-drawn patterns and bold reinterpretations from its extensive, historic archive. It draws heavily from the rural idyll of the English countryside. Its most recent campaign features England rugby player Maro Itoje as its brand ambassador.

Sanderson – style and design example

Source: Sanderson Design Group

"Beautifully crafted products that uphold the legacy of an Arts & Crafts icon"

Morris & Co

As custodians of the original company founded by William Morris, a key figure in the Arts & Crafts movement, Morris & Co embodies the ethos and decorative style of this important cultural icon. New designs are inspired by the extensive archive, comprising samples of every wallpaper as well as printed and woven textiles, logbooks and original wooden printing blocks.

Morris & Co – style and design example

Source: Sanderson Design Group

"Inspired colour stories and boldly expressive pattern creations"

Harlequin

Harlequin's ethos has long been one of pushing personal, design and industry boundaries, to produce inspired colour stories, bold and expressive colour creations with luxurious production techniques. Harlequin is also well-known for its playful range of designs for children, under the Harlequin Kids label.

Harlequin – style and design example

Source: Sanderson Design Group

"Cutting-edge design for dynamic metropolitan spaces"

Anthology

The Anthology brand has the greatest sense of sleek urban modernity, producing ranges for metropolitan spaces. Launched in 2014, it was the first group brand to be aimed specifically at the contract market. It has worked with a number of prestigious brands within the hospitality sector, including The Ned and Royal Meriden hotels. It was recently announced that the brand would be wrapped into the Harlequin brand, producing no new designs henceforth.

Anthology – style and design example

Source: Sanderson Design Group

"Polished looks embodying the best of British eclecticism"

Clarke & Clarke

Founded in 1999, Clarke & Clarke boasts one of the most eclectic portfolios within the Sanderson Design Group. Making nods from the sleekly modern to the decadently glamourous, Clarke & Clarke perfectly encapsulates the eccentricity in contemporary British design. It is pitched to a style-conscious demographic and is therefore in a perpetual state of invention and reinvention, committed to supplying the market with fresh ideas for modern living. It was acquired by the group in October 2016 and also incorporates the Studio G brand, which produces readymade curtains and cushions.

Clarke & Clarke – style and design example from the Emma J Shipley collection

Source: Sanderson Design Group

"Playfully British designs that bring joy to the everyday"

Scion

The Scion brand was launched in 2012 to provide fresh and upbeat ideas for modern living. The brand features many Scandinavian-inspired designs with flashes of zesty colours. It is a playful brand, as best epitomised by the characters of Mr Fox and friends, which have now become iconic. The brand has been featured heavily within John Lewis and recently brought together under the Scion Living franchised online store. The brand features across homewares from ceramics to bedding, as well as wallpaper and fabrics.

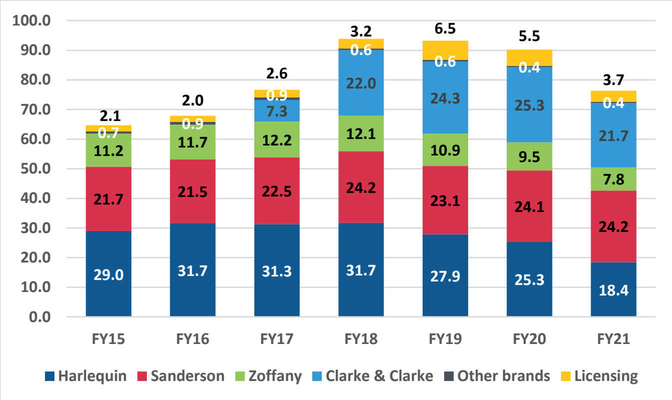
Scion – style and design example

Source: Sanderson Design Group

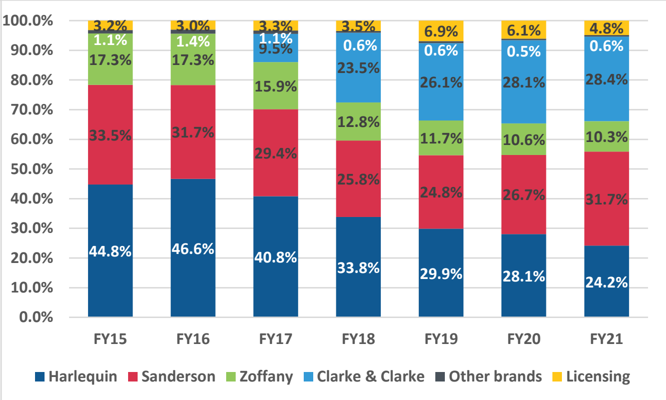
Brand revenues

The following charts show the progression of revenues from the core brands from FY15 to FY21, alongside the sales participation to the total, as they have been reported historically. They also include the contribution from licensing revenues. The impact of the acquisition of Clarke & Clarke to the group can clearly be seen from FY18 onwards. It is the biggest brand within the group, since it should be noted that Harlequin and Sanderson include revenues from other brands. The Sanderson brand is something of a misnomer as it includes Morris & Co. The Harlequin figure includes Scion and Anthology.

Brands and Licensing sales performance (£m)



Brands and Licensing sales mix (%)



Note: Harlequin includes Scion and Anthology; Sanderson includes Morris & Co; Clarke & Clarke includes Studio G

Source: Sanderson Design Group; Progressive Equity Research

A more transparent disclosure of brand revenues going forward

Going forward, SDG has decided to present revenue performance in a more transparent way for the individual brands. This new presentation was unveiled for the first time within the October interim results and accompanying presentation pack. Figures were presented for H1 revenues only, going back three years. Our overview of these interim results within the Financials and Forecasts chapter includes a chart showing the new brand revenue presentation, which unambiguously shows Clarke & Clarke to be the largest revenue generator of all group brands.

Launch of DTC brand Archive by Sanderson design…

The group launched a new brand, Archive by Sanderson Design, in September 2021. This is a direct to consumer (DTC) brand, developed in-house and available via its own website. The product range includes not only fabrics and wallpapers, but also accessories including curtains, cushions, and lamps. The Archive by Sanderson Design brand reinterprets heritage designs in inventive compositions and elaborate colourways for a fashion-forward, maximalist audience that is not currently served by the company's existing brands or routes to market. Archive will also be sold through an exclusive retail partnership with upscale department store Selfridges.

…reflects key elements of strategy and advances the push into digital marketing

The launch of Archive by Sanderson Design reflects key elements of SDG's growth strategy, particularly in advancing the group's digital strategy with a DTC offering that targets a new consumer demographic for the group. This customer targeting enables the group to develop its own ecommerce channel while protecting its traditional routes to market.

Customers and communication

Difference between customers and end-users

The majority of final or end-consumers of SDG's product offering comprises private households purchasing home adornment products, helping them to "live beautiful". This is not the case for Anthology, along with offerings from some of the other brands, which target the contract market. The customer base for the contract market is varied, including the hospitality sector and developers fitting out other residential and office developments and other public spaces.

Main customer groups

We would classify the main customer groups as:

- ***Multiple retailers***, typically serviced at a national account basis.
- ***Independent retailers***, serviced through buying groups and associations, wholesalers, or by direct sales, with around 2,000 active accounts in the UK.
- ***Interior designers***, offering bespoke services to consumers and businesses, most notably in the USA, and commanding better margins than traditional retail channels.
- ***Hospitality operators***, including but not exclusively hotels, restaurants, and cruise ships.
- ***Contractors***, providing fit-out services to a wide range of commercial businesses and property developers.

Key UK retail customers

Within the UK, key retail customers include the John Lewis Partnership, Brewers Decorator Centres, Wallpaper Direct (now an international business), e-commerce operator Wayfair, and Jane Clayton, again principally an online operator. As an aside, the Scion Living DTC website is operated via a franchise arrangement with Design Online, a company formed by Jane Clayton.

FY21 developments

Increase in online sales participation

UK & Ireland: In FY21, the diversity of the UK & Ireland customer base is shown by the fact that the top 20 customers (of which 12 were online retailers) accounted for just 32% of sales. Within the year, online sales leapt from 8% to 34%, with the various retail lockdowns undoubtedly accelerating the trend.

Extension of US network with more online partners and more agent showrooms

USA: FY21 saw the group establish new agent showrooms in Atlanta and Los Angeles, thereby strengthening its regional network and coverage. The US subsidiary also developed new internet relationships with Perigold (part of Wayfair Inc), Wallpaper Direct and Smith & Brown. In H1 FY22E, the group saw US sales increase 76% over the Covid-impacted prior year and 11% ahead on a two-year basis, underpinning the group's strategic goal of doubling sales in the US market. The e-commerce channel now represents 10% of total sales for SDG Inc, accounting for some 25% of Morris & Co sales. A further three full-line territory showrooms were opened in Michigan, Missouri and Kansas, making 25 in total, complemented by 30 new sub-trade agency showrooms in secondary markets. Except for the group's own two showrooms in New York and Chicago, all showrooms operate on commission-driven commercial arrangements.

Russia: The group agreed a new agency agreement with a central showroom in Moscow, replacing the prior set up with a company-owned operation and showroom.

Marketing communication

More direct brand promotion to consumers

As well as developing services to help the group's customers to service their clients and improve efficiencies, such as the Design Club offering digital launch events and digital design books rather than traditional pattern books, effectively a push marketing strategy, the group is also promoting its brands directly to consumers, thereby increasing awareness and driving demand into its traditional channels, in effect a pull marketing strategy. Examples of the latter include Sanderson's campaign fronted by Maro Itoje and the Harlequin 'Own the Room' campaign.

Sanderson – marketing campaign fronted by Maro Itoje

Source: Sanderson Design Group

Harlequin's 'Own the Room' campaign includes a customer quiz

The Harlequin campaign is based on a specially commissioned white paper, '*Is the colour of your home making you happy?*', written by Stephen Westland, a professor of colour science and technology, and Soojin Lee, a research fellow in colour design, both of the University of Leeds. The paper discusses the emotional and physical benefits of colour in the home. To help consumers unlock their perfect colour and design choices, Harlequin created an 'Own the Room' quiz based on four distinct Harlequin looks. The quiz, the white paper and further details of the 'Own the Room' campaign can all be found at the Harlequin website via this link: https://harlequin.sandersondesigngroup.com/white-paper

Big increases in Instagram followers

In line with the strategic framework, there has been a concerted push into digital marketing and social media over the past two years. One good element of this is that success can be seen and measured quantitatively through the number of followers of social media sites such as Instagram. The group has seen the number of its Instagram followers increase from 282,000 in February 2020 to 463,000 in October 2021, an increase of 65%. Scionliving.com had acquired 30,000 Instagram followers by October 2021, following its launch in early June.

Licensing

An important revenue and profit stream with reach into non-core product areas, notably apparel and homewares

Sanderson Design Group has an important revenue and profit stream derived from licensing arrangements with third parties, primarily retailers and manufacturers. SDG, as the licensor, grants the right to use its brand names and designs to a third party (the licensee) in return for licensing fees. The licensing fees will typically be linked to the value of sales by the licensee of those product lines using the group's designs or intellectual property (IP). Licensing has a reach and applications beyond the products manufactured by SDG, namely wallcoverings and fabrics, with applications in other product areas, including – but by no means limited to – apparel and homewares. These agreements often include a minimum guarantee for the licence period.

License periods vary in length

The licence period can vary from a few months, as with the Swedish clothing retailer Hennes & Mauritz (with Morris & Co) in 2018, to several years in duration. Other clothing and accessory brands the group has had licensing agreements with include the Japanese retailer Uniqlo (with Studio Sanderson and Scion) and Radley (with Sanderson). SDG has developed a fruitful relationship with NEXT plc over the last two years in apparel, homewares and furniture through the Scion, Sanderson and Morris & Co brands.

Radley handbags with Sanderson and William Morris cushions for John Lewis

Source: Sanderson Design Group; Progressive Equity Research

Profitable way of leveraging the archive, promotes the brands and drives consumer awareness

Licensing is beneficial to the group in two ways. First, and arguably most important, it is a highly profitable way for the group to leverage its brands, IP and cultural heritage, as embodied by its extensive archives. Second, it acts as a marketing tool for the group and its brands, driving consumer awareness and brand recognition, often reaching new customers outside its normal routes to market. This should then underpin and drive future demand, which is positive for the group's incumbent distribution channels.

Core licensing income excludes apparel and minimum guarantees

The phrase “core licensing income” was first introduced at the group’s FY20 full year trading update in February 2020. It excludes both apparel licensing income and minimum guarantees under IFRS15, which have to be recognised upon transfer of the licence to the licensee, rather than spread over the lifetime of the contract, as earned. Core licensing income includes bedding with the Irish company Bedeck, window-coverings with Blinds2Go, a subsidiary of Dutch company Hunter Douglas, and a number of important strategic partnerships across the homewares sector in Japan, including bedding with Nishikawa, textiles with Kawashima and wallcoverings with Sangetsu.

Blossoming relationship with NEXT and new contract with Williams Sonoma

As can be seen by reference to the earlier table ‘Summary of key events from 2014’, the group has been very active in seeking licensing opportunities over the past two years. Of particular note, in our view, is the blossoming partnership with NEXT plc, with a number of contracts covering both homewares and apparel. The recent licensing agreement with US housewares leviathan Williams Sonoma represents an important breakthrough in the huge American market, one of the core geographies targeted by SDG to drive future growth.

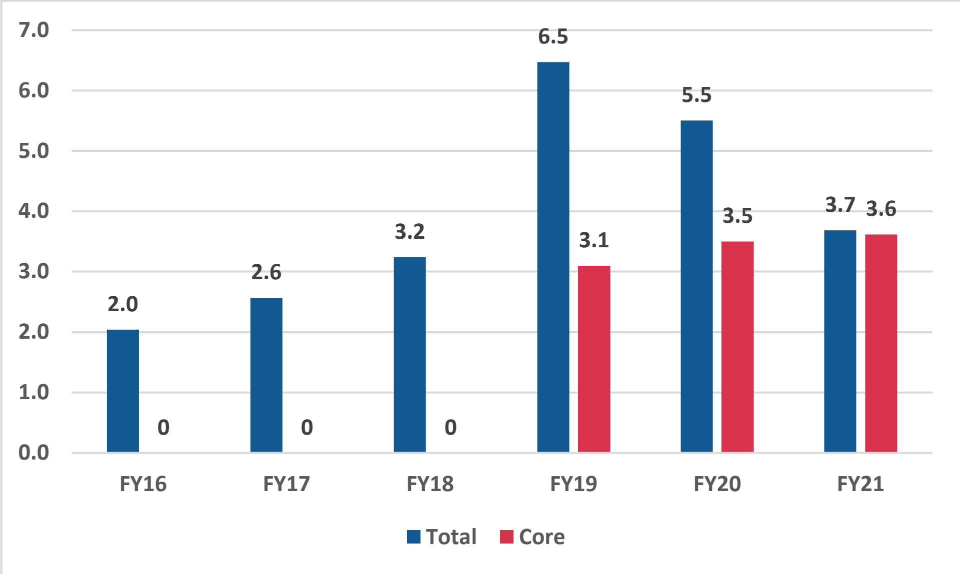
Scion Living and Morris & Co products at NEXT

Source: Sanderson Design Group; NEXT; Progressive Equity Research

H1 core licensing income up 20% over prior year, with total income up 54%

In H1 FY22E, the group reported core licensing income was up 20.0% on a reportable currency basis compared with H1 FY21 (to September 2020), and 33% up on H1 FY20 (to September 2019). This was driven by strong performances from core bedding, blinds and Japanese licensees. Total reported licensing income was up 53.8% to £2.0m on both a reportable and constant currency basis against H1 FY20, given a strong performance from apparel, but down 37.5% and 35.5%, respectively, compared with H1 FY20, which benefited from significant minimum guarantees and one-off income.

Evolution of total and core licensing stream (£m)



Source: Sanderson Design Group; Progressive Equity Research

Group also uses licensing arrangements, most notably Clarke & Clarke

The group also makes use of licensing arrangements in the role of licensee. This is most notably the case with Clarke & Clarke, which has signed licensing contracts with Tess Daly and heritage brand Wedgwood. The former arrangement covers homewares, while the Wedgwood contract will cover a range of bedding, fabrics and wallpapers to be launched in Spring 2022.

Operational infrastructure

SDG has around 610 employees and its corporate headquarters is located at Denham, near Uxbridge, in West London.

Corporate HQ houses substantial part of the group's extensive archive

The building also houses a substantial part of the group's unique archive of wallpaper and fabric samples, along with other important artefacts. Other parts of the archive are housed at the group's two major manufacturing plants: the Standfast & Barracks fabric printing plant in Lancaster and its Anstey wallpaper factory in Loughborough. Clarke & Clarke operates from a small office in Westhoughton, Bolton.

The main UK logistics warehouse is situated in Milton Keynes, a good central location for the UK. The company also operates a samples warehouse in New Jersey for its US operations, which are headquartered in New York.

International showrooms

The group operates its own showrooms in London, New York, Chicago, Paris, Amsterdam and Dubai.

Several different commercial models

Given the diverse nature of its customer base and the spread of its international operations, selling in over 85 countries worldwide, the group's commercial activities, notably its sales operations, use several different models. Some, such as in the UK, its major market, are an integral part of the group's activities and carried out under its own auspices by direct employees. In some markets, these commercial activities are carried out by third parties in the form of distributors (such as Kravet in the USA), wholesalers, sales/road representatives and agents – or indeed a combination of these, as they are by no means mutually exclusive.

Majority of product sold is manufactured in-house

The majority of product sold by the group is manufactured in-house. Some products are sourced from third parties, though the group does not currently have its own dedicated sourcing division. With the group looking to expand its product offering into new categories, with homewares targeted as a “third lever” to operate alongside fabrics and wallpaper from FY24, another of its strategic milestones for FY24 is to establish a sourcing division within the group.

Manufacturing

Manufacturing has a rich heritage, is a source of competitive differentiation, also supplying external customers

Just as the group’s archive is a source of differentiation from its competitors, providing a source of sustainable competitive advantage, so too are the group’s world-leading manufacturing facilities. Many of its competitors do not have their own manufacturing facilities, making them reliant on third parties and imports from overseas. Indeed, many well-known competitors are customers of the group’s manufacturing facilities, including Colefax and Fowler, Thibaut, Schumacher, Jim Thompson and Designers Guild, to name but a few. While Brexit has complicated and disrupted trade flows for the group, most notably for distribution into Europe, being the manufacturer of the majority of its products has been a major mitigating factor, compared with competitors that lack in-house manufacturing capability.

Anstey

A wide range of wallpaper production techniques

Anstey Wallpaper Company (Anstey) in Loughborough is the largest contract wallcovering printer in the UK and has the broadest machine profile in Europe, backed by all the necessary design and technical expertise required to offer a unique and unparalleled combination of printing permutations on a wide variety of substrates and widths. The printing techniques at Anstey range from traditional block printing to the latest digital printing. All wallpaper sold by SDG is produced by Anstey.

Wallpaper printing block featuring the royal crest

Source: Sanderson Design Group

Extensive experience at all market levels

Operating primarily at the premium end of the market, Anstey boasts extensive experience at all market levels, from exclusive wallcoverings for the decorator market to higher volume manufacturing for the wider market. In addition, Anstey is often involved in restoration projects and has supplied wallcoverings to many Royal residences and the Palace of Westminster. As well as producing for the Sanderson Design Group of brands, it also produces for many third-party customers in both the UK and overseas.

Printing capability from standard to ultra-width wallpapers

Anstey can accommodate print runs from as little as 150 rolls on machine processes, 50 rolls on digital and as few as six rolls on hand-printed product. It prints primarily at 52cm (20.5 inches), which is the 'standard' width for domestic wallpaper but can also print 'wide' width at 68cm (27 inches) and 76cm (30 inches). The factory can also produce specialist ultra-wide width wallpaper product at 135cm wide (53 inches) on its long tables, or on its digital machines, to produce stunning designs that can utilise such a huge scale.

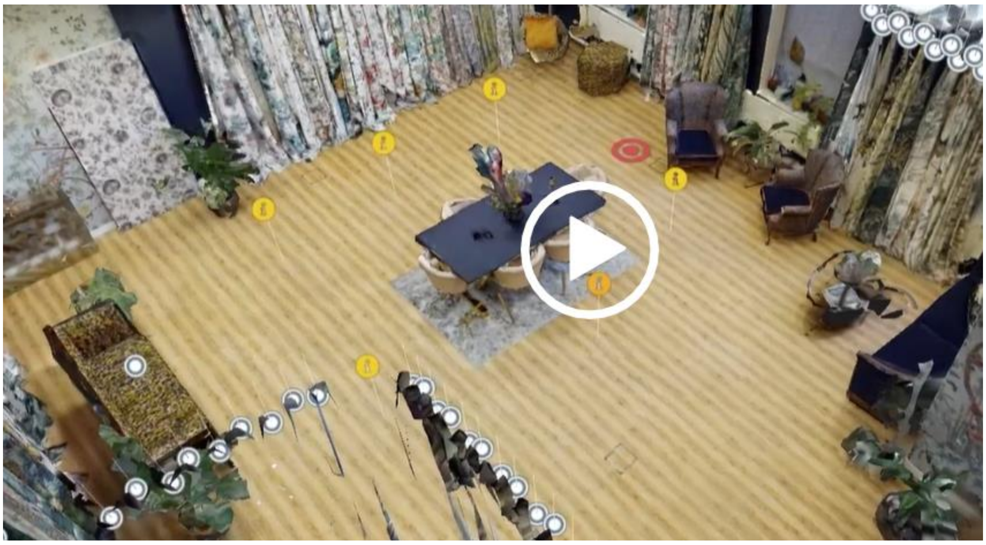
In FY20, Anstey produced 1.4m rolls – or 14,000 kilometres – of finished product.

Standfast & Barracks

Printing fabrics for over 90 years, now a leader in digital technology

Located in Lancaster, with a heritage stretching back over 90 years, Standfast & Barracks (Standfast) is one of the most versatile and distinctive fabric printers in the world, producing the finest quality prints for many design-led home furnishings and apparel brands on the market today. Standfast offers a wide choice of fabric printing techniques, from conventional rotary and flatbed screen printing to the latest ink-jet digital technology for short runs and special designs.

Standfast's new 3D virtual tour



Source: Sanderson Design Group

First fast-run digital printer installed in 2012

Standfast has long been known as an innovator and offers some of the most advanced digital printing techniques available worldwide. This, in turn, creates long-term relationships with customers who value expertise, passion and a focus on excellence. There has been a very rapid uptake in demand for digital fabric printing at the Lancaster factory, where the first fast-run digital printer was installed in 2012.

Combines both traditional and innovative, cutting-edge technology

The Standfast factory has been in operation for nearly 100 years and continues to produce prints combining both traditional and innovative, cutting-edge technology. The combination of a distinctive artisan approach to fabric printing and a cutting-edge in-house design team makes Standfast & Barracks one of the finest printers in the world. The rich heritage and wealth of printing knowledge within the team is exceptional, with the factory employing only the finest, skilled craftsmen in designing and printing cloths.

In keeping with its innovation in print technology, Standfast has recently introduced a 3D virtual showroom tour, allowing customers to browse its showroom offering remotely.

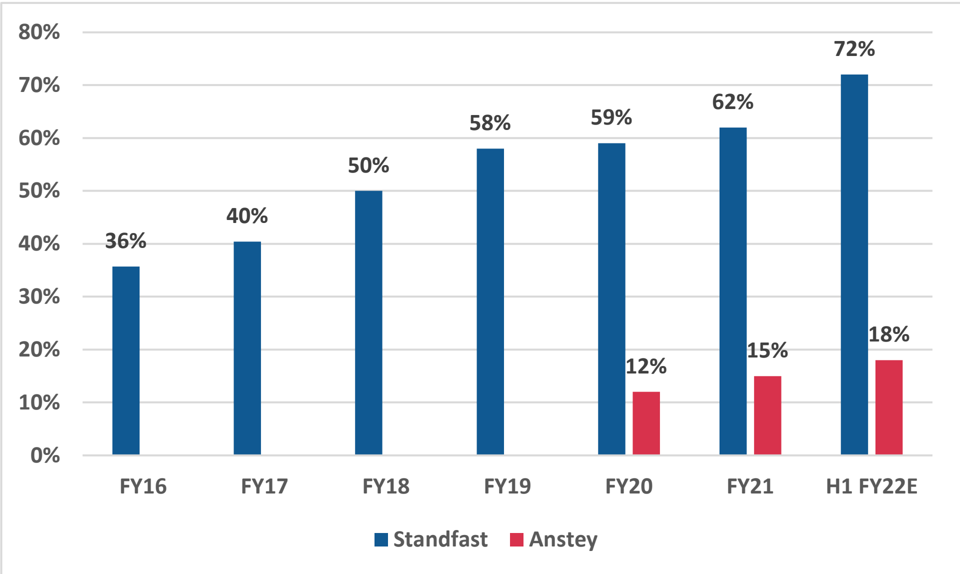
Customers who choose to work with Standfast have access to its extensive archive, either through licensing or using its full design and print service.

In FY20, Standfast printed 1.7m metres of fabric.

Digital mix of output higher at Standfast but set to rise at Anstey

The following chart compares the digital mix of output between Standfast and Anstey. The development of high-quality digital printing for wallpaper has lagged that achieved within fabrics, as can clearly be seen in the chart, with a lack of colour definition holding it back. Just as Standfast has been at the leading edge of digital printing within its field for around a decade, we expect Anstey to follow suit over the medium term as technology advances. The next generation of digital printer is expected at Anstey during the course of FY23. Over time, the objective is to reach a digital mix of around 50% in wallpaper.

Digital proportion of manufacturing output (%)



Source: Sanderson Design Group; Progressive Equity Research

Digital printing is more efficient and delivers higher gross margins

Working digitally is quicker and more efficient than many older and traditional printing technologies, delivering a higher gross margin. The planned and ongoing digitisation of the extensive archive will make a significant contribution to overall business efficiency, from research through design to printing, contributing to a higher level of profitability. The digitalisation of the archive was being undertaken internally but will be transferred to an external provider in December 2021.

Sustainability – Live Beautiful

Objective of being net carbon zero by 2030

In April 2021, the group formally launched its sustainability programme under the Live Beautiful banner. This includes two key commitments, namely its Zero by 30 (0/30) commitment to being net carbon zero by 2030 and its ambition to be the employer of choice in the interior design and furnishings industry.

Planet Mark certification achieved for three successive years

Sustainability had already been a focus for the group for some time, having appointed consultants in 2019 to assist with acquiring the Planet Mark certification and with the group's alignment to UN Sustainable Development Goals. The Planet Mark certification is an independent process for measuring both carbon footprint and social value. SDG has since been working on a wide range of initiatives from encouraging diversity, inclusivity and well-being to developing a digital printing technique that reduces water consumption. Importantly, as the following graphic shows, these initiatives have been incorporated into the Live Beautiful sustainability strategy.

Live Beautiful programme fully embedded in the business strategy

The Live Beautiful programme, covering three core elements of Products, People and Planet, is now fully embedded in the business strategy, with ESG workstreams in place to deliver ambitious goals. The group undertakes surveys to measure staff engagement with the group and its goals, with the most recent Engagement Survey results in May 2021 increasing to 78% from 58% in 2019.

The Live Beautiful vision

Source: Sanderson Design Group

As with the group's overall strategic plans, Live Beautiful has laid out specific events and quantifiable targets within a published timeframe, against and to which the group can be measured and held to account. For example, the group intends to have reduced its carbon emissions by 30% by Year 3 and by 50% by Year 5 of this programme.

More details of the Live Beautiful strategy can be found on the group's website via this link: https://www.sandersondesign.group/media/1477/live_beautiful_sustainability_strategy.pdf

Key Performance Indicators (KPIs)

KPIs measure a company's strategic, financial, and operational achievements

Key performance indicators (KPIs) are a set of quantifiable measurements used to gauge a company's overall long-term performance. KPIs specifically help to determine and, more importantly, measure a company's strategic, financial, and operational achievements. They are particularly useful to investors and stakeholders, especially where they enable comparisons to other businesses within the same sector.

Group KPIs are primarily financial in nature

In its annual report and accounts, SDG publishes a page reporting on its selected KPIs. These are primarily financial in nature, rather than covering more strategic and operational matters. Specifically, they are:

- Revenue and revenue growth
- Adjusted underlying PBT and margin
- Adjusted earnings per share
- Net cash (excluding lease funds) and net cash flow
- Inventory
- Capex
- Reported EBITDA

Within these, the deployment of capex clearly relates to both strategic and operational matters. The trajectory of inventory, given the group's focus on driving efficiencies, is clearly an important indicator of progress on that operational front.

The group addresses strategic and operational KPIs in other ways

While the KPIs above are centred around financial metrics, the group addresses more strategic and operational KPIs in other ways. These are most notably highlighted twice a year within the interim and preliminary results, or more specifically within the accompanying presentation packs, which are available on the corporate website within the Investors section (under the Results, Reports and Presentations tab). A slide presents "Progress against key strategic milestones", ticking where a deliverable has been achieved and showing where any deliverable has either not been achieved or delayed and carried forward. The following chart shows the latest update from the recent interim results presentation pack.

Progress against key strategic milestones from interim results presentation – October 2021

Source: Sanderson Design Group

Some data points provided on an ad hoc basis

The group also provides some data points on an ad hoc basis to show where progress has been made against stated goals. For example, in the latest interim results presentation, graphs were presented to give more insight into product efficiency. These showed not only the progression of the reduction of fabric and wallpaper SKUs, which it has provided regularly for some time, but also the corresponding progression of growth in average revenue per SKU. This showed the substantial increases in this metric offsetting the decline in SKUs in terms of aggregate turnover achieved, but obviously delivering scale and substantial efficiency benefits from the lower SKU base.

Best overview of KPIs arguably seen in progress against the group's strategic milestones

In our view, the most complete picture of the group's performance and delivery of its longer-term goals is obtained by looking at the KPIs in conjunction with progress against strategic milestones, as shown above.

Board and senior management team

The company's Board members are:

Dame Dianne Thompson – Non-executive Chairman

Dianne joined the Board in February 2019 and was appointed Non-executive Chairman in April 2019, following the appointment of the new Chief Executive Officer, Lisa Montague. Dianne is a highly experienced sales and marketing executive and currently a Non-executive Director of NEXT plc and Pagefield Ltd. From 2000 until 2014, Dianne was Chief Executive of Camelot Group plc, the UK National Lottery provider. Prior to that role, she held marketing and general management positions in a number of consumer and building materials businesses, including Signet Group plc, Sandvik Saws & Tools Ltd and ICI Paints.

Lisa Montague – CEO

Lisa joined the group in March 2019 as an Executive Director and became Chief Executive Officer (CEO) in April 2019. Lisa is a highly experienced luxury goods executive, with previous roles as CEO at Madrid-based international fashion brand Loewe SA, a Spanish luxury fashion house owned by the LVMH Group, CEO of Aspinal of London Group Ltd and COO of Mulberry Group plc. She has significant experience of leading and developing UK and international brand-based businesses with manufacturing and multi-channel distribution.

Mike Woodcock – CFO

Mike joined Sanderson Design Group in October 2021 in the role of Group Financial Officer, enabling a handover period prior to his becoming Chief Financial Officer (CFO) in November 2021. Mike qualified as an accountant at KPMG and has significant experience of international luxury and consumer brands in the quoted and private sectors. From 2001 until 2015, Mike was at Richemont Group, where his increasingly senior roles included CFO of Alfred Dunhill and CFO of Montblanc. He then moved to Belstaff as CFO until its sale in 2019. He joins the group from the CFO role at Paperchase

Christopher Rogers – Non-executive Director

Christopher joined the Board in April 2018 and held the role of Interim Executive Chairman for six months until Lisa Montague's appointment as CEO in April 2019. Christopher holds other non-executive roles as the Chairman of Wickes plc and as a Non-executive Director at Kerry plc, Vivo Energy plc and Snowfax TopCo Ltd. Christopher was an Executive Director of Whitbread plc for 11 years from 2005, first as Group Finance Director for seven years and then as Global MD of Costa Coffee, where he grew the brand internationally to become the world's second largest coffee shop chain.

Juliette Stacey – Non-executive Director

Juliette is currently Senior Independent Director and Chair of the Audit Committee at Fuller, Smith & Turner PLC, the hospitality group, and an adviser to a privately held property business, Middleton Advisors. Prior to her non-executive career, Juliette held executive leadership roles as Group CEO of Mabey Holdings Ltd, the engineering services group, and property group Savills PLC, having gained experience of advisory work at E&Y, where she qualified as an accountant.

Patrick Lewis – Non-executive Director

Patrick was, until last year, an executive and Board director of John Lewis Partnership (JLP), where he gained extensive consumer and retail experience. He joined JLP in 1994 and held managerial roles across the business before becoming CFO in 2015. Patrick's early career was at the management consultant, Bain & Company, followed by a move into industry at Procter & Gamble, the consumer brands business.

Other senior managerial roles within the group are held by:

Caroline Geary – Company Secretary (joined in 2000)

Mauricio Solodujin – Global Commercial Director (joined in 2019)

Nigel Hunt – Group Marketing & Digital Director (joined in 2019)

Ben Naylor – Group Operations Director (joined in 2020)

Carla Barnett – Group Human Resources Director (joined in 2016)

Claire Vallis – Creative Director (joined in 1996)

Biographies of these senior managers can be found within the 2021 annual report and accounts.

SDG's Group Leadership team comprises Lisa Montague, Mike Woodcock, Carla Barnett, Mauricio Solodujin, Ben Naylor, Claire Vallis and Nigel Hunt.

Growth drivers and opportunities

Four strategic pillars to drive growth

As previously described, SDG articulates its strategic priorities around four pillars to drive growth, namely:

- 1. ***Brands*** – elevating its brands to create demand
- 2. ***Products*** – reimagining its products (to stimulate demand)
- 3. ***Geographies*** – driving growth in key territories
- 4. **Customers** – exceeding customer demands in a digital world

Growth drivers closely aligned with these four pillars

It is unsurprising therefore that the growth drivers we highlight below are closely aligned with and expand upon these four pillars. Growth drivers can and should be applied to profits as well as turnover, so our drivers include the important area of improving business and operating efficiencies. Turnover growth should of itself drive incremental profitability through the benefits of operational leverage, but these will be further amplified through the delivery of greater operating efficiencies.

We see the following as the main growth drivers, all of which are areas of self-help action:

- ***Leveraging the unique archive:*** Increased leverage of the group's unique and extensive Intellectual Property (IP) in the form of its extensive archive, comprising over 150,000 original samples of wallpapers, fabrics and other artefacts. Digitisation of this source of sustainable competitive advantage will increase accessibility to and facilitate utilisation of this resource, bringing concomitant productivity gains.

- ***Domestic expansion:*** Extension of its market leadership position through enhanced relationships with retail, contract and interior design customers, driving higher average order values (AOV) – supported by demand created from increased media and digital marketing. The introduction of new DTC brands, such as Archive and the online shop, scionliving.com, will open complementary new channels to a wider market, attracting new customers to the group.

- ***International expansion:*** The main thrust on this front will be the markets of the USA and Northern Europe. Increasing brand awareness is a key driver in the USA whereas improving market penetration is key in Northern Europe (Nordics, France and Germany). SDG aims to double sales in both of these territories, compared with the FY20 base when its new strategy was unveiled.

- ***Licensing:*** Leveraging the group's brand equity to build out existing licensee relationships and attract new partners across a broad range of product categories.

- ***Range extension:*** The group intends to add a third lever to its core fabric and wallpaper ranges in the form of homewares. This is slated as a strategic milestone for FY24.

- ***Increasing brand awareness***: An integral part of group strategy is to elevate and promote the brands. High-profile media campaigns such as Sanderson's with Maro Itoje and Harlequin's 'Own the Room' campaign are leading the way on this front, complemented by a concerted push in social media and digital advertising.

- ***Increasing business efficiencies:*** These are being sought across many areas of the group to underpin profitability and profit margin expansion. Good progress has already been made on greater inventory efficiency through the reduction of annual collections launched and the total number of SKUs. Further infrastructure investment in areas such as digital printing and the new Enterprise Resource Planning (ERP) system at Standfast will improve efficiencies.

Any of the above drivers could individually deliver incremental growth for SDG. A combination of these will magnify and compound the rate of incremental growth.

Financials and forecasts

Forecasts, features and adjustments

The principal purpose of this chapter is to lay out our forecasts for the group, along with some of the key assumptions and drivers behind them. Our full analysis later in this chapter is presented showing two years of history and three years of forecasts. We also highlight certain features and definitions, such as adjusted PBT (and EPS), where SDG, like many other companies, adds back amortisation of acquired intangible assets, the LTIP accounting and defined benefit pension charges, together with other one-off exceptional costs. All of these costs are contained within the statutory profit & loss account, primarily within operating costs, to drive the reported (unadjusted) PBT figure.

Natural hedging and derivatives to manage FX impacts

As an international company, operating and selling around the globe, the consolidation of its accounts reflects both the transactional and translational effects of foreign exchange movements. This is closely monitored by the group and managed through a combination of natural hedging, whereby foreign-denominated revenues offset foreign-denominated outgoings, and derivative financial instruments, namely forward exchange rate contracts and swap exchange rate contracts.

Recent accounting changes

In terms of more accounting changes, we highlight two that have impacted the presentation of the group's financials:

- In FY19, the group adopted IFRS15, "Revenue from contracts with customers", which impacts the treatment of licensing revenue streams. The FY18 results were restated on a like-for like (LFL) basis to enable a direct comparison with FY19. The principal change required under the new accounting standard saw fixed minimum guaranteed income amounts being recognised upon transfer of the licence to the licensee. This meant such sums were recognised upfront in one sum, rather than reported when earned across the licence period. Other changes saw receipts from the provision of marketing and other support services reclassified to "Net other income", whereas they were previously deducted from distribution costs as a contribution to marketing expenses. Similarly, carriage recovery charges were reclassified as revenue, having previously been deducted from distribution costs. The net impact in FY19 saw reported PBT increase by £64k to £6.308m. With reference to the key changes outlined above, turnover was £3.4m higher than under the previous accounting methodology, distribution & selling expenses were £9.0m higher, and net other income was £5.6m higher.

- The group adopted IFRS16, relating to operating leases, in FY20. Prior years were reported under the IAS17 accounting standard. IFRS 16 was not applied retrospectively with no restatement to the FY19 financials resulting from the adoption of IFRS16. IAS17 saw operating leases charged to the P&L account as an operating expense, with no balance sheet implications. IFRS16 aims to align the financial presentation of leased assets more closely to that of owned assets, with balance sheets recognising right of use assets (ROUA) and a lease liability. Under IFRS16, instead of a rental charge, the profit and loss account recognises a depreciation charge on the ROUA and a finance charge within interest. This has the most noticeable effect of increasing EBITDA, with typically less marked changes at EBIT and PBT level. It has no impact on cash flows generated. In FY20, the change to IFRS16 resulted in a £271k increase to reported operating profit and a £26k increase to reported PBT.

Profit and loss account

Three sources of revenue

The group generates revenues from three main areas:

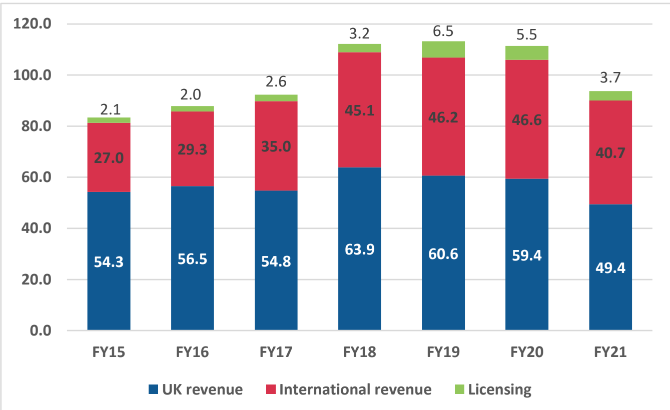
- ***Product sales*** – principally wallpaper, fabrics and paint, from its portfolio of heritage and more contemporary brands.
- ***Manufacturing*** – the group's manufacturing facilities supply the majority of the products sold by its portfolio of brands but also produce for third parties.
- ***Licensing*** – the group generates fees from the licensing of its Intellectual Property (IP), in the form of its brands and designs, to third parties, primarily retailers and manufacturers.

Turnover is generated globally, with the group's products sold in over 85 countries.

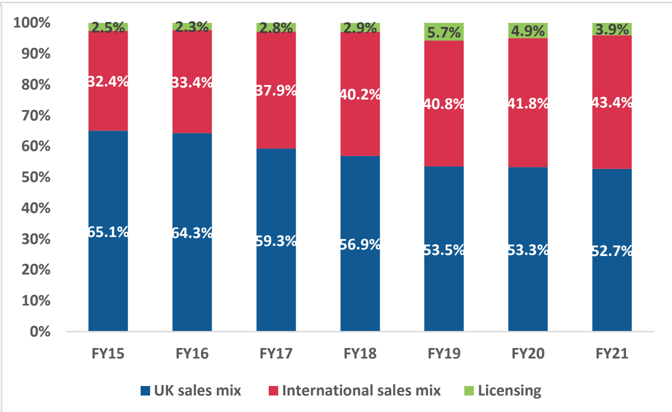
Good level of disclosure around group sales – by source, brand and geography

We believe SDG offers a good level of disclosure around revenue generation within the group, giving insight at a more detailed level within each of the three areas outlined above. Product sales are not only disclosed by brand, but also between UK and international revenue, with the latter split into three geographies – North America, Northern Europe and Rest of the World. Manufacturing revenues are disclosed at both a gross (including intra-group sales) and net (third-party only sales) level, the latter being the figure consolidated into group turnover. Gross (or total) manufacturing sales are split between the two units, namely Anstey and Standfast, with external sales allocated between domestic and international sales.

UK, International and Licensing revenue (£m)



UK, International and Licensing sales mix (%)



Source: Sanderson Design Group; Progressive Equity Research

Licensing revenue drops right through the P&L to the bottom line

Licensing revenue effectively drops right through the P&L down to the bottom line, as a 100% gross margin revenue stream. This enables the calculation of the gross margin for the combined Brands and Manufacturing operations, although the latter is not (yet) formally disclosed by the group. In the group's FY20 full-year trading update, reference was made for the first time to 'core licensing income'. This excludes both the recognition of fixed minimum guaranteed licensing income under IFRS 15, which can result in considerable lumpiness to licensing flows, and also income from seasonal apparel collaborations. The latter is excluded because apparel contracts are generally for much shorter periods than home adornment contracts, although they can be very remunerative. This was introduced with a view to aiding transparency for shareholders by giving greater insight into the underlying or core licensing income. While figures (and commentary) are now given on core and total licensing income, these are not formally disclosed within the segmental analysis notes within the report and accounts.

Gross margin structure

The reported gross margin is the aggregate of the three business areas, which have very different gross margin structures. Brands have the highest gross margins after Licensing but operate within a spread. The most premium brands, namely Zoffany, Sanderson and Morris & Co, operate with gross margins in the high 60's, akin to the gross margin level in the luxury goods sector. Clarke & Clarke, positioned as a quality but more accessible brand, operates on a lower gross margin, possibly some 10 percentage points below that of its more premium stablemates. Manufacturing operates on a lower gross margin, which we estimate to be around the mid-high 30's in percentage terms. The fabric unit, Standfast, enjoys a higher gross margin, aided by the high mix of more cost-efficient digital printing, whereas the Anstey wallpaper unit, with its more conventional machines, operates with a lower gross margin. Movements in the mix of group revenues generated across the three core business streams will therefore have a gross margin mix effect on the group's reported gross margin.

Comparison of gross profit margins – total, licensing and underlying (%)

(£m unless otherwise stated)	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Group turnover	112.2	113.3	111.5	93.8	110.9	117.7	127.0
- of which licensing	3.2	6.5	5.5	3.7	4.6	4.9	5.2
Turnover exc licensing	108.9	106.8	106.0	90.1	106.3	112.8	121.8
Group gross profit	68.0	67.5	68.1	57.0	68.8	73.0	78.7
- of which licensing	3.2	6.5	5.5	3.7	4.6	4.9	5.2
Gross profit exc licensing	64.7	61.1	62.6	53.3	64.1	68.1	73.5
Group gross margin (%)	60.6%	59.6%	61.1%	60.8%	62.0%	62.0%	62.0%
- licensing gross margin (%)	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Underlying gross margin (%)	59.4%	57.2%	59.1%	59.2%	60.4%	60.4%	60.4%

Source: Sanderson Design Group; Progressive Equity Research

Operating expenses

The group splits its operating costs between 'Administration costs' and 'Distribution and selling costs'. SDG also reports a figure for 'Other net income', which covers monies received from the sale of marketing materials, such as pattern books, and add-on services to customers. In FY21, this amounted to £2.0m. Given this, we include this additional income within 'Distribution and selling costs', thereby reducing the total sum. After this netting off, the mix between 'Administration costs' and 'Distribution and selling costs' stood at 70:30 in FY21 and 72:28 in FY20.

Fixed and variable costs

'Administration costs' are by nature primarily fixed costs, with the major exception of marketing. 'Distribution and selling costs' are by definition more variable in nature but include a number of fixed and semi-variable costs. With a relatively high proportion of fixed costs, at more than 50%, the group has a commensurately high level of operational gearing. This should be beneficial to profitability when its strategic goal of amplifying its brands and driving higher levels of sales growth comes to full fruition.

Rightsizing exercise in 2020 resulted in £3m of annualised savings

In response to the pressures caused by the pandemic and the likely adverse impact on demand, the group undertook a formal consultation exercise in 2020 to review its staffing structure. This was done with a view to rightsizing the cost base, improving efficiency and conserving cash. The result was a headcount reduction of 68 employees. The bulk, around 50 employees, was borne within the brands and central group services, with manufacturing seeing a smaller reduction of 15 people. This will result in annualised cost savings of £3m in FY22E, following realised savings of £1.2m in FY21. The headcount reduction also helped the speed of internal communications by delayering some functional roles, including finance.

Group presents adjusted profit figures, which drives our adjusted forecasts

In addition to the statutory reported figures, SDG presents adjusted profit figures to provide better insight into the underlying business performance on a consistent basis. The group adds back non-underlying charges, comprising amortisation of acquired intangible assets (relating to the Clarke & Clarke acquisition) and other exceptional items, to give an underlying profit before tax figure. Additional add backs of the LTIP charge and the net defined benefit pension charge drive an adjusted PBT figure, which is the figure we describe as fully adjusted PBT in our forecasts. This in turn drives our fully adjusted EPS figure.

Cash flow and balance sheet

A strong balance sheet

SDG has a strong balance sheet, with FY21 year-end net cash (excluding lease liabilities) of £15.1m. This included a short-term debt liability of £0.4m from a loan contract with Wells Fargo under the US Paycheck Protection Payment Scheme, a federal scheme providing aid in the pandemic. In April 2021, the group applied for forgiveness of the loan, which has subsequently been granted. The group therefore has no indebtedness other than its lease liabilities under IFRS16.

Revolving credit facility, but no current borrowings

In 2019, the group renewed its £12.5m multi-currency revolving credit facility with Barclays Bank; the agreement also including an additional £5m accordion facility option. The group therefore has considerable latitude and headroom to support future growth. Excluding a temporary overdraft facility in place between April 2020 and April 2021 to cover short-term issues caused by the Covid pandemic, SDG did not utilise any of its £17.5m facilities.

Small net cash inflows forecast

We are forecasting a small net cash inflow across our forecast period, which will see the cash balance increase to a projected £18.5m by the end of FY24E. This partly reflects the increased capex forecast over the next three years.

Investment capex to overlay on underlying maintenance capex of around £2.5m per annum

In recent times, the group has run with a relatively capex-light model, partly due to Covid and cash conservation. Annual maintenance capex is estimated to run at around £2.5m-£3.0m per annum. However, as the group looks to move more on to the front foot to drive both brand and manufacturing sales over the medium term, capex is set to rise over the next two to three years. Projects driving this rise in capex include the new ERP system implementation at Standfast & Barracks and next year's installation of a next generation digital printer at Anstey. FY24E will then see the relocation of the logistics warehouse in Milton Keynes, which will require fitting out expenditure.

Working capital usually shows small outflow

In terms of the broad working capital characteristics, these usually show small outflows, driven by the increase in inventory as the business continues to grow, with debtor increases offset by creditor increases of a similar quantum. As a percentage of sales, inventory fell from 25.7% in FY20 to 21.7% in FY21, in line with the group's commitment to reduce collections and SKUs, leading to improved stock efficiency and returns. Going forward, we have modelled inventory on the basis of 20% of group turnover, with stock growing in line with revenues.

Right-of-use assets

The balance sheet adjustments required under IFRS16 saw the recognition of £8.4m of right-of-use assets (ROUA) with a corresponding lease liability of £8.4m on the closing balance sheet for FY20. At the FY21 year-end, ROUA had depreciated to £5.8m with the lease liability paid down to £5.9m.

Pension schemes currently require £2.2m payments, covering contribution and expenses

SDG operates two defined benefit pension schemes, which have been closed to new members and service accruals since 2002 and 2005. The gross deficit on an IAS 19 basis as at 31 January 2021 stood at £5.6m, which had reduced further to a deficit of £4.7m as at 31 July 2021, ie the end of H1 FY22E. The group made payments to the schemes totalling £1.1m in the latest H1 period, comprising contributions (£931k) and administration costs (£199k), equating to a total of £2.2m on an annualised basis. The triennial valuation of the schemes is to be made based on the position on 5 April 2021. This could result in a change to the level of ongoing contributions to the schemes.

Carrying value of archive at £4.3m on balance

Having referred numerous times to the archive and its value to the group, we believe it is worthwhile highlighting its balance sheet treatment. The Arthur Sanderson and William Morris archive was acquired in 2003 as part of the group's acquisition of Arthur Sanderson & Sons. This archive comprises an unparalleled record of unique designs, predominantly fabrics and wallcoverings, which are used to generate royalty incomes for the business. The carrying value of this archive within intangible assets stands at £4.3m and is subject to an annual impairment test (more details on which can be found in Note 13 of the FY21 annual report and accounts). SDG believes the archive has an indefinite useful life and is therefore not subject to amortisation.

Interim results

Most recent financial update against last year's pandemic shows a strong bounce back

The most recent financial update from SDG was the group's interim results, which were announced on 13 October. Before moving to present our forecasts, we first review these results. The table below summarises the key performance metrics. Given the anomalies and distortions in the comparable period last year due to the Covid pandemic, temporary factory closure and consumer lockdowns, SDG presented the results achieved two years ago to enable a comparison with the most recent pre-pandemic trading performance. We have therefore included the percentage change in individual lines of our summary not only against last year, but also against the preceding year. The former shows a healthy bounce back from the trials and tribulations of last year but should not be seen as an underlying run rate going forward. The latter shows a more modest level of growth at revenue level, but much stronger progress at operating profit and PBT levels. This reflects the benefits of the cost-savings and redundancy programmes carried out last year in response to the pandemic.

Overview of interim results (H1 FY22E) against H1 FY21 and H1 FY20 (£m unless stated)

	H1 FY22E	H1 FY21	H1 FY20	H1 FY22 % change over H1 FY21	H1 FY20
Revenue:					
- Brands	43.2	31.0	43.1	39%	0%
- Manufacturing	12.2	6.5	9.6	89%	28%
- Licensing	2.0	1.3	3.2	53%	(37%)
Total	**57.5**	**38.8**	**55.9**	**48%**	**3%**
Gross profit	35.9	22.9	35.5	57%	1%
Gross margin (%)	*62.5%*	*59.0%*	*63.5%*	*+325bps*	*-100bps*
Distribution and selling costs	(10.0)	(6.2)	(9.1)	62%	10%
Administration costs	(21.0)	(17.5)	(22.7)	20%	(7%)
Total operating costs	(31.0)	(23.7)	(31.8)	31%	(3%)
Operating profit	4.9	(0.8)	3.7	(750%)	33%
Reported PBT	4.9	(0.9)	3.5	(643%)	41%
Adjusted PBT	**6.0**	**0.4**	**4.9**	**1550%**	**22%**
Adjusted diluted EPS (p)	**6.38**	**0.53**	**5.54**	**1104%**	**15%**
Dividend (p)	**0.75**	**0.00**	**0.52**	**n.a.**	**44%**

Source: Sanderson Design Group; Progressive Equity Research

Key highlights

We draw out the following observations with regard to the H1 FY22E performance:

- **Revenue:** Strong yoy growth with a 3% increase over H1 FY20 driven by Manufacturing and notwithstanding a decrease in Licensing revenues.

- **Gross margin:** A good recovery of 325bps over last year. The 100bps decline against H1 FY20 reflects the lower Licensing revenue in H1FY22E, with the adjusted underlying gross margin excluding Licensing down by just 17bps at 61.1% (vs 61.3% in H1 FY20). Brand product sales were reported to be 50bps higher than achieved in H1 FY20, excluding both Manufacturing and Licensing.

- **Distribution and selling costs:** The increases reflect the recovery in sales, together with higher container costs, carrier capacity issues, and additional costs arising from post-Brexit transportation and border issues.

- **Administration costs:** In H1 FY22E, these have returned to more normalised levels, including the reinstatement of marketing, travel and entertaining spend. Last year saw substantial cuts in discretionary spend due to Covid, with the benefit of the group's restructuring programme and cost-efficiency measures clearly visible in the 7% decline compared with H1 FY20.

- **Profit and EPS:** Operating profit, PBT and EPS measures show a consistent improvement against both of the previous periods. Adjusted PBT and adjusted EPS rose 22% and 15%, respectively, against the pre-pandemic levels delivered in H1 FY20.

- **Dividend:** In light of the above, the group has returned to the dividend list, announcing an interim dividend of 0.75p, an increase of 44% on the 0.52p announced for H1 FY20.

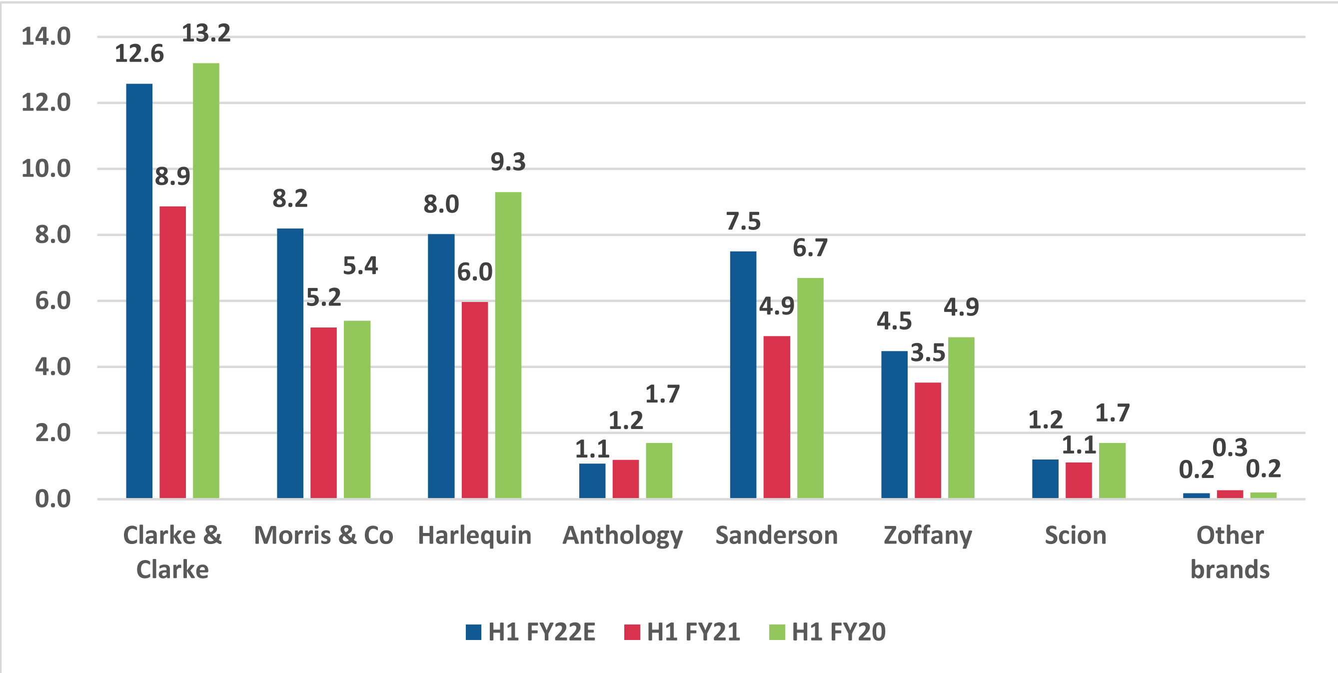
- **Operational highlights included:** Strong Manufacturing sales; good growth in International Brand sales, notably to North America and Northern Europe; the first major US licensing agreement with Williams Sonoma (post period in September 2021);

further licensing agreements signed with NEXT and Sangetsu; the launch of two DTC brands, Archive by Sanderson Design and scionliving.com, with each supporting the group's DTC digital strategy; the group also obtained Planet Mark certification for a third year in succession, reflecting and rewarding its commitment to sustainability through its Live Beautiful programme.

Anthology to be absorbed within Harlequin with no new products launched

With regard to its brand portfolio, SDG announced that it would be integrating the smaller Anthology brand within Harlequin and that henceforth no new Anthology products would be launched. With a view to providing greater transparency, the group also provided a greater level of insight into individual brand performance, providing revenue figures for each brand, redefining these more in line with the group's strategy. Historically, these have been presented with some brands combined, such as Morris & Co being reported within Sanderson, and Scion and Anthology within Harlequin, as shown earlier in this note.

H1 product revenue analysis by brand (£m)



Source: Sanderson Design Group; Progressive Equity Research

We have excluded Licensing income from the above table, as it is discussed more fully elsewhere, and its revenues are not allocated within the individual brands.

Trading outlook saw robust Manufacturing and Licensing offsetting some softening from Brand sales

In terms of the trading outlook, SDG pointed to continued robust performance from both Manufacturing and Licensing since H1, offsetting some softening from Brand sales. The group also stressed its focus on mitigating the potential of the ongoing cost pressures seen in H1, arising from global supply chain and other issues. The key Autumn selling weeks in October and November will shape the full-year outturn, but SDG remained confident of meeting the Board's expectations for the full year.

Forecasts

Forecast summary in line with group adjustments

The following table summarises our key forecasts for the three years to FY24E. It should be noted that we show forecasts here in line with the group's total adjustments, as discussed above. The more detailed forecasts, which follow this section, show the reported figures, as well as the adjusted figures shown summarised below.

FY20 included as a pre-pandemic base year for comparison purposes

Given the exceptional circumstances shaping the commercial performance of FY21, we have also included the figures for FY20. These can be referenced in relation to the forecast performance as a more normal and typical base year than FY21.

Summary of key P&L components – FY20-FY24E

	FY20	FY21	FY22E	FY23E	FY24E	3-yr CAGR
Turnover	**111.5**	**93.8**	**110.9**	**117.7**	**127.0**	**10.6%**
Gross profit	68.1	57.0	68.8	73.0	78.7	11.4%
Gross margin (%)	*61.1%*	*60.8%*	*62.0%*	*62.0%*	*62.0%*	
Adjusted EBITDA	**14.1**	**13.6**	**17.0**	**18.2**	**19.5**	**12.9%**
EBITDA margin (%)	*12.7%*	*14.5%*	*15.4%*	*15.4%*	*15.4%*	
Adjusted operating profit	**7.8**	**7.2**	**10.8**	**11.8**	**13.0**	**21.6%**
Operating margin (%)	*7.0%*	*7.7%*	*9.7%*	*10.0%*	*10.3%*	
Adjusted PBT	**7.4**	**7.1**	**10.6**	**11.6**	**12.8**	**21.9%**
Adjusted PBT margin (%)	*6.6%*	*7.5%*	*9.5%*	*9.8%*	*10.1%*	
Adjusted diluted EPS (p)	**9.2**	**7.8**	**11.8**	**12.9**	**14.6**	**23.2%**
Dividend (p)	**0.5**	**0.0**	**3.5**	**3.8**	**4.2**	**n.a.**
Net (debt)/cash - exc lease liabilities	**1.3**	**15.1**	**16.6**	**17.2**	**18.5**	**6.9%**

Source: Sanderson Design Group; Progressive Equity Research

Impressive double-digit three-year CAGRs forecast

We have added a column that shows the three-year CAGR for the forecast lines selected. These show impressive double-digit growth at all levels, which indeed increase as one moves down the P&L. The year-end net cash figure (excluding lease liabilities) does not show double-digit growth, although this still delivers a solid CAGR of 6.9% over the period. Gross, EBITDA, EBIT and PBT margins rise across the period in relation to the base year of FY21 (and indeed of FY20 if preferred).

Operating profit and PBT CAGR measures still in double digits against FY20 as a base year

It could be argued that using FY21 as a base flatters these CAGR figures. This certainly applies at turnover level and EPS level, both of which fell 15% relative to FY20. We have also looked at the CAGR metrics on a two-year, four-year, and adjusted three-year basis (comparing FY24E with FY20 but assuming just three years of compounding). These all show double-digit compound growth at adjusted operating profit, adjusted PBT and adjusted diluted EPS over the respective periods. This clearly underlines the strong growth potential for the group and strong delivery of shareholder value over the period.

Key forecast assumptions

The trajectory of all individual forecast lines is different. Our key assumptions regarding the pathway to FY24E are:

- ***Turnover:*** Growth is weighted to FY22E, followed by high single-digit growth in the latter two years. We forecast growth for Brands, Manufacturing and Licensing across the period, notwithstanding the potential lumpiness of the latter.

- ***Gross margin:*** We conservatively forecast a flat gross margin of 62.0% across the forecast period. This is below the 62.5% recorded in H1 FY22E, but higher than that delivered in the previous two years. Excluding Licensing, the underlying gross margin is also flat at around 60.4%.

- ***Adjusted operating costs:*** Notwithstanding the potential cost pressures mentioned above, we expect the group's efforts at mitigation, combined with improved operating efficiencies, will result in a decrease in the operating costs to sales ratio.

- ***Adjusted operating profit:*** The combination of a flat gross margin and a falling opex:sales ratio results in a rising adjusted operating profit margin. We forecast this to increase to 9.7% in the current year, followed by 30bps improvements in the two outer years, reaching 10.3% in FY24E.

- ***Adjusted PBT:*** The pattern outlined above for the adjusted operating profit is repeated at the adjusted PBT level, given minimal finance charges. The adjusted PBT margin comes in some 20bps lower than the operating profit margin, reaching 10.1% in FY24E.

- ***Adjustments:*** In our forecast years, we assume total adjustments from statutory reported PBT of £2.3m each year, covering the LTIP, pension and amortisation of acquired intangible asset charges.

- ***Dividend:*** Our dividend forecasts equate to a payout ratio of just under 30% relative to adjusted EPS, with a cover level of around 3.4x.

- ***Net cash:*** With a small cash inflow each year, net cash is forecast to rise to £18.5m by the end of our forecast period in FY24E.

Detailed P&L, cash flow and balance sheet forecast in following tables

We have discussed some of the key cash flow and balance sheet characteristics earlier, including the shape anticipated over the forecast period for capex and working capital. The following tables give our detailed forecasts for P&L account, cash flow and balance sheet.

Summary of Sanderson Design Group profit & loss account and cash flow forecasts

Profit and loss account					
Year to January	**FY20**	**FY21**	**FY22E**	**FY23E**	**FY24E**
Divisional turnover					
- Brands	84.7	72.6	85.7	91.0	98.5
- Manufacturing (net)	21.3	17.5	20.6	21.8	23.2
- Licensing	5.5	3.7	4.6	4.9	5.2
Group turnover	**111.5**	**93.8**	**110.9**	**117.7**	**127.0**
Cost of sales	(43.3)	(36.8)	(42.1)	(44.7)	(48.2)
Gross profit	68.1	57.0	68.8	73.0	78.7
Gross margin (GM) (%)	*61.1%*	*60.8%*	*62.0%*	*62.0%*	*62.0%*
Distribution and selling costs	(17.6)	(15.3)	(17.5)	(18.5)	(20.0)
Administration costs	(45.8)	(36.5)	(42.8)	(45.0)	(48.0)
Operating profit	**4.8**	**5.2**	**8.5**	**9.5**	**10.7**
Operating profit margin (%)	*4.3%*	*5.5%*	*7.6%*	*8.1%*	*8.4%*
Depreciation and amortisation	(7.4)	(7.4)	(7.4)	(7.5)	(7.6)
EBITDA	12.1	12.6	15.8	17.0	18.3
EBITDA margin (%)	*10.9%*	*13.4%*	*14.3%*	*14.4%*	*14.4%*
Interest charge	(0.4)	(0.2)	(0.2)	(0.2)	(0.2)
PBT	**4.4**	**5.0**	**8.3**	**9.3**	**10.5**
Exceptional/adjusting items	(3.0)	(2.1)	(2.3)	(2.3)	(2.3)
Adjusted profit before tax	**7.4**	**7.1**	**10.6**	**11.6**	**12.8**
Adjusted PBT margin (%)	*6.6%*	*7.5%*	*9.5%*	*9.8%*	*10.1%*
Adjusted diluted EPS (p)	**9.2**	**7.8**	**11.8**	**12.9**	**14.6**
Diluted reported EPS (p)	5.2	5.4	8.8	9.8	10.9
Dividend (p)	0.5	0.0	3.5	3.8	4.2
Adjusted EBITDA	14.1	13.6	17.0	18.2	19.5
Adjusted operating profit	7.8	7.2	10.8	11.8	13.0
Cash flow					
Year to January	**FY20**	**FY21**	**FY22E**	**FY23E**	**FY24E**
Operating profit	4.8	5.2	8.5	9.5	10.7
Depreciation and amortisation	7.4	7.4	7.4	7.5	7.6
Inventory (increase)/decrease	(0.4)	8.1	(1.8)	(1.4)	(1.8)
Debtors (increase)/decrease	(2.0)	2.3	(1.6)	(0.5)	(0.8)
Creditors increase/(decrease)	0.9	(3.5)	1.6	0.5	0.8
Pension, other	(1.1)	(1.7)	(2.4)	(2.4)	(2.4)
Operating cash flow	**9.6**	**17.8**	**11.6**	**13.2**	**14.1**
Interest	(0.5)	(0.3)	(0.2)	(0.2)	(0.2)
Dividends	(2.2)	0.0	(0.5)	(2.5)	(2.8)
Tax	(0.8)	(0.0)	(3.3)	(2.1)	(2.6)
Deferred tax	0.0	0.0	0.0	0.0	0.0
Capital expenditure	(2.5)	(1.1)	(3.3)	(5.0)	(4.5)
Trading cash flow	**3.6**	**16.4**	**4.3**	**3.3**	**4.0**
Short term investments	0.0	0.4	0.0	0.0	0.0
Sale of fixed assets	0.1	0.1	0.0	0.0	0.0
Acquisition/disposal of businesses	0.0	0.0	0.0	0.0	0.0
Share issues	0.0	0.0	0.0	0.0	0.0
Currency effects, leases, other	(2.8)	(3.1)	(2.9)	(2.8)	(2.6)
Net cash inflow/(outflow)	**0.9**	**13.8**	**1.5**	**0.5**	**1.4**
Net (debt)/cash exc leases	**1.3**	**15.1**	**16.6**	**17.2**	**18.5**

Source: Sanderson Design Group; Progressive Equity Research

Summary of Sanderson Design Group balance sheet forecasts

Balance sheet					
Year to January	**FY20**	**FY21**	**FY22E**	**FY23E**	**FY24E**
Tangible fixed assets	22.5	17.8	15.5	14.7	13.3
Intangible fixed assets	29.8	28.3	26.6	24.9	23.1
Investments and other	0.0	0.0	0.0	0.0	0.0
Total fixed assets	**52.3**	**46.2**	**42.0**	**39.6**	**36.4**
Stock	28.5	20.4	22.2	23.5	25.4
Trade and other debtors	20.5	18.3	19.9	20.4	21.2
Deferred tax	0.0	0.0	0.0	0.0	0.0
Cash and short term deposits	3.1	15.5	16.6	17.2	18.5
Current assets	**52.1**	**54.2**	**58.7**	**61.1**	**65.1**
Total assets	**104.4**	**100.4**	**100.7**	**100.7**	**101.5**
Trade and other payables	(22.9)	(20.5)	(22.1)	(22.5)	(23.3)
Borrowings	(1.7)	(0.4)	0.0	0.0	0.0
Other/lease liabilities	(2.8)	(2.7)	(2.7)	(2.7)	(2.7)
Current liabilities	**(27.5)**	**(23.6)**	**(24.7)**	**(25.2)**	**(26.0)**
Borrowings	0.0	0.0	0.0	0.0	0.0
Pension provisions	(5.7)	(5.6)	(4.7)	(4.7)	(4.7)
Deferred tax liabilities	(0.8)	(0.5)	(0.5)	(0.5)	(0.5)
Other/lease liabilities	(5.6)	(3.2)	(3.2)	(3.2)	(3.2)
Non-current liabilities	**(12.1)**	**(9.4)**	**(8.5)**	**(8.5)**	**(8.5)**
Total liabilities	**(39.5)**	**(32.9)**	**(33.2)**	**(33.7)**	**(34.4)**
Net assets	**64.8**	**67.5**	**67.5**	**67.0**	**67.1**

Source: Sanderson Design Group; Progressive Equity Research

Valuation

Valuation comments in relation to selected listed peer comparators

In this section, we review and comment on SDG's valuation in reference to a selection of listed peer comparator companies. This should not be seen as a definitive list of comparator companies, rather it is provided to give some insight into relative valuations. Investors may choose to compare SDG's valuation with one or a smaller number of companies from our selection or indeed choose companies we have not highlighted.

Few directly comparable listed peers, underlining SDG's unique characteristics

We believe there are very few companies in the listed arena that are directly comparable to Sanderson Design Group and its rich heritage. This underlines the unique characteristics of the group, in our view, both as a business and as an investment proposition. It also makes the compilation of a peer group of comparative companies (compcos) less straightforward and renders valuation comparisons arguably less useful than for other companies where there are more ready comparators. A further complication is that we have been unable to find consensus forecast data for some listed compcos, such as Colefax and Fowler, a smaller UK fabrics and wallpaper business and owner of several well-known brands including Jane Churchill and Sybil Colefax & John Fowler.

Common theme of selected peers is participation in the field of home adornment

We have therefore had to cast our net wider to include companies whose activities overlap with some of the group. The common theme binding these compcos is participation within the world of home adornment. As far as possible, we have also selected companies with a high design input and with a focus on brands and branding. We have also sought to mirror the group's positioning in the more premium segment of the market. Our compco set includes companies – like Sanderson Design Group – with their own manufacturing facilities, such as AS Creation Tapeten, Ethan Allen, Culp, Portmeirion and Churchill China. Our emphasis has been on the soft furnishings sector within home adornment, but not exclusively so. The selected compcos include both manufacturing and retailing entities. While not a uniform selection, we believe our selected compcos share several characteristics with Sanderson and are therefore still relevant, but admittedly to a lesser degree than with a group of directly comparable businesses.

An international spread including US and European companies

We have also endeavoured to include a geographic spread of companies, given the global nature of the markets the group is addressing. Our selection includes companies based and listed in the USA, Finland, France and Germany, as well as the UK. Our compco universe also covers a wide range of market capitalisation from £27m for French company U 10 to £10bn for the US multi-channel and multi-brand retailer Williams-Sonoma, with which Sanderson recently signed a licensing agreement.

Compco valuation metrics based on consensus forecasts and for calendar years

In the following table, we compare SDG with the selected compcos using three valuation metrics: EV/EBITDA, EV/sales and PER (price/earnings ratio). This table is based on consensus forecast data from Refinitiv Eikon and is presented on a calendar-year basis to permit direct comparability as company year-ends differ. It does not therefore coincide with SDG's January year-end. CY1 refers to the calendar year to December 2021 and CY2 to end December 2022. It should also be remembered that the quantum of analyst coverage of individual stocks will vary considerably, the number of forecast years may vary between analysts (typically meaning some fall-off in the number of FY3E estimates, which is why we do not include CY3 metrics) and that no forecast aggregator has access to all analyst forecasts, as mentioned earlier with regard to Colefax and Fowler.

Our analysis also shows year-on-year revenue growth

We have also included the year-on-year sales growth figures, as this more explicitly shows the relativity between high(er) and low(er) growth companies than simply relying on the EV/sales metric. We have also included the market capitalisation, expressed in sterling for ease of comparison, alongside the country where each stock has its primary listing.

A wide spread of valuation metrics

A cursory glance at the table shows a wide variance across valuation metrics and across companies. To smooth out the impact of metric outliers, we have included unweighted averages and the median for each metric for each year, which also include SDG. Given the absence of consensus EBITDA figures for U 10, this company has been excluded from the average and median EV/EBITDA metric calculation for both CY1 and CY2, ie 2021 and 2022. This exclusion is annotated in the footnote to the table.

Average and median figures also shown for the cohort

The median and average figures for the EV/sales metric include no adjustments. As with the two other valuation metrics, we see a spread of performance within the cohort. One reason for the enduring use of the EV/sales metric is that metrics are typically positive, which is useful for start-up and/or high-growth companies reporting EBITDA and PBT losses. Of itself, we would point out that this metric gives no direct insight into sales growth, profitability and margins. The EV/sales metric can be argued to give indirect insight into these, but it should be recognised that EV/sales as a standalone metric can be a somewhat limited and blunt instrument, in our view.

Valuation metrics for selected peer comparators (based on consensus forecasts)

	Listing location	Market cap £m	EV/EBITDA (x)		EV/Sales (x)		PER (x)		Sales growth	
			CY1E	CY2E	CY1E	CY2E	CY1E	CY2E	CY1E	CY2E
Sanderson Design Group PLC	***UK***	***126***	***7.2***	***6.1***	***1.0***	***1.0***	***16.2***	***13.2***	***14.4%***	***6.9%***
Churchill China PLC	UK	182	***20.2***	12.5	3.1	2.6	***42.1***	21.4	***52.0%***	***16.5%***
Portmeirion Group PLC	UK	95	9.5	7.2	1.1	1.0	18.2	11.9	3.4%	10.4%
Bed Bath & Beyond Inc	USA	1,061	4.2	3.3	0.2	0.2	29.8	10.8	(13.9%)	(2.6%)
Williams-Sonoma Inc	USA	10,005	8.7	8.7	1.6	1.6	14.1	14.3	23.1%	2.1%
Ethan Allen Interiors Inc	USA	451	5.0	4.8	0.7	0.7	9.9	9.3	7.3%	4.5%
Culp Inc	USA	115	5.5	4.8	0.4	0.4	23.2	15.5	8.4%	8.9%
Marimekko Oyj	Finland	566	16.4	***15.7***	***4.4***	***4.1***	31.2	***30.0***	10.8%	8.5%
Roche Bobois SA	France	289	7.2	7.3	1.4	1.4	16.8	17.0	21.0%	1.0%
AS Creation Tapeten AG	Germany	52	4.3	3.1	0.3	0.3	13.5	8.8	2.2%	11.7%
U10 Corp SA	France	27	n.a.	n.a.	0.3	0.3	9.2	8.0	14.6%	3.3%
Unweighted average*			**8.8**	**7.3**	**1.3**	**1.2**	**20.4**	**14.6**	**13.0%**	**6.5%**
Indexed to average			*81.5*	*82.9*	*77.5*	*78.5*	*79.5*	*90.6*	*110.6*	*106.5*
Median*			**7.2**	**6.6**	**1.0**	**1.0**	**16.8**	**13.2**	**10.8%**	**6.9%**
Indexed to median			*99.9*	*91.8*	*100.0*	*100.0*	*96.3*	*100.0*	*133.2*	*100.0*
Indexed to best in highest rating			***35.6***	***38.8***	***23.3***	***23.7***	***38.6***	***44.0***	***27.7***	***41.9***

** = Average and median EV/EBITDA metrics exclude U10 in both CY1 and CY2*
Priced as at market close on 26 October
Source: Refinitiv Eikon; Progressive Equity Research

SDG metrics indexed against the average and median figures of the cohort…

We have also indexed SDG's valuation metrics to the average and median figures collated. This is done as follows: SDG metric divided by average/median metric, multiplied by 100. Where SDG's metric is equal to the average/median sector figure, the result would therefore be 100. A higher figure indicates than SDG is valued above (or at a premium to) the average/median figure and conversely a figure lower than the average indicates that SDG is valued below (or at a discount to) the average/median metric.

…and to the highest peer figure by valuation metric and year

In addition, we have indexed SDG to the highest metric within the peer cohort. We have emboldened and italicised the best-in-class metrics for ease of reference. The best-in-class metrics are delivered by two companies, namely the Finnish lifestyle design company Marimekko and the British company Churchill China, a manufacturer and supplier of high-quality professional tableware.

SDG's sales growth rate is higher than most of the cohort

SDG has a higher rate of forecast sales growth compared with most of the peer group. SDG's consensus sales growth forecasts of 14% and 7% are above both the average and median figures for CY1, reflected in indexed figures of 111 and 133, respectively. In CY2, SDG indexes at 107 against the average and 100 against the median. Thus, it can be seen that SDG's growth prospects are better than the aggregate for our compco group.

The group's valuation is lower than the average and median figures, by 10% on a combined basis…

In contrast to its growth outlook relative to the compcos, SDG trades at a discount against both the average and median valuation metrics of the group, more notably against the average than the median figures, where it is more closely aligned. Taking a simple arithmetic average of the indexed valuations over both years suggests SDG's valuation is around 18% and 2% lower, respectively, than the average and median for the compco cohort, or 10% lower on a combined basis.

…and significantly lower than best-in-class companies (though this may reflect special circumstances for those specific peers)

We have also benchmarked and indexed SDG's valuation metrics against the best-in-class within the compco cohort. In relation to the three valuation metrics, SDG's valuation indexes at 24%-44% against the best in class of our peer comparators (and at 34% on average). This could of course reflect special circumstances relating to the companies yielding these best-in-class metrics.

We remind investors that they should take their own views on the relevant risks and rewards when assessing and applying any valuation criteria.

Risk factors

A look at potential downside risk factors

All companies face risks that could impact on their trading performance and reputation. In turn and by extension, these could have an impact on our forecasts, to the upside as well as the downside. We focus in this section on the factors that could apply downside risk. This is not intended to be a fully comprehensive list, nor do we address all the mitigating actions that the group undertakes to minimise such risks.

External and internal risks summarised

We would generally characterise risk factors as falling into two high-level categories, namely ***external*** and ***internal***. The company's annual report & accounts includes a more extensive section on the risks and uncertainties faced by the company, along with mitigating controls undertaken by the group.

External risk factors

External factors are typically those beyond the direct control of the company, but which do have an impact – direct or indirect – on the company. Risk arises when changes occur that are different to or impact on a company's planning assumptions. Examples of external factors include:

- macro-economic events/change, such as Brexit
- legislation
- competition
- fashion trends
- technology
- currency movements
- natural disasters, such as the coronavirus pandemic.

These can have a direct impact on factors including, but not limited to, economic growth, disposable income, consumer confidence and behaviour. In turn, these will impact consumers' willingness and ability to purchase goods, with discretionary items deferred or consumers trading down, for example in economic downturns.

Sudden and dramatic moves in foreign exchange rates and raw material costs lead to an increase in a manufacturer's intake prices. Manufacturers must then decide whether to absorb these higher costs, resulting in lower margins, or to increase selling prices, which could result in reduced demand, especially if competitors choose not to pass on these price increases. Currency hedging, or natural hedging, where companies like Sanderson Design Group have substantial foreign currency receipts, can help to offset such risks.

Brexit has resulted in layers of extra documentation and therefore additional costs in relation to exporting into and importing from the EU. This has resulted in some delayed shipments to the EU in 2021.

Competition is a fact of life. The group competes against a wide range of competitors, both for customers and for human capital. Commercial success depends on a wide range of factors, with the group seeking to differentiate itself through the quality of its products, its British manufacturing and the cultural heritage of its brand portfolio.

Within the home furnishings sector, as in the clothing market, the ***prevailing fashion trends can have a significant impact on commercial success***. The group's brand portfolio, appealing to a wide spectrum of tastes from classic to more contemporary and modern looks, helps to mitigate fashion risks.

Internal risk factors

Internal risk factors relate to the company and usually fall therefore within the company's remit to oversee and control. These are no less important than external factors, in that they can have a significant impact on the ability of a company to operate, to compete, and to meet – or better exceed – customer expectations. Operational disruption can arise from a wide range of factors.

Any ***disruption in a production facility or distribution centre***, whether from mechanical failure, an IT/systems issue or a disaster such as a fire or flood, can adversely affect product flow, customer deliveries and brand image and reputation. ***Systems failures or poorly managed systems upgrades*** in any functional area can have a detrimental impact on the execution of a company's daily activity and routines. Such failures can also impact on the collection and collation of data used to manage the business or which would help to identify issues and rectify problems.

Quality control of output is essential to maintain customer satisfaction, maintain brand equity and avoid potentially costly product recalls or product liability claims.

The ***departure of key management or senior personnel*** for whatever reason can also have a disruptive influence, not only in terms of business operations and staff morale, but also on City and market perception. The loss of business contacts, supplier relationships and business knowledge with a departing key manager has an opportunity cost in terms of replacement, which is damaging in its own right, but would be viewed even more negatively if the individual involved moved to a competing business.

Risk management

As stated above, the annual report & accounts includes a more extensive section on the risks and uncertainties faced by the group, a categorisation of the main types of risks faced (Marketplace, Financial and Operational), together with controls to mitigate the identified risks. For reference and completeness, the 11 risks highlighted by the company are:

- Trading environment
- Brexit
- Competition
- Foreign exchange
- Pension funding
- Recruitment and retention of key employees
- Reputational risk
- Environmental risk
- Health and safety risk
- Major incident or disaster
- IT risk

Major shareholders

The following table shows the group's major shareholders as at 29 October 2021.

Major shareholders as at October 2021

Name	Number of shares (m)	% of share capital
Octopus Investments	8.64	12.2%
Fidelity International	5.54	7.8%
Ennismore Fund Management	5.11	7.2%
BGF Investment Management	4.25	6.0%
Hargreaves Lansdown Asset Management	3.76	5.3%
Schroder Investment Management	3.54	5.0%
Charles Stanley	3.53	5.0%
Brown, Shipley & Company	1.89	2.7%
Close Brothers Asset Management	1.31	1.8%
Allianz Global Investors	1.30	1.8%

Source: Refinitiv Eikon; Progressive Equity Research

Financial Summary: Sanderson Design Group

Year end: January (£m unless shown)

PROFIT & LOSS	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Revenue	111.5	93.8	110.9	117.7	127.0
Adj EBITDA	14.1	13.6	17.0	18.2	19.5
Adj EBIT	7.8	7.2	10.8	11.8	13.0
Reported PBT	4.4	5.0	8.3	9.3	10.5
Fully Adj PBT	7.4	7.1	10.6	11.6	12.8
NOPAT	5.8	5.5	8.1	9.0	9.0
Reported EPS (p)	5.2	5.4	8.8	9.8	10.9
Fully Adj Dil EPS (p)	9.2	7.8	11.8	12.9	14.6
Dividend per share (p)	0.5	0.0	3.5	3.8	4.2
CASH FLOW & BALANCE SHEET	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Operating cash flow	9.6	17.8	11.6	13.2	14.1
Free Cash flow	3.6	16.4	4.3	3.3	4.0
FCF per share (p)	5.0	23.2	6.1	4.7	5.6
Acquisitions	0.0	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	0.0	0.0	0.0	0.0	0.0
Net cash flow	0.9	13.8	1.5	0.5	1.4
Overdrafts / borrowings	(1.7)	(0.4)	0.0	0.0	0.0
Cash & equivalents	3.1	15.5	16.6	17.2	18.5
Net (Debt)/Cash	1.3	15.1	16.6	17.2	18.5
NAV AND RETURNS	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Net asset value	64.8	67.5	67.5	67.0	67.1
NAV/share (p)	91.3	95.1	95.1	94.4	94.5
Net Tangible Asset Value	35.0	39.2	40.9	42.2	44.0
NTAV/share (p)	49.3	55.2	57.7	59.4	62.0
Average equity	32.4	66.2	69.0	71.4	73.6
Post-tax ROE (%)	22.7%	10.7%	15.3%	16.2%	17.4%
METRICS	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Revenue growth	(1.6%)	(15.9%)	18.3%	6.2%	7.9%
Adj EBITDA growth	5.2%	(3.8%)	25.5%	6.7%	7.5%
Adj EBIT growth	(21.3%)	(6.6%)	48.6%	9.6%	10.4%
Adj PBT growth	(23.2%)	(3.7%)	49.2%	9.8%	10.6%
Adj EPS growth	(15.0%)	(14.8%)	_- 50.7%_-	_- 9.6%_-	_- 13.1%_-
Dividend growth	(84.0%)	(100.0%)	N/A	_- 8.6%_-	_- 9.2%_-
Adj EBIT margins	7.0%	7.7%	9.7%	10.0%	10.3%
VALUATION	**2020**	**2021**	**2022E**	**2023E**	**2024E**
EV/Sales (x)	1.0	1.2	1.0	0.9	0.9
EV/EBITDA (x)	7.8	8.1	6.4	6.0	5.6
EV/NOPAT (x)	18.8	19.7	13.4	12.2	12.2
PER (x)	18.4	21.6	14.3	13.1	11.6
Dividend yield	0.3%	N/A	2.1%	2.2%	2.5%
FCF yield	3.0%	13.7%	3.6%	2.8%	3.3%

Source: Company information and Progressive Equity Research estimates

11 November 2021

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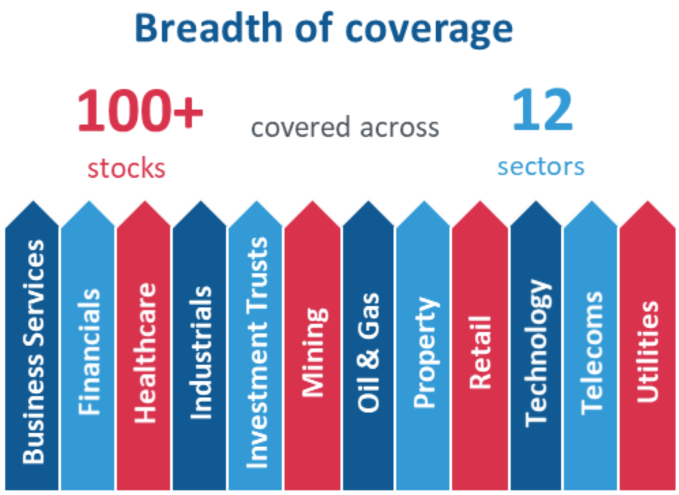

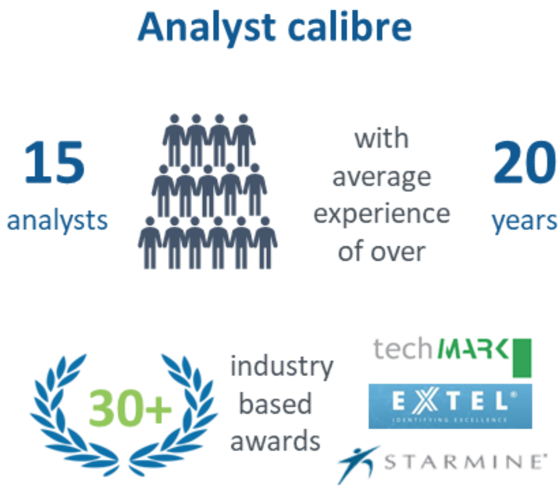

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