

Crown Crafts, Inc.

CRWS:NASDAQ

Analyst: Matthew Schilling

Sector: Consumer Disc.

BUY

Price Target: \$10.33

Key Statistics as of 10/21/2015

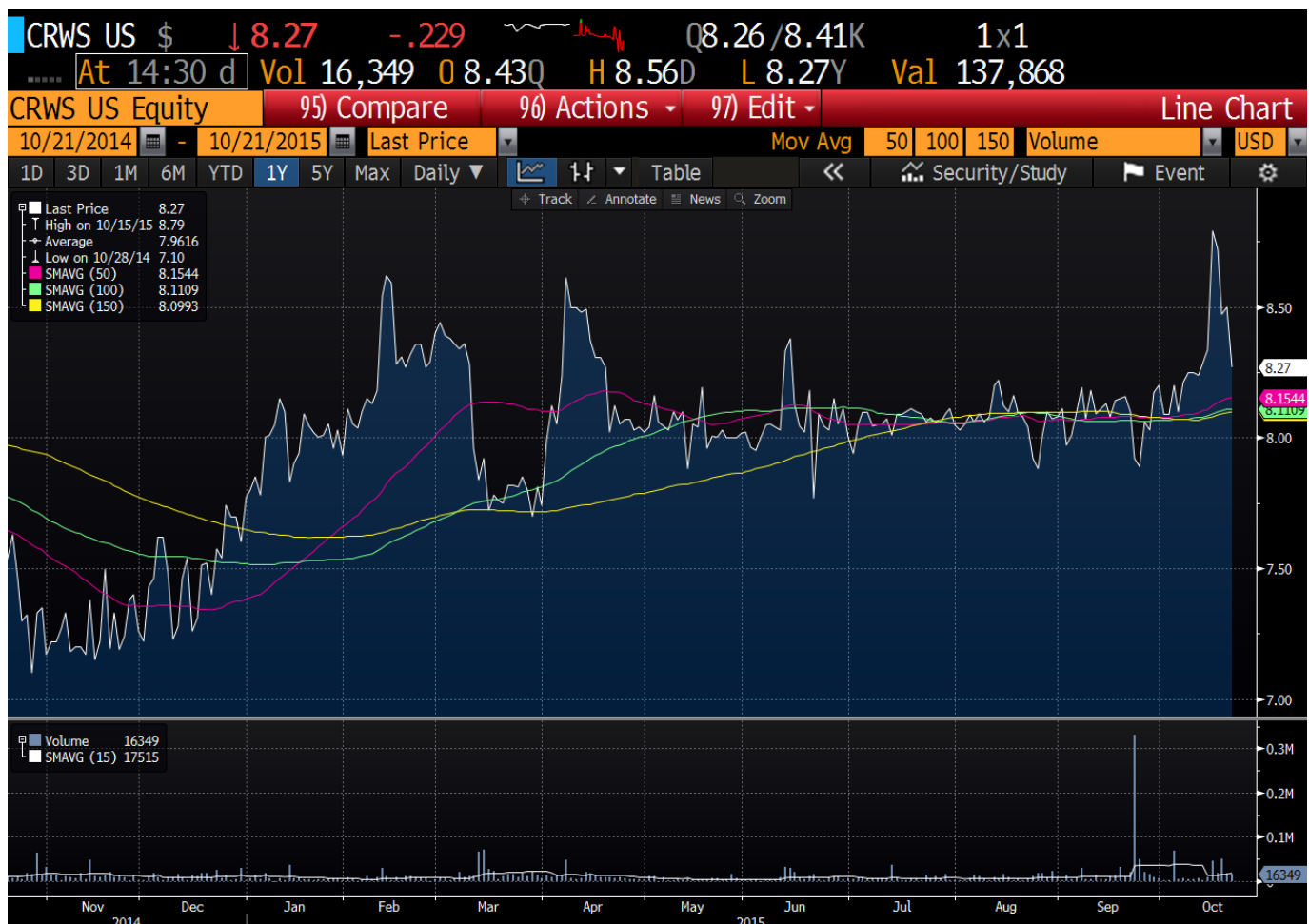
Market Price:	\$8.27
Industry:	Textiles
Market Cap:	\$84.6M
52-Week Range:	\$7.07-\$8.97
Beta:	0.49

Thesis Points:

- Positive Macroeconomic Outlook: The end of the “Baby Recession”
- Industry Leader in a Stable Retail Niche
- Income Opportunity in Dividend Yields

Company Description:

Crown Crafts, Inc. founded in 1957, is a retail company that designs, markets and provides home textile furnishings and accessories. The operate through their wholly owned subsidiaries, Crown Crafts Infant Products, Inc. and Hamco, Inc. Products of the subsidiaries include infant bedding, blankets, bibs, bath items and other nursery items.

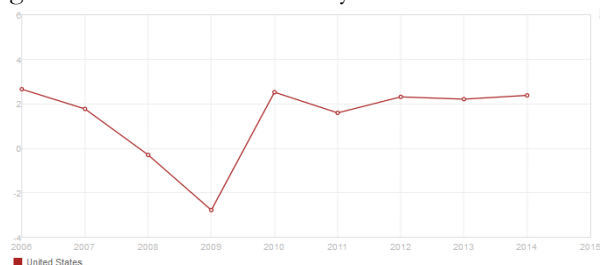


Thesis

Crown Crafts, Inc. (CRWS), will become a beneficiary of a change in macroeconomic factors, specifically of sociocultural factors due to the positive growth in the economy of the United States. They are the industry leader in their niche retail industry due to their breadth of product lines, licensing agreements, product differentiation, relationships with buyers, and their financial position. Due to their lack of debt and a moderate cash balance they are in a financially flexible position which allows them to fund future growth projects and acquisition opportunities. In addition, Crown Crafts has a dividend yield of 3.9%, which resulted in a payment of \$0.32 per share in 2014, making this investment an income stock with significant growth potential.

Macroeconomic Industry Overview

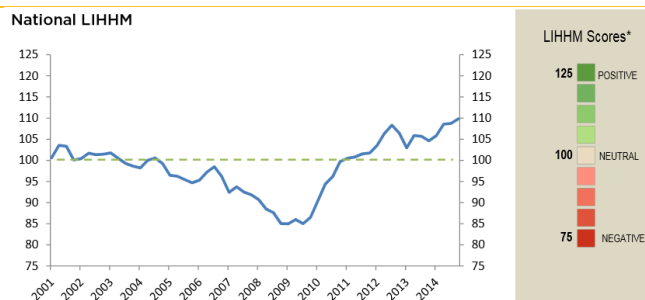
In 2007, the United States went into an economic recession stunting the economy as a whole causing negative growth in GDP in 2008 and 2009. Since the recession, the economy has recovered and consistently grown at a rate around 2% a year.



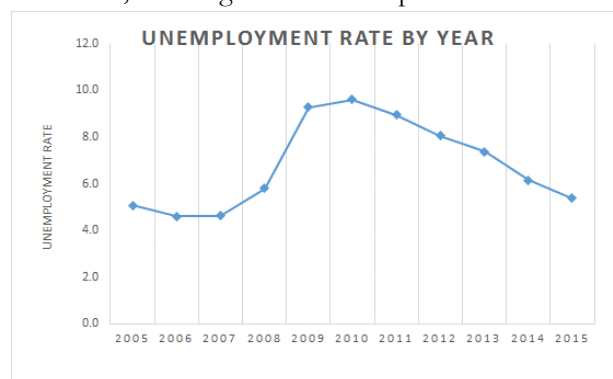
(GDP Growth % From 2006-2014)

Real GDP growth estimates for the next fiscal year are projected to be over 2%, with estimates hovering between 2.4 and 2.7 percent. All indications point towards healthy economic growth as a whole which improves consumer confidence within the United States.

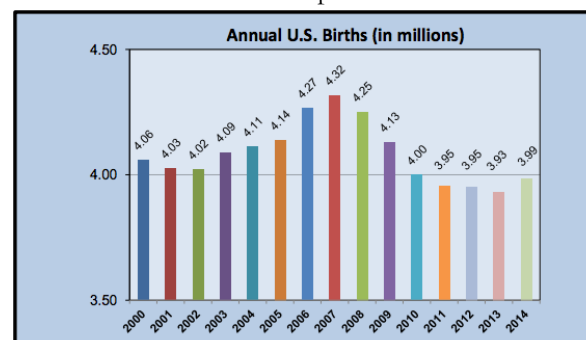
Another key market that has recovered since the recession is the housing market. The Leading Index of Healthy Housing Markets (LIHHM) claims the market to be the healthiest it has been since 2001. In addition the LIHHM indicates stability within the market claiming that none of the 40 largest metropolitan statistical areas, or MSAs, are vulnerable to a housing downturn and just two MSAs are ranked negatively.



Furthermore, the LIHHM forecasts a slight increase in the markets' score, creating greater consumer confidence in a crucial family oriented market. The next macroeconomic factor is the unemployment rate within the United States. In 2009, the tail end of the recession, unemployment more than doubled from where it was in 2007 (4.6% to 9.3%). Since 2009, the rate has gradually decreased, reaching the current September rate of 5.1%.



The increase in employment directly related to GDP growth and the healthiness of many key markets. The increase is another factor that gives the macroeconomic outlook a more positive look, especially for consumers planning on starting a family. Along with employment rates, the national average salary has increased by 3.43% from 2013 to 2014. The stable growth of GDP, the healthiness of the housing market, the decrease in unemployment and the increases in average salaries make an ideal economic setting to start or extend a family. Growth in birth rates climbed to a high before the recession due to consumer confidence in the housing market and increases in disposable incomes.



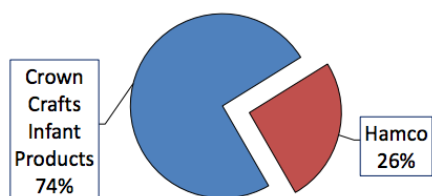
When the recession struck, the socioeconomic outlook on having children turned negative, as people felt they

could not afford to have children during the time creating the “Baby Recession”. The new macro outlook on the economy has changed that view, as birthrates experienced their first year of growth, between 2013 and 2014, since 2007 and rates are expected to continually increase. The increase in births will ultimately increase the demand for baby products, Crown Crafts’ specialty.

Crown Crafts’ Operations

Crown Crafts has two wholly owned subsidiaries, Crown Crafts Infant Products, Inc. and Hamco, Inc.

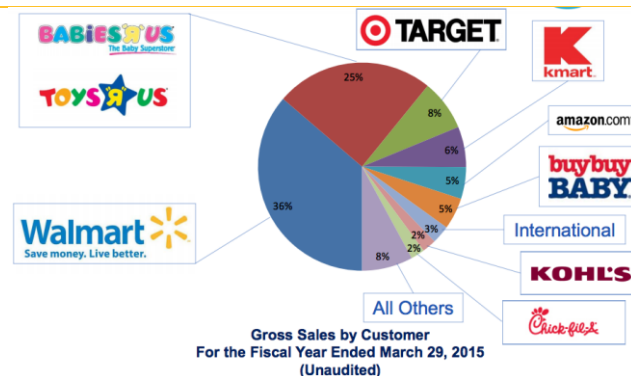
Net Sales by Operating Subsidiary



Crown Crafts Infant Products, Inc. is based in Compton, California and mainly manufactures infant bedding, blankets and accessories to mass and specialty markets. Hamco, Inc. is the market leader of infant and toddler bibs and disposable products. Between the two subsidiaries, a wide variety of products are produced all targeted at infants and toddlers. One unique factor that separates their operations is the amount of quality production licenses they hold, licenses include huge brands like Disney.



These key licenses give them branding icons that are superior to that of their peers and create a competitive advantage for Crown Crafts. In addition, they have strong relationships with major retailers such as Walmart, giving them large arenas to generate sales revenue. All major customers of Crown Crafts’ products are listed in the graph below.



The strength of their relationships with retailers extends to having private label programs with Walmart (“Parent’s Choice”), Target (“Circo”) and Babies ‘R’ Us (“Koala Baby”).

Benefits of Operating in this Niche Markets

Manufacturing infant and toddler based products creates a smaller, more selective, demographic. The main demographic is parents with children under or around the age of 5. With birth rates currently sitting around 4 million per year and increased projections in those rates demonstrates that it is relatively smaller than other markets but not so small where upside company growth is truncated. However due to its limited size the threat of new entrants is low because the industry is overlooked. The products being produced within this niche industry do not suffer from the threat of substitution. The products are essential to the wellbeing of an infant and once a child is born their parents must supply them with these products. Companies are also not affected by the bargaining power of suppliers. Most of the products being manufactured use basic raw materials that are not scarce and can be made in numerous factories overseas. Threats of competition within the industry are somewhat high as companies fight for the limited market share. However, companies are able to gain a formidable advantage through product differentiation, an example would be product licensing. The main concern within this industry is the bargaining power of buyers. If large retail corporations decide to drop a product from their shelves or inventory, it could result in significant drops in sales revenues. Overall this niche industry is one that has limited risk to begin with and numerous opportunities to lower that risk.

Leader in Niche Industry

Main competitors of Crown Crafts, Inc. are typically, private, Nano-cap companies that manufacture one of the particular products that Crown Crafts makes.

Competitors	Infant Bedding (27% of Sales)	Toddler Bedding (25% of Sales)	Bibs (16% of Sales)	Blankets (15% of Sales)	Accessories (10% of Sales)	Disposables (7% of Sales)	Main Product Focus
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DEX Products	Infant Bedding	Toddler Bedding	Bibs	Blankets	Accessories	Disposables	Main Product Focus
Garanimals	✓	✓					Young Children Clothing
Graco Baby	✓				✓		Strollers, highchairs and car seats
Pampers						✓	Diapers
Skip Hop				✓	✓		Baby Item accessories
Burt's Bees Baby (Ayablu)	✓	✓	✓	✓	✓		Baby clothes and apparel
Just one you (Carter's)			✓	✓	✓		Baby Apparel

(Products sold by competitors that Crown Crafts current sells.)

An example of the fragmented market competition is DEX Products, they make infant products such as, baby sleep aids, baby bottle warmers, and safety items but they also make bibs. Technically they are competition but their smaller scale operation and lack of brand licensing creates a negligible effect on the overall sales revenue of Crown Crafts. These fragmented competitors lack the influential power of a larger consolidated firm. In addition, they have managed to differentiate their products, that have the same functionality of competitor's, by acquiring major licensing deals with heavily branded companies and by creating private brand labels with major retailers. These competitive advantages are the reason why they are more profitable than companies that compete more directly with Crown Crafts, companies like Burt's Bees Baby. The reviews of their manufactured goods on online sites are positive as they average between four and five stars.



Sadie & Scout Anchor Crib Sheet - Navy
by Crown Crafts

\$22.99
Only 1 left in stock - order soon.

More Buying Choices
\$17.99 new (10 offers)

★★★★★ 16
FREE Shipping
Home & Kitchen: See all 222 items

The company's private brands also thrive, without the licensing icons, due to the quality of their products. Having many of their retail items reviewed as nearly 5-star products and best sellers after numerous reviews.

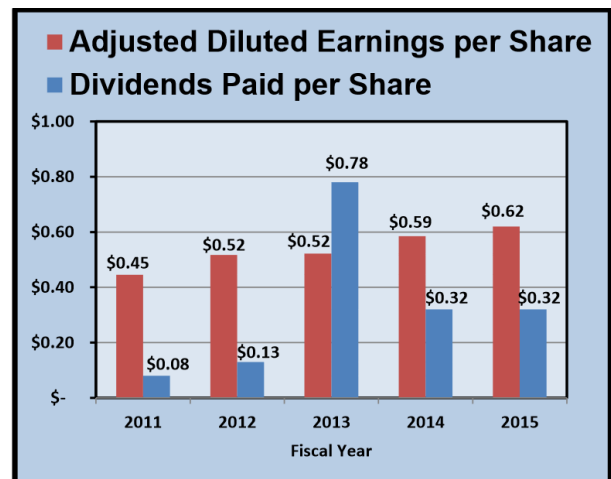


Parent's Choice Unscented Baby Wipes,
\$13.47 1.7¢ / each

Best Seller in Baby Wipes
★★★★★ (602)
[Show only Parent's Choice items](#)

The company has managed to create these competitive advantages while eliminating all the debt from their balance sheet. Crown Crafts has visible indications of growth, the main one is in the growth of EBITDA, which is up from \$10.4M in 2014 to \$12.5M in 2015. EBITDA margins, earnings per share, and revenues are also increasing. They also have reported \$8.2M in cash over the last twelve months positioning them to make a possible acquisition or to take on a project. Currently the company's focus is on organic growth, trying to grow the brands they already have by increasing the product variety. However, management made it clear to investors that they are willing to grow through acquisition but a point has been made that they will holdout on making a deal until they are sure it is profitable. In addition, they know this is an avenue to expand but they are not fixated on inorganic growth because they know there is stability in their current operations.

Income from Dividends



CRWS is a dividend paying stock opportunity that has significant growth potential. The company paid out \$0.32 per share in dividends last year. The dividend yield on this stock is approximately 3.9%. If the stock continues their trend of steady, sustainable growth, which all indications are that it will, dividend payouts will continue at this rate, if not grow, resulting in a significant income for investors. In addition, the company currently holds \$8.2M in cash for possible

acquisitions. If the desired investment for management does not present itself, there is a possibility of cash being disbursed as a dividend. This is a dividend paying stock that has growth potential, making it ideal for investors that are looking for income on top of capital gains.

Conclusion

I am recommending a buy on Crown Crafts, Inc. There is an ideal macroeconomic outlook for their industry, one in which they will thrive. Due to their product differentiation and relationships with retailers, current threats within the industry are not strong enough to derail Crown Crafts. The financials of the company are rock solid due to their increasing EBITDA, lack of debt, and capacity to expand through acquisitions due to cash reserves. Enticing dividend payments of 3.9% plus the expected growth in stock price makes this stock a strong buy.

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Crown Crafts, Inc.		CRWS	Analyst Matthew Schilling	Current Price \$8.28	Intrinsic Value \$10.33	Target Value \$10.33	Dividend Yield 4%	1-y Return: 28.61%	NEUTRAL
General Info		Peers	Market Cap.	Management					
Sector	Consumer Discretionary	CSS Industries Inc.	\$238.67	Professional	Title	Comp. FY2013	Comp. FY2014	Comp. FY2015	
Industry	Textiles, Apparel and Luxury Goods	Blyth, Inc.		Chestnut, E.	Chairman, Chief Executive Officer, President	\$773,704	\$1,809,916	\$1,152,751	
Last Guidance	February 11, 2015	Dorel Industries Inc.	\$1,026.08	Elliott, Olivia	Chief Financial Officer, Principal Accounting C	\$321,656	\$554,934	\$481,567	
Next earnings date	November 11, 2015	Caleffi S.p.A.	\$15.02	Freeman, Nanci	Chief Executive Officer of Crown Crafts Inta	\$362,106	\$696,025	\$621,109	
Market Data		Omikenshi Co.,Ltd.	\$5,030.43	Cowart, Kenneth	Director for Information Systems	\$0	\$0	\$0	
Enterprise value	\$76.44	KG Denim Ltd.	\$1,313.48	Bush, Mary	Director of International Sales	\$0	\$0	\$0	
Market Capitalization	\$84.68	Alps Industries Ltd.	\$201.44	Wagnon, Robert	Vice President and Controller	\$0	\$0	\$0	
Daily volume	0.02	Döhler S.A.	\$272.32	Past Earning Surprises					
Shares outstanding	9.96	Shri Lakshmi Cotyyn Limited	\$78.58	Revenue		EBITDA	Norm. EPS	Standard Error of "Surprise"	
Diluted shares outstanding	10.10	Shanghai Haixin Group Co., Ltd.	\$1,449.27	Last Quarter	11.49%	33.33%	28.57%	6.63%	
% shares held by institutions	44.94%	Current Capital Structure		Last Quarter-1	5.16%	-4.09%	-8.70%	4.07%	
% shares held by insiders	14.73%	Total debt/ Common Equity (LTM)	0.33	Last Quarter-2	12.19%	11.71%	11.11%	0.31%	
Short interest	0.20%	Cost of Borrowing (LTM)	0.00%	Last Quarter-3	0.94%	-37.89%	-7.14%	11.83%	
Days to cover short interest	1.19	Estimated Cost of new Borrowing	0.00%	Last Quarter-4	-7.81%	-17.26%	-30.00%	6.43%	
52 week high	\$8.97	Altman's Z	6.71	Standard error	3.7%	12.2%	9.9%	5.04%	
52-week low	\$7.07	Estimated Debt Rating	AAA	Standard Error of Revenues prediction	3.7%				
5y Beta	0.83	Current levered Beta	0.16	Imputed Standard Error of Op. Cost predictio	11.6%				
6-month volatility	20.30%	LTM WACC	3.38%	Imputed Standard Error of Op. Cost predictio	NM				
Proforma Assumptions									
Convergence Assumptions		General Assumptions		Items' Forecast Assumptions			Other Assumptions		
All base year ratios linearly converge towards the Industry Group ratios over an explicit period of 10 years		Money market rate (as of today)	0.28%	Base year (LTM)	Convergence period (Industry Group)	Adjustment per year	Tobin's Q	80%	
		Risk-Free rate (long term estimate)	2.92%	Operating Cash./Rev.	0.00%	0.0%	Excess cash reinvestment	Money market rate	
		Annual increase (decrease) in interest rates	0.1%	NWV./Rev.	27.55%	-1.1%	Other claims on the firm's assets	\$0.00	
		Marginal Tax Rate	37.5%	NPPE./Rev.	0.57%	11.88%	Capitalization		
		Country Risk Premium	6.5%	Dpx./NPPE	61.98%	23.12%	100% of all rent expenses are capitalized and amortized 'straightline' over 10 years		
				NOPAT/MARGIN	9.37%	-0.2%	100% of all R&D expenses are capitalized and amortized 'straightline' over 10 years		
				Op. Exp./Rev.	86.08%	0.1%	E&P expenses are not capitalized		
				SBC./Rev.	1.02%	0.78%	SG&A expenses are not capitalized		
				Rent Exp./Rev.	1.59%	2.35%	Valuation Focus		
				R&D./Rev.	0.00%	3.10%	DCF Valuation	100%	
				E&D./Rev.	0.00%	0.00%	Relative valuation	0%	
				SG&A./Rev.	14.64%	25.06%	Distress Valuation	0%	
				ROC	17%	12.49%	Monte Carlo Simulation Assumptions		
				EV./Rev.	0.90x	1.03x	Revenue Growth deviation	Normal (0%, 1%)	
				EV/EBITDA	6.48x	8.22x	Operating expense deviation	Normal (0%, 1%)	
				Debt/Equity	33%	94%	Continuing Period growth	Triangular (5.335%, 6.5%, 5.665%)	
				Unlevered beta	0.13	1.01	Country risk premium	Triangular (2.91%, 3%, 3.09%)	
				Cost of Borrowing	0%	6%	Intrinsic value σ(e)	\$0.02	
				Dividends./REV	4%	2%	1-year target price σ(e)	\$0.02	
Valuation									
Forecast Year	ROC	WACC	Total Capital	Implied Enterprise Value	Other Claims on Assets and Dilution Cost	Shares Outstanding	Price per Share	Monte Carlo Simulation Results	
LTM	17.2%	3.4%	\$51.01	\$99.92	\$2.12	9.96	\$10.40		
FY2016	17.4%	4.0%	\$57.09	\$101.15	\$2.16	9.96	\$10.38		
FY2017	15.5%	4.6%	\$63.41	\$103.29	\$2.19	9.96	\$10.41		
FY2018	14.0%	5.2%	\$69.89	\$106.30	\$2.21	9.96	\$10.52	The 3σ(e)-adjusted intrinsic value is \$10.33; the 3σ(e)-adjusted target price is \$10.33; and the analysts' median target price is \$10.75	
FY2019	12.8%	5.9%	\$76.56	\$110.28	\$2.22	9.96	\$10.70		
FY2020	11.7%	6.5%	\$83.47	\$115.35	\$2.22	9.96	\$10.96		
FY2021	10.9%	7.1%	\$90.69	\$121.66	\$2.22	9.96	\$11.33		
FY2022	10.2%	7.7%	\$98.28	\$129.38	\$2.11	9.96	\$11.81		
FY2023	9.7%	8.3%	\$106.33	\$138.72	\$1.76	9.96	\$12.43	Sensitivity Analysis	
FY2024	9.2%	9.0%	\$114.91	\$149.95	\$0.00	9.96	\$13.21	Revenue growth variations account for 95.9% of total variance	
FY2025	8.8%	9.6%	\$124.12	\$163.38	\$0.00	9.96	\$14.07	Risk premium's variations account for 2.5% of total variance	
Continuing Period	12.5%	9.4%	\$79.60					Operating expenses' variations account for 1.4% of total variance	
								Continuing period growth variations account for 0.2% of total variance	