

## Crown Crafts, Inc.

Nasdaq: CRWS

**Analyst:** Benjamin Lunaud

**Sector:** Cons Discr

**BUY**

Price Target: \$10.10

### Key Statistics as of 3/19/2015

Market Price:	\$7.99
Industry:	Consumer Discretionary
Market Cap:	\$80.4M
52-Week Range:	\$7.07 - \$8.78
Beta:	0.74

### Thesis Points:

- Positive macroeconomics outlook
- Free cash flow should increase faster than expected
- CRWS has competitive advantages and will continue to do better than its peers
- Attractive dividend yield

### Company Description:

Description: Crown Crafts Inc. distributes infant, toddler, and juvenile consumer products in the United States and internationally, through its subsidiaries, designs, markets. It provides cribs, toddler bedding, blankets, nursery, toddler accessories, room décors, burp cloths, bathing accessories, reusable and disposable bibs, disposable placemats, cup labels, toilet seat covers, changing mats, reusable and disposable floor mats, hooded bath towels, washcloths, and other infant, toddler, and juvenile soft goods. The company sells its products primarily to mass merchants, mid-tier retailers, juvenile specialty stores, value channel stores, grocery and drug stores, restaurants, internet accounts, wholesale clubs, and retailers through a network of sales forces, independent commissioned sales representatives, and distributors. The company was founded in 1957 and is headquartered in Gonzales, Louisiana.



## Thesis

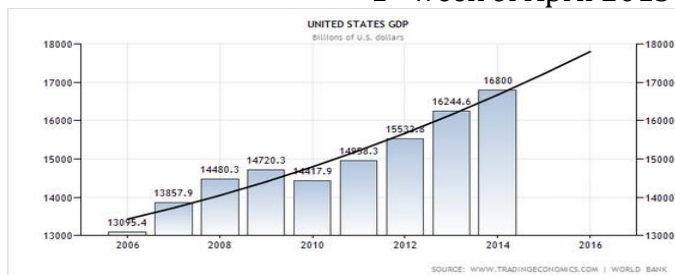
Crown Crafts inc is undervalued compared to its peers and industry; the recommendation is to buy. The company is currently traded at \$7.85 per shares and the target price is based on the proforma (presented at the end of the report) is \$10.10, a potential upside of 30.32% with the dividend yield. The industry outlook shows that revenue is expected to grow due to an increase of consumption in the next few years. The company has no debt and is generating enough cash to make future profitable investments. CRWS has a competitive advantage allowing it to do better than its peers in terms of margin, liquidity and debt management. The firm has a favorable position to make acquisitions, expand product development, and increase shareholder value through higher dividends. CRWS proposes attractive dividend yields at 4.13%. When looking also at multiples, CRWS is undervalued based on relative valuation.

## CRWS Business

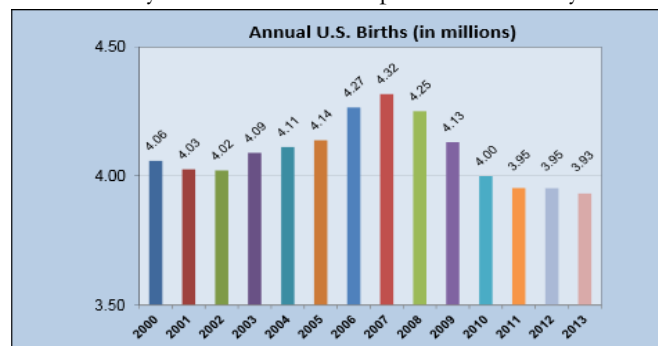
Crown Crafts recognizes two operating subsidiaries: Crown Crafts Infant Products and Hamco. Through these subsidiaries Crown Crafts manufactures products in the following sectors of the infant and toddler consumer goods industry: bedding, blankets, accessories, bibs, bath, and handwoven products. More specifically these products include nursery accessories: room decor, nap mats, burp cloths, hooded bath towels, washcloths, disposable placemats, cup labels, toilet seat covers, and changing mats. These products are part of licensed and branded collections as well as exclusive private label programs. Crown Crafts holds licenses with Disney Baby, Sesame Street, Fisher-Price, Nickelodeon, Crayola Beginnings, and Baby Looney Tunes. The Company owns the trademarks for Nojo, Bibsters, and Neat Solutions.

## Industry Overview

As shown on the graph on the top right corner, U.S GDP has been growing at 4% annually since 2010. The US economy is recovering and is expected to grow faster in the next few years.

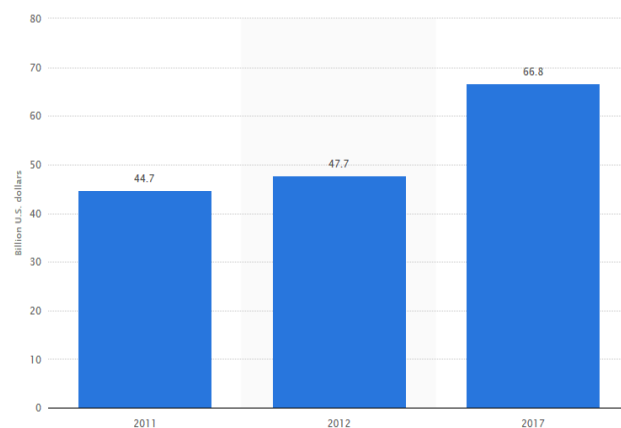


In 2016 the GDP is expected to increase to 17955.19, an increase of 7% from 2015. Americans have begun to feel more confident about growth, making the U.S a more secure place to raise children. Higher income, the stock market at a historic high, and rising house prices result in Americans feeling richer. Nearly half of moms say that the economy factored into their plan to have baby.



The graph above shows that annual U.S births decreased by over 8% from 2007 to 2013. This has hurt CRWS revenues which decreased by 0.2% CAGR in the last 5 years. However since 2010 the births rate became flat and is most likely to grow in the next few years.

Baby care market size worldwide in 2011, 2012, and 2017 (in billion U.S. dollars)



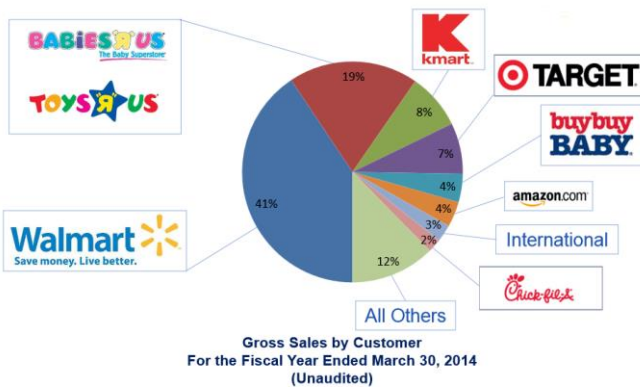
The chart above shows that revenue in the industry is expected to grow faster until 2017. This is due to a higher expected consumption and a probable increase in birth rate in future years.

Revenue for CRWS has been growing at 3.7% last year, much better than a negative 8% in 2013 and is expected

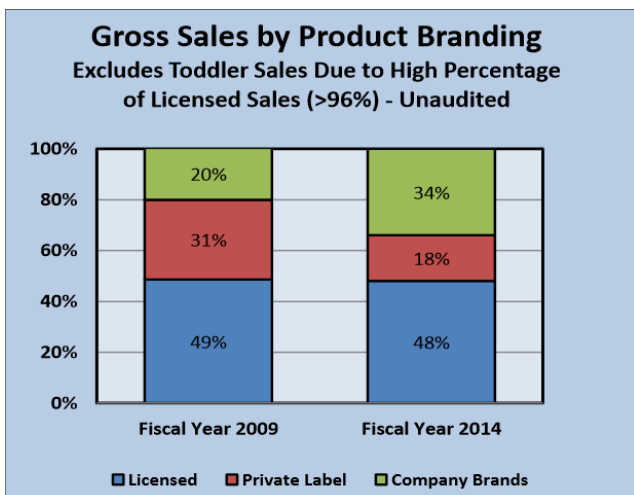
to grow at 4.7% in 2015. CRWS future revenue should be higher than expected due to higher birth rate, increase in consumption for the industry, and a positive macroeconomics outlook.

## Financial performances

CRWS beat earning estimates in the last quarter. For the quarter that ended December 28, net sales for FY'15 were \$23.743 million, as opposed to \$20.619 in the same quarter of the previous year or an increase of 15%. Net income for the same period also increased from \$1.779 million last year to \$2.046 this year, an increase of 15%. Diluted EPS increased as well from \$0.18 last year to \$0.20 in this year's current quarter or an increase of \$0.02 per diluted share.

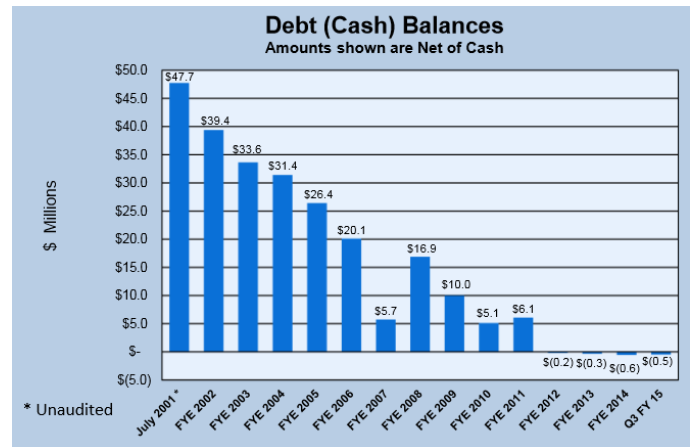


Crown Crafts relies on major customers who are Walmart, Target, and Toy's R Us. The company revenue is substantially dependent on these with 67% of revenue coming from these costumers (Graph above). If the company cannot sustain these arrangements it could impact negatively revenue, but these are long-term relationships and look stable.



## Siena Market Line 1<sup>st</sup> week of April 2015

The chart shows that 48% of all revenue results from licensing agreements for popular characters. Revenue coming from the company brand has been growing at 34% in 2014 compared to 20% in 2009. This is expected to increase and will generate more revenue for CRWS. Analysts estimate revenue to grow at 4.2% in 2015, an increase of 0.5% from 2014. It should increase faster in future years due to an increase in demand, new product placements, and new product developments.



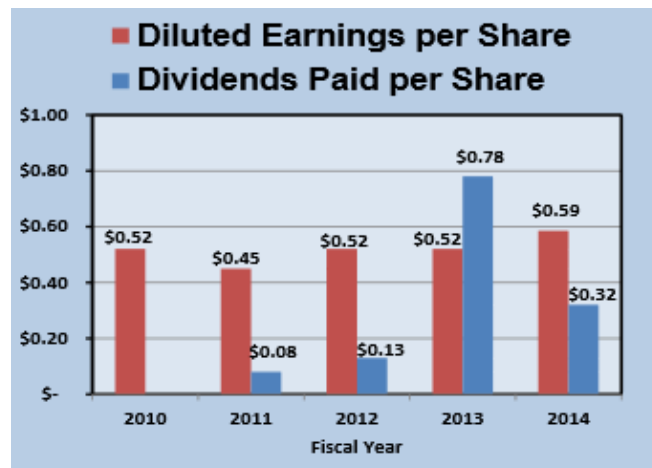
As shown on the graph above the company is debt free since 2012. In addition to lowering debt levels, the company has since December 2006, paid \$18.4 million for acquisitions, \$16.0 million in cash dividends, and \$3.1 million for open market stock repurchases. This shows that CRWS is able to maintain stable cash flow. The cash in the balance sheet has been increasing by 49% annually since 2010.

CRWS has strict cost management to maintain a healthy balance sheet and preserve positive operating cash flows and value creation. The company is able to reduce its cost by outsourcing mass production business to manufacturers in China, where the labor and rent expenses are relatively low. In addition Crown Crafts inc is looking for future acquisitions and will beneficiate from economic of scale.

To reduce cost and expand faster the company made three acquisitions over the past years and will continue to look for other opportunities. They also sign agreements with other companies. CRWS management explained that they prefer to wait for the best opportunity in the future instead of taking the most immediate chances to grow.

placements, future acquisitions, and existing competitive advantages. These investments are expected to generate more revenue in the future.

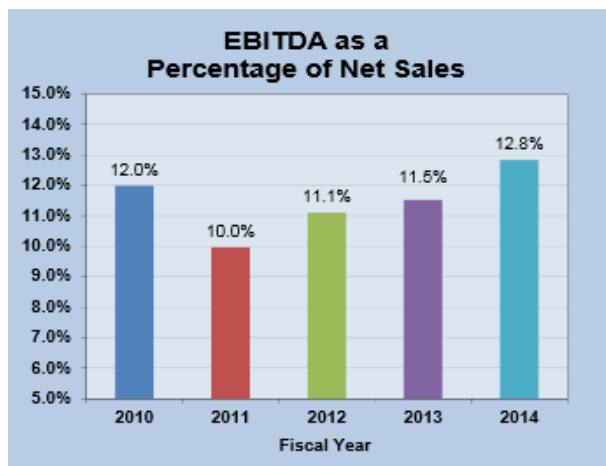
## Dividend Yield



The graph above shows that dividend per share has been increasing since 2011, showing that the company is focused on return to shareholders. CRWS is able to constantly generate positive cash flows and create value for shareholders. This allows Crown Crafts to maintain a dividend payout ratio of 39% on its common stock. After paying off \$6.3 million of debt in 2012, the Company also paid \$1.3 million in dividends at \$0.13 per share. In 2013 Crown Crafts paid \$7.7 million in dividends at \$0.78 per share, including a special dividend of \$0.50. CRWS proposes now an attractive dividend yield of 4.13%.

## Conclusion

Crown Craft inc, is considered undervalued at a price of \$7.99. The valuation based on the proforma presented on the last page shows a target price of \$10.10. CRWS is a leader in its niche markets. The company is doing better than its peers and is expecting to gain market shares in the future. EBITA is growing faster than revenue growth. The company has no debt and is generating enough cash to distribute attractive dividends to shareholders. Management insisted on the fact that future expansion will be also possible through acquisitions. Finally the industry outlook looks positive for the company and will allow CRWS to generate more revenues in the future. The recommendation is a Buy.



As a result, EBITDA margins have been increasing since 2011 and are expected to increase in the future to 13.7%, better than the average industry. The graph above shows that EBITDA, as a percentage of sales, has been growing also. Cost control allows the company to have EBITDA growing faster than revenue growth, meaning an increase in free cash flows and value creation. Higher revenue in the future should also generate more cash for CRWS and create more value for shareholders.

## CRWS vs competitors

Kimberly-Clark Corp is the leader in baby and child-specific products with a 17% value share in 2013. Two of the main competitors are Kid Brands inc, and Summer Infant inc. LeapFrog Enterprises and Dorel Industries have also been chosen in the proforma to do the valuation. CRWS has several competitive advantages. They are leader in terms of product categories and in placement products in retail. The company is highly focused on quality and on diversification of product categories. CRWS has its own brand, which is growing; it has also licensed collections and private-label programs for some particular customers.

Thanks to its competitive advantages, CRWS is able to perform better than its competitors. CRWX's EBITDA margin is 13%, 8% higher than a 5% median for its peers. CRWS has a ROIC of 12.3%, higher than an average of 4.2% for its peers. The company has no debt, a bankruptcy cost much lower than its peers with an Altman Z score of 5.98 compared to a median of 2.34 for their competitors. Overall Crown Craft is doing better than the competition in terms of profitability, debt management, and liquidity.

The firm is expected to gain market shares in the future and will do better than competitors thanks to new

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<b>Crown Crafts, Inc.</b>		<b>CRWS</b>	<b>Analyst</b> Benjamin Lnaud	<b>Current Price</b> \$7.99	<b>Intrinsic Value</b> \$8.25	<b>Target Value</b> \$10.08	<b>Divident Yield</b> 4%	<b>Target Return</b> 30.32%	<b>BULLISH</b>		
<u>General Info</u>		<u>Peers</u>		<u>Market Cap.</u>	<u>Management</u>						
Sector	Consumer Discretionary	Dorel Industries Inc		\$1,142.34	<b>Professional</b>	<b>Title</b>	<b>Comp. FY2012</b>	<b>Comp. FY2013</b>	<b>Comp. FY2014</b>		
Industry	Textiles, Apparel and Luxury Goods	Kid Brands, Inc		\$0.02	Chestnut, E.	Chairman, Chief Executive Offic	\$ 522,412.00	\$ 773,704.00	\$ 1,809,916.00		
Last Guidance	Feb-11-2015	Summer Infant, Inc		\$49.90	Elliott, Olivia	Chief Financial Officer, Principa	\$ 250,748.00	\$ 321,656.00	\$ 554,934.00		
Next earnings date	6/17/2015	LeapFrog Enterprises Inc		\$160.07	Freeman, Nanci	Chief Executive Officer of Crow	\$ 317,840.00	\$ 362,106.00	\$ 696,025.00		
<u>Market Data</u>		<u>Current Capital Structure</u>			<u>Historical Performance</u>						
Enterprise value	\$77.41	Total debt/ market cap	0.00%				<b>CRWS</b>	<b>Peers</b>	<b>Industry</b>	<b>All U.S. firms</b>	
Market Capitalization	\$805.40	Cost of Borrowing	0.00%		Growth	-0.9%		3.3%		6.0%	
Daily volume	0.45	Interest Coverage	26134.21%		Retention Ratio	29.6%		97.1%		61.6%	
Shares outstanding	10.06	Altman Z	5.98		ROIC			4.8%		11.8%	
Diluted shares outstanding	10.02	Debt Rating	AAA		EBITDA Margin	11.3%		5.0%	9.8%	13.7%	
% shares held by institutions	77.59%	Levered Beta	1.14		Revenues/Invested capital	173.4%		120.1%	205.3%	202.3%	
% shares held by insiders	14.93%	WACC (based on market value weights)	8.17%		Excess Cash/Revenue	0.6%		4.6%	12.1%	18.5%	
Short interest	0.27%				Unlevered Beta	0.47		1.05	1.12	0.95	
Days to cover short interest	2.34				TEV/REV	0.6x		0.7x	0.5x	2.4x	
52 week high	\$8.78				TEV/EBITDA	5.4x		9.3x	8.8x	11.3x	
52-week low	\$7.07				TEV/EBITDA	5.6x		12.2x		15.4x	
5y Beta	0.71				TEV/UFCF	5.8x		18.7x		26.8x	
6-month volatility	25.75%				<u>Non GAAP Adjustments</u>						
<u>Past Earning Surprises</u>					Operating Leases Capitalization	100%		Straightline		10 years	
	<b>Revenue</b>	<b>EBITDA</b>	<b>Norm. EPS</b>		R&D Exp. Capitalization	0%		N/A		N/A	
Last Quarter	12.2%	0.0%	11.1%		Expl./Drilling Exp. Capitalization	0%		N/A		N/A	
Last Quarter-1	0.9%	-37.9%	-7.1%		SG&A Capitalization	0%		N/A		N/A	
Last Quarter -2	-7.8%	-17.3%	-30.0%								
Last Quarter -3	-2.2%	-0.5%	-4.5%								
Last Quarter -4	-0.7%	18.1%	5.9%								
<u>Proforma Assumptions</u>		<u>Forecasted Profitability</u>									
	<b>Period</b>	<b>Rev. Growth</b>	<b>Adj. Op. Cost/Rev</b>		<b>Revenue</b>	<b>NOPLAT</b>	<b>Invested capital</b>	<b>UFCF</b>			
Operating. Cash/Cash	0.0%	LTM	4%	85%	\$83.90	\$5.73	\$48.76	\$3.54			
Unlevered Beta	1.05	LTM+1Y	4%	84%	\$86.95	\$7.16	\$51.46	\$5.17			
Rev/Invested Capital	140.0%	LTM+2Y	3%	84%	\$89.79	\$7.86	\$52.84	\$6.48			
Continuing Period Revenue Growth	3.2%	LTM+3Y	3%	84%	\$92.72	\$8.24	\$54.26	\$6.83			
Long Term ROIC	9.8%	LTM+4Y	3%	84%	\$95.71	\$8.48	\$55.70	\$7.04			
Invested Capital Growth	Equals to Maintenance	LTM+5Y	3%	84%	\$98.80	\$8.60	\$58.75	\$5.54			
Justified TEV/REV	0.7x	LTM+6Y	3%	84%	\$101.98	\$8.71	\$60.89	\$6.57			
Justified TEV/EBITDA	9.3x	LTM+7Y	3%	85%	\$105.25	\$8.80	\$62.46	\$7.24			
Justified TEV/EBITDA	12.2x	LTM+8Y	3%	85%	\$108.62	\$8.90	\$63.91	\$7.44			
Justified TEV/UFCF	18.7x	LTM+9Y	3%	85%	\$112.10	\$8.96	\$66.30	\$6.58			
<u>Valuation</u>											
	<b>ROIC</b>	<b>WACC</b>	<b>EVA</b>	<b>Enterprise Value</b>	<b>Total Debt</b>	<b>Other claims</b>	<b>Equity</b>	<b>Adjusted Price</b>			
LTM	12.3%	8.2%	\$2.23	\$99.03	\$0.00	\$10.72	\$88.32	\$9.21			
LTM+1Y	14.3%	8.3%	\$3.04	\$103.41	\$0.00	-\$2.02	\$105.43	\$10.83			
LTM+2Y	15.3%	8.4%	\$3.58	\$106.33	\$0.00	-\$11.91	\$118.24	\$12.06			
LTM+3Y	15.6%	8.5%	\$3.80	\$108.13	\$0.00	-\$22.23	\$130.36	\$13.27			
LTM+4Y	15.6%	8.6%	\$3.86	\$109.77	\$0.00	-\$32.94	\$142.71	\$14.49			
LTM+5Y	15.4%	8.7%	\$3.90	\$112.38	\$0.00	-\$42.38	\$154.77	\$15.76			
LTM+6Y	14.8%	8.8%	\$3.61	\$114.99	\$0.00	-\$53.03	\$168.02	\$17.06			
LTM+7Y	14.5%	8.9%	\$3.41	\$117.85	\$0.00	-\$64.55	\$182.40	\$18.48			
LTM+8Y	14.2%	9.0%	\$3.29	\$120.29	\$0.00	-\$76.49	\$196.79	\$19.90			
LTM+9Y	14.0%	9.1%	\$3.20	\$122.78	\$0.00	-\$87.83	\$210.61	\$20.93			
<u>Monte Carlo Simulation Assumptions</u>		<u>Monte Carlo Simulation Results</u>									
	<b>Base</b>	<b>Stdev</b>	<b>Min</b>	<b>Max</b>	<b>Distribution</b>	<b>Intrinsic Value</b>	<b>1y-Target</b>				
Revenue Variation	0	10%	N/A	N/A	Normal	Mean est.	\$9.21	\$10.83			
Op. Costs Variation	0	10%	N/A	N/A	Normal	σ(e)	\$0.32	\$0.25			
Market Risk Premium	6%	N/A	5%	7%	Triangular	3 σ(e) adjusted price	\$8.25	\$10.08			
Long term Growth	3%	N/A	-1%	8%	Triangular	Current Price	\$7.99				
Terminal Value	0	0.1	N/A	N/A	Normal	Analysts' median est.		\$10.50			