RADNOR CAPITAL PARTNERS

Communisis plc

CMS | FTSE Small Cap | Media |52p |£105m

GDPR … a storm in a teacup

1 Year Chart

Source: FactSet

Looking at the recent share price performance, one might have been excused for thinking these interims would have contained a perfect GDPR induced storm. However, the reality is that Communisis had not a bad first half at all. GDPR did have an impact but Communisis is much more than just a direct mail story and good performances from the digital side of the business as well as Brand Deployment saw this largely mitigated. Communisis continues to win, retain and extend high value, multi-year contracts which speaks volumes for the credibility and the breadth of the proposition. The recent de-rating looks unwarranted and the 7.6x prospective PE feels anomalous against the backdrop of re-affirmed guidance; solid top line and good potential for margin expansion. Throw in a de-gearing balance sheet and an attractive, and well covered, dividend and we have a risk/return profile that has moved too far.

- **H1 2018 results solid:** At a headline level, H1 demonstrated good progress against a varied trading backdrop. Critically, the resilience of the Customer Experience multi-channel offering offset GDPR induced softness in direct mail volumes. Elsewhere CMS continues to generate good free cash-flow with a further reduction of net debt. The net pension deficit continues to shrink, further de-risking the balance sheet and increasing strategic flexibility.

- **GDPR a short term negative but not the whole story:** The introduction of GDPR saw direct mail volumes come off in H1, however print is inherently lower margin while growth in non-print channels (digital mostly), new client wins and a solid performance from Brand Deployment helped to make up the balance. Critically, the underlying momentum and visibility in the business has seen full year guidance re-affirmed.

- **Investment case unchanged:** There is nothing in these results that challenges the investment case we outlined in our initiation of coverage note in March 2018. We believe Communisis, through its scale and multi-channel proposition, is ideally placed to benefit from clients' unchanging need to communicate with customers in an increasingly fragmented and regulatory fraught environment. Ironically, we see GDPR and what it represents, as a significant longer-term growth driver for Communisis.

- **Valuation:** The shares have de-rated significantly seemingly in anticipation of bad news which has not materialised. Investors are left with the combination of an unchanged investment case and a more attractive entry point. Communisis is not a stellar growth story, however a solid top line coupled with margin expansion potential should see double digit EPS growth over the medium term. The steadily improving balance sheet provides a strategic flexibility that is difficult to see in a PER of **7.6x** and yield of **5.4%**.

2nd August 2018

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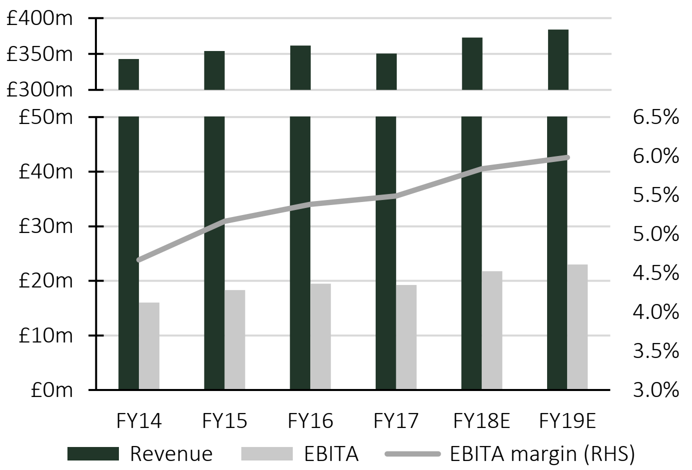
Year End December	Revenue, £m	PBT adj, £m	EPS (p)	Div (p)	Net Cash, £m	PER x	Yield %
FY 2016A	361.9	16.7	6.1	2.4	-30.4	8.6	4.7%
*FY 2017A	350.7	15.3	5.6	2.6	-24.3	9.3	5.0%
**FY 2018E*	*372.8*	*18.8*	*6.9*	*2.8*	*-20.0*	*7.6*	*5.4%*
**FY 2019E*	*384.0*	*20.3*	*7.7*	*2.9*	*-14.8*	*6.8*	*5.6%*

**Restated for the adoption of IFRS 15* *Source: Radnor Capital Partners*

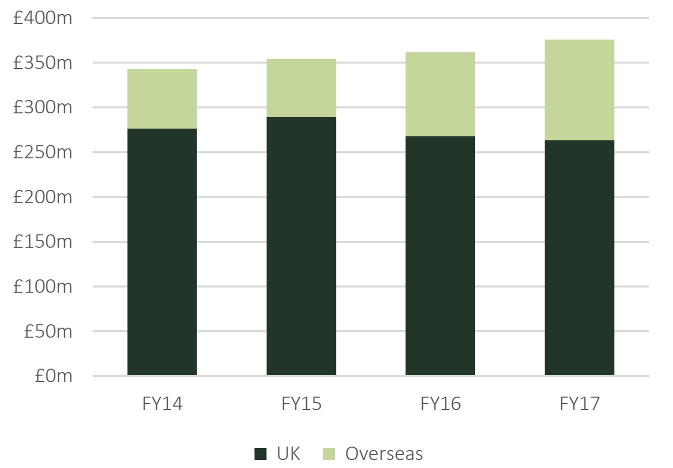
INVESTMENT CASE IN CHARTS

Source: Radnor Capital Partners, FactSet, Communisis

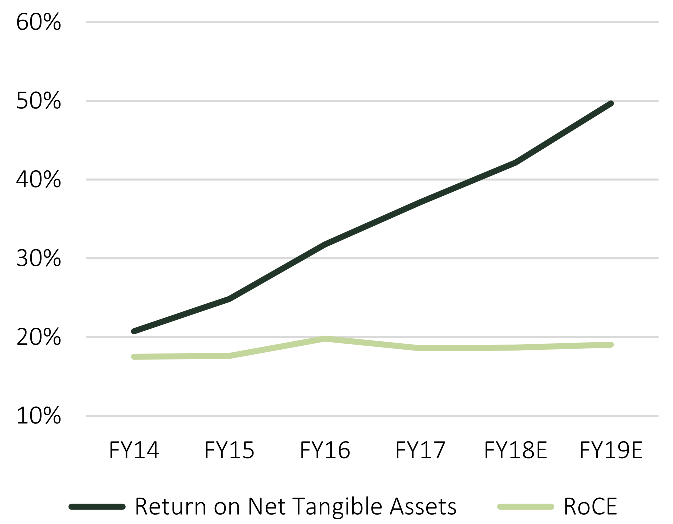
Revenue, EBITA & Margin



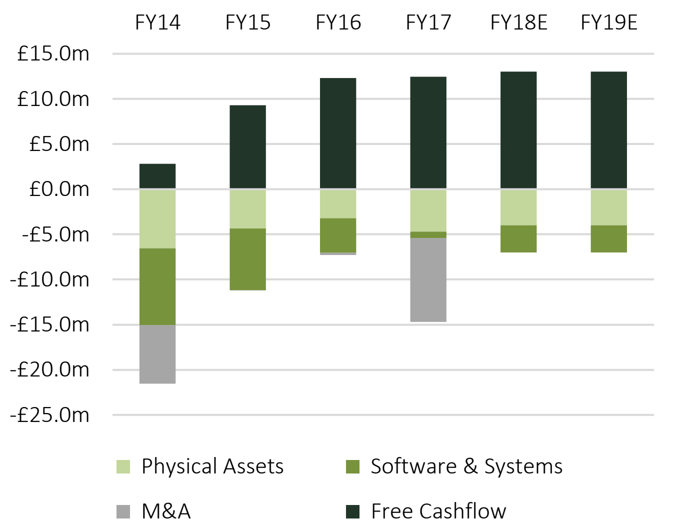
Geographic Revenue Split



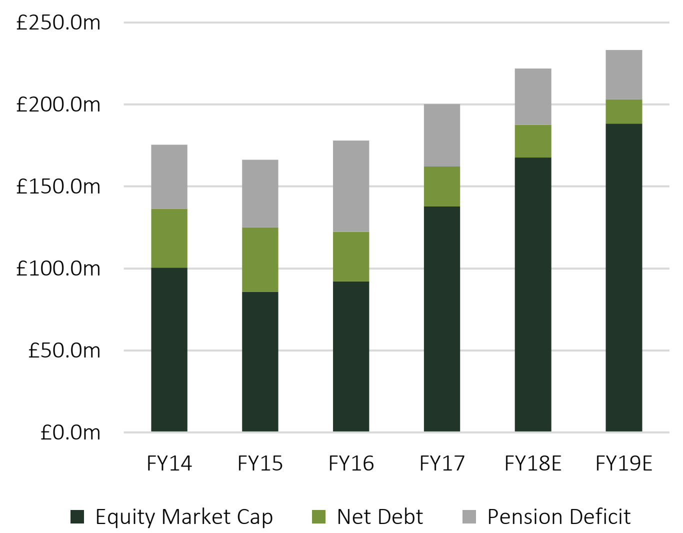
Returns on Net Tangible Assets & Capital Employed



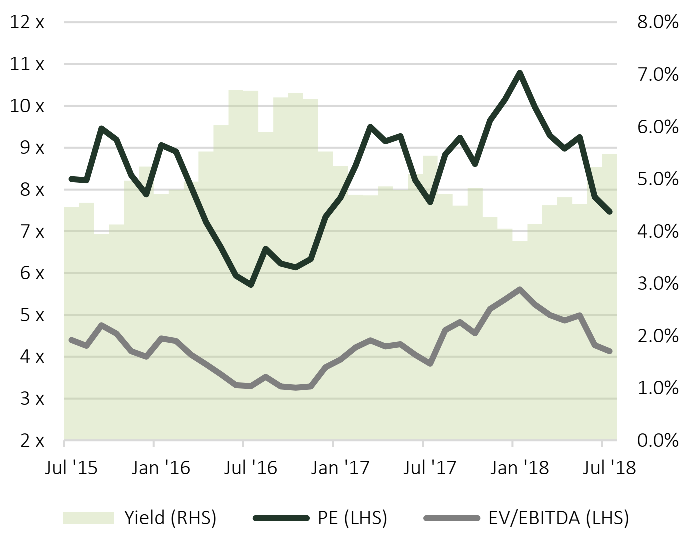
Capex, M&A and Free Cashflow



Evolution of Communisis EV (constant 7.6x multiple)



Prospective PE, EV/EBITDA and Yield



H1 2018 RESULTS – Progress against a varied backdrop

H1 2018 results

The IFRS 15 reporting standard on contract recognition came into force in January and FY 2017 numbers have been re-stated accordingly. These restatements are non-cash related and sit within the Customer Experience division where the longer-term client contracts reside.

Psona and Psona Films have also been re-classified within the Brand Deployment division to better reflect the nature of the work undertaken.

Key highlights:

- Group revenue **up 9%** y/y to £188.6m.
- Group divisional EBITA (pre-central & shared costs) was **up 3%** to £17.6m while headline Group EBITA was down 7% to £7.7m.
- Headline Group EBITA margins decreased 68 bps to 4.1%. Headline margins were down in Customer Experience (although H1 17 margins were flattered by a historic provision release) but stable in Brand Deployment. On an underlying basis, like for like trading margins were broadly stable.
- Group adjusted PBT was **up 2%** to £6.5m due to lower net finance costs as the pension deficit and net debt continue to reduce.
- Exceptional items totalled £2.1m (H1 17: £1.2m) delivering a statutory PBT of £4.0m (H1 17: £4.8m).
- A lower tax charge benefited headline adjusted EPS, **up 6%** to 2.52p (H1 17: 2.37p).
- Interim dividend **up 5%** to 0.93p.
- Operating cashflow (prior to working capital) was £10.7m, up 7% y/y. Working capital absorbed £0.8m while capital expenditure was £2.9m (H1 17: £1.4m).
- Free cashflow was £5.5m (H1 17: £6.5m).
- Net debt down to £23.7m (H1 17: £28.3m), representing 0.83x trailing 12M EBITDA.
- The IAS 19 pension deficit reduced to £32.4m (2017 year end: £38.2m).

Customer Experience

- Revenue of £87.7m up 11% y/y. EBITA of £12.0m was flat y/y with margins of 13.7% (15.0% in H1 FY17).
- The key driver was a change in mix with direct mail marketing volumes weaker y/y around the introduction of GDPR. This was driven by underlying clients pausing their

outbound marketing whilst the regulation came into force and data integrity and compliance had to be assessed.

- GDPR is not a CMS specific issue with a number of marketing services companies highlighting short term challenges as all consumer facing organisations were impacted. Broad indications are that activity levels are normalising.

- Offsetting GDPR was a strong performance from the transactional outbound business combined with a significant increase in digital output. All in all, 14% of outbound communications were digital in H1 2018 compared to 9% in H1 2017.

- It is also worth highlighting that the H1 2017 comparable was flattered by a £1.1m historic provision release.

- CMS has announced a new long-term client win with Zurich Insurance. In line with other recent multi-year contract wins and extensions, this contract will span communication channels with an emphasis on digital. This contract win underlines the ability of CMS to deliver a full "omni" channel consumer communication proposition to its client base of predominantly large-scale consumer facing brands.

Brand Deployment

- Revenue of £100.9m up 7% y/y. EBITA of £5.6m up 8% with margins stable at 5.5%.

- Overall, performance was solid. During the first half, CMS signed a significant three year expansion of an existing FMCG client contract, which will see the existing territories of Poland, Portugal and Spain expand to include Italy and the Middle East. This will have the effect of taking this client from a top 10 position within Brand Deployment to the top three.

- Elsewhere, the Bacardi contract has been extended for a further three years and the scope has increased to include permanent point of sale.

- Importantly, H2 will see the Noosh marketing services software platform go live which will enhance client servicing and procurement. This will deliver immediate margin benefits through enhanced procurement and divisional simplification.

Exceptional Items

- Total exceptional items in H1 were £2.1m, compared to £1.2m in H1 2017. These exceptional costs can be broken down into two categories.

- **Internal**. These totalled £0.8m and reduced by £0.4m compared to H1 2017. These break down into £0.4m on restructuring within Brand Deployment, £0.3m on one-off GDPR implementation costs and £0.1m of acquired client assets.

- **External**. These totalled £1.3m and relate primarily to professional fees relating to the Value Enhancement Programme announced at the FY17 final results. The focus here has been on the composition of the group.

Outlook – guidance unchanged

Despite GDPR holding Customer Experience back in the first half, the outlook commentary talks to overall expectations for FY 2018 being unchanged.

- Firstly, and most importantly, the GDPR induced softness was short term in nature and was driven by some, but not all, clients pausing their direct mail activity. Whilst this temporary hiatus was clearly unwelcome, the worst effects seem to have passed.

- CMS is much more than just a direct mail business and, in many ways, the H1 performance underscores this point. Despite a material decline in direct mail volumes, we estimate the divisional profit impact to be less than 4% of our expectation for divisional EBIT for FY 18E. This suggests to us:

  1) that direct mail margins are significantly lower than other Customer Experience outputs

  2) continued growth in the output mix represented by non-print (14% in H1 18 vs 9% in H1 17) will see any future volatility impact decrease in scale

  3) the margin impact in H1 18 was experienced before any real benefits from the Value Enhancement Programme have started to come through. We covered the VEP and the potential for broader margin expansion with Customer Experience in some detail in our initiation of coverage note in March 2018 ("Cross Channel Communications"). In a nutshell, we believe CMS can drive a healthy level margin expansion through a mix of internal efficiencies and value focused contract pricing. This will take time to deliver, due to the long-term nature of the key client contracts but will increasingly insulate the business from short term fluctuations such as GDPR.

  4) The biggest risk to CMS is not in the absolute profitability of the absent volume, but more in the opportunity cost of under-utilised assets. Again, this is one the areas that is a focus of the VEP, where technology investment should mitigate against over-capacity depressing short-term margins.

- CMS has continued to win new clients and secure extensions to existing clients both in Customer Experience and Brand Deployment.

- The Zurich win for Customer Experience is notable for the fact that it is multi-channel, not based on print only. The five year contract length further adds to the good forward visibility within much of the business. As part of the new IFRS 15 reporting, longer term contract revenue represented 60% of CE in H1 18 while short term projects represented 36%.

Radnor estimates

At a headline level, we have left our key estimates broadly unchanged for FY2018E. Below the surface, there are a number of minor moving parts. We have re-cut our revenue estimates to take IFRS 15 into account and the re-classification of Psona and Psona Films into Brand Deployment.

Below we highlight our key estimates:

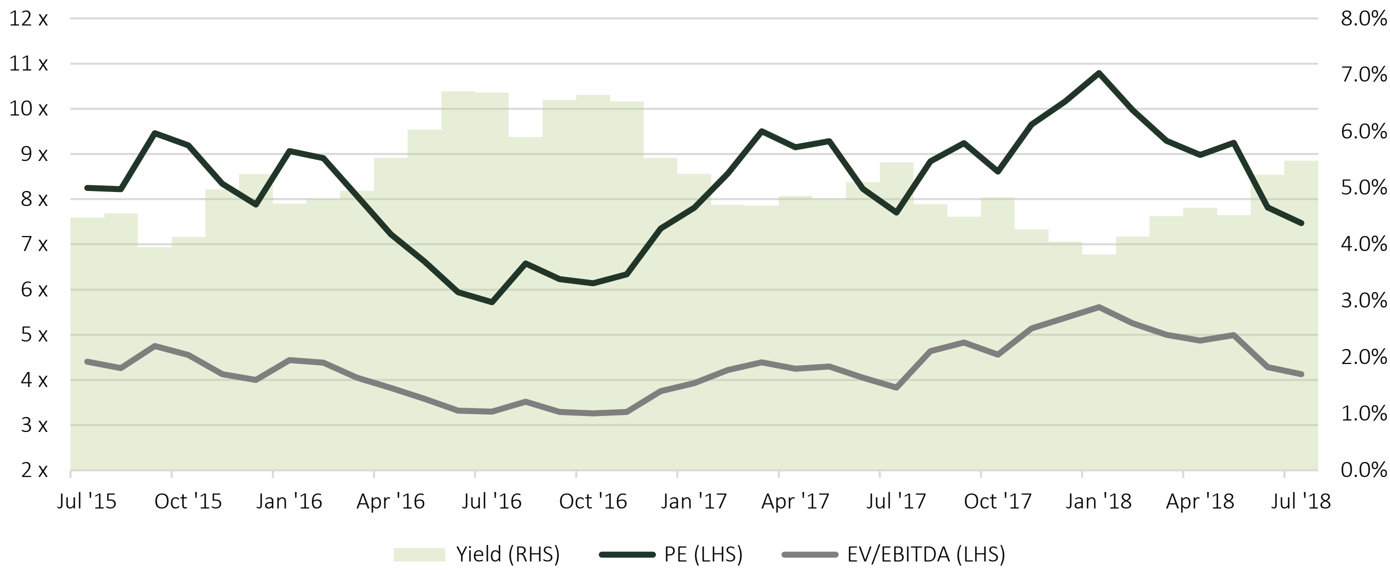
Income Statement Y/E Dec, £m	FY15	FY16	* FY17	y/y	*FY18E	y/y	* FY19E	y/y
Customer Experience								
- Revenue	209.8	185.1	161.2	*-15%*	170.0	*6%*	175.1	*3%*
- EBITA	23.6	19.9	22.4	*11%*	23.8	*6%*	24.9	*4%*
- Margin	11.2%	10.8%	13.9%		14.0%		14.2%	
Brand Deployment								
- Revenue	144.4	176.9	189.5	*7%*	202.8	*7%*	208.8	*3%*
- EBITA	14.1	16.2	14.6	*-11%*	16.2	*11%*	16.9	*4%*
- Margin	9.8%	9.2%	7.7%		8.0%		8.1%	
Revenue	**354.2**	**361.9**	**350.7**	*-3%*	**372.8**	*6%*	**384.0**	*3%*
Contribution	**37.6**	**36.1**	**37.0**	*2%*	**40.0**	*8%*	**41.8**	*4%*
Central Costs	-13.0	-11.1	-11.8		-12.3		-12.7	
Corporate Costs	-6.4	-5.6	-5.9		-6.0		-6.1	
EBITA - Adj.	**18.3**	**19.5**	**19.3**	*-1%*	**21.8**	*13%*	**23.0**	*6%*
- Margin	5.2%	5.4%	5.5%		5.8%		6.0%	
Net Finance Costs	-3.8	-2.8	-3.9		-3.0		-2.7	
PBT - Adj	**14.5**	**16.7**	**15.3**	*-8%*	**18.8**	*23%*	**20.3**	*8%*
Goodwill	-1.2	-0.8	-0.7		-0.7		-0.7	
Non-Operating Items	4.0	-4.3	-2.1		-4.5		-1.5	
PBT - Reported	**17.3**	**11.6**	**12.5**	*8%*	**13.5**	*8%*	**18.1**	*34%*
Tax - Adjusted	-3.7	-4.0	-3.5		-4.3		-4.2	
Tax - Reported	-2.8	-3.0	-2.3		-4.3		-4.2	
EPS - Adj. Dil. (p)	**5.2**	**6.1**	**5.6**	*-7%*	**6.9**	*22%*	**7.7**	*12%*
EPS - Basic (p)	7.0	4.1	4.9		4.4		6.6	
Dividend per share (p)	2.2	2.4	2.6	*7%*	2.7	*5%*	2.8	*5%*
Diluted Shares (m)	207.7	209.5	209.8		210.4		210.4	
Op. Cashflow pre WC	**23.9**	**22.8**	**20.3**		**24.6**		**25.8**	
Working Capital	0.2	-0.5	1.7		-1.4		-0.8	
Net Interest & Tax	-3.8	-4.3	-5.2		-6.1		-5.8	
Capex	-11.0	-5.7	-4.9		-5.9		-7.3	
Net Debt	**-39.4**	**-30.4**	**-24.3**		**-20.0**		**-14.8**	
Net Pension Deficit	-41.1	-55.5	-38.2		-34.2		-30.2	
Net Assets	126.8	118.2	134.4		143.0		149.2	

**Restated to reflect the adoption of IFRS 15* *Source: Radnor Capital Partners, Communisis PLC*

Valuation

In Figure 1 below, we show the evolution of the Communisis 1 year forward PE and EV/EBITDA multiples and the forward dividend yield over the last three years. This is based on market consensus forecasts

Figure 1: Communisis 1 year forward PE, EV/BITDA and dividend yield history



Source: FactSet

- Following a period of steady positive re-rating, CMS has seen its forward PE decline significantly since the start of 2018. Earnings estimate revisions have been broadly stable throughout this period.

- The shares now stand at a prospective PE of 7.6x and a dividend yield of 5.3%.

- Given the confirmed guidance for FY 18, this de-rating looks to have been overdone. If the market had been pricing in a GDPR shock, then it is likely to be disappointed. There has been an effect, but the CMS ship has not been knocked off course.

- The basics of the investment case we outlined in our initiation of coverage note remain unchanged.

  1) Fundamental demand drivers support a steady, single digit revenue growth proposition with margin expansion off a low base

  2) Steadily reducing net debt and pension deficit further improving an already secure balance sheet

  3) Strategic optionality when it comes to sector consolidation and / or shareholder returns

  4) Attractive valuation entry point

Communisis plc

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Price (p):	52 p
Market Cap:	109 m
EV:	129 m

PROFIT & LOSS

Year to 31 January, £m	2015	2016	2017	FY18e	FY19e
Customer Experience	*209.8*	*185.1*	*161.2*	*170.0*	*175.1*
Brand Deployment	*144.4*	*176.9*	*189.5*	*202.8*	*208.8*
Group Net Revenue	**354.2**	**361.9**	**350.7**	**372.8**	**384.0**
Customer Experience	*23.6*	*19.9*	*22.4*	*23.8*	*24.9*
Brand Deployment	*14.1*	*16.2*	*14.6*	*16.2*	*16.9*
Central Costs	*(13.0)*	*(11.1)*	*(11.8)*	*(12.3)*	*(12.7)*
Head Office	*(6.4)*	*(5.6)*	*(5.9)*	*(6.0)*	*(6.1)*
EBITA - Adjusted	**18.3**	**19.5**	**19.3**	**21.8**	**23.0**
Associates & JV's	-	-	-	-	-
Net Interest	(3.8)	(2.8)	(3.9)	(3.0)	(2.7)
PBT - Adjusted	**14.5**	**16.7**	**15.3**	**18.8**	**20.3**
Non Operating Items	2.8	(5.1)	(2.8)	(5.2)	(2.2)
PBT - IFRS	**17.3**	**11.6**	**12.5**	**13.5**	**18.1**
Tax	(2.8)	(3.0)	(2.3)	(4.3)	(4.2)
Tax - Adjusted	(3.7)	(4.0)	(3.5)	(4.3)	(4.2)
Tax rate - Adjusted	*25.6%*	*23.7%*	*23.0%*	*23.0%*	*23.0%*
Minority interests	-	-	-	-	-
No. shares m	207.3	209.2	208.8	209.4	209.4
No. shares m, diluted	207.7	209.5	209.8	210.4	210.4
IFRS EPS (p)	7.0	4.1	4.9	4.4	6.6
Adj EPS (p), diluted	**5.2**	**6.1**	**5.6**	**6.9**	**7.7**
Total DPS (p)	2.2	2.4	2.7	2.8	2.9

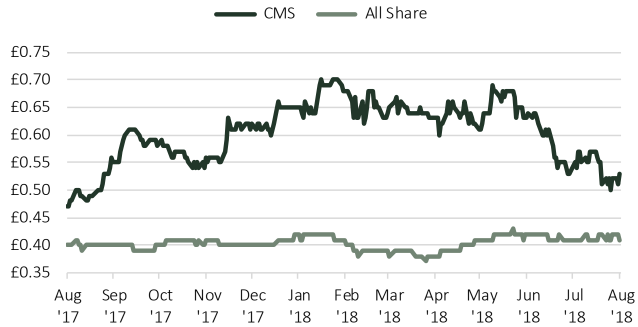
CASH FLOW

Year to 31 January, £m	2015	2016	2017	FY18e	FY19e
EBITDA	**29.3**	**29.4**	**26.4**	**29.3**	**30.8**
Pension Contribution	(2.9)	(2.8)	(4.0)	(4.0)	(4.0)
Working Capital	0.2	(0.5)	1.7	(1.4)	(0.8)
Other	(2.4)	(3.2)	(2.2)	(0.7)	(1.0)
Cash from Ops	**24.2**	**22.9**	**21.9**	**23.2**	**25.0**
Cash Interest	(2.3)	(2.0)	(1.8)	(1.8)	(1.6)
Cash Tax	(1.6)	(2.3)	(3.4)	(4.3)	(4.2)
Tangible Capex	(4.2)	(3.1)	(1.3)	(4.0)	(4.5)
Intangible Capex	(6.8)	(2.6)	(3.7)	(1.9)	(2.8)
Free Cashflow	**9.3**	**12.9**	**11.8**	**11.1**	**11.9**
Inv in new contracts	-	(1.2)	(0.7)	(1.1)	(0.2)
Dividends	(4.3)	(4.8)	(5.2)	(5.6)	(5.8)
Acquisitions & Inv.	(0.0)	(0.3)	(9.3)	-	-
Financing	3.6	(3.4)	(5.5)	(0.2)	(0.6)
Net Cashflow	**8.6**	**3.3**	**(9.0)**	**4.3**	**5.3**
Net Cash (Debt)	(39.4)	(30.4)	(24.3)	(20.0)	(14.8)

BALANCE SHEET

Year to 31 January, £m	2015	2016	2017	FY18e	FY19e
Intangibles	192.4	187.9	177.7	180.8	177.6
P,P+E	23.1	21.6	19.3	17.1	17.8
Tax Asset & Other	4.5	7.2	16.5	16.5	16.5
Total Fixed Assets	**220.0**	**216.8**	**213.5**	**214.4**	**211.9**
Net Working Capital	(12.7)	(12.7)	(16.6)	(17.2)	(17.7)
Capital Employed	**207.3**	**204.1**	**196.9**	**197.2**	**194.2**
Pension Deficit	(41.1)	(55.5)	(38.2)	(34.2)	(30.2)
Net Debt	(39.4)	(30.4)	(24.3)	(20.0)	(14.8)
Net Assets	**126.8**	**118.2**	**134.4**	**143.0**	**149.2**

PRICE CHART - 2 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

SHAREHOLDERS

	% of ord. Share capital
Richard Griffiths	19.6%
Janus Henderson	10.0%
Otus Capital Mgmt	6.1%
Crux Asset Mgmt	5.7%
Majedie Asset Mgmt	4.4%
Axa Fram Inv Mgrs	3.8%
Slater Inv	3.0%
Dimensional	2.8%
Cavendish Asset Mgmt	2.4%
Miton Asset Mgmt	2.3%
	60.1%

RATIOS

	2015	2016	2017	FY18e	FY19e
RoE	8.5%	10.8%	8.8%	10.1%	10.8%
RoCE	8.8%	9.5%	9.8%	11.0%	11.8%
Asset Turnover (x)	0.6x	0.6x	0.6x	0.6x	0.6x
NWC % Revenue	3.6%	3.5%	4.7%	4.6%	4.6%
Op Cash % EBITDA	82.5%	77.9%	83.1%	79.2%	81.2%
Net Debt / EBITDA	1.3x	1.0x	0.9x	0.7x	0.5x

VALUATION

Fiscal	2015	2016	2017	FY18e	FY19e
P/E	10.0x	8.6x	9.3x	7.6x	6.8x
EV/EBITDA	4.4x	4.4x	4.9x	4.4x	4.2x
Div Yield	4.2%	4.7%	5.1%	5.4%	5.6%
FCF Yield	7.2%	10.0%	9.1%	8.6%	9.2%
EPS growth		17.1%	-7.4%	22.2%	11.6%
DPS growth		10.0%	9.9%	5.0%	5.0%

REGULATORY DISCLOSURES

This research is deemed to be a minor non-monetary benefit for the purposes of MiFID II.

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DISCLAIMER