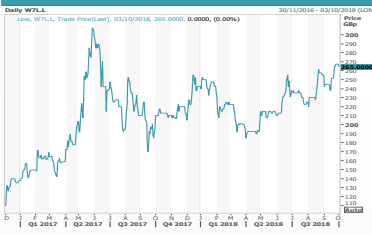




## Personal Products



Source: Eikon Thomson Reuters

## Market data

EPIC/TKR	W7L
Price (p)	265
12m High (p)	275
12m Low (p)	150
Shares (m)	76.7
Mkt Cap (£m)	203.4
EV (£m)	198.8
Free Float*	34.7%
Market	AIM

\*As defined by AIM Rule 26

## Description

Warpaint is a UK-based colour cosmetics specialist that sells creative, design-focused and high-quality cosmetics at affordable prices. The company comprises of two divisions: own-brand (W7, Retra and others) and close-out. It has a presence in more than 60 countries worldwide.

## Company information

Joint CEO	Sam Bazini
Joint CEO	Eoin Macleod
CFO	Neil Rodol
Chairman	Clive Garston

+44 1753 639 130

[www.warpaintlondonplc.com](http://www.warpaintlondonplc.com)

## Key shareholders

Directors*	53.5%
Schroder Inv. Mgmt.	10.1%
BlackRock Inv. Mgmt.	9.9%
Hargreave Hale	3.1%
J O Hambro Capital Mgmt.	2.0%
Columbia Threadneedle	1.8%

\*includes shares held by directors' wives

## Diary

Apr'19	Full-year results
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## Analyst

Yingheng Chen 020 7194 7638  
[yc@hardmanandco.com](mailto:yc@hardmanandco.com)

## WARPAINT LONDON PLC

## 1H'18 interims: delivering the results

Warpaint's interim results for the six months ending June 2018 showed revenue up 38.7% to £18.4m (1H'17: £13.3m). The company's two divisions, own-brand and close-out, represented 84% and 16%, respectively, of the total revenue. Exports now account for 56% of sales, of which sales to the EU grew by 110% to £6.7m. Both of the company's leading brands, W7 and Technic, are 2H-biased due to the nature of the gifting market, and about two thirds of FY revenue will be concentrated in the second half. While costs remain relatively flat, we expect profitability to be very much 2H-weighted also.

- **Interim results:** Group gross profit increased 30% to £6.7m, and the gross margin fell slightly to 36.5% due to product mix. The net cash position increased by £2.1m to £4.6m. Warpaint declared a 1.5p interim dividend – a 7.1% increase compared to 1H'17 – in keeping with its progressive dividend policy.
- **Retra:** Retra is now fully integrated, and its revenue contribution was £4.1m for 1H'18, of which Technic accounted for £2.9m. Since the acquisition, Retra has expanded its presence by attending trade shows. As a result, the Christmas order book had increased significantly at end-June 2018, ahead of the prior period.
- **Acquisitions:** The past 12 months have proved exciting for the company, with the acquisition of Retra in Nov'17, and then the acquisition of US distribution business, Leeds Marketing, in Aug'18. We believe these new add-ons will give Warpaint better access to/control of the largest colour cosmetics market in the world (the US).
- **Risks:** For Warpaint to remain successful, several key factors have to be considered: i) continuing growth in the discount retail sector; ii) the successful integration of the new acquisitions; and iii) the company's ability to deliver new and innovative products.
- **Investment summary:** Retra now fully integrated and with the recent acquisition of Leeds Marketing, Warpaint is well positioned to maximise the benefit of the additional assets. It enjoys a much faster growth rate than the rest of the colour cosmetics sector globally, and has an attractive RoE. Warpaint offers the opportunity to invest in the fast-growing colour cosmetics sector, with a highly experienced management team.

## Financial summary and valuation

Year-end Dec (£000)	2016	2017	2018E	2019E	2020E
Sales	22.5	32.5	55.1	63.9	70.9
EBITDA (adj.)	6.3	8.0	13.1	15.5	17.3
Operating profit (adj.)	6.2	7.3	10.1	12.5	14.4
PBT (adj.)*	6.1	7.7	12.4	15.2	17.0
Basic EPS (adj.) (p)*	7.9	9.7	13.7	16.7	18.6
DPS (p)	1.5	4.0	5.5	6.6	7.9
P/E (x)*	33.7	27.4	19.3	15.9	14.2
EV/EBITDA (x)	31.7	24.9	15.2	12.9	11.5
Dividend yield	0.6%	1.5%	2.1%	2.5%	3.0%
RoE	-	20.0%	18.6%	21.1%	21.4%

\*excludes amortisation of intangible assets

Source: Hardman &amp; Co Research

## Table of contents

1H'18 interim results.....	3
Revenue .....	3
Gross profit/margin .....	5
Balance sheet .....	6
Operations.....	6
Leeds Marketing acquisition.....	7
Three-year strategic plan .....	8
Long-term incentive plan .....	9
Financials .....	10
Profit & loss.....	10
Balance sheet .....	11
Cashflow .....	12
Disclaimer .....	13
Status of Hardman & Co's research under MiFID II .....	13

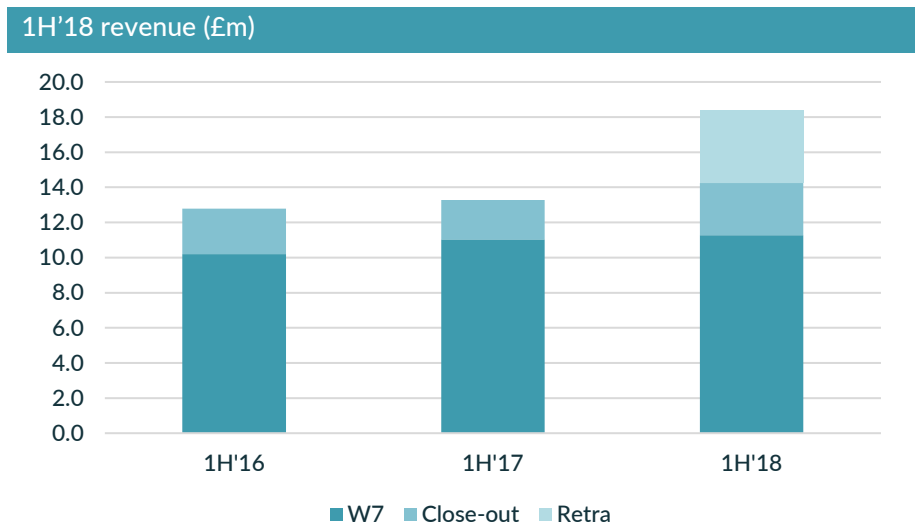
# 1H'18 interim results

Warpaint's results for the six-month period to the end of June 2018 were the first set of interims to include sales from Retra (acquired in November 2017) for a complete reporting period.

## Revenue

Good revenue progress from own-brand and close-out in 1H'18

Both the own-brand and close-out divisions made good progress during 1H'18. Group sales for the period increased by 38.7% to £18.4m (1H'17: £13.3m). On a like-for-like basis, excluding the contribution from Retra, revenue grew by 7.3%. The sales contribution from the now fully-integrated Retra was £4.1m, of which Technic accounted for £2.9m. The close-out division continues to be an opportunistic business for the group, and sales were slightly ahead of expectations at £2.98m (1H'17: £2.2m), an increase of 33.2%.

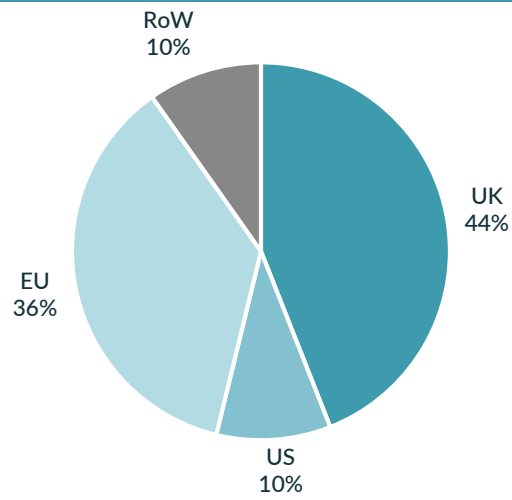


Source: Warpaint, Hardman & Co Research

UK the biggest market for group revenue...

The UK remains the biggest market for the group, accounting for 44% of total revenue for the period, at £8.1m. Sales from RoW were lower than in 1H'17, at £1.8m, due to the timing difference of some large orders. Sales into Europe increased by 110.4% compared with 1H'17, due to the large proportion of revenue from Retra in the region and 35% growth in W7 sales into the EU compared to H1'17.

1H'18 revenue by geography

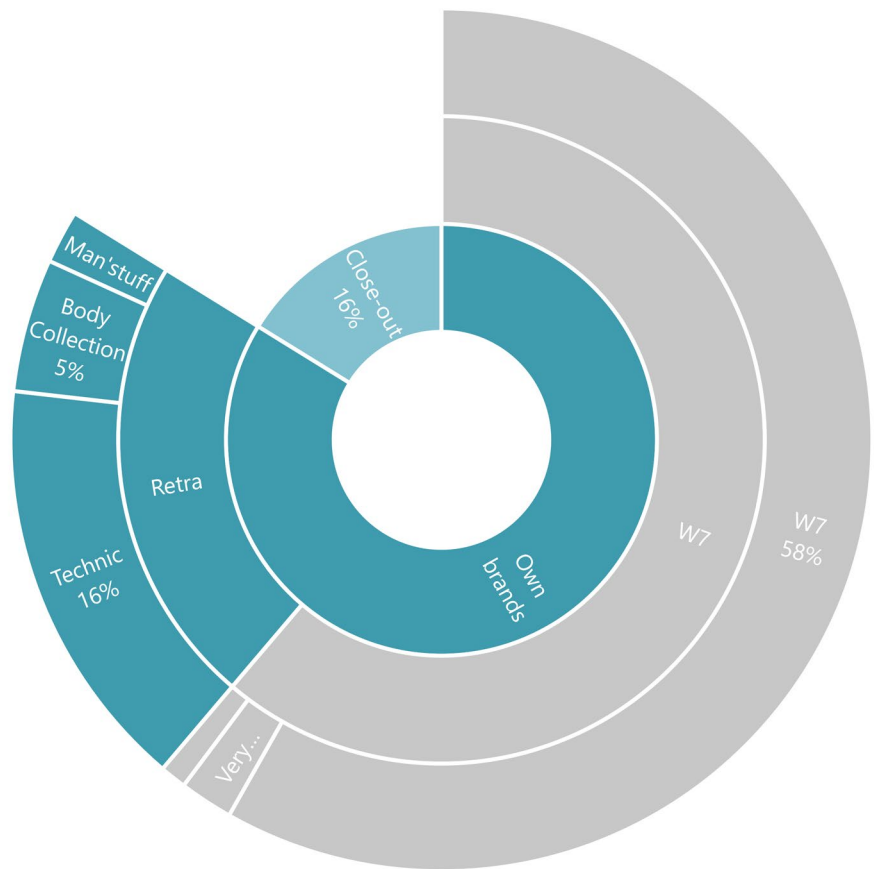


Source: Warpaint, Hardman & Co Research

...and own-brand the biggest division

The own-brand division accounted for 84% of total revenue for the first half, at £15.4m.

1H'18 revenue by division



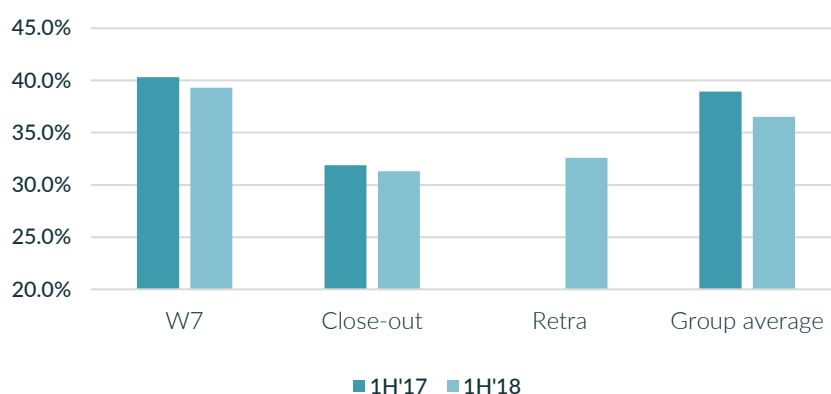
Source: Warpaint, Hardman & Co Research

## Gross profit/margin

### Gross profit up, gross margin down

Gross profit rose 30.0% to £6.7m, while the gross margin fell by 2.4ppts to 36.5% (1H'17: 38.9%) due to the change in product mix. The gross margin from the W7 brand, the group's flagship brand, was 39.3% (1H'17: 40.3%), while that from Retra was 32.6%. Retra, based in Yorkshire, has a particular focus on the gifting market, as well as on products and accessories in bathing ranges, tanning and men's grooming. Because of this market focus and product range, Retra, on average, has a lower gross margin compared with W7.

### Gross margin, 1H'18 vs. 1H'17



Source: Warpaint, Hardman & Co Research

### P&L, 1H'18 vs. 1H'17

Year-end Dec (£m)	1H'17	1H'18
Own-brand	11.0	15.4
Close-out	2.2	3.0
<b>Sales</b>	<b>13.3</b>	<b>18.4</b>
Growth rate	3.8%	38.7%
Cost of sales	-8.1	-11.7
<b>Gross profit</b>	<b>5.2</b>	<b>6.7</b>
Gross margin	38.9%	36.5%
SG&A	-2.1	-3.9
<b>Underlying EBITDA</b>	<b>3.1</b>	<b>2.8</b>
Underlying EBITDA margin	23.2%	15.5%
Share-based payments	0.0	0.0
Depreciation and amortisation	-0.2	-1.4
<b>Underlying EBIT (before exceptionals &amp; SBP)</b>	<b>2.9</b>	<b>1.4</b>
Exceptional items	0.0	-0.1
<b>EBIT (as reported)</b>	<b>2.9</b>	<b>1.4</b>
Finance costs	0.0	-0.1
<b>Adjusted PBT</b>	<b>2.9</b>	<b>2.5</b>
Underlying PBT margin	21.8%	13.8%
<b>Pre-tax profit</b>	<b>2.9</b>	<b>1.3</b>
Tax	-0.6	-0.3
<b>Underlying net income</b>	<b>2.3</b>	<b>1.1</b>
<b>Net income</b>	<b>2.3</b>	<b>1.0</b>

Source: Warpaint, Hardman & Co Research

A swing of ca.£190k of FX in Admin costs across the two periods

Operating expenses (excluding depreciation, amortisation and exceptional items) increased by £1.8m from Retra for the period. Compared with 1H'17, this is the first six-month period for which Warpaint included the entire operating expenses from Retra since the acquisition in November 2017.

## Balance sheet

Strong balance sheet and progressive dividend policy

In the company's 2017 annual report, the management team mentioned its focus of being debt-free, cash-generative and delivering a progressive dividend policy. We are pleased to note that Warpaint has made progress on all these fronts. The net cash position increased to £4.6m at the end of the period. Despite the \$2.16m (ca.£1.66m) for the acquisition of Leeds Marketing, we are expecting the group to end FY18 with a net cash position of £4.1m. The company declared a 1.5p interim dividend – a 7.1% increase compared to 1H'17 – in keeping with its progressive dividend policy.

## Operations

56% of revenues now come from overseas

The group's own-brand division continued to grow at a fast rate in 1H'18, both domestically (UK) and internationally. In particular, we note that Warpaint's flagship brand, W7, is now being sold in 56 countries. 56% of the group's revenues now come from the overseas markets, with a 35.3% increase in the EU and 3.4% in the US (15.4% in dollar terms) in 1H'18. With the acquisition of Leeds Marketing in August 2018 and by bringing the US operation in-house, we expect to see further growth from the US.

On 24 April, Warpaint's wholly owned subsidiary, Warpaint Cosmetics (2014) Ltd, was awarded the Queen's Award for International Trade.

## Leeds Marketing acquisition

Acquisition enables better access  
to/control of largest colour cosmetics  
market in the world

On 2 August 2018, Warpaint announced the acquisition of Marvin Leeds Marketing Services Inc (Leeds Marketing), its US distributor, for a total consideration of \$2.16m in cash, subject to an adjustment to the net assets acquired. The acquisition will provide better access to, and control of, some of its key customers in the US, while also being a platform for further expansion in the Americas.

Leeds Marketing is a New York-based distributor focusing primarily on the US and Canada. It had an exclusive distribution agreement with Warpaint for the US until January 2018, accounting for two thirds of its revenue. In the year to 31 December 2017, it had \$5.9m revenues and \$0.4m adjusted PBT.

Leeds Marketing distributes to some major US discount retailers, such as the TJX Group and Bealls Outlet Stores. It has also opened accounts recently with Century 21, Forever 21 and Macys Backstage. The acquisition provides Warpaint with direct access to its key customers in the US, as well as expansion opportunities in North America.

Of the total \$2.16m payment, Warpaint has so far paid \$2.0m, with two further payments of \$0.08m due at the end of September and December.

## Three-year strategic plan

In our initiation report, '[Painting a bright future](#)', we highlighted Warpaint management's three-year strategic plan. In the 1H'17 interim statement, the company published a fuller version of this plan, identifying six key strategic areas of priority for the next development phase, which we again highlight below.

### *Continue to develop and build its brands*

The company will focus on building its major brands, by continuing with its current marketing strategy of the utilisation of brand ambassadors, bloggers and vloggers to engage with a target audience, in particular through the use of social media campaigns and interaction with its loyal brand users.

### *Provide new product development (NPD) that meets consumers' changing needs and tastes*

One of the key focuses of the business and the NPD team is to supply its customers with a wide range of affordable, high-quality cosmetics. The company prides itself on its ability to deliver new, on-trend products, and with a quick turnaround time compared with the bigger brands. Now, with new brands in the portfolio, such as Technic, Body Collection and Man'sstuff, the NPD team will also focus on developing products that cater to a wider range of customers. As part of this strategy, Warpaint has expanded its team by employing a dedicated product development officer with more than 10 years of experience in the cosmetics, hair care, skin care and oral care product development areas, as well as experience in sourcing, purchasing and supply chain management.

### *Grow market share in the UK*

Warpaint will continue to grow its market share in the UK, and the management team believes that more than 75% of the UK market remains unexploited – in particular pharmacy chains, and several high-street chains and grocers. The company is expecting to grow in the UK by both continuing the development of its e-commerce platform in the UK and the use of short-term experts to open doors, and gaining access into some of the types of stores mentioned above.

### *Grow US awareness and sales of the W7 brand and launch W7 successfully in China*

With Leeds Marketing, Warpaint can now be seen as a local company in the US, which, together with its e-commerce site, enables a more rapid expansion in the US, the largest colour cosmetics market in the world (\$12bn). The company also has several initiatives under way to tap into China, the fastest-growing market in the world, with a CAGR of 9.4% between 2015 and 2018 in the colour cosmetics sector.

### *Reduce costs*

Continue to develop and improve the efficiency of the company's supply chain. Utilising the advantage brought to the group by Retra, Warpaint can potentially consolidate its supply chain and ultimately reduce production costs.

### *Drive shareholder value*

The management team has identified financial targets to its performance.



## Long-term incentive plan

As part of the company's strategy to drive shareholder value, Warpaint announced the implementation of a new long-term incentive plan (LTIP) with initial grants to six senior members of the management team. The LTIP has been established to incentivise management over the long term.

Grants to senior management		
Board member	Role	Share options
Samuel Bazini	Joint CEO	1,534,986
Eoin Macleod	Joint CEO	1,534,986
Neil Rodol	CFO	306,996

*Source: Warpaint, Hardman & Co Research*

### *Performance conditions*

The share options are subject to a set of performance conditions based on the achievement of EPS and total shareholder return (TSR), measured over a period of up to five years, with an exercise price of 254.5p. The performance conditions are:

- ▶ 50% of the options is subject to an adjusted EPS growth performance condition:
  - Threshold vesting of 20% of the options is at an achieved EPS CAGR of 12.5%.
  - Full vesting at 22.5% EPS CAGR.
- ▶ 50% of the options is subject to an absolute total shareholder return performance condition:
  - Threshold vesting of 20% of the options is achieved at 8% compound annual TSR.
  - Full vesting at 18% compound annual TSR measured from 31 December 2017.

# Financials

## Profit & Loss

Both of the company's leading brands, W7 and Technic, are 2H-biased, due to the nature of the gifting market. We expect that ca.60% and ca.78% of full-year revenue will come from these brands, respectively, in 2H. Warpaint's management team has emphasised that the close-out division will remain an opportunistic area for the group, and therefore we are not changing our full-year revenue estimate of £5.7m for this division, despite a 33% increase in 1H. We have included a revenue contribution of ca.£1.5m from the newly acquired US operation, Leeds Marketing from 2019.

The order book for Christmas increased significantly to £8.2m for own brands at the end of June 2018. The group now has much better 2H revenue visibility given Retra's strength in the gifting market.

Profit & Loss account					
Year-end Dec (£m)	2016	2017	2018E	2019E	2020E
Own-brand division	21.9	26.9	49.5	58.2	65.3
Close-out division	0.6	5.7	5.7	5.7	5.7
<b>Sales</b>	<b>22.5</b>	<b>32.5</b>	<b>55.1</b>	<b>63.9</b>	<b>70.9</b>
Growth rate		45%	69%	16%	11%
Cost of sales	-13.7	-19.9	-33.9	-38.9	-43.0
<b>Gross profit</b>	<b>8.8</b>	<b>12.6</b>	<b>21.2</b>	<b>25.0</b>	<b>27.9</b>
Gross margin	39.1%	38.8%	38.5%	39.1%	39.3%
SG&A	-2.5	-4.7	-8.1	-9.5	-10.6
<b>Underlying EBITDA</b>	<b>6.3</b>	<b>8.0</b>	<b>13.1</b>	<b>15.5</b>	<b>17.3</b>
Underlying EBITDA margin	28%	25%	24%	24%	24%
Share-based payments	0.0	0.0	-0.1	-0.1	-0.1
Depreciation and amortisation	-0.1	-0.7	-3.0	-3.0	-2.9
<b>Underlying EBIT (before exceptionals &amp; SBP)</b>	<b>6.2</b>	<b>7.3</b>	<b>10.1</b>	<b>12.5</b>	<b>14.4</b>
Underlying EBIT margin	27%	23%	18%	20%	20%
Exceptional items	-1.7	-0.4	-0.1	0.0	0.0
<b>EBIT (as reported)</b>	<b>4.4</b>	<b>6.9</b>	<b>9.9</b>	<b>12.4</b>	<b>14.3</b>
Finance costs	0.0	0.0	-0.2	0.0	0.0
<b>Adjusted PBT</b>	<b>6.1</b>	<b>7.7</b>	<b>12.4</b>	<b>15.2</b>	<b>17.0</b>
Underlying PBT margin	27%	22%	18%	20%	20%
<b>Pre-tax profit</b>	<b>4.4</b>	<b>6.9</b>	<b>9.8</b>	<b>12.4</b>	<b>14.3</b>
Tax	-1.3	-1.4	-1.9	-2.4	-2.7
<b>Underlying net income</b>	<b>4.9</b>	<b>6.3</b>	<b>10.5</b>	<b>12.8</b>	<b>14.3</b>
Underlying net income margin	22%	20%	19%	20%	20%
<b>Net income</b>	<b>3.1</b>	<b>5.5</b>	<b>7.9</b>	<b>10.0</b>	<b>11.5</b>
Net income margin	14%	17%	14%	16%	16%
<b>Underlying basic EPS (p)</b>	<b>7.9</b>	<b>9.7</b>	<b>13.7</b>	<b>16.7</b>	<b>18.6</b>
Growth rate		23%	42%	22%	12%
Basic EPS (p)	5.1	8.3	10.3	13.1	15.0
Growth rate		65%	23%	27%	15%
Dividend (p)	1.5	4.0	5.5	6.6	7.9

Source: Warpaint, Hardman & Co Research

## Balance sheet

Warpaint has a very active inventory management system, due to the size of its product portfolio. Keeping track of stock levels, as well as colour and fashion trends, is a key part of inventory management. Warpaint does not have its own manufacturing facilities. Capex is kept at a very low level.

The company intends to pay off the remaining debt, taken on as part of the acquisition of Retra, by the end of 2018.

<b>Balance sheet statement</b>					
<b>@ 31 Dec (£m)</b>	<b>2016</b>	<b>2017</b>	<b>2018E</b>	<b>2019E</b>	<b>2020E</b>
<b>Non-current assets</b>					
Goodwill	0.5	8.0	8.4	8.4	8.4
Intangibles	1.4	10.7	9.0	6.4	3.7
Property, plant and equipment	0.2	1.5	1.2	1.1	1.0
	<b>2.2</b>	<b>20.1</b>	<b>18.6</b>	<b>15.8</b>	<b>13.1</b>
<b>Current assets</b>					
Inventories	7.7	11.5	13.5	15.5	17.7
Trade and other receivables	5.4	13.2	18.1	21.3	24.3
Derivative financial instruments	0.0	0.0	0.0	0.0	0.0
Cash and cash equivalents	3.5	3.4	4.4	8.9	13.8
	<b>16.6</b>	<b>28.1</b>	<b>36.0</b>	<b>45.8</b>	<b>55.8</b>
<b>Total assets</b>	<b>18.7</b>	<b>48.3</b>	<b>54.6</b>	<b>61.6</b>	<b>68.9</b>
<b>Current liabilities</b>					
Trade payables	-2.8	-3.5	-7.0	-8.0	-8.8
Loans and borrowings	0.0	-0.6	0.0	0.0	0.0
Corporate tax liabilities	-1.3	-0.9	-1.6	-1.7	-2.0
Derivative financial instruments	0.0	0.0	0.0	0.0	0.0
	<b>-4.2</b>	<b>-5.1</b>	<b>-8.6</b>	<b>-9.7</b>	<b>-10.8</b>
<b>Non-current liabilities</b>					
Bank loans	0.0	-0.8	0.0	0.0	0.0
Deferred tax liabilities	-0.3	-2.0	-1.6	-1.2	-0.8
	<b>-0.3</b>	<b>-2.8</b>	<b>-1.6</b>	<b>-1.2</b>	<b>-0.8</b>
<b>Total liabilities</b>	<b>-4.4</b>	<b>-7.8</b>	<b>-10.2</b>	<b>-10.9</b>	<b>-11.6</b>
<b>Equity</b>	<b>14.3</b>	<b>40.4</b>	<b>44.4</b>	<b>50.8</b>	<b>57.3</b>

Source: Warpaint, Hardman & Co Research

## Cashflow

<b>Cashflow statement</b>					
<b>Year-end Dec (£m)</b>	<b>2016</b>	<b>2017</b>	<b>2018E</b>	<b>2019E</b>	<b>2020E</b>
<b>PBT</b>	4.4	6.9	9.8	12.4	14.3
Depreciation	0.1	0.2	0.5	0.3	0.3
Amortisation	0.1	0.5	2.5	2.7	2.7
(Profit)/loss on disposal	0.0	0.0	0.0	0.0	0.0
Share-based payments	0.0	0.0	0.1	0.1	0.1
Change in working capital	-0.1	-0.3	-3.4	-4.3	-4.2
Tax paid	-1.5	-2.1	-2.0	-2.3	-2.6
<b>Net cashflow from operating activities</b>	<b>3.0</b>	<b>5.2</b>	<b>7.5</b>	<b>8.9</b>	<b>10.5</b>
Purchase of intangible assets	-0.1	-0.1	0.0	0.0	0.0
Purchase of PP&E	-0.2	-0.6	-0.2	-0.2	-0.2
Acquisition of business	0.0	-16.2	-1.7	0.0	0.0
Bank balances acquired	0.1	0.2	0.0	0.0	0.0
Sale of investments	0.0	0.0	0.0	0.0	0.0
Proceeds from sale of PP&E	0.0	0.0	0.0	0.0	0.0
<b>Net cashflow from investing activities</b>	<b>-0.1</b>	<b>-16.5</b>	<b>-1.9</b>	<b>-0.2</b>	<b>-0.2</b>
Proceeds from new share issuance	2.5	21.2	0.0	0.0	0.0
Share issue costs	-0.1	-0.9	0.0	0.0	0.0
Repayment in borrowings	-0.7	-7.3	-1.4	0.0	0.0
Dividend	-2.8	-1.9	-3.1	-4.1	-5.3
<b>Net cashflow from financing activities</b>	<b>-1.1</b>	<b>11.2</b>	<b>-4.5</b>	<b>-4.1</b>	<b>-5.3</b>
Net increase/(decrease) in cash	1.7	-0.1	1.0	4.5	4.9
Cash B/F	1.8	3.5	3.4	4.4	8.9
<b>Cash C/F</b>	<b>3.5</b>	<b>3.4</b>	<b>4.4</b>	<b>8.9</b>	<b>13.8</b>

Source: Warpaint, Hardman & Co Research

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