The small company specialists

# COMPANY INFORMATION

## Churchill China PLC (LSE - CHH)

**Date Prepared: May 2007**

| Company Eye Ranking | 38/50 |
|---|---|

## EDITOR'S NOTE

Churchill China plc is one of the worlds major manufacturers and distributors of high quality ceramic tableware. Based in Stoke on Trent, England, Churchill can trace its development back to the establishment of one of its constituent companies, Sampson Bridgwood, in 1795.

Over the last few years Churchill has been restructured and re-invented. The Group has emerged as a leaner business with a strong balance sheet and the capacity to invest for the medium term where Churchill perceives attractive opportunities.

## 2 YEARS CHART/RSI - 14


## FUNDAMENTALS

| Company Name | |
|---|---|
| Current Price | 280 |
| Status | AIM |
| Market Cap | 30.65 m. |
| Price to Book Ratio | 1.2 |
| Shares in Issue | 10.945.876 m. |
| Activities | Manufacture and sale of ceramic products for the catering and household markets around the world |
| Sector | Household Goods |
| Corporate advisor | Brewin Dolphin Securities Limited |
| Registrar | Lloyds TSB Registrars |

## HISTORY

The Churchill group is an amalgamation of several family owned potteries which can trace their history back over 200 years to the Bridgewood family. The Roper dynasty in fine tableware began in 1922 when Edward Roper took a half share in James Broadhurst, a Longton based pottery firm. His son Peter followed him into the business and the company expanded with the acquistion of Sampson Bridgewood.

In 1994 Churchill, in addition to their Hotelware and Tableware division, formed a Bone China division by the acquistition of the Crownford company in Longton, manufacturers of bone china giftware and tableware under the Queen's trademark. This was added to with the acquisition of Wren in 1998. Until 1994 the Group was wholly owned by the Roper Family, however following a placing of shares on the London stock market the Group now has a wide range of investors, although the family still retain overall control.

Churchill China purchased the brand James Sadler, one of the worlds largest manufacturers of ceramic teapots, in March 2000, after the company went into receivership.

The company now employs 1200 people in 4 factories within the heart of The Potteries.

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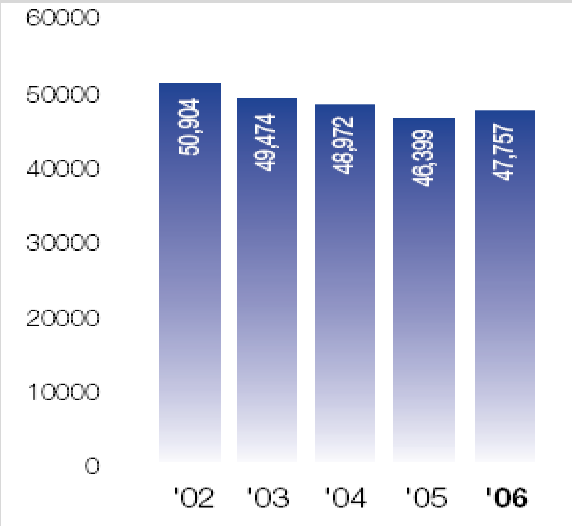
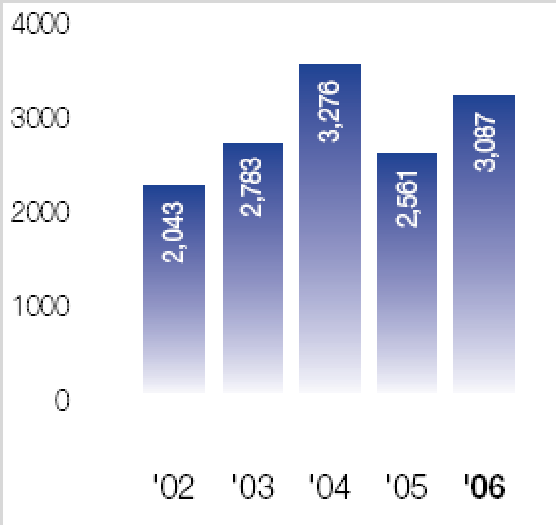
## BUSINESS

Churchill supplies a wide range of ceramic tableware and related products to customers in hospitality and home markets around the world through an extensive network of retailers, agents and distributors.
The Company operates from four manufacturing units in Stoke on Trent which are supported by distribution centres and a sourcing operation which allows Churchill to offer a "one stop shop" to its customers. Churchill manufactures a wide range of durable vitrified earthenware, mainly for hospitality markets, and earthenware and bone china products for home markets. This manufacturing output is complemented by an ability to source and supply porcelain and stoneware products to complete its ceramic tableware offering. The range of product within each of these areas is enormous. In Churchill's Dining Out division, which supplies hospitality markets, products vary from simple white plates to specialist products for ethnic restaurants. The Dining In division, which supplies product for use in the home, provides not only Traditional Prints and Classic English design, but also a collectable range and high fashion products to meet today's changing lifestyles.

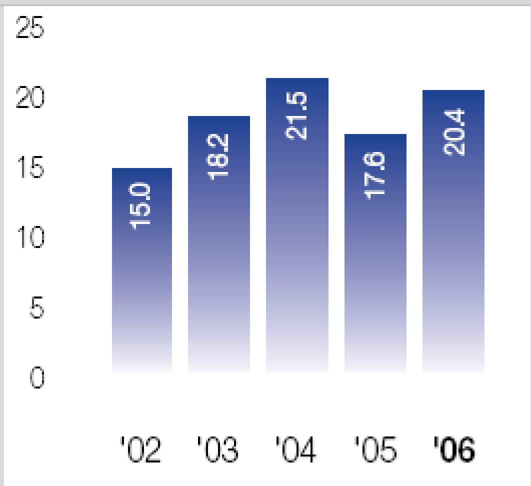
## COMPANY PERFORMANCE



(Turnover £000)



Profit before profit on disposal of fixed assets and exceptional items (£000)



Adjusted earnings per share (p)

## SECTOR PERFORMANCE

FTSE AIM 5 Years

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## EXPANSION

To support growth in export markets, the company has invested further sales resource in its US and Spanish operations.

More recently Churchill has opened an office in Dubai to capitalise on significant growth opportunities in the Middle East.

## STRATEGY

The group's strategy for the Retail business is to develop direct shipments to major UK and overseas customers facilitated by its Shanghai office. Churchill's competitive advantage is to add value through top level design, procurement and fulfilment for branded and bespoke products to both full service and direct ship customers. This strategy is already generating additional quality listings and will benefit the Group through increased contribution

## DIRECTORS

**Jonathan Sparey**, non executive Director, aged 48, is a partner in L.E.K. Consulting, a leading international corporate strategy firm. He was previously a Director of the merchant bank Samuel Montagu and Co. He joined the Board in 2000.

**Andrew Roper**, Group Managing Director, aged 57, has worked for the Company since 1973. He is a qualified Chartered Accountant and has responsibility for the development of Group strategy and for operational performance and development. He was appointed to his present role in 1998.

**David Taylor**, Finance Director and Company Secretary, aged 46, has worked for the Group for 14 years. Following qualification as a Chartered Accountant with KPMG, he worked in a number of finance roles before joining Churchill in 1992. He was appointed to the Board in 1993.

**Rodney Kettel**, non executive Director, aged 62, was formerly a partner in PricewaterhouseCoopers, Chartered Accountants, Birmingham, and has extensive experience in advising listed companies. He joined the Board in 1999.

**David O'Connor**, Managing Director: Retail products, aged 49, has worked for Churchill for 15 years in a number of production, operations and marketing roles. He has extensive experience within the Ceramics industry and joined the Board in 1999.

**Ralph Grundy**, Managing Director: Hospitality products, aged 45, joined Churchill in 1998 and was appointed to the Board in 2000. He has worked in a number of senior sales and marketing roles, principally within the luxury and fast moving consumer goods sectors.

**Iain Trevenon Hicks**, Director: Iain has been employed by Churchill since 1992 and has been a member of the board of Churchill's main operating subsidiary, Churchill China (UK) Limited, since 2001. Iain has responsibility for Sourcing and Information Technology within the Group.

## CHAIRMAN'S FINANCIAL RESULT

In the year to 31 December 2006 Group sales were £47.8m (2005: £46.4m) and profit before exceptional items and taxation was £3.1m (2005: £2.6m). This increase continues the progress made in the second half of 2005. Profit after exceptional items but before taxation was £5.7m (2005: £2.8m).

Over the year the Group has generated strong operating cash flow of £5.7m (2005: £5.4m) before one off pension payments. This was achieved through a combination of improved profitability and disciplined working capital management, which led to a reduction in stock of £1.8m and consequent improvement in cash flow. There was little effect on overall cash balances from exceptional items as receipts from property disposals were matched by a one-off payment into the Group's defined benefit pension scheme. Nevertheless cash balances improved from £2.6m at the end of 2005 to a figure of £6.4m at 31 December 2006.

The results for the period include a number of exceptional items resulting in a net benefit to profit before taxation of £2.7m (2005: £0.3m). In January 2006 The Group disposed of the Alexander Pottery, Cobridge realising gross proceeds of the sale of £3.0m and an exceptional gain of £1.9m. Additionally, the cessation of future accrual to the Group's defined benefit pension scheme on 31 March 2006 led to a one off positive adjustment in relation to the curtailment of future benefits.

This amount of £1.1m (2005: nil) has been treated as exceptional given its size.

Conversely, the consolidation of activities from its Whieldon Road site has necessitated a reduction in the carrying value of certain plant and machinery at that location, a charge of £0.3m has been made against profits

The additional contributions made into the Group's defined benefit scheme and the cessation of future accrual have significantly reduced the Group's liability in respect of its net pension deficit to £2.8m (2005: £6.5m). The Board now believes that the pension deficit is at a manageable level which for the foreseeable future may be addressed without significant additional funding.

Adjusted earnings per share were 20.4p (2005: 17.6p). Basic earnings per share were 37.6p (2005: 24.7p).

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## SHAREHOLDINGS

| | Number | % |
|---|---|---|
| LandFinance Limited | 1,130,000 | 10.4 |
| S Baker | 1,020,000 | 9.4 |

| | Number | % |
|---|---|---|
| J A Roper | 1,020,000 | 9.4 |
| Michael J Roper | 920,370 | 8.4 |
| Discretionary Unit Trust | 500,000 | 4.6 |
| Henderson Global Investors | 440,000 | 4.1 |

## FINANCIAL HISTORY

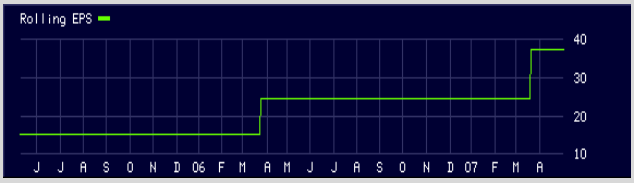
**Consolidated profit and loss account for the year ended 31 December 2006**

| £000 | Year to 31 December 2006 | Year to 31 December 2005 |
|---|---|---|
| Turnover | 47,757 | 46,399 |
| Operating profit | 3,561 | 2,696 |
| Share of operating profit of associate net of impairment | 5 | (21) |
| Profit on disposal of fixed asset | 1,876 | 269 |
| Net interest receivable and similar income / (expense) | 305 | (114) |
| Profit on ordinary activities before taxation | 5,747 | 2,830 |
| Tax on profit on ordinary activities | (1,659) | (152) |
| Profit on ordinary activities after taxation | 4,088 | 2,678 |
| Dividends | (1,217) | (1,194) |
| Retained profit for the year | 2,871 | 1,484 |
| Basic earnings per ordinary share | 37.6 | 24.7 |
| Diluted basic earnings per ordinary share | 37.5 | 24.6 |

**Consolidated balance sheet as at 31 December 2006**

| £000 | 31 December 2006 | 31 December 2005 |
|---|---|---|
| Fixed assets | 11,632 | 12,366 |
| Intangible Assets | 34 | 56 |
| Tangible assets | 10,779 | 11,485 |
| Investments | 819 | 825 |
| Current assets | 23,679 | 22,834 |
| Stocks | 6,857 | 8,646 |
| Debtors: amounts falling due within one year | 10,412 | 10,537 |
| Investments and other assets for sale | 0 | 1,022 |
| Cash at bank and in hand | 6,410 | 2,629 |
| Creditors: amount falling due within one year | (6,332) | (6,268) |
| Net current assets | 17,347 | 16,566 |
| Total assets less current liabilities | 28,979 | 28,932 |
| Creditors: amounts falling due after more than one year | 0 | (16) |
| Provisions for liabilities and charges | (60) | (6) |
| Pension liability | (2,764) | (6,464) |
| Net assets | 26,155 | 22,446 |
| Capital and reserves | | |
| Called up share capital | 1,090 | 1,086 |
| Share premium account | 2,266 | 2,207 |
| Revaluation reserve | 1,275 | 1,287 |
| Other reserves | 274 | 266 |
| Profit and loss account | 21,250 | 17,600 |
| Equity shareholders' funds | 26,155 | 22,446 |

## 2 YEARS ROLLING EPS




## 2 YEARS P/E RATIO


## OUTLOOK

The Board believes that demand for hospitality products in developed markets will continue to increase as leisure related spending continues to grow. There has been a significant expansion in eating out in the UK to the extent that there are now over 300,000 individual foodservice outlets covering a wide range of commercial and institutional activities. The Group intends to continue to expand its leading UK position whilst investing in the development of export markets. The opportunities overseas may be divided into markets where hospitality is

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well established, but the Group has not achieved a reasonable market share and developmental markets where demand for hospitality products is likely to grow as local or regional economies develop. It is therefore believed that there will be significant opportunities for further and sustained growth in the medium and long term. Demand for retail products has been subject to a number of pressures in recent years. Overall volume demand in the Group's principal markets has remained steady, however the monetary value of the markets has reduced as price points have fallen, mainly due to overseas competition and changes in the structure of retail distribution channels. It is believed that these pressures are unlikely to abate in the short term although a degree of price stability does appear to be emerging and is expected to continue.

## RISK FACTORS

In addition to the other relevant information, the following specific factors should be considered carefully when evaluating whether to make an investment in the Company. The investment offered in this document may not be suitable for all of its recipients. Before making an investment decision, prospective Investors should consult a person authorised under the Financial Services and Markets Act 2000 who specialises in advising on the acquisition of shares and other securities. A prospective Investor should consider carefully whether an investment in the Company is suitable for him/her in the light of his/her personal circumstances and the financial resources available to him/her. There are various risk and other factors associated with an investment of the type described in this document. In particular:

The value of an investment in the Company is largely dependent upon the expertise of the Directors and their ability to Identify and acquire or invest in suitable companies or businesses. There can be no certainty that the Company will be able to identify suitable acquisition targets or complete the purchase of any identified targets at a price the Directors consider acceptable. In the event of an aborted acquisition it is likely that resources may have been expended on investigative work and due diligence, which cannot be recovered.

The acquisition of other businesses can involve significant commercial and financial risks and there can be no certainty that any acquired business will not have a material adverse effect on the operations, results or financial position of the Company.

## CONTACT

Marlborough Pottery
High Street, Tunstall, Stoke-on-Trent
Staffordshire
ST6 5NZ
United Kingdom

## RANKING

| | Ranking out of 50 (50 being highest) |
|---|---|
| **Business model - competitive advantage** | |
| Competition | 37 |
| Customers | 39 |
| Low cost | 40 |
| Management | |
| - corporate governance | 37 |
| - quality | 36 |
| - shareholding | 39 |
| Product | 39 |
| Sector | 37 |
| **Financial evaluation** | |
| Early and profitable exit potential | 36 |
| Financial strength | |
| - cash flow | 38 |
| - conservative accounting | |
| - need for funding | |
| Growth at a reasonable price | 40 |
| Risk | 38 |
| | |
| **Overall average rating** | **38** |

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## FURTHER INFORMATION ABOUT THE RANKING

**Competitive advantage**
Companies are assessed according to their business model and how this translates into strong and sustainable competitive advantage. This can only be achieved with low cost activities and doing something different from the competition. This 'differentiation' must add value to the customer who is then prepared to pay a premium price. The differentiation is most obvious in the product but it can exist anywhere in the company's value chain of activities, such as easy payment terms, convenient locations, superior management, and quality of suppliers. Companies that do not achieve competitive advantage because they have the same costs and/or do the same as the competition are marooned in a profitless zone. They helplessly try to compete with the one weapon left open to them, which is the disaster of cutting prices and typically leads to similar retaliation by competitors, with disastrous results.

## THE FOLLOWING ELABORATES ON THE RANKING CRITERIA

**Competition**
How intense is the competition and are there barriers to entry?

**Customers**
Is the company controlling its customers and therefore its revenue streams? Are customers glued to the company and providing valuable and reliable recurring revenue or are they one-off, or 'transactional', providing shaky revenue? The company should ideally have weak and numerous customers.

**Low costs**
Has the company achieved low cost activities thus allowing more of the top line revenue to trickle down to the profit line?

**Management**
Is there good corporate governance? What is the quality of management, as this is crucial to any business? Are the directors' shareholdings significant but not so large that they control the company?

**Product**
Is the product different from the competition and adds value to the customer? Are there threatening substitutes? Does it have a powerful brand?

**Sector**
Is the company in an attractive sector that is profitable and adds value? Services tend to be more protected than products from international competition. Does the sector ride the tailwind of multi-year mega trends? Is the business well positioned in the current stage of the economic cycle? What is its resistance to a recession?

**Profitable exit potential**
What is the potential for selling the share profitably? This is more applicable to pre-flotation investments.

**Financial strength**
Does the company have strong cash flow, the lifeblood of any business? Is the accounting conservative or is there 'accounting for growth'? Does it need more funding? Is the profit margin healthy and at least equal to its sector? What has been the track record in the growth rate of profits?

**Growth at a reasonable price**
Does the share offer growth at a reasonable price? This is commonly measured using the PEG. This is the price earnings ratio (PE) divided by the forecast growth rate in earnings per share (EPS). The lower the PEG the better and under 1.0 is considered good for a blue chip company and under 0.6 for a small growth company.

**Risk**
What is the risk rating of the share due to factors such as new markets, its business model and strategies?