Lifetime Brands Investment Report

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Search Process

Lifetime Brands ("Lifetime") meets three of four criteria for a possibly undervalued stock. While the company's P/B of 1.23x marginally exceeds the threshold (1.2x), its P/E of 6.73x is below the 13x threshold. Its market cap of $257.78-million is below the $1.2-billion US company threshold, and its small size suggests minimal analyst coverage. There is no indication of financial distress, or company problems such as lawsuits, meaning the company is likely undervalued due to its obscurity, rather than its undesirability.

Industry and Company Analysis

Lifetime is an American company that designs, manufactures, and sells kitchenware, tableware, and other home products. They recently acquired Filament Brands ("Filament") for $293.3-million, taking on significant debt to do so. This transaction brought on Filament CEO Robert Kay as Lifetime's new CEO. It also added new brands, new product categories, and new commercial clients to Lifetime's business.

Lifetime has medium business risk. These products are mainstream household every-day use goods found in all households, indicating medium risk. However, industry earnings are tied to the housing market, and many products are discretionary purchases. This raises earnings volatility. Certain company characteristics mitigate these risks. Lifetime competes in the lower end of the market; this affordability reduces business risk. Furthermore, 25% of Lifetime's sales are attributed to brick-and-mortar retailers (i.e. Costco and Walmart) who have competitive advantages against other retailers in an e-commerce era.

Lifetime's adjusted debt/capital ratio 52.8% is higher than the optimal range of 30-49%. This indicates high financial risk, and an intuitive debt rating between BBB-B. Our analysis of key credit ratios indicates a BB rating. Management has also targeted to be under 3.0x debt/EBITDA in two years. This intention to pay down debt regularly will likely move capital structure back into the optimal range.

Accordingly, cost of debt (Kd) was 5.3%, ERP was 5.9%, cost of equity (Ks) was 11.2%, and WACC was found to be 7.3%. These conclusions led us to a WACC of 7.3%. The average first pass ROIC (using both methods) was found to be 6.61%; as ROIC exceeds WACC, it is predicted that EPV will exceed NAV.

Valuation

The NAV price per share is $23.38 was calculated. Key drivers were operating leases, PPE, the Filament Acquisition, and Customer Relations. The Filament acquisition price was added to the NAV; Filament was formerly private and no public information was available. Our calculated value of customer relations was subtracted from Lifetime's Intangible Assets, as this had already capitalized relationships. As Lifetime's SG&A was not publicly segmented, we used competitors average R&D/Sales ratio (0.42%) as a proxy, with a 1.25x and 10 year multiplier.

An EPV per share price of $9.43 was calculated driven by stable 9-year EBIT margins of 4.9%. With the exception of 2008, the company's margins were very stable, and as a result we decided to remove 2008 margins from our average. One-time adjustments occurring 9/10 years were included to penalize the company, with the exception of merger related expenses. To reflect changes due to the Filament merger, incremental analyst forecasts on EBITDA figures were used, removing any cost synergies incurred to remain conservative. D&A was assumed to be the same percentage of sales (2.4%) for the merged company. Zero-growth capex was calculated using 2015-2016 as a proxy given the shrinking in sales in 2016-2017. Zero-growth Capex and D&A were assumed to be equal as it made up 1/2 of the D&A expense. Our NAV is greater than EPV, which is in line with our initial assumption. Furthermore, Second pass ROIC (4.74%), is also less than WACC (7.31%), aligning with the fact that NAV exceeds EPV.

Catalyst Discussion

We concluded the probability of realizing the catalyst to be 70%, with the issue lying mainly in excess capacity. Interviews and personal email exchanges with the Chairman showed management has a strong understanding of shifting channel dynamics and the importance of e-commerce. Their focus is on paying down debt as opposed to acquisitions; this will allow CEO Robert Kay to focus on integrating the newly acquired Filament business. Kay has a history of successful integrations while serving as CEO of Filament, adding many new brands to their business with strong and growing margins.

The company does not have a competitive disadvantage. They have kept up with changing channel dynamics, strategically focusing on e-commerce while also having secured their largest retailer contract ever in 2018.

Excess capacity is the biggest issue for the company. Having completed such a big acquisition, the company has almost doubled its size. No financial statements have been released post-acquisition, so it's difficult to evaluate how quickly redundant assets will be eliminated. However, management has quoted the company's supply chain infrastructure can support a $2-billion company. Accordingly, it is reasonable to expect that Lifetime will reduce redundancies between the two companies and realize economies of scale to produce a larger portfolio of products. New management has strong experience in this industry and has acknowledged their new asset base and indicated their plans to improve their ability to capitalize on these assets.

Recommendation

After combining both our intrinsic value ($19.20) with our margin of safety (33%), an entry price of $12.80 was determined. With a market price of $12.55, we recommend buying this company.