

10th January 2024

Strong sales growth momentum remains in place

Marks Electrical Group's sales growth remained strong at 17.8% in FY2024 Q3, and the company appears on track to match our full year expectations of an 18.7% increase following a strong 21.5% advance in the previous year. However, the challenging trading environment is expected to impact gross margins negatively. As a result, we cut our FY2024 EBITDA forecast from £8.0m to £5.0m and reduce our fair value for the shares from 150p to 100p.

The long term growth story based on market share and service levels arguably remains intact.

After 22.0% growth in the first 9 months of FY2024, the company only has to achieve 9% growth in Q4 to match our forecasts, which appears very doable. In the first 9 months of the year there were share gains in both its Major Domestic Appliances and Consumer Electronics markets.

But as a company with a core strength in premium products, MRK's gross margins have come under pressure.

Customers' buying patterns have been negatively impacted by the challenging trading environment, which resulted in some demand shift towards lower price point brands. In addition to our FY2024 EBITDA forecast cut (from £8.0m to £5.0m), we reduce FY2025 expectations from £10.0m to £7.0m. These changes are both driven by gross margin. MRK retains tight control of overheads and plans to keep advertising stable at 5.0% of sales revenue.

MRK's service levels remain central to the business's offering and ability to grow market share without recourse to discounting.

The company achieved record volumes in the first nine months of FY2024 and maintained its industry-leading 4.8 Trustpilot score. MRK has now reached over 60,000 reviews with 95% of them being either 4 or 5 Star. Execution of delivery & installation services "in-house" remains central to the offer and brand perception, notably during the peak trading period.

A reduction in profit expectations is clearly disappointing.

That said, investors in our view should appreciate the core qualities of the MRK investment case. In particular, there is significant geographic headroom within the UK for further online market share growth from its current 5% level. Moreover, the business model is structured to be not only profitable but also on an underlying basis be cash generative, which has positive implications for the dividend outlook.

Fair value remains above current share price

Today's caution on FY2024 and FY2025 profits prompts us to reduce our estimated fair value for MRK's share from 150p to 100p. We base this revised fair value on 0.8x and 19.0x FY2024 EV/sales and EV/EBITDA respectively. Our DCF analysis supports this valuation.

Company Data	
EPIC	MRK
Price (last close)	92p
52 weeks Hi/Lo	110p/78p
Market cap	£96m
ED Fair Value/share	100p

Share Price, p



Source: ADVFN

Description

Marks Electrical Group PLC (MRK) is a fast growing online electrical goods retailer, which was founded by its current CEO Mark Smithson in 1987. MRK focuses on premium branded Major Domestic Appliances, which it can deliver with its in-house wholly owned fleet of vehicles to more than 99% of the English population on a next day basis.

The company operates from a single site in Leicester, which also houses its headquarters.

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Key Financials

Year to 31st March	2020A	2021A	2022A	2023A	2024E	2025E
Revenue (£m)	31.5	56.0	80.5	97.8	116.0	130.0
Revenue growth	0.8%	77.7%	43.8%	21.5%	18.7%	12.0%
EBITDA (£m) (adj)	1.3	7.7	7.2	7.5	5.0	7.0
EPS diluted (adj) (p)	0.66	5.05	5.01	4.82	2.59	3.80
DPS (p)			0.67	0.96	1.04	1.14
EV/sales (x)	2.7	1.5	1.1	0.9	0.7	0.7
EV/EBITDA (x)	67.6	11.2	11.9	11.5	17.3	12.4
P/E ratio (x)	139.9	18.2	18.4	19.1	35.6	24.2
Yield			0.7%	1.0%	1.1%	1.2%

Source: ED estimates, company historic data

Strong sales growth momentum remains in place

Today's trading statement from Marks Electrical prompts us to retain our sales forecasts for FY2024 and FY2025, but reduce our profits expectations for both years and our estimated fair value for the shares. We look at forecasts first before covering valuation in a separate section.

Changes to forecasts

Our changes to forecasts are summarised in Figure 1. Our sales revenue expectations for FY2024 and FY2025 remain intact. **It should be noted that in the first 9 months of FY2024 sales grew by 22.0%.** While the rate decelerated to 17.8% in Q3, the implied final quarter growth rate to match our forecasts in the Jan-Mar 2024 period would be a much slower 8.8%.

Weaker gross margins explain the changes to our EBITDA forecasts, which have been reduced materially. We cut our FY2024 EBITDA forecast from £8.0m to £5.0m and FY2025 expectations from £10.0m to £7.0m. Overheads are expected to continue to be managed conservatively and remain between 5.0% and 6.0% of sales revenue. FY2024 gross margin estimates are reduced from 18.0% to 15.4%, with an FY2025 cut from 18.2% to 15.9%.

Importantly, the company will sustain reinvestment of sales revenue into the business's awareness profile through advertising and marketing at 5.0%. It has no plans to take short term measures to enhance profitability which might be expected to undermine franchise and shareholder value.

Figure 1 - Changes to forecasts

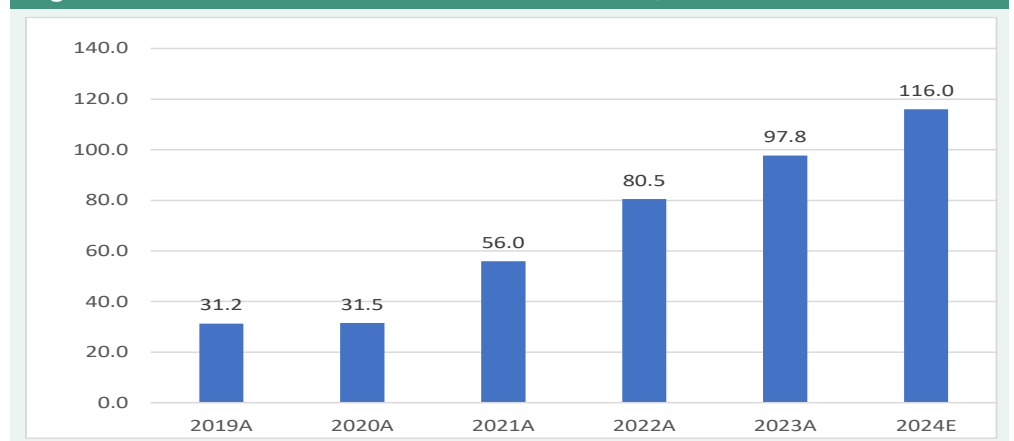
All figures in £m	FY2024			FY2025		
	Old	New	Change	Old	New	Change
Sales revenue	116.0	116.0	0.0%	130.0	130.0	0.0%
EBITDA – adjusted	8.0	5.0	-37.5%	10.0	7.0	-29.9%

Source: ED estimates

Long term sales growth story

MRK's sales growth track record is impressive. The company's expected ability to nearly quadruple sales between FY2019 and FY2024E is summarised in Figure 2. This progression reflects a focus on premium brands, raised awareness levels for the Marks Electrical brand itself and a consistent focus on providing best-in-class service. MRK still enjoys significant market share expansion headroom.

Figure 2 – MRK sales revenue FY2019 to FY2024E, £m



Source: Company data and ED estimates

Valuation & financials

Relative valuation

The central investment case for Marks Electrical remains profitable market share driven growth, which should generate underlying increases in both free cash flow and dividends for shareholders.

In our view these qualities, not all of which are shared by its peer group, should be reflected in how the company is valued irrespective of near-term gross margin volatility.

Our relative valuation in Figures 3 and 4 assesses Marks Electrical against peer groups of MDA and CE providers and online retail businesses respectively. We reduce our fair value from 150p to 100p, which implies FY2024 EV/sales of 0.8x and 19.0x FY2024 EV/EBITDA based on our unchanged sales and downwardly revised profit forecasts. Note that the 0.8x EV/sales implication of this 100p fair value is a marked reduction from our previous 1.3x assumed EV/sales fair value.

Figure 3 - Relative valuation - online MDA providers

	Share price (p)	Mkt cap (£m)	Net debt (£m)	EV (£m)	Sales 2024 (£m)	EV/ sales (x)	EBITDA 2024 (£m)	EV/ EBITDA (x)	EPS 2024 (p)	P/E (x)	DPS 2024 (p)	Yield
AO World (AO)	92	512	55	567	1036	0.5	58.0	9.8	3.8	23.9	n/a	n/a
Currys (CURY)	49	538	1270	1808	9004	0.2	530.0	3.4	7.1	6.9	1.5	3.1%
Marks Electrical (MRK)	92	96	-8	88	116	0.8	5.0	17.6	2.6	35.4	1.0	1.1%
Average						0.5		10.3		23.1		2.1%

Source: ADVFN, MarketScreener, Stockopedia and Equity Development estimates

Figure 4 - Relative valuation - online consumer goods providers

	Share price (pence)	Mkt cap (£m)	Net debt (£m)	EV (£m)	Sales 2024 (£m)	EV/ Sales (x)	EBITDA 2024 (£m)	EV/ EBITDA (x)	EPS 2024 (p)	P/E (x)	DPS 2024 (p)	Yield
ASOS (ASC)	388	408	649	1057	3227	0.3	117	9.0	-55.8	n/a	n/a	n/a
B&M (BME)	559	5616	2002	7618	5401	1.4	867	8.8	37.3	15.0	22.5	4.0%
Boohoo (BOO)	35	430	162	592	1535	0.4	62	9.6	-1.7	n/a	n/a	n/a
Dunelm (DNLM)	1076	2183	288	2471	1723	1.4	290	8.5	74.3	14.5	62.9	5.8%
Marks Electrical (MRK)	92	96	-8	88	116	0.8	5.0	17.6	2.6	35.4	1.0	1.1%
Next (NXT)	8426	10449	1669	12118	5440	2.2	1167	10.4	564.0	14.9	208	2.5%
Ocado (OCDO)	709	5514	899	6413	2752	2.4	306	n/a	-44.8	n/a	n/a	n/a
Pets at Home (PETS)	309	1537	362	1919	1488	1.3	257	7.5	21.2	14.6	12.8	4.2%
Average						1.3		10.2		18.9		3.5%

Source: ADVFN, MarketScreener, Stockopedia and Equity Development estimates

DCF valuation

We include a DCF valuation for Marks Electrical in Figure 5, which gives a valuation message in line with our downwardly reduced 100p fair value – i.e. an intrinsic value per share which is above the current share price.

The discounted free cash flow calculation in the table is based on unlevered free cash flow. It excludes any finance costs because these are captured in the group's net cash position. The net debt figure is based on end FY2024 H1.

We use a standard 8.5% discount or hurdle rate as a proxy for the company's weighted average cost of capital (WACC). The terminal growth rate is 2.0%, which reflects a long-term GDP growth trajectory for the UK economy.

Figure 5 - MRK DCF calculation

Y/E 31 Mar (£'000s)	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	2033F
Free cash flow (unlevered)	-976	4,953	7,222	8,796	10,590	10,802	11,018	11,238	11,463	11,692
Discount rate used (%)	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%
Timing factor	0.25	1.25	2.25	3.25	4.25	5.25	6.25	7.25	8.25	9.25
Discount factor	0.98	0.90	0.83	0.77	0.71	0.65	0.60	0.55	0.51	0.47
Present value	-956	4,473	6,011	6,748	7,487	7,039	6,617	6,221	5,848	5,498
Sum of discounted cash flows	54,985									
Terminal growth rate (%)	2.0%									
Terminal value	91,769									
Net debt/cash if positive	-7,945									
Equity value	138,809									
No. of shares (m)	104.9									
Value per share (pence)	132									

Source: Equity Development

Financial forecasts

Our revised income statement forecasts appear in Figure 6. We also reduce our net cash assumption from £12m at end FY2024 to £8m, which is reflected in a lower level of finance income.

As mentioned earlier, we reduce our gross margin forecast in FY2024 from 18.0% to 15.4% with an FY2025 cut from 18.2% to 15.9%.

Importantly, Figure 7 and Figure 8 demonstrate the underlying financial health and cash generation qualities of Marks Electrical Group.

The central medium- and longer- term messages are sustained double-digit sales revenue growth without recourse to discounting, high returns on capital employed and strong cash conversion.

Figure 6 – Income statement

Figure 6 - Income statement

31st March year-end	2021A	2022A	2023A	2024E	2025E
All figures in £'000s					
Revenue	55,984	80,478	97,754	116,048	129,963
Increase (%)	77.7%	43.8%	21.5%	18.7%	12.0%
Cost of sales	-44,064	-64,583	-78,792	-98,146	-109,310
Gross profit	11,920	15,895	18,962	17,902	20,653
Gross margin (%)	21.3%	19.8%	19.4%	15.4%	15.9%
Other operating income	165				
Advertising & marketing	-1,641	-4,004	-4,906	-5,802	-6,498
Other operating expenses (exc depn)	-2,580	-4,644	-6,507	-7,100	-7,150
Total operating expenses	-4,221	-8,648	-11,413	-12,902	-13,648
As % sales revenue					
Advertising & marketing	-2.9%	-5.0%	-5.0%	-5.0%	-5.0%
Other operating expenses	-4.6%	-5.8%	-6.7%	-6.1%	-5.5%
Total operating expenses	-7.5%	-10.7%	-11.7%	-11.1%	-10.5%
EBITDA (adjusted)	7,699	7,247	7,549	5,000	7,005
EBITDA margin adj. (%)	13.8%	9.0%	7.7%	4.3%	5.4%
Depreciation & amortisation	-875	-861	-1,307	-1,640	-1,837
Operating profit (adjusted)	6,824	6,386	6,242	3,360	5,168
Operating margin adj (%)	12.2%	7.9%	6.4%	2.9%	4.0%
Net income (adjusted)	5,296	5,255	5,067	2,718	3,989
EPS (adjusted) (pence)	5.05	5.01	4.83	2.59	3.80
EPS (adjusted) (pence) - fully diluted	5.05	5.01	4.82	2.59	3.80
DPS (pence)		0.67	0.96	1.04	1.14

Source: Company historic data and Equity Development estimates

Figure 7 - Balance sheet

31st March year-end	2021A	2022A	2023A
All figures in £'000s			
Assets			
Investments	1,146	1,293	1,716
Property, plant & equipment	5,623	841	1,559
Right-of-use assets	779	2,328	1,418
Total non-current assets	7,548	4,462	4,693
Inventories	11,432	14,389	14,200
Trade and other receivables	2,839	2,627	3,982
Cash and cash equivalents	1,493	3,872	9,972
Total current assets	15,764	20,888	28,154
Total assets	23,312	25,350	32,847
Liabilities			
Trade and other payables	8,303	13,067	16,545
Corporation tax liabilities	1,557	145	302
Borrowings	233		
Lease liabilities	330	938	921
Total current liabilities	10,423	14,150	17,768
Other payables	17		
Borrowings	1,304		
Lease liabilities	422	1,324	473
Deferred tax liabilities	618	466	782
Provisions for liabilities	155		
Total non-current liabilities	2,516	1,790	1,255
Total liabilities	12,939	15,940	19,023
Issued capital and reserves			
Share capital	100,000	1,049	1,049
Share premium account		4,694	4,694
Treasury shares		-4	-4
Merger reserve	-99,994	-100,000	-100,000
Revaluation reserve	1,235	0	0
Retained earnings	9,132	103,671	108,085
Total equity	10,373	9,410	13,824
Total liabilities and equity	23,312	25,350	32,847

Source: Company historic data

Figure 8 - Free cash flow

31st March year-end	2021A	2022A	2023A	2024E
All figures in £'000s				
Cash from operating activities	7,747	4,416	7,548	5,080
Changes in operating assets and liabilities				
Inventories	-7,110	-2,957	189	-3,654
Receivables	-1,197	212	-1,345	-2,745
Payables	3,513	4,926	3,461	3,096
Cash from operations	2,953	6,598	9,853	1,778
Corporation tax paid	-66	-2,042	-784	-722
Net cash from operating activities	2,887	4,556	9,069	1,055
Cash flows from investing activities				
Property, plant & equipment - purchases	-216	-583	-1,049	-2,031
Deposits on right of use assets		-304		
Property, plant & equipment - disposals	26	65		
Income from investments		48		
Net cash from investing activities	-190	-774	-918	-2,031
Dividends received				
Issue of ordinary share capital		4,740		
Repayment of borrowings	-227	-1,537		
Interest paid	-42	-11		
Interest paid on lease liabilities	-28	-54	-67	
Principal repayment of lease liabilities	-312	-657	-967	
Net cash from finance activities exec dividends	-609	2,481	-1,034	
Free cash flow before dividends on shares	2,088	6,263	7,117	-976
Dividends paid		-3,884	-1,017	-1,051
Free cash flow after dividends	2,088	2,379	6,100	-2,027

Source: Company historic data and Equity Development estimates

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