Marks Electrical Group

Service uplift sparks 25% sales growth

12th October 2023

Marks Electrical Group's sales revenue advanced by 24.8% in the first half of its 2024 financial year, according to a trading update released today, as the company made further market share gains in its core categories. An improved service offering, which now includes integrated installation services, made a notable impact: not only in a strong sales growth rate, but also a best-in-class 4.8 Trustpilot score. Given MRK's strong cash position and clearly articulated strategy for sustainable business expansion, we maintain our 150p fair value for the shares.

MRK's 24.8% first half sales growth compares with 27.0% achieved in HY2023 H2 and evidences a consistent ability to gain market share and rapidly grow sales through its premium offering and service quality. Notably strong advances by category included +71% for televisions, +74% for washer-dryers and +36% for American fridge-freezers. These gains were achieved against relatively flat domestic markets for both Major Domestic Appliances (MDAs) and Consumer Electronics (CEs).

Importantly, MRK's sales growth appears to be reaping sustained benefits from incremental service levels, as highlighted in our FY2023 results report (Built in installations enhance growth outlook,14th June 2023). The company made **a strategic decision to add integrated, gas, electric and television installation services** – which is arguably a premium offering – to its next day delivery service. This move has paid off as these orders rose to 7,000, from 2,500 a year earlier.

Due to first half sales growth strength, we have revised upwards our sales forecast for FY2024 from £114.5m to £116.0m. However, we reduce our EBITDA forecast from £8.9m to £8.0m as well as making downward adjustments to FY2025. Margins are expected to contract as a result of order growth being faster than revenue, higher driver wages and the integrated installation service addition. Importantly, the company is not willing to make reductions in marketing spend to offset these items. Rather, it continues to invest in brand recognition with a view to sustainable growth.

Significant upside to our 150p fair value

Marks Electrical aims to deliver superior service quality and increase brand recognition. As a business, it is taking advantage of the sizeable market headroom it enjoys from a currently less than 3% share of MDAs and a smaller portion of CEs. Consistent revenue growth above 20% since IPO, with 19% expected in FY2024, merit a higher rating in our view.

We base our long-held 150p/share fair value on 1.3x and 18.1x FY2024 EV/sales and EV/EBITDA respectively, a valuation backed up by a DCF calculation.

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**	**8.0**	**10.0**
EPS diluted (adj) (p)	0.66	5.05	5.01	4.82	4.48	5.94
DPS (p)			0.67	0.96	0.90	1.19
EV/sales (x)	**3.2**	**1.8**	**1.3**	**1.0**	**0.9**	**0.8**
EV/EBITDA (x)	79.1	13.1	14.0	13.4	12.7	10.1
P/E ratio (x)	**164.4**	**21.4**	**21.6**	**22.4**	**24.1**	**18.2**
Yield			0.6%	0.9%	0.8%	1.1%

Source: ED estimates, company historic data

Company Data

EPIC	MRK
Price (last close)	108p
52 weeks Hi/Lo	110p/55p
Market cap	£113m
ED Fair Value/share	150p

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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Trading statement highlights

Marks Electrical grew sales by 24.8% in the first half of FY2024 with robust performances in both Major Domestic Appliances (MDA) and Consumer Electronics (CE). Importantly, this growth rate was achieved against markets which were broadly flat in the trading period – i.e. the growth was driven by the company making further market share gains.

In our view, continuous market share gains remain central to the sales growth case for Marks Electrical as the company benefits from not only investing in its brand awareness through advertising, but also by extending its service offering. At end FY2023, Marks Electrical's market share in MDA was 2.5% and in CE was 0.3% (with higher shares of online) despite overall brand awareness having risen to 15% from 7% a year earlier.

Hence, there is significant headroom for market share driven growth, and scope for a fast pace of expansion as market share begins to mirror gains in brand awareness.

.Figure 1 - Pre close trading update - key figures

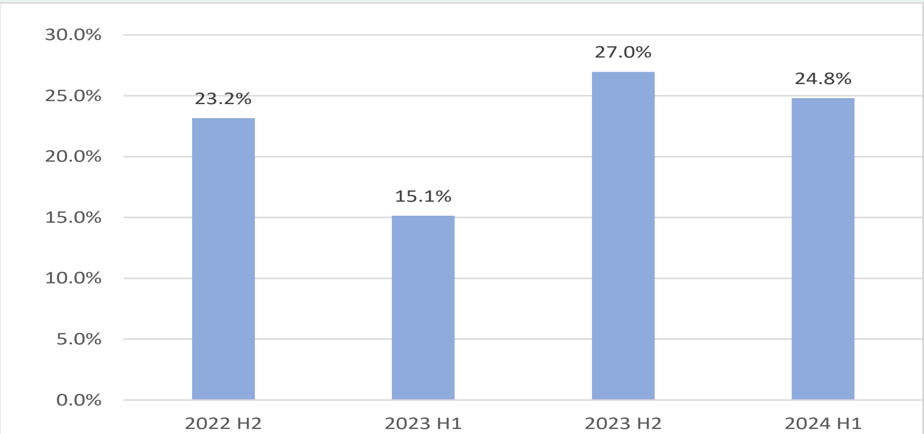
All currency figures in £m	FY2023 H1	FY2024 H1	change
Sales revenue	£43.1	£53.9	+24.8%
Integrated installation orders	2,500	7,000	+180%
Freestanding installation orders	5,000	11,000	+120%
Trustpilot score	4.8pts	4.8pts	unchanged
Net cash position	£7.7	£10.9	+£3.2

Source: Company data

We summarise today's trading statement highlights in Figure 1, which include data not only for sales revenue itself but also the important numbers for installation orders and the company's net cash position.

MRK's consistent and sustained double-digit sales momentum in recent half yearly periods is summarised in Figure 2. The £43.1m sales achieved in FY2024 H1 represents a compound growth rate of 38.4% since FY2021 H1, which was the last reporting period ahead of the company's November 2021 IPO.

Figure 2 – MRK half yearly sales growth rates YOY (%)



Source: Company data

MRK's £10.9m net cash position represents a pleasing improvement on both end-FY2023 and last year's interim statement when the corresponding balances were £10.0m and £7.7m respectively.

It is important to note that a combination of tight working capital management and implementation of strict cost controls are central to the company's ability to generate positive cash flow for shareholders.

In FY2023 the company reduced its inventory/sales ratio to 14.5% from 17.9% in FY2022, which was itself a reduction from 20.4% in FY2021. As a result, MRK is not only in a strong position to fund further business expansion – e.g. the investment of £1.2m in FY2024 H1 in its vehicle fleet and distribution centre – but also to pay dividends to shareholders.

Superior service generation – integrated installation services

The major uplift to service quality in FY2023 was the introduction of a built-in installations service, whereby the company can install MDAs into fully fitted areas of customers' residences.

As mentioned on the front page of this report, the nature and importance of this service were commented on in detail in our 14th June 2023 publication: Built in installations enhance growth outlook.

The service offered is a premium one and available on a next-day basis. It covers all of integrated, gas, electrical and television installation services and is thus appropriate for fully fitted areas of customers' dwellings, notably kitchens and living areas which house electrical appliances.

For example, installation of a new major domestic appliance into a fully-fitted kitchen can be done on a next day basis with similar potential for a wall-mounted large screen television.

The data in today's trading update confirms the positive impact on MRK's decision to invest both time and financial resources into this service expansion, and that it made good economic sense. Not only has the company clearly gained market share against a flat market, but has also seen significant growth from 2,500 to 7,000 in these kinds of orders within 12 months.

By taking the service fully in-house, rather than outsourcing such installations, Marks Electrical is able to increase the reliability of the service and make it **next day** - rather than with waiting times of up to four weeks, which occurred under the previous operating regime. Moreover, MRK captures the entire value chain – a clear positive move for shareholders.

In addition, there has been an observable tendency for the company's customers to trade up to more premium products when purchasing appliances and goods via the next-day integrated installation service. Such higher price point items include gas range cookers, more upmarket integrated MDAs and premium brands of large televisions.

Superior service confirmation – excellent 4.8 Trustpilot score

An improved and superior service offering is reflected in MRK's best-in-class Trustpilot score of 4.8 points. The score continues to outperform that of its principal competitors. **This comparison is shown in Figure 3**. Importantly, the commercial competitors highlighted include the listed companies AO World and Curry's which we use in our relative valuation in Figure 5.

Given the relationship between service quality – i.e. Trustpilot rating – and the potential to grow sales revenue sustainably through market share gains in the near term, there is a strong argument that a higher Trustpilot rating should be reflected to some extent in a superior share price valuation.

Figure 3 - Peer Trustpilot scores

Company	Website	Trustpilot rating
Marks Electrical	www.markselectrical.co.uk	4.8
AO	www.ao.com	4.6
John Lewis	www.johnlewis.com	4.0
Currys	www.currys.co.uk	3.7

Sources: uk.trustpilot.com

Changes to forecasts

We include changes to our full year FY2024 forecasts in Figure 4. While FY2024 represents an upgrade to our sales forecast, it should be noted that to achieve this number discrete FY2024 H2 sales growth would have to be around 14%, which would be a marked slowdown from the 24.8% pace achieved in the first half.

Our reduction to EBITDA reflects pressure on margins from three sources. First, order growth was faster than revenue growth. Second, the company decided in view of higher living costs to pay its drivers a 10% wage increase. Third, there was incremental expenditure associated with the strategic decision (clearly a successful one in terms of growth) to implement its fully integrated installation service offering.

In the following year, we have trimmed FY2025 sales from £137m to £130m and EBITDA from £12m to £10m. However, both would represent double-digit advances on our expected FY2024 outcomes – to the tune of 12% and 20% respectively.

Figure 4 - Changes to FY2024 forecasts

£'000s	Old	New
Sales revenue	114.525	116,048
EBITDA – adjusted	8,933	8,000
EBITDA margin	7.8%	6.9%

Source: Equity Development estimates

Investment case

The central investment case for Marks Electrical's shares remains firmly in place. The company is well invested to meet demand growth in its business both financially and operationally, as well as enjoying significant scope to generate this demand growth through increased brand awareness.

Operational highlights include strong service levels, with a best-in-class 4.8 TrustPilot rating, tight management of working capital - which delivers significant free cash flow benefits - and consistent market share gains through increased awareness.

The company's financial strength remains particularly important as evidenced by its ability to fund a strategic expansion to its service offering such as integrated installation services as well as rewarding shareholders with higher dividends.

Valuation & financials

Relative valuation

Our relative valuation in Figures 5 and 6 assesses Marks Electrical against peer groups of MDA and CE providers and online retail businesses respectively. **We maintain our fair value at 150p**, which implies FY2024 EV/sales of 1.3x and 18.1x FY2024 EV/EBITDA based on our revised forecasts.

While MRK trades at a premium to both AO World and Currys – both of which have inferior Trustpilot ratings – when using EV/sales and EV/EBITDA, it is worth noting that relative to other listed online providers the shares trade at a discount on EV/sales.

Moreover, in contrast to some members of both groups, MRK currently pays a dividend and has the cash flow credentials to expand that pay-out in due course. Free cash flow before dividends was around 7 times the actual dividend pay-out in FY2023.

Figure 5 - 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)	85	466	76	542	1120	0.5	57.3	9.5	3.9	21.9	n/a	n/a
Currys (CURY)	48	529	1360	1889	9090	0.2	526.0	3.6	7.0	6.8	2.1	4.5%
Marks Electrical (MRK)	**108**	**113**	**-12**	**101**	**116**	**0.9**	**8.0**	**12.7**	**4.5**	**24.1**	**0.9**	**0.8%**
Average						0.5		8.5		18.7		2.6%

Source: ADVFN, MarketScreener, Stockopedia and Equity Development estimates

Figure 6 - 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)	393	393	778	1171	3561	0.3	120	9.8	-67.3	Nmf	n/a	n/a
B&M (BME)	571	5727	2018	7745	5403	1.4	863	9.0	37.5	15.2	21.5	3.8%
Boohoo (BOO)	30	368	162	530	1577	0.3	64	8.3	-1.7	Nmf	n/a	n/a
Dunelm (DNLM)	1047	2125	288	2413	1725	1.4	291	8.3	74.5	14.1	63.7	6.1%
Marks Electrical (MRK)	**108**	**113**	**-12**	**101**	**116**	**0.9**	**8.0**	**12.7**	**4.5**	**24.1**	**0.9**	**0.8%**
Next (NXT)	6888	8541	1669	10210	5344	1.9	1140	9.0	544.0	12.7	206	3.0%
Ocado (OCDO)	588	4572	899	5471	2765	1.8	53	Nmf	-45.1	Nmf	n/a	n/a
Pets at Home (PETS)	322	1604	362	1966	1491	1.3	265	7.4	21.0	21.2	12.8	4.0%
Average						1.2		9.2		17.4		3.5%

Source: ADVFN, MarketScreener, Stockopedia and Equity Development estimates

DCF valuation

We include a DCF valuation for Marks Electrical in Figure 7, which gives a valuation message consistent with our 150p fair value – i.e., an intrinsic value per share which is well 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.

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 is consistent with a long-term GDP growth trajectory for the UK economy.

Figure 7 - MRK DCF calculation

31st March year-end										
All figures in £'000s										
	2024F	**2025F**	**2026F**	**2027F**	**2028F**	**2029F**	**2030F**	**2031F**	**2032F**	**2033F**
Free cash flow (unlevered)	3,238	5,449	7,259	8,839	10,639	10,852	11,069	11,290	11,516	11,746
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	0.60	1.60	2.60	3.60	4.60	5.60	6.60	7.60	8.60	9.60
Discount factor	0.95	0.88	0.81	0.75	0.69	0.63	0.58	0.54	0.50	0.46
Present value	3,083	4,782	5,872	6,589	7,310	6,872	6,460	6,073	5,710	5,367
Sum of discounted cash flows	58,119									
Terminal growth rate (%)	2.0%									
Terminal value	89,595									
Net debt/cash if positive	9,972									
Equity value	**157,686**									
No. of shares (m)	104.9									
Value per share (pence)	**150**									

Source: Equity Development estimates

Financial forecasts

Our financial forecasts include the changes referred to above – i.e. an uplift to FY2024 sales and reduction in the estimate for FY2025. We reduce our EBITDA forecasts for both years to reflect the margin issues discussed on page 4 or this report.

Key features of our current forecasts include a high-teens pace of sales growth in FY2024, gross margins of 18.0% compared with 19.0% previously, and sustained reinvestment in advertising and marketing to the tune of 5.0%.

Note that higher distribution and installation costs can have a negative impact on gross margins while gross product margin – i.e. mark-up – remains the same.

But the overall message of Marks Electrical having high turnover in relation to working capital, and thus being cash generative, remains in place. As a result, we are confident that the company can sustainably fund expansion while paying dividends to shareholders.

Our forecasts for income statement, balance sheet and free cash flow appear in Figures 8, 9, and 10.

The central messages are sustained meaningful sales revenue growth, high returns on capital employed and strong cash conversion.

Figure 8 - Income statement

31st March year-end All figures in £'000s	**2021A**	**2022A**	**2023A**	**2024E**	**2025E**
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	-95,146	-106,310
Gross profit	11,920	15,895	18,962	20,902	23,653
Gross margin	21.3%	19.8%	19.4%	18.0%	18.2%
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**	**8,000**	**10,005**
EBITDA margin adj. (%)	13.8%	9.0%	7.7%	6.9%	7.7%
Depreciation & amortisation	-875	-861	-1,307	-1,640	-1,837
Operating profit (adjusted)	**6,824**	**6,386**	**6,242**	**6,360**	**8,168**
Operating margin adj (%)	12.2%	7.9%	6.4%	5.5%	6.3%
Net income (adjusted)	5,296	5,255	5,067	4,710	6,239
EPS (adjusted) (pence)	5.05	5.01	4.83	4.49	5.94
EPS (adjusted) (pence) - fully diluted	**5.05**	**5.01**	**4.82**	**4.48**	**5.94**
DPS (pence)		0.67	0.96	0.90	1.19

Source: Company historic data and Equity Development estimates

Figure 9 - 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 and Equity Development estimates

Figure 10 - 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	8,100
Changes in operating assets and liabilities				
Inventories	-7,110	-2,957	189	-3,654
Receivables	-1,197	212	-1,345	-745
Payables	3,513	4,926	3,461	3,096
Cash from operations	2,953	6,598	9,853	6,798
Corporation tax paid	-66	-2,042	-784	-1,529
Net cash from operating activities	**2,887**	**4,556**	**9,069**	**5,268**
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		
Principal repayment of lease liabilities	-312	-657		
Net cash from finance activities excl. dividends	-609	2,481	-1,034	
Free cash flow before dividends on shares	**2,088**	**6,263**	**7,117**	**3,238**
Dividends paid		-3,884	-1,017	-1,004
Free cash flow after dividends	**2,088**	**2,379**	**6,100**	**2,234**

Source: Company historic data and Equity Development estimates

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