

Marks Electrical Group



Sales advance by 21.5% to £97.8m in FY2023

12th April 2023

A better than-expected 21.5% increase in sales revenue to £97.8m, higher EBITDA margins and strong cash conversion were the key features of today's Marks Electrical Group (MRK) FY2023 trading update. In addition, a positive start to April augurs well for FY2024, a year in which we expect to see further market share gains and expansion of the product and service offering. With a trailing EV/sales ratio of only 0.8x we continue to argue that the shares appear undervalued and reiterate our fair value of 150p for the shares.

Marks Electrical enjoyed full year 21.5% sales growth in FY2023. Momentum remained strong throughout the final quarter, with a 21.2% gain in March 2023. Margin gains were complemented by improvements in working capital and inventory management, which resulted in strong cash conversion. The closing net cash position was positive to the tune of £10m.

The company gained market share in both its Major Domestic Appliance (MDA) and Consumer Electronics (CE) core markets in FY2023 as its arguably best-in-class customer service was reflected in a 4.8 Trustpilot rating. Specific category strengths included washing machines, tumble dryers and small domestic appliances – notably air fryers, coffee machines and vacuum cleaners.

Marks Electrical has sizeable headroom to grow market share. The company remains active in raising brand awareness through TV, social media, radio and out-of-home advertising. However, with a UK market share of only around 3% and national awareness levels still well beneath 20%, there is still significant scope to invest further in the company's brand and grow share accordingly.

Operational highlights in today's release focused significantly on customer service quality. MRK saw 80% growth in its newly formed integrated gas, electrical and TV installation services. The company invested further in delivery vehicles in the period, which also benefits brand awareness at grass roots level. Furthermore, expansion of the company's warehousing capacity broadened the company's all-important ability to execute next-day deliveries across the UK.

Significant potential upside to our 150p fair value

Achievement of above double-digit sales growth, higher margins and strong cash conversion in FY2023 further bolsters our confidence in our fair value for Marks Electrical Group of 150p per share based on relative valuation and DCF. At that fair value, the shares would be trading on FY2024 EV/sales of 1.3x and 16.5x FY2024 EV/EBITDA based on our revised forecasts.

Company Data

EPIC	MRK
Price (last close)	84p
52 weeks Hi/Lo	100p/55p
Market cap	£88m
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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Key Financials

Year to 31st March	2019A	2020A	2021A	2022A	2023E	2024E
Revenue (£m)	31.2	31.5	56.0	80.5	97.8	114.5
Revenue growth		0.8%	77.7%	43.8%	21.5%	17.2%
EBITDA (£m) (adj)	1.9	1.3	7.7	7.2	7.5	8.9
EPS adjusted (p)	1.10	0.66	5.05	5.01	4.60	5.33
DPS (p)				0.67	0.92	1.07
EV/sales (x)	2.5	2.5	1.4	1.0	0.8	0.7
EV/EBITDA (x)	41.3	60.7	10.1	10.7	10.3	8.7
P/E ratio (x)	76.6	127.0	16.5	16.7	18.2	15.7
Yield				0.8%	1.1%	1.3%

Source: ED estimates, company historic data

Sales advance by 21.5% to £97.8m in FY2023

Rapid 21.5% sales revenue growth, higher margins and strong cash conversion were the salient financial features of Marks Electrical Group's (MRK) FY2023 performance, a year which finished on a robust note with a 21.2% sales increase in March, and +20.0% over the final quarter (Q4 period to 31st March 2023). Furthermore, there are early indications of sustained sales momentum at the start of FY2024 as April recorded a positive start.

The central investment case for the shares remains firmly in place, in our view. The company is well invested to meet demand growth in its business operationally as well as enjoying significant scope to generate this demand growth through increased brand awareness. Furthermore, market share is comparatively small at around 3% despite three consecutive years of exponential progress in sales.

Investors should also note the company's EV/sales valuation in the context of its end-year net cash balance of £10.0m which is deducted from market capitalisation to calculate Enterprise Value. **For a profitable, cash generative business with an obvious claim to being a rapidly growing business, an EV/sales ratio of 0.8x seems relatively low.** We base our 150p valuation on FY2024 EV/sales of 1.3x and 16.5x FY2024 EV/EBITDA. Our DCF valuation points to an even higher share price of 210p.

FY2023 highlights

Financial highlights

The key financial figures from the FY2023 trading update are summarised in Figure 1. The stronger-than-expected sales number reflects the company's ability to make further market share gains in both its core categories rather than overall growth in its main markets.

MRK also benefited from an improved gross margin, as expected, in the second half of its financial year while **cost discipline drove EBITDA expansion from £7.3m in FY2022 to over £7.5m in FY2023.** The company continues to reinvest in its brand building which is targeted to be around 5.0% of annual sales.

Cash conversion was clearly strong in FY2023 given that at least £7.5m of EBITDA coincided with a £6.1m improvement in the company's net cash position. This positive development was attributed to further improvements in working capital and inventory turn, both of which should be sustainable.

Figure 1 - Trading update highlights

All figures in £m	FY2022	FY2023	change
Sales revenue	80.5	97.8	21.5%
Adjusted EBITDA	7.2	7.5	4.1%
Net cash position	3.9	10.0	+£6.1m

Source: Company data

Operational highlights

MRK enjoyed market share gains in both its Major Domestic Appliance (MDA) and Consumer Electronics (CE) markets in FY2023. Highlighted categories included washing machines, tumble dryers and small domestic appliances: notably, air fryers, coffee machines and vacuum cleaners. In addition, **the company experienced rapid growth in its newly formed integrated gas, electrical and television installation services** which grew by 80% in the final quarter of the last financial year.

A combination of investment in brand awareness, and an ability to execute orders and delivery, was reflected in MRK's Trustpilot rating retaining industry leading status in FY2023. Social media, television,

radio and out-of-home advertising were the key forums for the company's brand awareness building initiatives in the period.

We compare relative Trustpilot ratings for MRK and the company's key competitors in Figure 2. In the final quarter of FY2023 the company received more than 4,500 5-star Trustpilot reviews.

Figure 2 - Comparative Trustpilot ratings

Company	Website	Trustpilot rating
Marks Electrical	www.markselectrical.co.uk	4.8
AO	www.ao.com	4.6
John Lewis	www.johnlewis.com	3.9
Currys	www.currys.co.uk	3.6

Sources: Company websites and uk.trustpilot.com

Changes to forecasts

As a result of a better-than-expected financial performance we make positive adjustments to the expected final FY2023 outcomes for sales revenue, adjusted EBITDA and adjusted EPS which are summarised in Figure 3. In addition, we make an upward adjustment to our sales revenue expectation for FY2024.

We trim our profit expectations for FY2024. However, we argue that investors should note that MRK continues to invest in brand awareness while remaining competitively positioned in terms of pricing. As a result, our forecasts include an expected half point reduction in gross margin in FY2024 but with a modest uptick in EBITDA margins as control on overheads expansion remains tight.

Our overall conclusion is that MRK is well placed to continue delivering double-digit sales growth going forwards. In particular, the company boasts an attractive combination of significant demand headroom due to rising brand awareness, more-than-adequate operational capacity and a strong financial position.

Figure 3 - Changes to forecasts

All figures in £m	FY23			FY24		
	Old	New	Change	Old	New	Change
Sales revenue	89.0	97.8	9.8%	112.8	114.5	1.5%
EBITDA – adjusted	6.9	7.5	8.8%	9.6	8.9	-7.1%
EPS - adjusted (pence)	4.32	4.60	6.5%	5.74	5.33	-7.1%

Source: Company data for FY2023 sales revenue and ED estimates

Headroom to grow

As mentioned above, we argue that MRK enjoys significant demand growth headroom through increased brand awareness and geographic reach. We summarised brand awareness by region and UK population by region in our 10th January 2023 report: [Revenue growth accelerates to 33.4% in Q3](#).

The central conclusion from comparing population with awareness levels is that some of the largest regions – i.e. the South-East and London which represent 27% of the UK population - continue to have relatively low levels of brand awareness at 6% and 4% respectively. In contrast, East Midlands awareness is 16% with West Midlands at 10%.

As a result, we see significant headroom for awareness growth while still targeting regions with sizable populations – notably the North West and East England. Figure 4 summarises the position.

Figure 4 - UK population and Marks Electrical brand awareness by region

Region	Population	As % UK population	Awareness May 2022
South East	9,217,265	14%	6%
London	9,002,488	13%	4%
North West	7,367,456	11%	7%
East England	6,269,161	9%	7%
West Midlands	5,961,929	9%	10%
South West	5,659,143	8%	2%
Yorkshire/Humber	5,526,350	8%	4%
East Midlands	4,865,583	7%	16%
North East	2,680,763	4%	9%
England total	56,550,138	83%	7%
Scotland	5,466,000	8%	
Wales	3,169,586	5%	
Northern Ireland	2,680,763	4%	
UK total	67,866,487	100%	

Source: www.statista.com and You Gov – 4 to 5 May 2022 based on 1,875 respondents

A strong start to FY2024 confirms positive sales momentum

MRK appears to have started the FY2024 on a positive note. While it is early days, the company implies that the strong end to the previous financial year – i.e., 21.2% growth in March – continued into April.

Importantly, MRK is well placed to meet the operational requirements to meet this kind of growth in demand for its products and services. Further investment in delivery vehicles and additional warehouse mezzanine floors should be associated with both increased capacity and an ability to expand next day delivery capability across the UK.

Valuation & financials

Relative valuation

Our relative valuation assesses Marks Electrical against peer groups of MDA and CE providers and online retail businesses. We maintain our fair value at 150p, which implies FY2024 EV/sales of 1.3x and 16.5x FY2024 EV/EBITDA based on our revised forecasts.

Moreover it should be noted that - unlike many peers - MRK is profitable, generates high returns on capital employed (as discussed our 8th November 2022 report [Connecting the growth drivers](#)) and is cash generative.

In addition, MRK has substantial headroom to grow in terms of market share headroom, the scope to grow brand awareness, superior service level and potential to expand geographically. **In our view, these qualities fully merit a premium valuation.**

We summarise relative valuation based on FY2023 in Figures 5 and 6 and include our discounted cash flow calculation in Figures 7 and 8. That our DCF valuation stands above our fair value gives added comfort to our view that MRK has the potential to trade at a significantly higher rating than the current one.

Figure 5 - Relative valuation - online MDA providers

	Share price	Mkt cap	Net debt	EV	Sales 2023	EV/ sales	EBITDA 2023	EV/ EBITDA	EPS 2023	P/E 2023	DPS 2023	Yield
	(p)	(£m)	(£m)	(£m)	(£m)	(x)	(£m)	(x)	(p)	(x)	(p)	
AO World (AO)	67	336	102	438	1135	0.4	41	10.8	0.6	105.9	n/a	n/a
Currys (CURY)	56	641	1342	1983	9413	0.2	509	3.9	7.1	7.9	2.8	4.9%
Marks Electrical (MRK)	84	88	-10	78	98	0.8	7.5	10.3	4.6	18.2	0.9	1.1%
Average						0.5		8.3		44.7		3.0%

Source: ADVFN, MarketScreener, Stockopedia and Equity Development estimates

Figure 6 - Relative valuation - online consumer goods providers

	Share price	Mkt cap	Net debt	EV	Sales 2023	EV/ Sales	EBITDA 2023	EV/ EBITDA	EPS 2023	P/E 2023	DPS 2023	Yield
	(pence)	(£m)	(£m)	(£m)	(£m)	(x)	(£m)	(x)	(p)	(x)	(p)	
ASOS (ASC)	760	760	533	1293	3791	0.3	186	6.9	15.2	50.0	n/a	n/a
B&M (BME)	488	4891	2040	6931	4960	1.4	797	8.7	36.6	13.3	22.5	4.7%
Boohoo (BOO)	55	689	51	740	1758	0.4	62	12.0	-1.0	Nmf	n/a	n/a
Dunelm (DNLM)	1010	2060	251	2311	1622	1.5	269	8.6	72.3	14.0	47.9	4.4%
Marks Electrical (MRK)	84	88	-10	78	98	0.8	7.5	10.3	4.6	18.2	0.9	1.1%
Next (NXT)	6479	8099	1802	9901	5133	1.9	1148	8.6	571.0	11.3	195	3.0%
Ocado (OCDO)	524	4047	576	4623	2844	1.5	36	Nmf	-47.3	Nmf	n/a	n/a
Pets at Home (PETS)	374	1891	377	2268	1407	1.6	258	8.8	21.6	21.2	12.3	3.3%
Average						1.2		9.1		21.3		3.4%

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	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F
Free cash flow (unlevered)	7,197	3,736	6,691	8,314	8,480	8,650	8,823	8,999	9,179	9,363
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	0.00	1.00	2.00	3.00	4.00	5.00	6.00	7.00	8.00	9.00
Discount factor	1.00	0.92	0.85	0.78	0.72	0.67	0.61	0.56	0.52	0.48
Present value	7,197	3,444	5,684	6,509	6,119	5,752	5,408	5,084	4,779	4,493
Sum of discounted cash flows	54,467									
Terminal growth rate (%)	2.0%									
Terminal value	156,282									
Net debt/cash if positive	9,977									
Equity value	220,727									
No. of shares (m)	104.9									
Value per share (pence)	210									

Source: Equity Development

However, **this should be seen as conservative given the company's consistent ability to gain market share from its current low single digit market share position.** The DCF derived value per share is translated into implied valuation FY2023 multiples in Figure 8. Given that our above calculation is in excess of the fair value which we use, these implied multiples all exceed those which we use to generate a fair value. As a result, our fair value approach can be seen as conservative relative to DCF.

Figure 8 - Implied MRK valuation at DCF result

Implied Enterprise Value	210,750
Sales revenue FY2023	97,753
EV/sales	2.2
EBITDA FY2023 (adjusted)	7,542
EV/EBITDA	27.9x
EPS FY2023 (adjusted)	4.6
P/E	45.7x

Source: Equity Development

Financial forecasts

Changes to forecasts were discussed in an earlier section of this report which included an upgrade to expected sales in FY2024 and reductions in both EBITDA and EPS. For FY2023, today's trading update includes only sales revenue and EBITDA updates rather than full financial data. According to MRK's [corporate website](#), the company plans to release full year financial data on 14th June 2023.

Our forecasts for income statement, balance sheet and free cash flow appear in Figures 9, 10 and 11. **The central messages are sustained sales revenue growth, high returns on capital employed and strong cash conversion.**

Figure 9 - Income statement

31st March year-end	2019A	2020A	2021A	2022A	2023E	2024E
All figures in £'000s						
Revenue	31,247	31,500	55,984	80,478	97,753	114,525
Increase (%)	0.0%	0.8%	77.7%	43.8%	21.5%	17.2%
Cost of sales	-25,411	-26,381	-44,064	-64,583	-78,692	-92,765
Gross profit	5,836	5,119	11,920	15,895	19,062	21,760
Gross margin(%)	18.7%	16.3%	21.3%	19.8%	19.5%	19.0%
Other operating income	26	159	165			
Advertising & marketing	-2,296	-1,772	-1,641	-4,004	-5,500	-5,726
Other operating expenses (exc depn)	-2,133	-2,637	-2,580	-4,644	-6,020	-7,100
Total operating expenses	-4,429	-4,409	-4,221	-8,648	-11,520	-12,826
EBITDA (adjusted)	1,882	1,280	7,699	7,247	7,542	8,933
EBITDA margin adj. (%)	6.0%	4.1%	13.8%	9.0%	7.7%	7.8%
Depreciation & amortisation	-420	-506	-875	-861	-1,400	-1,640
Operating profit (adjusted)	1,404	964	6,824	6,386	6,142	7,293
Operating margin adj (%)	4.5%	3.1%	12.2%	7.9%	6.3%	6.4%
Finance expense	-96	-116	-70	-65	-70	0
Share based payment expense				-75		
Net fair value gains	107	123	400	195		
Pre-tax profit (adjusted)	1,308	848	7,154	6,441	6,072	7,293
Taxation (adjusted)	-149	-158	-1,458	-991	-1,245	-1,699
Tax rate (adjusted) (%)	-11.4%	-18.6%	-20.4%	-15.4%	-20.5%	-23.3%
Net income (adjusted)	1,159	690	5,296	5,255	4,827	5,594
EPS (adjusted) (pence)	1.10	0.66	5.05	5.01	4.60	5.33
DPS (pence)				0.67	0.92	1.07

Source: Company historic data and Equity Development estimates

Figure 10 - Balance sheet

31st March year-end	2019A	2020A	2021A	2022A	2023E
All figures in £'000s					
Assets					
Non-current assets					
Investments	665	746	1,146	1,293	1,543
Property, plant & equipment	5,268	5,091	5,623	841	1,152
Right-of-use assets	445	418	779	2,328	2,328
Total non-current assets	6,378	6,255	7,548	4,462	5,023
Current assets					
Inventories	4,772	4,322	11,432	14,389	13,950
Trade and other receivables	1,968	1,642	2,839	2,627	3,191
Cash and cash equivalents	670	179	1,493	3,872	9,977
Total current assets	7,410	6,143	15,764	20,888	27,118
Total assets	13,788	12,398	23,312	25,350	32,140
Liabilities					
Current liabilities					
Trade and other payables	5,155	4,592	8,303	13,067	15,872
Corporation tax liabilities	265	244	1,557	145	145
Borrowings	1,592	961	233		
Lease liabilities	332	137	330	938	1,139
Total current liabilities	7,344	5,934	10,423	14,150	17,156
Non-current liabilities					
Other payables	512	197	17		
Borrowings	1,743	1,529	1,304		
Lease liabilities	54	185	422	1,324	1,324
Deferred tax liabilities	368	383	618	466	1,234
Provisions for liabilities	155	155	155		
Total non-current liabilities	2,832	2,449	2,516	1,790	2,558
Total liabilities	10,176	8,383	12,939	15,940	19,714
Issued capital and reserves					
Share capital	6	6	100,000	1,049	1,049
Share premium account				4,694	4,694
Treasury shares				-4	-4
Merger reserve			-99,994	-100,000	-100,845
Revaluation reserve	573	573	1,235	0	0
Retained earnings	3,033	3,436	9,132	103,671	107,533
Total equity	3,612	4,015	10,373	9,410	12,426
Total liabilities and equity	13,788	12,398	23,312	25,350	32,140

Source: Company historic data and Equity Development estimates

Figure 11 - Free cash flow

31st March year-end	2019A	2020A	2021A	2022A	2023E	2024E
All figures in £'000s						
Cash from operating activities	1,882	1,280	7,747	4,417	7,472	8,933
Changes in operating assets and liabilities						
Inventories	-381	450	-7,110	-2,957	439	-3,669
Receivables	-78	326	-1,197	212	-564	-547
Payables	369	-759	3,513	4,925	2,805	2,723
Cash from operations	1,792	1,297	2,953	6,598	10,152	7,440
Corporation tax paid	-82	-297	-66	-2,042	-1,245	-1,699
Net cash from operating activities	1,710	1,000	2,887	4,556	8,907	5,741
Cash flows from investing activities						
Property, plant & equipment - purchases	-218	-57	-216	-583	-1,711	-2,004
Deposits on right of use assets				-304		
Property, plant & equipment - disposals	48	156	26	65		
Income from investments				48		
Net cash from investing activities	-170	99	-190	-774	-1,711	-2,004
Dividends received		42				
Issue of ordinary share capital				4,740		
Repayment of borrowings			-227	-1,537		
Interest paid	-75	-105	-42	-11	-70	
Interest paid on lease liabilities			-28	-54		
Principal repayment of lease liabilities			-312	-657		
Net cash from finance activities exc dividends	-75	-63	-609	2,481	-70	
Free cash flow before dividends on shares	1,465	1,036	2,088	6,263	7,127	3,736
Dividends paid	-352	-315		-3,884	-1,022	-1,016
Free cash flow after dividends	1,113	721	2,088	2,379	6,105	2,720

Source: Company historic data and Equity Development estimates



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