Marks Electrical Group

Lighting the touch paper

16 March 2022

Marks Electrical's proven ability to serve the sizable UK major domestic appliance market with premium products on a next day delivery basis is central to its impressive growth story. The company's combination of proprietary technology, scalable business model, ample demand headroom and demonstrably high-quality leadership supports the case for a higher valuation than so far awarded by investors. This report argues that a fair value / share is 150p.

- The group's core operating model benefits from **a 5-pillar approach** which embraces up-to-date technology, a simple and proven distribution network, a scalable delivery model, premium products, and the importance of a favourable online user experience. These qualities should mean market share gains and sustainable financial strength.

- **MRK's addressable markets are sizable**. It sells into a £5.3bn UK Major Domestic Appliance (MDA) market, of which it currently has just a 1.2% share. Moreover, MRK is now establishing itself in Televisions using the same operating platform. Importantly, online appears set to grow in importance for both MDAs and TVs with the likelihood that next day delivery, judging by other leading e-commerce providers, will become almost essential.

- Marks Electrical as a brand has **substantial room to grow its recognition** and overall identity, which means that reinvestment in the brand should generate notable returns. The company is actively seeking to increase its own brand awareness and thus enhance sales in key regions. Aside from cash investment, the Marks Electrical brand can benefit reputationally from the integrity of both the premium branded product and service offering – i.e. the "*Marks Electrical Difference*."

- This is **a well-run business** with a dynamic leadership team. The group is centrally run from a single site in the logistically convenient city of Leicester, close to the UK's all-important M1 motorway. Operating as a single site business massively simplifies daily running of the company's delivery system. In addition, it allows employee performances to be enriched by a 'tight' focus and a common ambition to provide best-in-class service.

Robust financials and upside to ratings

Prospects look exciting. First, the scalable nature of the business should deliver increased operating margins even after brand promotion. Second, there is scope to sustain growth from relatively low inventory levels which has clear, positive implications for free cash flow. At our 150p fair value level the implied ratings are an FY2023 EV/sales ratio of 1.6x and 18.8x EV/EBITDA.

Key Financials

Year to 31st March	2019A	2020A	2021A	2022E	2023E	2024E
Revenue (£m)	**31.2**	**31.5**	**56.0**	**80.5**	**96.9**	**118.1**
Revenue growth (%)		0.8	77.7	43.7	20.4	21.9
EBITDA (£m) (adj)	**1.9**	**1.3**	**7.7**	**7.2**	**8.2**	**10.4**
EPS adjusted (p)	1.1	0.7	5.0	4.7	5.3	6.3
DPS (p)				0.8	1.1	1.3
EV/sales (x)	**3.2**	**3.2**	**1.8**	**1.2**	**1.0**	**0.8**
EV/EBITDA (x)	53.3	78.4	13.0	14.0	12.2	9.7
P/E ratio (x)	**88.7**	**149.1**	**19.6**	**20.9**	**18.5**	**15.6**
Yield (%)	0.0	0.0	0.0	0.8	1.1	1.3

Source: ED estimates, company historic data

Company Data

EPIC	MRK
Price (last close)	98p
Hi/Lo since IPO	128p/96p
Market cap	£101m
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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Contents

Investment case

The central investment case for Marks Electrical is the company's ability to gain market share by raising awareness of its delivery of premium, branded Major Domestic Appliances (MDAs) and televisions (TVs) to retail customers on a next day basis via its online platform. The simplicity of that message is supported by a clearly articulated, focused approach to doing business.

The MRK premium branded offering primarily serves the Major Domestic Appliance market which is currently estimated to be worth around £5.3bn and in the past seven years grew at a 3.4% compound rate (*source: Marks Electrical analysis of GfK data*). In recent years MRK has consistently gained share of this sizable addressable market, and we see those share gains as proving more important to its growth than that of the overall market.

MRK's market share gains to date are significantly a function of the company's ability to operate at best practice levels in both customer online experience and speed of delivery. In addition, there is a major service element to the MRK customer proposition given its ability promptly to respond to customer enquiries on a person-to-person basis. Overall service quality is a critical element of the investment case too.

Target KPIs, which we discuss further in our Financials and Valuation section, are summarised in Figure 1:

Figure 1 - Target KPIs

Target criterion	Medium-term targets
Revenue growth	Double-digit
Marketing spend / sales	~5.0%
Adj. EBITDA margin	~8.0%-9.0%
Capex / revenue	<3.0%
Working capital / sales	<7.5%
Dividend	~20% pay-out ratio

Source: Company presentation data

A 1.2% Major Domestic Appliances market share in FY2021 allows substantial headroom for sales expansion, so long as it continues to execute on a superior basis to its identifiable competition. In particular, the company has relatively high 11% recognition in its home East Midlands versus 6% across all of England and an unusually low 3% in London (which is currently Marks Electrical's largest customer market in the country for deliveries on a daily basis). As awareness outside its home turf improves, so should both brand recognition and sales volume.

The unique nature of Marks Electrical's core online offering is a vital component of the company's investment case. The company shouldn't be seen as a replica version of its key competitors (e.g. AO or Currys) in terms of service offering, which in turn should be reflected when benchmarking relative valuation. MRK delivers on a next day basis from a single site and is oriented towards premium, established brands. We discuss the "Marks Electrical Difference" and the company's best-in-class Trustpilot ratings in more detail in this report.

Prospective sales revenue growth of over 40% in the current financial year - after 55% in Q1 to Q3 according to a 10th January 2022 trading update - is both impressive and consistent with an appropriately sized budget for MRK to reinvest in its brand. The company has plans in place to increase its above-the-line marketing in social media, other digital formats, and mass media including selective use of television. As awareness increases, so should sales revenue – notably in those regions with large populations where the company is relatively under-represented in terms of both sales and brand recognition.

MRK's single site location for all of head-office, sales, customer service, warehousing and distribution enables the company to benefit from a strong 'head-to-toe' people culture. Lines of communication are tight across the group's major activities with constant information flow available to management in relation to pricing, revenue, inventory, delivery performance, customer service, and productivity. This healthy corporate culture should be seen as a business enabler in our view and a salient source of shareholder value creation. Management estimate that their current site has capacity for £250m in annual sales, so they have plenty of runway and are also exploring future larger site options for expansion, with the same single-site ethos.

MRK's valuation appears undemanding relative to a peer group of other online homeware distributors and electrical goods retailers. Consequently, there is good scope for the rating of the company's shares to increase. This report argues that on improved ratings **a fair value for the shares is 150p**.

Lighting the touch paper

Marks Electrical appears well positioned to enjoy a sustained period of double-digit sales revenue and profit growth based on the company's ability to deliver a best-in-class service into a sizable and growing addressable market. MRK already has **a demonstrable track record** of making market share gains in its core business of Major Domestic Appliances.

The group was founded in 1987 by its current Chief Executive Officer and largest shareholder, Mark Smithson, to sell MDA with a narrow initial range of 20 products. The company launched its website in 2003 which swiftly led to online sales reaching 80% of the total by 2006.

Since 2017 MRK has operated from a single location in Boston Road, Leicester which is conveniently located close to the all-important M1 motorway. This base is within one day's drivable reach of over 99% of the English population.

MRK shares were admitted to trading on London's AIM market via an Initial Public Offering and share placing at a price of 110p on 5th November 2021.

Figure 2 – Marks Electrical's customised delivery vans

Source: Company presentation data

This report initiates Equity Development's coverage of Marks Electrical Group and analyses the investment case for the shares. Our note covers the core customer offering in detail, analyses the company's addressable market and potential for growth, evaluates prospects for the Marks Electrical brand itself to expand in value, and highlights the importance of MRK's strong culture. A highly engaged and motivated workforce, many of whom are now shareholders in the company, is a major asset.

Our financials section includes forecasts for revenue and earnings as well as a relative valuation. Aside from the growth prospects inherent in our forecasts it should be noted that MRK enjoys significant scope to generate both abundant free cash flow and strong returns on capital employed. Versus a select group of "peer" companies, its valuation appears undemanding, given its scope for growth.

Simplicity at the core

Marks Electrical Group's core concept is relatively straightforward. Retail consumers are able to order online from a wide range of Major Domestic Appliances and have those items delivered and installed into their domestic dwellings the following day. Clearly, the ability to deliver that service level requires significant complexity management in terms of inventory and logistics. But in our opinion investors should not lose sight of MRK's simplicity at the core.

MRK's stated five operating pillars, which benefit from being both proven and proprietary, remain central to the group's growth strategy. We summarise these pillars in the bullet points below and comment on each of them individually.

- Technology driven operating model
- Simple and proven distribution network
- Scalable, vertically integrated delivery model
- Stocking products that meet changing market demand and trends
- Providing an excellent online shopping experience

Technology driven operating model

MRK's proprietary technology platform is arguably both proprietary and growth enhancing. Both qualities augur positively for shareholder value creation.

The key components of the technology driven operating model include the pricing tool, operating platform, logistics management, customer interface and website. The common thread that they have is the ability to enhance customer experience while simultaneously embracing simplicity.

Pricing tool

MRK looks to sell its range of MDAs at the correct price for the end consumer – i.e. market price. As a result, its pricing tool which tracks market prices down to individual line level is vital. MRK does not currently own any brands itself so must therefore be competitive. Its pricing tool is proprietary and developed in-house, with OEMs commenting on the accuracy of its capabilities.

The system works on either manual or automated pricing on any product by SKU. The system automatically updates the website and the team have developed the capability to update Google ads within minutes of price changes through their automated feeds.

Operating platform

Vendor management from its 50+ brand offering is also an important component of the operating platform. MRK uses its bespoke (again, proprietary) and refined Enterprise Resource Planning tool automatically to import and process vendor price lists as well as product specifications and invoices. The benefits for consumer interface and stock management are clear.

Logistics management

Proprietary technology is central to logistics management. The company's in-house developed Picklist enables it to manage all warehouse logistics and stock management using mobile Personal Digital Assistant (PDA) technology.

Moreover, there is a direct interface with the website which minimises human intervention in the picking and routing process. MRK's van fleet and the warehouse in action are illustrated in Figures 2 and 3 respectively.

Figure 3 - The warehouse in action

Source: Company presentation data

Customer interface

As world e-commerce leaders have already demonstrated for some time, **end-customer interface is a vital component of the success of any online business**. This opinion has been embraced by MRK. In particular, the company uses optimised software to keep its end-customers updated while establishing multiple touch points via texts and e-mail. In addition, purchasers are informed of a two-hour delivery slot, with messages received 30 minutes prior to delivery and a tracking tool to monitor the progress of the delivery vehicle right to the doorstep.

Website

MRK offers a bespoke website which uses Amazon Web Services (AWS) but was entirely developed and is wholly maintained in-house. The company argues that this delivers the benefit for flexibility and rapid customisation. The system benefits from AWS cloud infrastructure which has dynamic server scaling eliminating user capacity constraints.

Simple and proven distribution network

The distribution network is a major beneficiary of the company's decision to operate from a single site location - and the geographical position of that location.

The benefits of MRK having a single site are clear. First, the company can load its distribution vans overnight directly from its warehouse for all orders placed ahead of 6pm. Second, all its vans – which are largely wholly owned – can be both maintained by the company's own mechanics and re-fuelled onsite. Third, there is no need to participate in any trunking activities via Heavy Good Vehicles, which adds significant operational complexity and cost, with the need for multiple satellite warehouses across the country.

The Leicester location gives Marks Electrical same day access to more than 80% of the UK population – and over 99% of the English population – on a next day basis. As a result, their ability to deliver goods free of charge for orders in excess of £150 is a cost but **gives the group a critical competitive advantage**.

Scalable, vertically integrated delivery model

Control of distribution is central to the MRK delivery model. Aside from having every vehicle return to headquarters on a daily basis, there are significant cultural benefits from the company's drivers being in close touch with colleagues. MRK's drivers remain the principal human interface for the company with customers and recent purchasers of items.

MRK places a high level of emphasis on training its drivers – i.e. 3 month programmes - both in terms of operating vehicles and installing appliances. This training benefits the drivers themselves through a variable, delivery complexity and customer-prompted reward scheme which allows the drivers to earn above average rates of pay, enabling MRK to attract high-quality talent.

As stated above, the fleet of Mercedes vans is wholly owned with the age managed to maintain a three-year warranty. The customised design of the vehicles and full ownership enables them to carry the Marks Electrical brand name with clear positive implications for overall brand recognition and company profile.

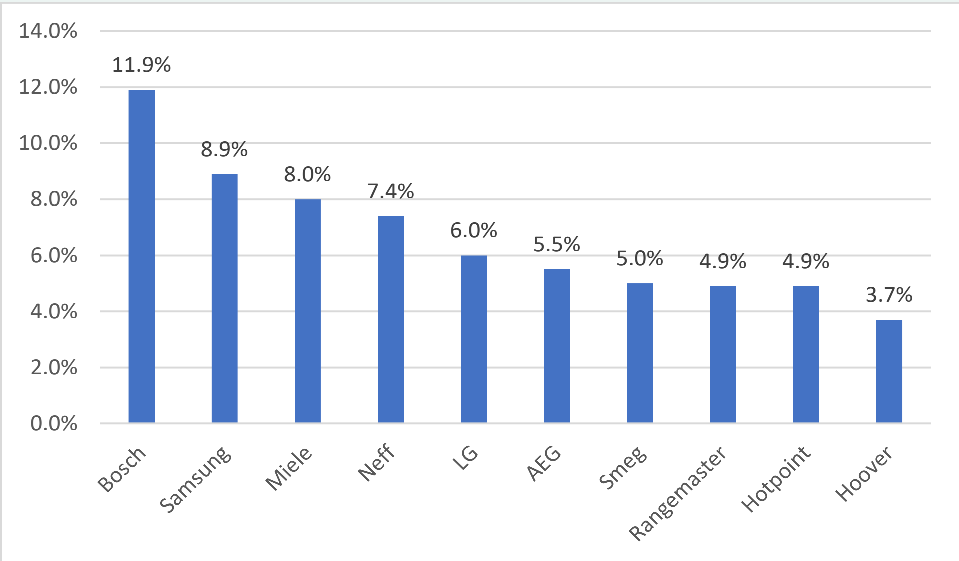
Stocking products to meet changing market demand and trends

Marks Electrical positions itself in the affordable premium product bracket of the MDA market with a similar positioning likely in audio-visual as that franchise grows. This premium focus ensures improved quality, reduced returns and lower customer complaints as the brands it operates with are both well-made and market leaders in their categories.

It manages the brand portfolio to **work with around 50 partners**, most of which have well recognised names. Overall, the top 10 brands represent around 65% of group sales revenue in MDA.

However, brand concentration risk is reduced by **no single brand accounting for more than 12% of sales**, in FY2021. We summarise sales revenue by the leading brand partners as a portion of the FY2021 total in Figure 4.

Figure 4 – Marks Electrical brand partners as % FY2021 sales revenue

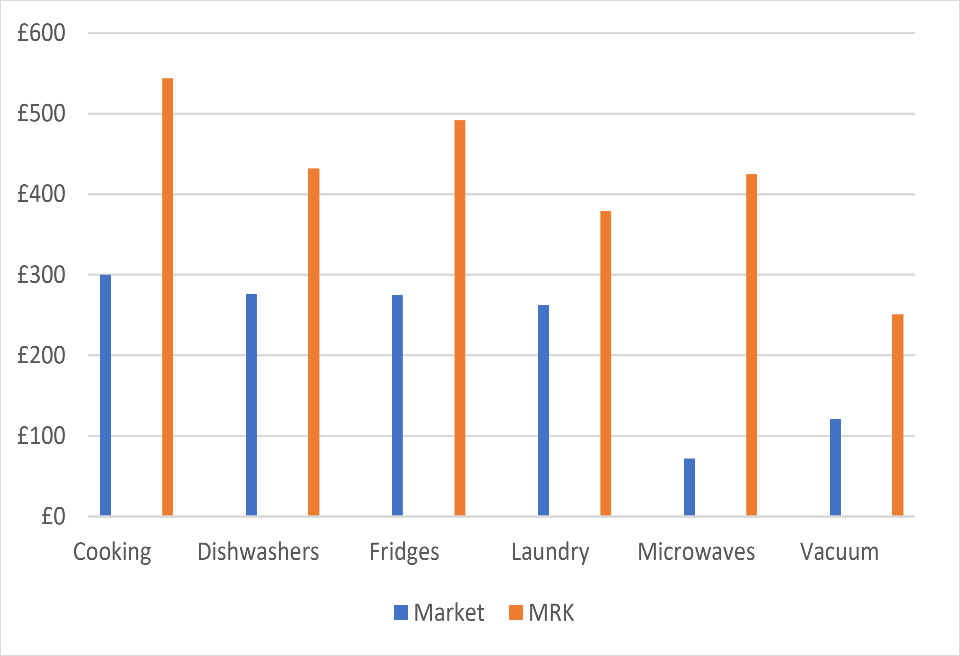


Source: Company presentation data

A focus on premium brands delivers the sales revenue benefit to MRK of operating at higher price points within all of the key MDA categories – namely **cooking, dishwashers, refrigeration, washers & dryers, microwave ovens** and **vacuum cleaners**.

Aside from the near-term revenue benefit of this approach, a focus on premium brands reduces the likelihood of faulty products being returned, as well as selling into the natural tendency for consumers to trade up as underlying per capita GDP increases. This premium focus also improves the value on each van to maximise delivery efficiency. We summarise the company's relative price positioning in Figure 5.

Figure 5 – A focus on higher value premium appliances (excl. VAT)



Source: Marks Electrical calculations based on GfK market data

Providing an excellent online shopping experience

As stated above, an excellent customer online experience is vital to the success of an internet-based business such as MRK. As a result, the interface is tightly managed which is also a benefit of the company's single site location. Moreover, the online experience is backed up by an in-house telesales staff which receives regular product training from manufacturers**.**

Put bluntly, very little is left to chance.

Important features of the online offer include the check-out process, which prioritises simplicity, and regular customer updates throughout the delivery process.

Furthermore, Trustpilot ratings confirm customer satisfaction with the Marks Electrical offering. The company's 10th January 2022 trading update showed an improvement in this rating from 4.7 to 4.8, which is market-leading versus its peer set.

The Marks Electrical difference in a nutshell

What we refer to as the "*Marks Electrical difference*" is central to MRK's value proposition - both in outright commercial terms, as the company seeks to expand market share and grow sales revenue, and in terms of how the company is assessed and valued relative to comparative companies. Hence, we highlight this important level of differentiation in our investment case for the shares.

Marks Electrical's relevant competitor set in MDAs includes the publicly listed companies AO and Currys as well as the privately owned partnership John Lewis. AO is the most online oriented of the three, while John Lewis still appears most grounded in its physical retail origins.

The critical MRK differences, in our view, relate to its ability to deliver MDAs on a free next day basis in owned and managed trucks via a recognisably user-friendly website and with readily available UK-based, person-to-person telephone back-up.

MRK's competitors are unable to match this offer in its entirety. For example, AO does not guarantee "next day" for all orders placed before 6pm and Currys uses an online chat function rather than direct telephone access for its customers. Furthermore, all three competitors operate from multiple warehousing locations, adding complexity, and in our view lack the element of direct customer relationship ownership via the online offering. Clearly, Currys and John Lewis have the largest legacy retail functions.

Figure 6 – Competitor websites and 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 (www.markselectrical.co.uk, www.ao.com, www.currys.co.uk www.johnlewis.com) and uk.trustpilot.com

A superior online experience for Marks Electrical customers relative to the above-mentioned competitor set tends to be borne out by these four companies' relative Trustpilot ratings, which we summarise in Figure 6 and which includes hyperlinks to the relevant websites.

Trustpilot itself is a consumer review website which conducts multiple real-time reviews of businesses worldwide and is objective. Currently, MRK leads the Trustpilot rankings with a 4.8 ranking while Currys scores lowest with only 3.6.

Given the differentiated services which we identify, a superior Trustpilot rating for Marks Electrical overall is not necessarily surprising. However, it does tend to vindicate the company's emphasis on simplicity, free next day delivery and continues to support the case from operating out of a single site, where customer service quality can be monitored on a real time basis, not to mention the profitability benefits of this simplified operating model.

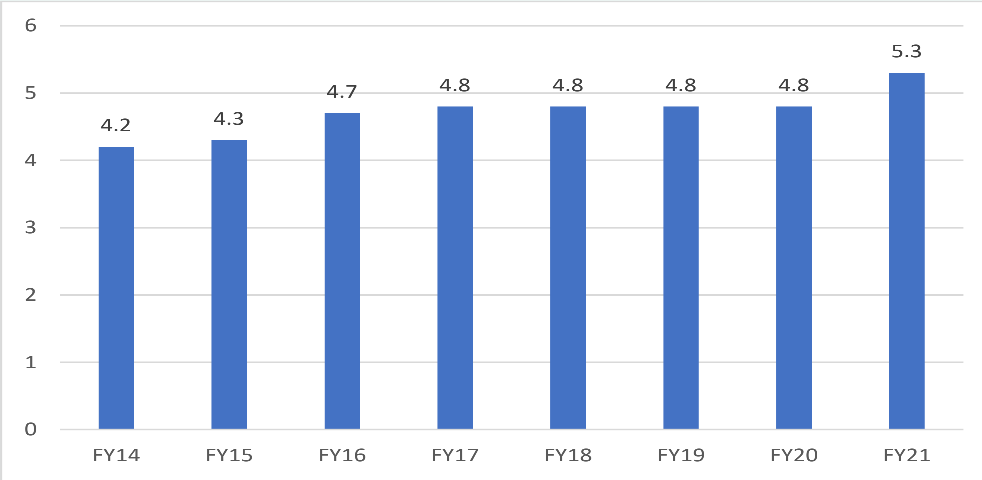
Gaining share in a >£5bn market

Marks Electrical benefits from selling into a sizable addressable market. Furthermore, the company's current share of that market, at 1.2% in FY2021, implies substantial headroom to grow so long as the company meets customer requirements.

The current market size for Major Domestic Appliances is estimated to be £5.3bn, based on FY2021, with a further £2bn opportunity in prospect for televisions.

Market growth for MDAs is summarised in Figure 7 below. Having plateaued in the previous three years, the market moved swiftly forward by 10.2% in FY2021 to record a 3.4% compound annual growth rate in the period shown. Clearly, the redirection of household funds towards appliances during the first year of Covid-related lockdown, which matches MRK's 2021 financial year, was positive for market growth.

Figure 7 – UK major domestic appliance market (FY2014 to FY2021) in £bn



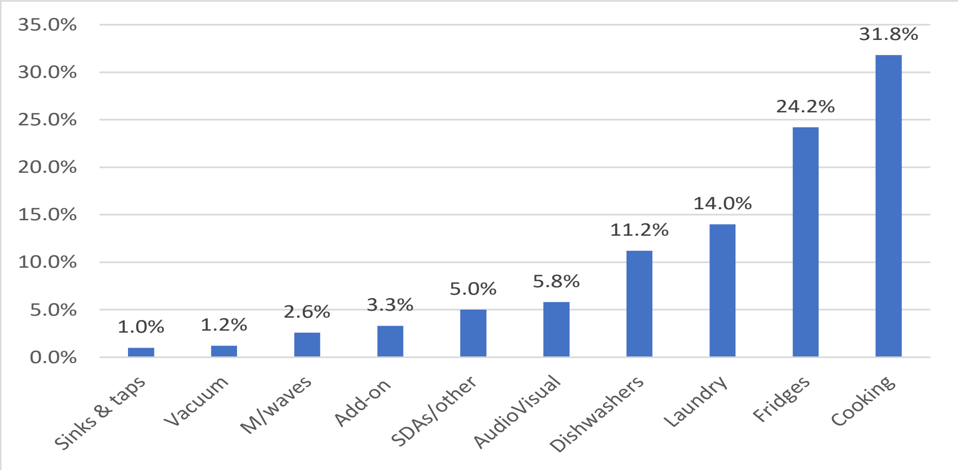
Note: Refers to financial years ending 31st March.

Source: Company data based on GfK market data

MDA market in more detail

Figure 8 shows MRK's product sales by category. According to MRK's own analysis, based on GfK market data, the company consistently gained share across all seven of the major categories in the past four years with the strongest performance being in cookers where it currently boasts 2.8%. MRK has higher market shares in the larger items that are more difficult to deliver, which it refers to as "unfriendly freight".

Figure 8 - Product sales breakdown by category

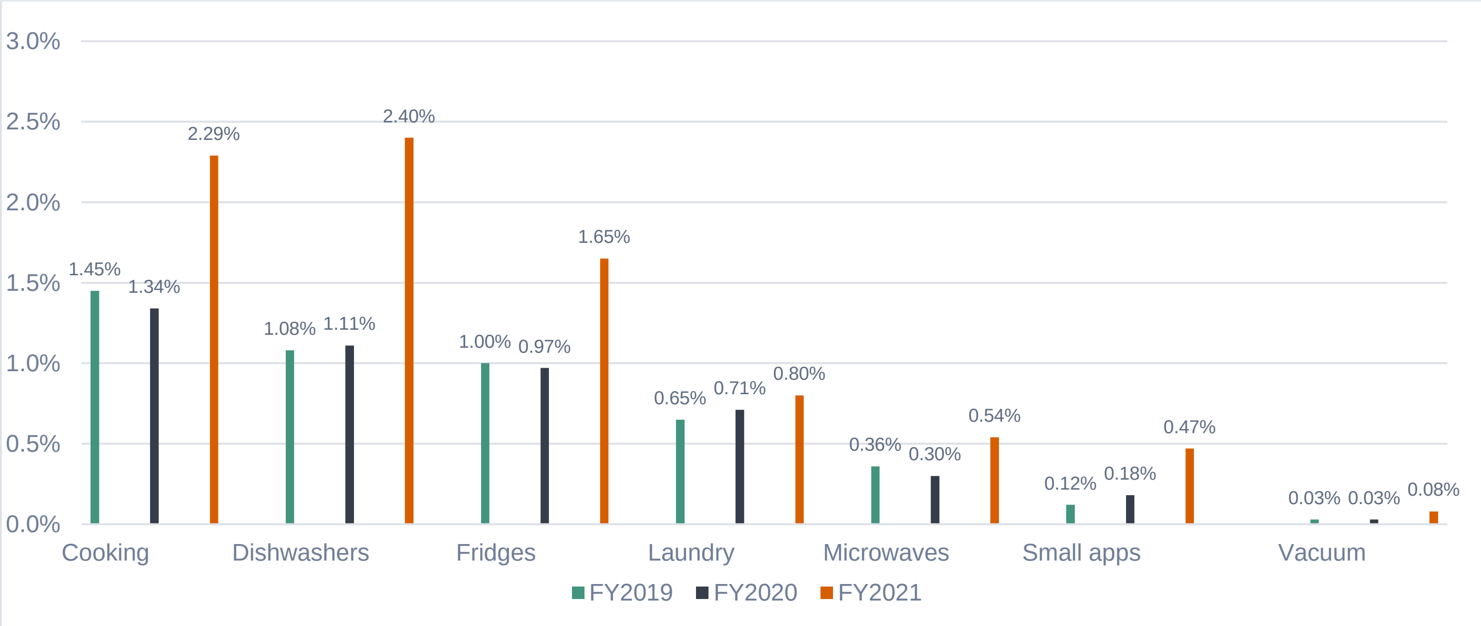


Source: Company data

Market shares by type of appliance in FY2021 are detailed in Figure 9. **Importantly, the company recorded a higher market share than in FY2020 in every category shown.**

Such a performance tends to reflect the efficacy of how MRK operates in terms of overall product offering and customer service, rather than being distorted by any fortuitous wins in a particular category.

Figure 9 - MRK market share by category - FY2019 to FY2021



Source: Company data based on GfK market data

Over a seven years period, MRK steadily increased share of the overall MDA market from 0.4% in FY2014 to 1.2% in FY2021, which is an important harbinger for future growth. The company reported further share gains in its 10th January 2022 Q1-Q3 trading statement.

The implied growth contribution for the company from market share gains in this period – i.e. 16% - was significantly larger than the market CAGR discussed above.

Potential for MDA market to grow

MDA market growth is less important to the overall investment case than MRK's opportunity to gain share within that market.

Furthermore, it is important to stress not just the prospects for growth in the MDA market but also **online purchase of MDAs**. According to global market research and market data company Mintel's "*UK Major Domestic Appliances, Market Report 2021*," online's share was 68% last calendar year compared with 58% in 2020 and a lower figure of 52% in 2017 with in-store purchases being the primary loser.

Marks Electrical is a specialist online business. Any further gains in the popularity of online will naturally benefit MRK given it is a specialist online provider.

Penetrating England more widely

We are happy to keep reminding readers that the potential for MRK to grow rapidly through market share gains eclipses that of category growth. In our view, the salient statistics are the relatively low market share that the company currently has – i.e. around 98% of the market is still available to MRK – and the benchmark level of recognition that the company already has in its core East Midlands trading area.

There is no geographic impediment to MRK being able to achieve more uniform levels of brand recognition and associated market share levels across the whole of its trading area – i.e. England and South Wales.

As Figure 10 illustrates, by far the largest portion of the country's population is accessible on a single day round-trip basis from Boston Road, Leicester.

Figure 10 - UK population by region (number of people) in 2020

Region	Population	As % England	As % UK
South East	9,217,265	16.3%	13.6%
London	9,002,488	15.9%	13.3%
North West	7,367,456	13.0%	10.9%
East England	6,269,161	11.1%	9.2%
West Midlands	5,961,929	10.5%	8.8%
South West	5,659,143	10.0%	8.3%
Yorkshire/Humber	5,526,350	9.8%	8.1%
East Midlands	4,865,583	8.6%	7.2%
North East	2,680,763	4.7%	4.0%
England total	**56,550,138**	**100.0%**	**83.3%**
Scotland	5,466,000		8.1%
Wales	3,169,586		4.7%
Northern Ireland	2,680,763		4.0%
UK total	**67,866,487**		**100.0%**

Source: www.statista.com

Building the brand

Raising awareness of the Marks Electrical offering is closely linked with building brand recognition. With confidence in strong gross margins moving forward, a robust online offering, excellence in execution and a robust core regional franchise, the company is well placed both financially and in terms of intellectual property to achieve these objectives.

The business is the brand

As discussed in our assessment of the core offering and how it executes, MRK benefits from a number of proprietary qualities which empower the company as a business. While the company's name derives from its founder, the essential brand equity is in fact the business itself. Despite the potential for widescale complexity, Marks Electrical delivers simple solutions for its customers on an end-to-end basis.

A significant component of the brand equity is the culture put in place by the founder and CEO himself, Mark Smithson. His original vision to sell MDAs online and implement delivery and customer service at best practice is reinforced on a daily basis by the company's single location with both the telesales and customer help lines located in close proximity to other head office functions.

Importantly, none of this should change as the company expands. While its current site still has capacity, the company has already identified alternative sites nearby with similar proximity to the M1 Motorway as they map out their growth trajectory. A single site approach to the whole business remains very much in the Marks Electrical DNA.

Equally vital for the brand itself is the customer experience on product delivery. MRK has a policy in place to reward its driver/installers financially for positive Trustpilot feedback from customers as well as more complex installations.

The company facilitates a good drop-off experience with the use of bespoke-built vans, specific tail-lift platforms to ease deliverer workload, and quality tools for the team including sack barrows and thresholds strips which improve and enhance speed of delivery.

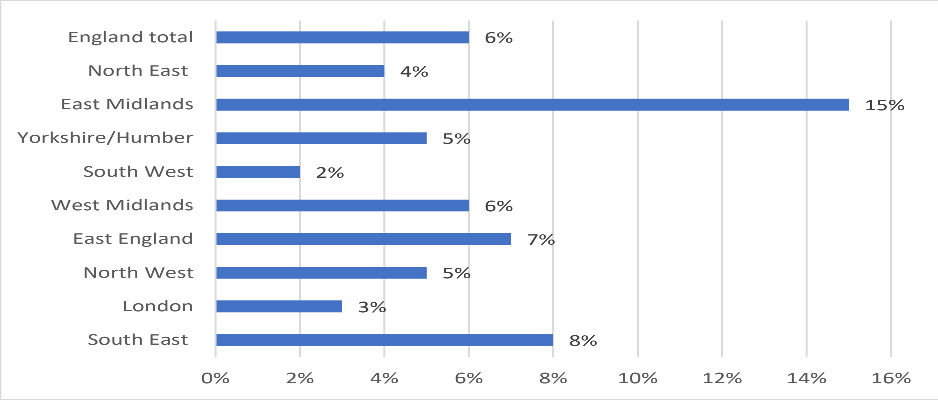
Raising awareness

A regional planogram of awareness for Marks Electrical is summarised in Figure 11. Unsurprisingly, East Midlands currently leads in terms of recognition. However, there is no reason why that should always be the case.

In particular, none of the company's sizable target regions in terms of demographics is located more than one day's return journey from Leicester by road – notably, the South East, London, the North West and the West Midlands whose populations amount to 56% of England's total as shown before.

As mentioned earlier in our "Investment case" commentary, London is currently the largest market for deliveries and sales on a daily basis for MRK. The relatively low 3% MRK brand awareness in the capital represents a significant opportunity, in our view.

Figure 11 – Marks Electrical Brand Awareness



Source: YouGov 25-26 August 2021 based on sample of 1,700 adults surveyed across England

The significance of MRK's gross margin**,** which rose from 16.3% to 21.3% in FY2021, is that it provides the company with sufficient funds to invest in its brand through the normal above-the-line channels – i.e. **spend money on pure advertising.** Going forward, the company expects gross margin to stabilise in the 18-20% range. MRK states that its investment in marketing will adopt a three-step approach which includes online, offline, and social media. We look at each individually:

Online

The channels that the company has identified for online include the following:

- SEO - Search Engine Optimisation
- PPC - Pay Per Click
- CRO – Conversion Rate Optimisation
- CRM – Customer Relationship Management

Search Engine Optimisation Search engine optimisation (SEO) is the tool for getting web pages to rank higher in the more frequently used search engines. Because search is one of the main ways in which people discover content online, ranking higher in search engines can lead to an increase in traffic to a website. Given the company is an online business, this tool dovetails well with the offering.

Pay per click mirrors SEO and suits online businesses. The benefit of pay per click is that the company only pays for potential customers who actively click on its links.

CRO is expected to improve website conversion rates.

CRM investment is expected to give the company an improved database and facilitate demography-based marketing.

Understandably, the company has multiple plans to improve the above areas, but is keeping these under its cap given the competitive nature of the industry in which it operates.

Offline

TV campaigns. MRK has already engaged in television advertising on a direct above-the-line brand building basis. Moreover, a targeted approach using pay TV channels is a viable and arguably cost-effective option. The company expects to work with Sky, Channel 4 and ITV. While costly and at times hard to measure directly in terms of impact, the ongoing task of building brand awareness should drive an increase in the customer database.

Social

Social media platforms offer a route to brand building with the added benefit of campaigns which are specifically targeted at a platform's audience.

The company has also expressed interest in **Programmatic display advertising,** which uses Artificial Intelligence directly to target potential customers. For MRK, where customers clearly frequently have one-off need states – for example, an appliance requires urgent replacement – this can be a cost-effective tool.

Powering brand voltage

While this report makes no attempt quantitatively to measure MRK's "brand voltage," what is clear in our view is that there is a sizable equity in the combination of both the franchise as it stands and the ability for MRK to push the Marks Electrical brand name towards higher levels of recognition and customer loyalty.

The uniqueness of the core franchise offering (free next day delivery of MDAs and TVs) combines well with the integrity of the business structure to raise both the reputation and recognition of the business.

Management and Strategy - power to the people

Marks Electrical's relatively simplistic business strategy, strong all-pervasive corporate culture and dynamic leadership team combine well, in our view, to enhance growth prospects for the group.

Simplicity reduces strategic risk

MRK's central growth strategy embraces the simplicity found elsewhere in the group. The company's focus is organic sales revenue expansion from its core appliances franchise – i.e. MDAs and TVs – driven out of a single site. This approach has already been demonstrably successful. Continuation of the strategy implies reduced business risk. We note that there are no immediate prospects of the company becoming acquisitive.

People culture

The efficacy of MRK's people culture is enhanced by the single site approach to running the business. Every member of the team touches base with head office on pretty much a daily basis. All business activities are in close proximity to each other and even when drivers are away from head-office they are in company owned, MRK branded vehicles with customised modifications.

The employee buy-in associated with a strong people culture was strengthened by the company's 2021 Initial Public Offering. Each employee received 2,700 shares in Marks Electrical Group. The company's stated four core values, which employees are encouraged to embrace, are summarised as follows:

- Try your hardest
- Think like a customer
- Move at pace
- Be honest. Always

Environmental, Social and Governance

Marks Electrical's ESG credentials are strong, in our view, and ESG compliance is already an increasingly important criterion by which companies are judged. MRK's ESG strategy comprises its **Operational Environmental Approach** and its **Corporate Environmental Approach**.

The *Operational* approach includes the company's in-house recycling scheme where capital investments are already in place. This involves removing waste packaging materials (cardboard, plastic, polystyrene, strapping) from customers' new appliances and returning them to base to be recycled.

In addition, the company offers the removal of old domestic appliances and works with a third party, The Appliances Recycling Group, to ensure the old appliances are recycled to the government's WEEE regulation scheme for waste electrical and electronic equipment.

From a *Corporate* approach, the company tracks all its carbon emissions from its deliveries and warehouse operations and offsets these with verified carbon offsets to ensure its operations are **carbon neutral**. The list of offsets purchased so far is also readily available through Ecologi.com and at the date of writing the company has already paid to offset over 2,700 tonnes of carbon, and counting …

MRK is committed to running a carbon neutral operation and is also in discussions with vehicle manufacturers regrading fleet electrification, a longer-term project.

Leadership team

MRK's leadership team is spearheaded by its founder and CEO Mark Smithson, who since 1987 has built the business up into an online, technology-driven nationwide retailer. His vision and hands-on day by day execution remain a key component of the company's corporate culture and an attributable source of success.

The executive team is bolstered by a proven CFO in Josh Egan and supported by an experienced team of executives who boast a wide range of disciplines and relevant career experiences which will support the potential of the business to move up to the "next level" in terms of both overall size and market share.

MRK's senior management team consists of Heads of Human Resources, Information Technology, Financial Reporting, Sales & Marketing, Purchasing & Stock Control, Suppler Management and Operations. Complementary backgrounds include key roles at other important consumer facing companies, which include LG, Dominos, Burts Snacks, as well as DHL, Grant Thornton and Cromwell Tools.

Governance

We summarise the board of directors in Figure 12 and detail their biographies in the ensuing paragraphs. Effective governance is reflected in the company's strong people culture, in addition to its increasingly important ESG credentials.

Figure 12 - Board of Directors

Officer	Age	Position	Appointment date
Marnie Millard	57	Independent non-executive Chair	Admission date
Mark Smithson	56	Chief Executive Officer	14 July 2021
Josh Egan	35	Chief Financial Officer	11 October 2021
David Wilkinson	65	Independent non-executive Director	Admission date
Alyson Fadil	48	Independent non-executive Director	Admission date

Source: Marks Electrical Group PLC Admissions Document, 2nd November 2021

Mark Smithson is the founder of Marks Electrical and started the business in 1987, aged 21. Under Mark's leadership, the Group has developed into a fast growing online electrical retailer in the MDA market in the UK. Since founding the business, Mark has built strong relationships with key manufacturers over a long period of time and continues to drive and develop the Group's strategy and daily business operations.

Josh Egan joined Marks Electrical as chief financial officer in 2021. Josh is an experienced finance professional with strong listed company experience, having held regional CFO, head of investor relations, and business development roles at Intertek Group plc and Inchcape plc. Prior to this, Josh worked at Greenhill International & Co and before joining Greenhill, qualified as a chartered accountant with Ernst & Young.

Marnie Millard joined the Board as Independent Non-executive Chair. Marnie is an experienced public company executive and non-executive director, having previously acted as chief executive officer of the AIM-listed Nichols plc since 2012, and brings a wealth of experience in public company management, marketing and brand-building. Marnie is also currently a non-executive director of Finsbury Food plc since 2016 and chair of its remuneration committee since 2019.

David Wilkinson joined the Board as non-executive director. David is an experienced non-executive chairman and director and an ex-Ernst & Young senior partner with a specific background and experience in retail and entrepreneurial led businesses. David is currently non-executive director and chair of the remuneration committee of RBG Holdings plc, as well as being senior independent director and chair of the audit committee of Saietta Group plc.

Alyson Fadil joined the Board as non-executive director. Alyson has over 20 years' experience in recruitment, internal communications, talent development and building employee engaged cultures. Alyson is the current chief people officer of online clothing retailer N Brown plc, a role she has held since 2018. Alyson has worked on the boards of dynamic, fast paced retail businesses including Missguided and Sofology.

Financials & valuation

Relative valuation

Relative valuation tables for Marks Electrical Group are included in Figures 13 and 14. We draw together two groups. Figure 13 shows MRK relative to its **two primary online competitors in the MDA space**. Figure 14 draws valuation comparisons with a **broader group of web-based consumer goods companies**.

Importantly, in the case of Figure 13 we highlight the potential for MRK to trade at a premium valuation to both AO and Currys based on the superior objective feedback received for its offering, as evidenced by its higher Trustpilot rankings, and the unique service qualities which we identify in our section entitled the *"Marks Electrical Difference*."

In our view, MRK's single site operating model, its location and following day service offer give the company superior traction while reducing risk. Moreover, MRK is both more profitable and capable of generating substantial cash which is reflected in a stated 20% pay-out dividend policy.

Figure 13 - Relative valuation - online MDA providers

	Share price p	Mkt cap £m	Net Debt £m	EV £m	Sales 2022 £m	EV/ Sales x	EBITDA 2022 £m	EV/ EBITDA x	EPS 2022 p	EPS 2023 p	P/E 2022 x	P/E 2023 x	DPS 2022 p	Yield
AO World (AO)	85	407	-11	396	1599	0.2	11.8	33.5	-4.0	-2.0	n/a	n/a	n/a	n/a
Currys (CURY)	85	945	671	1616	9853	0.2	582.0	2.8	11.0	13.0	7.7	6.5	3.0	3.5%
Marks Electrical (MRK)	98	103	-3	100	80	1.2	7.2	14.0	4.7	5.3	21.0	18.4	0.8	0.8%
Average						**0.6**		**16.8**			**14.4**	**12.5**		**2.2%**

Source: ADVFN, Market Screener, ED
Share prices at 15th March 2022 close

Relative to a broader group of web-based consumer goods companies, MRK trades beneath the average of this peer group on EV/sales and P/E grounds. While EV/EBITDA represents a premium and the dividend yield is lower, we note the scope for operational gearing to substantially boost profitability at MRK going forward and the ample cash headroom to raise the dividend pay-out ratio.

We strip out Ocado from the profitability measures due ongoing expectations of losses at EBITDA and EPS level.

Figure 14 - Relative valuation - online consumer goods providers

	Share price (p)	Shares (m)	Mkt cap (£m)	Net debt (£m)	EV (£m)	Sales 2022 (£m)	EV/ sales (x)	EBITDA 2022 (£m)	EV/ EBITDA (x)	EPS 2022 (p)	EPS 2023 (p)	P/E 2022 (x)	P/E 2023 (x)	DPS 2022 (p)	Yield (%)
ASOS (ASC)	1663	100	1658	-125	1533	4290	0.4	276	5.6	73.0	109.0	22.8	15.3	n/a	n/a
B&M (BME)	555	1001	5561	1985	7546	4757	1.6	822	9.2	41	39	13.5	14.2	17.0	3.1
Boohoo (BOO)	87	1239	1083	-79	1004	1978	0.5	126	8.0	3.0	4.0	29.1	21.8	n/a	n/a
Dunelm (DNLM)	1098	202	2222	103	2325	1504	1.5	287	8.1	80	81	13.7	13.6	42.0	3.8
Marks Electrical (MRK)	98	105	103	-3	100	80	1.2	7	14.0	4.7	5.3	21.0	18.4	0.8	0.8
Next (NXT)	6240	127	7945	1825	9770	4758	2.1	1162	8.4	528	563	11.8	11.1	255.0	4.1
Ocado (OCDO)	1188	741	8805	954	9759	2990	3.3	58	nmf	-45	-32	nmf	nmf	n/a	n/a
Pets at Home (PETS)	377	500	1884	341	2225	1296	1.7	269	8.3	27	28	14.0	13.5	11.0	2.9
Average							**1.5**		**8.8**			**18.0**	**15.4**		**2.9**

Share prices are as of 15th March 2022 close

MRK's combination of market share gains, track record, and sizable headroom to add market share, places the company in a strong position when valued against a number of online companies. It can be argued that the scope for superior sales revenue growth merits significantly higher multiples in terms of EV/sales and EV/EBITDA as well as P/E.

In our opinion, MRK is an ambitious company at the relatively early stage of its achievable market share gains journey. As a result, what might normally be considered "punchy" multiples seem appropriate.

We base our fair value of 150p on the expected outcome for FY2023 which begins in April 2022. At 150p the relevant FY2023 EV/sales multiple would be 1.9x, EV/EBITDA 18.8x and a 28.2x P/E. (Note that in our relative valuation tables comparative EV/EBITDA ratios are based on FY2022).

Financial forecasts

Rapid sales growth for three consecutive years is a salient feature of our financial forecasts. We look for revenue to increase by 44% in FY2022, having grown by 55% in the first nine months of the year, and to post gains of around 20% in the subsequent two years.

Our revenue projections are based on assumed growth for MRK's core MDA, and more recently TV markets. To these we apply a market share assumption which is expected to grow from its relatively low bases in both categories.

The market share data which we include in this report can be translated into inferred gross revenue for the categories. We then deduct UK VAT at 20%.

Gross margins were unusually strong at 21.3% in FY2021 and are likely to ease in FY2022 as the pricing opportunity associated with Covid fades. Going forward, we forecast 19.5% gross margins, which is in line with company guidance.

MRK expects to reinvest 5% in its brand marketing on a sustainable basis. However, there is scope for this percentage to be increased in the event of scale benefits from sales growth exceeding expectations. Stated dividend policy going forward is a 20% pay-out ratio.

The strength of MRK's balance sheet should be noted in our view. The company paid down all of its bank debt with a £1,538k repayment that was reported in its interim results statement, released on 18th November 2021. The FY2022 balance sheet will be published on 7th June 2022 at which time we expect to initiate forecasts that reflect the finalised post-IPO financial structure of the group.

The company has no external debt facilities and is committed to remaining in a net cash position.

Working capital requirements are expected to remain at about their current level with the potential for stock turnover to improve from 4.9x reported in FY2021 to above 6.0x in our forecast period. The company does not extend consumer credit and expects both receivables and payables to grow no more quickly than sales revenue.

Free cash flow is expected to be positive and become increasingly so as revenue and profits increase. Capital expenditure of 1.5% to 2% of sales revenue is expected to be a sustainable underlying outcome.

Figures 16, 17, 18 and 19 include our forecasts for the group's revenue model, income statement, balance sheet and free cash flow respectively.

The company will release a trading update on 12th April 2022 in relation to the FY2022 financial year. We summarise this year's financial calendar in Figure 15.

Figure 15 - Financial calendar 2022

12 April	Full year trading update
7 June	Full year results announcement FY2022 (12months to 31st March 2022)
11 August	Annual General Meeting
18 November	Half year results announcement FY2023 (12 months to 30th September 2022)

Source: Company

Figure 16 - Revenue model

31 March y/e, £m	2019A	2020A	2021A	2022E	2023E	2024E
MDA						
UK market size	4,800	4,800	5,300	5,400	5,500	5,600
Market growth	0.0%	0.0%	10.4%	1.9%	1.9%	1.8%
MRK market share	0.8%	0.8%	1.2%	1.7%	2.0%	2.4%
TV						
UK market size	n/a	n/a	2,000	2,160	2,340	2,380
Market growth	n/a	n/a	n/a	8.0%	8.3%	1.7%
MRK market share	0.0%	0.0%	0.2%	0.3%	0.3%	0.5%
Implied revenue (gross)						
Implied sales revenue – MDA	37.0	36.5	64.7	92.3	112.5	133.8
Implied sales revenue – TV			3.4	6.4	7.0	11.9
Implied gross sales revenue	37.0	36.5	68.1	98.7	119.5	145.7
Net sales revenue	31.2	31.5	56.0	80.5	96.9	118.1

Sources: Marks Electrical calculations based on GfK market data and Equity Development estimates

Figure 17 - Income statement

31 March y/e, £000s	2019A	2020A	2021A	2022E	2023E	2024E
Revenue	31,247	31,500	55,984	80,470	96,896	118,092
Change	0.0%	0.8%	77.7%	43.7%	20.4%	21.9%
Cost of sales	-25,411	-26,381	-44,064	-64,778	-78,001	-95,064
Gross profit	5,836	5,119	11,920	15,692	18,895	23,028
Gross margin (%)	18.7%	16.3%	21.3%	19.5%	19.5%	19.5%
Other operating income	26	159	165	173	182	191
Advertising & marketing	-2,296	-1,772	-1,711	-4,050	-4,845	-5,905
Other operating expenses	-2,133	-2,637	-3,550	-5,560	-7,190	-8,385
Total operating expenses	**-4,429**	**-4,409**	**-5,261**	**-9,610**	**-12,035**	**-14,289**
As % sales revenue						
Advertising & marketing	-7.3%	-5.6%	-3.1%	-5.0%	-5.0%	-5.0%
Other operating expenses	-6.8%	-8.4%	-6.3%	-6.9%	-7.4%	-7.1%
Total operating expenses	-14.2%	-14.0%	-9.4%	-11.9%	-12.4%	-12.1%
EBITDA (adjusted)	**1,882**	**1,280**	**7,699**	**7,155**	**8,242**	**10,392**
EBITDA margin adj.	6.0%	4.1%	13.8%	8.9%	8.5%	8.8%
Depreciation	-420	-506	-827	-900	-1,200	-1,463
Operating profit (adjusted)	1,404	964	6,776	6,255	7,042	8,930
Operating margin adj	4.5%	3.1%	12.1%	7.8%	7.3%	7.6%
Finance expense	-96	-116	-70	-100	-70	-70
Pre-tax profit (adjusted)	1,308	848	6,706	6,155	6,972	8,860
Taxation (adjusted)	-149	-158	-1,458	-1,262	-1,394	-2,215
Tax rate (adjusted) (%)	-11.4%	-18.6%	-21.7%	-20.5%	-20.0%	-25.0%
Net income (adjusted)	1,159	690	5,248	4,893	5,577	6,645
EPS (adjusted) (pence)	1.1	0.7	5.0	4.7	5.3	6.3
DPS (pence)				0.8	1.1	1.3

Source: ED estimates, Company historic data

Figure 18 - Balance sheet

31 March y/e, £000s	2019A	2020A	2021A
Assets			
Non-current assets			
Investments	665	746	1,146
Property, plant & equipment	5,268	5,091	5,623
Right-of-use assets	445	418	779
Total non-current assets	6,378	6,255	7,548
Current assets			
Inventories	4,772	4,322	11,432
Trade and other receivables	1,968	1,642	2,839
Cash and cash equivalents	670	179	1,493
Total current assets	7,410	6,143	15,764
Total assets	**13,788**	**12,398**	**23,312**
Liabilities			
Current liabilities			
Trade and other payables	5,155	4,592	8,303
Corporation tax liabilities	265	244	1,557
Borrowings	1,592	961	233
Lease liabilities	332	137	330
Total current liabilities	7,344	5,934	10,423
Non-current liabilities			
Other payables	512	197	17
Borrowings	1,743	1,529	1,304
Lease liabilities	54	185	422
Deferred tax liabilities	368	383	618
Provisions for liabilities	155	155	155
Total non-current liabilities	2,832	2,449	2,516
Total liabilities	**10,176**	**8,383**	**12,939**
Issued capital and reserves			
Share capital	6	6	6
Revaluation surplus	573	573	1,235
Retained earnings	3,033	3,436	9,132
Total equity	3,612	4,015	10,373
Total liabilities and equity	**13,788**	**12,398**	**23,312**

Source: Company historic data and Equity Development estimates

Figure 19 - Free cash flow

31st March year-end	2019A	2020A	2021A	2022E	2023E	2024E
All figures in £'000s						
Cash from operating activities	**1,042**	**268**	**6,045**	**5,457**	**5,772**	**7,397**
Changes in operating assets and liabilities						
Inventories	-381	450	-7,110	-2,568	-3,000	-2,500
Receivables	-78	326	-1,197	839	-408	-527
Payables	369	-759	3,513	4,399	2,590	3,341
Cash from operations	952	285	1,251	8,128	4,953	7,712
Corporation tax paid	-82	-297	-66	-2,042	-1,394	-2,215
Net cash from operating activities	**870**	**-12**	**1,185**	**6,086**	**3,559**	**5,497**
Cash flows from investing activities						
Property, plant & equipment - purchases	-218	-57	-216	-1,408	-1,696	-2,067
Property, plant & equipment - disposals	48	156	26			
Net cash from investing activities	**-170**	**99**	**-190**	**-1,408**	**-1,696**	**-2,067**
Dividends received		42				
IPO proceeds				4,481		
IPO costs				-2,500		
Interest paid	-75	-105	-42	-100	-70	-70
Net cash from finance activities	**-75**	**-63**	**-42**	**1,881**	**-70**	**-70**
Free cash flow before dividends	**550**	**-81**	**911**	**6,458**	**1,723**	**3,290**
Dividends paid	**-352**	**-315**		**-3,883**	**-1,231**	**-1,186**
Free cash flow after dividends	**198**	**-396**	**911**	**2,575**	**492**	**2,104**
Note item:						
Repayment of borrowings				-1,537		

Source: Company historic data and Equity Development estimates

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