

Marshall Motor Holdings

Interim results

Strong H1 in a softening market

As indicated in the pre close trading statement, Marshall Motor Holdings (MMH) made good progress in H117, outperforming a weaker UK new car retail market. While uncertainty remains over the direction of end market demand, management's growth strategy is facilitated by the strengthened balance sheet. Our forecasts are unchanged and assume ongoing market pressure in the second half of the year, with the rating discount to its peers likely to unwind further on any signs of market resilience during H2.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15	1,232.8	15.8	15.8	2.98	9.4	2.0
12/16	1,899.4	25.4	26.2	5.50	5.7	3.7
12/17e	2,271.1	28.3	28.6	6.45	5.2	4.3
12/18e	2,296.5	28.9	29.2	6.90	5.1	4.6

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles and exceptional items.

Strong underlying growth in H117

Another record trading period was driven by a combination of both acquired and ongoing activities in Retail. Overall group revenues grew 6.7% like-for-like and Ridgeway's contribution was in line with expectations. Revenues rose by 43.7% to almost £1.2bn and profit before tax increased 32.9% to £18.6m. Despite margin investment in the used car activities to increase throughput, progress in Retail more than offset the anticipated fall in profit in the smaller Leasing segment. Adjusted net debt stood at £35.1m at the end of the period, representing 0.7x 12-month trailing EBITDA. The freehold/long lease property portfolio of £112.5m represents 145p per share or 71% of net assets (£158.0m or 204p per share). The strong balance sheet allows management to pursue both organic and acquired growth opportunities, and the 19% increase in the dividend is a sign of confidence.

Market direction likely to clarify in H2

Car market prospects remain uncertain due to a combination of factors: revised vehicle excise duties (VED); the general election; potential Brexit outcomes; adverse press with respect to personal contract plans (PCPs) to finance new and used car purchases; and the continuing policy bias against diesel. The pull forward of new car sales into Q117 caused by the VED changes has been especially distorting, with weakness persisting into July. As H2 progresses we expect a return to more representative car purchasing behaviours, but as yet it is hard to determine whether this is up or down. The SMMT now expects a 6.3% fall in H217 new car sales as reduced confidence among buyers continues to weigh on purchasing.

Valuation: Discount to peers set to close

Our earnings forecasts assume a tougher trading environment in the second half and remain unchanged following our recent modest upgrade. The shares continue to trade at a 25% P/E ratio discount to MMH's immediate peers in UK automotive retailing, with a prospective yield over 4%. We feel the discount is likely to close should market conditions show signs of improvement in the second half.

Automotive retail

16 August 2017

Price 149p
Market cap £115m

Adjusted net debt (£m) at 30 June 2017	35.1
Shares in issue	77.4m
Free float	34.9%
Code	MMH
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	4.9	(5.7)	(1.7)
Rel (local)	4.6	(5.0)	(8.3)
52-week high/low	178.5p	133.5p	

Business description

Marshall Motor is the seventh largest UK motor retailer, operating 104 franchises spread across 24 brands at 90 locations. It is one of six UK dealership groups that represent each of the top five volume and premium brands. The group has a strong presence in eastern and southern England.

Next events

Pre close statement	January 2018
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Interim results and outlook

Another record trading period was boosted by the full period contribution from Ridgeway. MMH made strong progress in H117 as group sales rose 43.7% to £1.19bn (H116 £0.83bn). Adjusting for the acquisition, sales rose by 6.7% on a like-for-like basis, an encouragingly strong performance against a new car market that was down 1.3%. In part the outperformance is driven by the increasing premium brand franchise mix, which now represent 62% of MMH's portfolio and which continue to deliver strong performances. Underlying profit before tax and EPS both rose by 32.9%. The majority of the improvement can be attributed to the full consolidation of Ridgeway as it increased its contribution to underlying profit before tax by £4.4m to £5.4m.

Exhibit 1: Marshall Motor Holdings first half key data

Six months to June (£m)	H116	H117	% change
Revenues	826.4	1,187.4	43.7%
EBITDA	18.7	27.4	46.8%
EBIT (underlying)	16.3	22.4	37.2%
Profit before tax (underlying)	14.0	18.6	32.9%
EPS (p) - underlying	14.0	18.6	32.9%
DPS (p)	1.80	2.15	19.4%
Net debt	93.1	101.1	
Adjusted net debt	32.4	35.1	
NAV per share (p)	178	204	

Source: Marshall Motor reports

As shown in Exhibit 2, group gross margins fell from 11.9% in H116 to 11.6% in H117 largely reflecting the impact of investment in used car sales in the Retail segment. Leasing fell in line with management expectations, which however represented a sequential improvement compared to H216. Gross margins rose in both the new car and aftersales activities.

Exhibit 2: Marshall Motor Holdings gross margin analysis

Year end December (£m)	2016			2017	% change
	H1	H2	FY	H1	H117 vs H116
New	30.8	38.1	68.9	45.1	46.4%
Aftersales	39.7	52.6	92.3	57.3	44.3%
Used	22.8	27.9	50.7	31.2	36.8%
Retail segment gross profit	93.3	118.6	211.9	133.6	43.2%
Leasing segment	4.9	3.7	8.6	4.032	-16.8%
Group gross profit	98.2	122.3	220.5	137.6	40.2%

Gross margin (%)

New	7.1%	6.9%	7.0%	7.4%
Aftersales	46.1%	45.2%	45.6%	46.5%
Used	7.4%	6.8%	7.1%	6.8%
Retail	11.6%	11.3%	11.4%	11.4%
Leasing	24.0%	19.3%	21.7%	20.7%
Group	11.9%	11.4%	11.6%	11.6%

Source: Marshall Motor reports, Edison Investment Research estimates

Operating costs represented 9.7% of revenues compared to just over 10% in both halves of FY16. This has been achieved despite several cost headwinds such as increased credit card fees, the living wage and other factors. Employee costs remained stable compared to H216, with a rise in other costs being the main driver of the overall sequential increase of £7.5m compared to H216.

Exhibit 3: Operating cost analysis

Year end December	2016			2017	% change	
(£m)	H1	H2	FY	H1	H117 vs H116	H117 vs H216
Employee costs	42.1	59.1	101.2	59.0	40.2%	-0.2%
D&A	2.4	4.5	6.9	5.0	113.1%	10.8%
Operating lease	4.8	5.5	10.3	5.7	19.1%	4.5%
Legal & professional charges	2.7	0.5	3.2	0.6	-77.3%	24.0%
Other	31.8	38.1	69.9	44.9	41.2%	17.8%
Total	83.7	107.7	191.4	115.2	37.7%	7.0%

Source: Marshall Motor reports

In the Retail segment overall new car sales rose by 27.6% to 27,928 units in the period (H116 21,884 units), a like-for-like decline of 3.8% reflecting the policy to withdraw from lower margin fleet sales. These fell by 8.7% on a like-for-like basis, although 11,026 units represented a 20.6% increase when including Ridgeway sales. The like-for-like decline in retail sales of 0.4% compared to a H117 UK retail car sales decline of 4.8% and overall unit sales rose by 32.7% to 16,902 cars.

Overall new car revenues (51.3% of Retail segment sales) increased by 41.8%, reflecting the improved mix brought by the addition of Ridgeway with gross margins improving by 23bp to 7.4% generating gross profits that were 46.3% higher at £45.1m. This was just over one-third of the retail segment's gross profit.

Exhibit 4: MMH half yearly analysis by segment

Year to December	2016			2017e			% change		
(£m)	H1	H2	FY	H1	H2e	FYe	H1	H2e	FYe
New Car	431.0	552.3	983.3	611.2	588.4	1,199.6	41.8%	6.5%	22.0%
Aftersales	86.2	116.4	202.6	123.3	111.0	234.4	43.1%	-4.6%	15.7%
Used Car	306.8	411.5	718.3	458.2	397.0	855.2	49.3%	-3.5%	19.0%
Intra group	-17.9	-26.5	-44.5	-24.9	-30.7	-55.6	38.9%	15.6%	25.0%
Retail revenues	806.1	1,053.7	1,859.7	1,167.8	1,065.7	2,233.5	44.9%	1.1%	20.1%
Leasing	20.2	19.2	39.3	19.5	17.7	37.2	-3.2%	-7.9%	-5.5%
Unallocated	0.2	0.1	0.3	0.1	0.2	0.4	-22.8%	65.4%	15.0%
Group revenues	826.4	1,073.0	1,899.4	1,187.4	1,083.6	2,271.1	43.7%	1.0%	19.6%
Retail underlying EBIT	16.8	17.4	34.2	24.2	17.3	41.4	43.6%	-0.7%	21.1%
Leasing	3.2	2.5	5.7	2.6	2.6	5.2	-18.4%	5.8%	-7.9%
Unallocated	-5.6	-2.0	-7.6	-4.4	-5.1	-9.5	18.3%	32.4%	25.5%
Group underlying EBIT	14.5	17.9	32.3	22.4	14.7	37.1	37.2%	-7.8%	15.0%

Underlying EBIT margins

Retail	2.09%	1.65%	1.84%	2.07%	1.62%	1.86%
Leasing	15.86%	12.79%	14.37%	13.37%	14.70%	14.00%
Group	1.75%	1.66%	1.70%	1.89%	1.36%	1.64%

Source: Marshall Motor reports, Edison Investment Research estimates

Used car revenues (38.4% of Retail) rose by 49.3% on unit sales that rose 43.1% to 23,716 (H116 16,976 units) or by 5.8% on a like for like basis. Used car gross profit rose by 36.9% to £31.2m, with a gross margin of 6.8%, down 63bp on the prior year. The reduction was largely due to efforts to increase stock turnover and drive volume. MMH has a much larger used stock pool following the 2015 and 2016 acquisitions and continues to develop its offering in the segment, especially through an increased online presence with the acquisition of a new web domain (www.marshall.co.uk) and the launch of a used car app.

PCP popularity remained high, accounting for 83% of financed new car sales for MMH. In the used car segment, PCPs financed 62% of financed purchases, up from 55% in H116. The increased overall penetration of PCPs provides a ready flow of three- to four-year-old good-quality used cars, as well as providing improved visibility and connection with customers and facilitating aftersales in conjunction with service plans. We continue to regard the concerns over the use of PCPs as a finance method as being of more concern in the lower end of the market, which is not where major retailers such as MMH operate. Creditworthiness is already a major check against customers.

Aftersales services, including bodyshop, continued to show good growth consistent with the growing UK car parc (vehicles in use). Revenues of £123.3m were up 43.1% on H116 (£86.2m) or 2.3% like-for-like. Aftersales accounts for just 10.5% of Retail turnover, but with gross margins rising to 46.5% (H116 46.1%), gross profit of £57.3m represents 42.9% of the segment total. Vehicle service performance was particularly strong during the period.

In the smaller Leasing segment EBIT fell 11.0% to £2.6m, despite 1.5% year to date growth in the fleet to 6,290 vehicles (up 3.5% over the 12 months). Lower disposal profits per unit and a very strong comparable period performance were the main reasons for the earnings decline. The net book value stood at £72.2m at the period end financed largely through back-to-back loans of £65.9m. The fleet is expected to continue to grow, with a strong order book at the half year.

UK car market prospects remain mixed

The labour market fundamentals and the low interest environment remain supportive of a buoyant new car market. However, consumer and business confidence has had to contend not just with concerns over Brexit but also with the uncertainty that has been created by the general election. Add to this the distortion of the VED changes, negative press with respect to PCP finance and the policy shifts away from diesel, and it is unsurprising that a good deal of uncertainty remains over the direction of the market. The strong Q1 performance has now been outweighed by four straight months of decline.

The SMMT new car registration forecast for 2017 has been revised down once again having been raised from the initial 5% decline to a 2.2% fall in May. The forecast, which is derived from the average consensus of a panel of forecasters, is now for a decline of 3.7% to 2.594m units from 2.693m in 2016. A further 3.4% decline is anticipated in 2017. New light commercial vehicle (LCV = vans) sales are expected to fall by 2.0% to 0.368m vehicles this year and 1.0% in 2018. Both car and van sales remain at very high levels in historical terms. Diesel cars' share of the new car market continues to fall sharply to 43.2% expected this year, down from 47.7% in 2016 and a peak of 50.8% in 2012.

The implication is that the new car market will see a sharper fall in new car sales of 6.3% in H217, compared to the 1.3% decline in H1. The used car market remained buoyant through Q1 with a 3.4% rise in transactions to 2.1m units. However, the overall picture remains muddled and any improvement in confidence levels could stimulate an improvement in demand. Aftersales activity is expected to continue to grow in line with the larger car parc in the UK, supported by an increased number of cars financed on PCPs that require service histories to be maintained.

Earnings estimates unchanged with higher dividend

Like its peers. MMH's most profitable activities in the Retail segment are used car sales and aftersales services. It remains to be seen how the market background translates from the softer new car market but H117 has been encouraging in terms of MMH's outperformance of the market, which we expect to continue in H217. We have a more cautious expectation for the group in like-for-like terms. We expect leasing to remain relatively stable at H117 levels and thus feel our existing overall group earnings estimates are achievable.

The only change is that we have increased our dividend forecast following the larger than expected increase in the interim payment. Assuming management maintains its 1:2 split with the final, we now forecast 6.45p for the current year compared to 6.00p previously. This would be covered 4.4x by FY17e EPS, within management's guided range of 4-5x cover. Of course this does have a modestly detrimental impact on net debt both this year and next.

Exhibit 5: Financial summary

	£m	2015	2016	2017e	2018e
Year end 31 December		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue		1,232.8	1,899.4	2,271.1	2,296.5
Cost of Sales		(1,087.5)	(1,678.9)	(2,003.1)	(2,025.5)
Gross Profit		145.3	220.5	268.0	271.0
EBITDA		22.8	38.7	44.8	44.9
Operating Profit (before amort. and except.)		18.7	32.3	37.1	37.7
Intangible Amortisation		(0.2)	(0.3)	(0.4)	(0.4)
Exceptionals		(0.5)	(3.2)	0.0	0.0
Other		0.0	0.0	0.0	0.0
Operating Profit		18.0	28.8	36.7	37.3
Net Interest		(2.9)	(6.9)	(8.9)	(8.8)
Profit Before Tax (norm)		15.8	25.4	28.3	28.9
Profit Before Tax (FRS 3)		15.1	21.9	27.9	28.5
Tax		(3.6)	(4.4)	(6.2)	(6.4)
Profit After Tax (norm)		9.4	20.2	22.1	22.5
Profit After Tax (FRS 3)		11.5	17.5	21.7	22.1
Average Number of Shares Outstanding (m)		59.4	77.2	77.2	77.2
EPS - normalised (p)		15.8	26.2	28.6	29.2
EPS - normalised and fully diluted (p)		15.3	25.5	27.9	28.5
EPS - (IFRS) (p)		19.3	22.6	28.1	28.7
Dividend per share (p)		3.0	5.5	6.5	6.9
Gross Margin (%)		11.8	11.6	11.8	11.8
EBITDA Margin (%)		1.8	2.0	2.0	2.0
Operating Margin (before GW and except.) (%)		1.5	1.7	1.6	1.6
BALANCE SHEET					
Fixed Assets		150.0	326.4	353.7	380.3
Intangible Assets		40.8	122.0	122.2	122.2
Tangible Assets		109.2	204.4	231.6	258.1
Investments		0.0	0.0	0.0	0.0
Current Assets		307.5	475.2	483.1	476.1
Stocks		240.6	380.0	386.1	382.6
Debtors		28.9	71.0	68.1	64.3
Cash		24.1	0.1	0.1	0.1
Other		13.9	24.1	28.8	29.1
Current Liabilities		(290.1)	(584.9)	(525.0)	(535.5)
Creditors		(263.4)	(507.2)	(525.0)	(535.5)
Short term borrowings		(26.7)	(77.7)	0.0	0.0
Long Term Liabilities		(37.6)	(71.1)	(149.1)	(141.1)
Long term borrowings		(24.7)	(41.4)	(119.5)	(111.5)
Other long term liabilities		(12.9)	(29.7)	(29.7)	(29.6)
Net Assets		129.9	145.7	162.7	179.9
CASH FLOW					
Operating Cash Flow		29.6	98.9	65.7	75.4
Net Interest		(1.1)	(1.4)	(2.9)	(3.8)
Tax		(3.0)	(17.3)	(6.2)	(6.3)
Capex		(39.6)	(61.9)	(66.4)	(65.1)
Acquisitions/disposals		(21.5)	(91.4)	1.0	0.0
Financing		66.9	0.0	0.0	0.0
Dividends		(15.4)	(3.3)	(4.5)	(5.1)
Other		8.6	(15.5)	13.0	13.0
Net Cash Flow		24.5	(91.8)	0.4	8.0
Opening net debt/(cash)		51.7	27.2	119.0	119.4
HP finance leases initiated		0.0	0.0	0.0	0.0
Other		0.0	0.0	0.0	(0.0)
Closing net debt/(cash)		27.2	119.0	119.4	111.4

Source: Marshall Motor reports, Edison Investment Research estimates

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