EDISON

Norcros

H122 results

Delivering progress

Construction & materials

Management guidance and our headline estimates are unchanged following a very good H122 trading performance. Norcros is a leading player in its product categories and market channels, and represents a modestly valued way for investors to gain exposure to the active residential renovation subsector.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/20	342.0	27.1	26.1	3.1	11.8	1.0
03/21	324.2	29.0	29.1	8.2	10.6	2.7
03/22e	380.1	34.6	32.8	9.0	9.4	2.9
03/23e	392.0	36.0	34.0	9.8	9.0	3.2

Note: *PBT and EPS (fully diluted) are normalised, excluding amortisation of acquired intangibles, exceptionals, pension net finance costs and change in fair value of derivatives.

Robust model delivering profit growth

H122 results for Norcros showed excellent progress; revenue of c £200m (+18.4% constant currency exchange rate, like-for-like, CC l-f-l, versus H120) and EBIT of £22m (11.0% margin, 140bp above H120 levels) were both consistent with pre-close guidance, as was the period-end core net cash of £1m. Both divisions delivered strong underlying revenue progress and UK operations drove the group EBIT uplift. Norcros declared a 3.1p interim dividend. While underlying market demand has been good overall, the company's robust business model (which has performed creditably through both the COVID dip and subsequent rebound) has additionally secured share gains. In sectors where supply chain challenges, transportation and other cost inflation have been widely flagged across the industry, this is a noteworthy achievement.

Balanced outlook, guidance maintained

With regard to outlook, management maintained previous guidance, balancing out currently healthy activity levels by referencing some of the factors which were successfully navigated in H1 (eg cost inflation, supply chain challenges) as well as an expectation of 'normalising consumer demand' in both of its main sales territories. Our estimates are unchanged at the headline level, although we have slightly rebalanced the EBIT mix in favour of the UK based on H122 performance. It is too early to make any concrete observations concerning the latest COVID concerns, noting from previous experiences that the impacts have included demand-side benefits and supply-side costs.

Valuation: Outperformance but rating still modest

Having risen by 54% ytd, Norcros's share price has significantly outperformed the FTSE All-Share Index. Much of this occurred in the early part of 2021; apart from a spike with the H122 pre-close update in October, it has traded in a range around 300p for much of the year. With unchanged estimates this time, valuation metrics are very similar to our last note with a current year P/E of 9.4x and an EV/EBITDA (adjusted for pensions cash) of 5.9x. A track record of market outperformance and balance sheet capacity to enhance this through M&A activity are relevant considerations for investors, we feel, pending improved visibility on the business cycle once COVID factors start to recede.

20 December 2021

Price	**307p**
Market cap	**£248m**
	ZAR21.2/£
Net cash (£m) at end September 2021 Pre-IFRS 16 basis	1.0
Shares in issue	80.8m
Free float	98%
Code	NXR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	0.0	4.7	54.7
Rel (local)	0.8	2.0	38.8
52-week high/low		341p	186p

Business description

Norcros is a leading supplier of showers, enclosures and trays, tiles, taps and related fittings and accessories for bathrooms, kitchens, washrooms and other commercial environments. It has operations in the UK and South Africa, with some export activity from both countries.

Next event

H122 DPS 3.1p to be paid 11 January 2022

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Edison profile page

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H122 results overview

Strong first half performance in H122 saw Norcros sustain and extend its excellent H221 trading period, which gathered momentum after lockdown-related disruption in the early part of FY21. Against the pre-COVID H120, the company generated good double-digit underlying revenue growth and a 140bp group EBIT margin improvement (to 11%) led by UK operations. Note that all of this progress was generated organically. Norcros ended H122 with a net cash position down to modest levels substantially due to inventory investment above typical seasonal levels. Following a COVID-related pause in H121, the 3.1p interim dividend was in line with that declared for H120.

Exhibit 1: Norcros – divisional and interim splits

£m								Actual H122 vs H120	CER l-f-l H122 vs H120	Actual H122 vs H121
	H120	H220	2020	H121	H221	2021	H122			
Group revenue	**181.2**	**160.8**	**342.0**	**135.3**	**188.9**	**324.2**	**200.8**	**10.8%**	**18.4%**	**48.4%**
UK	115.6	109.8	**225.4**	93.7	126.5	**220.2**	130.8	13.1%	17.5%	39.6%
South Africa	65.6	51.0	**116.6**	41.6	62.4	**104.0**	70.1	6.8%	20.0%	68.4%
Group operating profit (post SBP)	**17.4**	**14.9**	**32.3**	**12.8**	**21.0**	**33.8**	**22.0**	**26.5%**	**N/A**	**72.0%**
UK (including SBP)	12.5	11.9	**24.4**	10.8	16.1	**26.9**	17.0	36.3%	N/A	57.7%
South Africa	4.9	3.0	**7.9**	2.0	4.9	**6.9**	5.0	1.4%	N/A	148.7%
£/ZAR	18.35		**18.97**	21.95		**21.00**	20.00	-8.2%		9.7%

Source: Company. CER l-f-l = constant exchange rate, like-for-like (and adjusts for 27-week H120 and 26-week H122).

Unless stated otherwise, the percentage changes below are all versus the H120 base period.

UK operations: Volume growth and mix effects enhance margin

First-half underlying revenue growth of 17.5% was driven slightly more by volume than pricing, although both showed good advances over H120. The price component partly reflected increases driven by tight supply chain conditions – as seen widely across the sector – but also mix effects. Six of the seven operating companies in the UK achieved revenue growth and, with some of the larger profit contributors also experiencing favourable operational gearing, this drove an overall UK EBIT margin uplift of 120bp versus H120 to 13.0%, a new UK record level we believe.

The trading period was characterised by generally better demand in the residential repair, maintain or improve (RMI) facing channels including retail and online-led vendors. Norcros's operations also further strengthened their position with new housebuilders through new listings and inventory availability. After a period of mixed performance, some of the larger subsidiary companies saw good export demand – especially into the Republic of Ireland – although this was not universal. The three standout company performances (all percentage changes in l-f-l revenue versus H120) were:

- **Triton** (showers, +31.5%, comprising retail +51.5%, trade +12% and export +34%),
- **Merlyn** (shower enclosures, +37.9%; retail +20.7%, trade +61.8% and export +42%),
- **Croydex** (bathroom accessories, +25.7%, driven by retail +30%)

A further three also grew their top line by double digits; a recovery in important export markets benefited Vado, while progress for the other two was UK-led.

- **Vado** (+10.3%), **Abode** (+12%), **Norcros Adhesives** (+19.7%)

Lastly, Johnson Tiles was the only UK business which saw a reduction in sales (by 15%); two-thirds is understood to have been due to an exit from lower-margin lines following a previous capacity reduction action (ie closing the second kiln). Apart from this, Johnson Tiles probably has the highest exposure to the commercial and social housing sectors compared to its UK sister companies and these subsectors have not seen demand as strong as that in private residential.

South African operations: Retail sector leads the way

H122 revenue rose by +20% CER l-f-l (versus H120), heavily influenced by retail sector exposure and, although the divisional EBIT margin fell slightly (by 40bp to 7.1%), operating profit was still c 10% higher on the same basis. After taking a c 8% adverse £/ZAR position into account (again versus H120), sterling profitability was only marginally ahead.

Across the South African businesses, the retail channel was clearly much firmer than all of the others served. **Tile Africa** (a broad-range bathroom products retailer) is the only end-consumer/ user-facing operation in the Norcros group with 34 stores (two of which are franchised) stretching from the Western Cape to the northern Limpopo province. It is the largest of Norcros's four South African operating companies, accounting for just over half of divisional revenue and saw growth of 34% in the period. Underlying residential renovation demand was strong but we believe that inventory availability benefited market share also, as in the UK. Exposure to small contracting business is less significant than retail for Tile Africa; new housebuilding activity remained firm but small commercial projects less so. Supply chain and import restrictions reported elsewhere do not appear to have affected sales performance materially, although may have contributed to a slightly tighter EBIT margin.

While the companies with greater exposure to the trade, contract and commercial channels performed less strongly, some progress was evident. Johnson Tiles South Africa (JTSA, tiles manufacture, sourcing and supply) and TAL (building adhesives) grew revenues by 10.8% and a more marginal 0.9% respectively. Bear in mind that both companies supply Tile Africa also, so underlying activity was stronger than headline growth figures suggest. That said, they are both more exposed to larger commercial projects also, as is House of Plumbing where revenues increased by 10.3% in local currency. This was a three-outlet specialist trade plumbing distributor when it was acquired on 1 April 2019 (ie at the beginning of FY20). While COVID 19 further dampened commercial sector demand that was already soft in comparison to other subsectors, this has allowed Norcros to open a further three outlets formerly run by a competitor that went into administration. This takes the total to seven – having opened another one previously – and looks to be a strategically sensible move consistent with plans for network expansion, albeit that some margin dilution is likely until these new depots become fully integrated.

Balance sheet capacity supports strategic investment

Norcros successfully de-geared during COVID-affected FY21 and, despite rebuilding inventory levels and paying the FY21 final dividend, retained a £1m net cash position (pre-IFRS 16 basis) at the end of H122. This was an improvement from c £7m net debt a year earlier, though down from c £10m net cash at the start of the current financial year.

The healthy increase in EBIT/EBITDA was more than absorbed by a c £18m working capital outflow in the H122 trading period, substantially due to inventory investment with only a minor net absorption into trade receivables/payables. A number of different elements are at work here. Firstly, there is a normal seasonal working capital build reflecting the underlying pattern of demand. Given that business activity levels recovered strongly in H221 and continued into H122, we feel that the normal seasonal pattern will have been superseded by the requirement to hold higher than normal stock to sustain service levels. In the initial COVID lockdown period in 2020, demand recovered faster than supply leading to a thinning of inventory levels generally, so the process of rebuilding began in H221. In addition, with ongoing supply chain challenges, Norcros has taken the strategic decision to invest in higher stock volumes which, amplified by price inflation, has driven the significant working capital absorption seen in H122 and lower cash conversion than normal. Norcros has the balance sheet to support this action and it appears to have been a source of competitive advantage in winning new business and gaining market share. There were no other major new features behind the **operating cash flow of £6m** for the first half.

Other cash flow items were as expected and resulted in a broadly neutral free cash flow position for the half prior to payment of the FY21 final dividend (£6.6m) and principal lease repayments (£2.4m), and overall net cash outflow for the group of c £9m. For the record, Norcros had just under £24m lease liabilities on its end-H122 balance sheet.

Cash flow outlook: Norcros expects to maintain a strategic inventory investment for the time being, meaning that only a small seasonal H2 unwind is likely. An increase in capex has been flagged for the year including IT infrastructure upgrades at Triton and Tile Africa, but otherwise spread across the group; £9m spend for the year is approaching two times owned asset depreciation and we see this level continuing. An overall expected net inflow in H222 rebuilds the net cash position, although not quite back to start year levels on our estimates.

Acquisitive growth potential: Norcros's last acquisition was House of Plumbing (on 1 April 2019) and since this time – even after the above inventory investment – pro forma net debt of c £44m has been replaced by the modest net cash position at the end of H122. Absent any acquisitions, we project net cash generation of c £10m in both FY23 and FY24. Norcros has a committed £120m RCF plus £30m accordion financing arrangement, which runs to November 2022 and will be due for renewal shortly. The recent cash flow performance clearly illustrates a business resilience and capacity for strategic investment and M&A activity despite challenging market conditions.

Pension update: lastly, we should mention the group's defined benefit pension scheme, where the latest triennial review (with a 1 April 2021 valuation date) is currently underway. The gross scheme deficit was c £6m at the end of H122, which we believe is the lowest level for 10 years, and the current arrangement with trustees provides for c £3.3m additional cash contributions by Norcros to the scheme per year. Over the last decade, group EBIT has more than trebled and, given that the balance sheet is also ungeared, it is fair to say that the company covenant has strengthened over this period. The scheme liability position – which stood at £416m at the end of FY21 – is still material of course but the level of contributions relative to the scheme deficit, and with an upswing in the interest (and discount) rate cycle underway, suggests that cash requirements are unlikely to get materially more onerous.

Outlook substantially unchanged

At the time of reporting H122 results, management was expecting little change in market conditions and, although supply chain challenges were ongoing, this partly reflected healthy demand levels which have also allowed input price increases to be passed through. We will continue to monitor margin development and track underlying volume growth rates in subsequent trading updates to ascertain whether an anticipated 'normalisation of demand' is occurring. At this stage, we have made no material changes in our estimates save for a slight rebalancing of group EBIT towards UK operations and away from South Africa, with no overall net change.

The existing group M&A strategy was also unchanged, with an acquisition pipeline that was said to be 'well developed'. Consequently, there is a reasonable expectation of further deal activity at some point – although none is factored into our estimates – and this may well inform the refinancing decision-making process over the next 12 months.

Exhibit 2: Financial summary

£m	2015	2016	2017	2018	2019	2020	2021	2022e	2023e	2024e
March	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS	**Cont.**	**Cont.**	**Cont.**	**Cont.**	**Cont.**	**Cont.**	**Cont.**	**Cont.**	**Cont.**	**Cont.**
Revenue	222.1	235.9	271.2	300.1	331.0	342.0	324.2	380.1	392.0	404.0
Cost of Sales	N/A	N/A	(171.7)	(190.4)	(206.8)	(217.5)	N/A	N/A	N/A	N/A
Gross Profit	N/A	N/A	99.5	109.7	124.2	124.5	N/A	N/A	N/A	N/A
EBITDA IFRS16	24.3	28.0	31.6	34.7	42.2	38.8	39.9	44.7	46.8	48.5
Op Profit (before SBP)	18.3	22.5	25.2	28.3	35.6	32.2	34.7	39.9	41.3	42.7
Net Interest	(1.2)	(0.9)	(0.9)	(1.1)	(1.8)	(1.6)	(1.5)	(0.6)	(0.7)	(0.6)
Other financial - norm	(3.1)	(3.1)	(3.6)	(2.8)	(2.9)	(3.5)	(4.3)	(4.7)	(4.6)	(4.6)
Other financial	2.1	(0.2)	(4.2)	(4.5)	2.3	0.9	(3.0)	(0.4)	(0.4)	(0.4)
Intangible Amortisation	(0.3)	(0.9)	(1.2)	(2.2)	(3.5)	(3.7)	(3.7)	(3.7)	(3.7)	(3.7)
Exceptionals	(4.8)	(2.0)	(3.8)	(4.2)	(4.3)	(9.3)	(3.8)	0.0	0.0	0.0
Profit Before Tax (norm)	14.0	18.5	20.7	24.4	30.9	27.1	29.0	34.6	36.0	37.5
Profit Before Tax (company norm)	15.8	20.4	22.9	26.3	32.6	28.8	30.6	36.3	37.6	39.1
Profit Before Tax (statutory)	11.0	15.4	11.5	13.5	25.4	15.0	18.5	30.5	31.8	33.4
Tax	(3.0)	(2.4)	(3.0)	(3.6)	(6.0)	(4.1)	(3.5)	(7.6)	(7.9)	(8.3)
Other	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Profit After Tax (norm)	11.1	16.1	17.7	20.8	24.9	23.0	25.5	27.0	28.1	29.3
Profit After Tax (statutory)	8.1	13.0	8.5	9.9	19.4	10.9	15.0	22.9	23.9	25.1
Avge Number of Shares Outstanding (m)	59.2	60.6	61.1	68.0	80.2	80.3	80.6	80.9	81.0	81.0
Avge Number of Shares Outstanding FD (m)	61.5	62.2	63.1	69.8	81.1	81.0	80.8	82.4	82.5	82.5
EPS FD - norm (p)	18.0	24.7	24.4	26.8	29.6	26.1	29.1	32.8	34.0	35.5
EPS FD - co norm (p)	21.1	27.7	27.8	29.5	31.7	28.2	31.1	34.8	36.0	37.4
EPS - statutory (p)	13.2	20.8	13.4	14.1	23.9	13.5	18.6	27.8	29.0	30.5
Dividend per share (p)	5.6	6.6	7.2	7.8	8.4	3.1	8.2	9.0	9.8	10.3
Gross Margin (%)	N/A	N/A	36.7	36.5	37.5	36.4	N/A	N/A	N/A	N/A
EBITDA Margin (%)	10.9	11.9	11.7	11.6	12.8	11.3	12.3	11.8	11.9	12.0
Op Margin (before GW and except.) (%)	8.2	9.5	9.3	9.4	10.8	9.4	10.7	10.5	10.5	10.6
BALANCE SHEET										
Fixed Assets	78.3	93.4	98.8	147.9	138.0	150.8	141.2	140.9	140.7	140.3
Intangible Assets	26.9	44.7	44.8	98.9	94.9	96.5	93.6	89.9	86.2	82.5
Tangible Assets	37.6	38.2	43.0	45.0	42.3	49.6	47.6	51.1	54.6	57.8
Other Fixed Assets	13.8	10.5	11.0	4.0	0.8	4.7	0.0	0.0	0.0	0.0
Current Assets	100.4	119.4	165.3	165.1	169.5	188.7	171.0	198.2	214.7	232.8
Stocks	52.2	60.1	70.3	74.9	79.5	78.9	78.1	91.6	94.4	99.3
Debtors	42.6	53.4	57.5	64.4	62.8	62.5	64.6	72.6	76.0	80.1
Cash	5.6	5.9	37.5	25.8	27.2	47.3	28.3	34.0	44.3	53.3
Current Liabilities	(60.0)	(67.6)	(105.7)	(89.8)	(85.1)	(79.2)	(104.1)	(109.2)	(112.0)	(114.1)
Creditors	(58.6)	(64.8)	(74.8)	(81.3)	(81.3)	(79.1)	(104.1)	(109.2)	(112.0)	(114.1)
Short term borrowings	(1.4)	(2.8)	(30.9)	(8.5)	(3.8)	(0.1)	0.0	0.0	0.0	0.0
Long Term Liabilities	(67.4)	(97.6)	(101.8)	(118.6)	(96.7)	(155.9)	(59.7)	(55.5)	(52.5)	(50.9)
Long term borrowings	(18.4)	(35.6)	(29.8)	(64.4)	(58.4)	(83.6)	(17.8)	(25.8)	(25.8)	(25.8)
Other long-term liabilities	(49.0)	(62.0)	(72.0)	(54.2)	(38.3)	(72.3)	(41.9)	(29.7)	(26.7)	(25.1)
Net Assets	51.3	47.6	56.6	104.6	125.7	104.4	148.4	174.4	190.9	208.1
CASH FLOW										
Operating Cash Flow	16.2	18.5	25.5	23.5	35.3	34.8	60.0	30.4	42.5	42.1
Net Interest	(1.3)	(0.9)	(0.9)	(1.1)	(1.8)	(3.5)	(3.2)	(2.4)	(2.5)	(2.4)
Tax	(0.5)	(1.0)	(1.9)	(4.9)	(4.6)	(5.3)	(3.5)	(7.4)	(8.5)	(8.8)
Capex	(1.4)	(6.6)	(8.0)	(7.7)	(5.5)	(4.8)	(2.8)	(9.0)	(9.0)	(9.0)
Acquisitions/disposals	3.3	(23.6)	(2.7)	(59.1)	(2.1)	(9.2)	0.0	0.0	0.0	0.0
Financing	0.2	0.1	0.0	30.1	(0.9)	(0.8)	0.3	(0.8)	(0.8)	(0.8)
Dividends	(3.1)	(3.6)	(4.2)	(5.0)	(6.4)	(7.0)	0.0	(9.1)	(7.4)	(8.0)
Net Cash Flow	13.4	(17.1)	7.9	(24.2)	14.0	4.2	50.8	1.7	14.3	13.1
Opening net debt/(cash)	27.4	14.2	32.5	23.2	47.1	35.0	36.4	(10.5)	(8.2)	(18.5)
IFRS 16 Finance leases	0.0	0.0	0.0	0.0	0.0	(3.8)	(4.3)	(4.0)	(4.0)	(4.0)
Other	(0.2)	(1.2)	1.4	0.3	(1.9)	(1.8)	0.4	0.0	0.0	0.0
Closing net debt/(cash)	14.2	32.5	23.2	47.1	35.0	36.4	(10.5)	(8.2)	(18.5)	(27.5)
IFRS 16 lease liabilities						(25.1)	(24.2)	(23.7)	(23.7)	(23.7)

Source: Company accounts, Edison Investment Research

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