EDISON

Marshall Motor Holdings

FY18 results

A record year despite challenges

Automotive retail

FY18 was another record year for the continuing businesses, with underlying PBT delivered as we expected, a modest rise on FY17 aided by a strong Q4 performance in used cars. The outlook remains challenging for car retailers, compounded by the uncertainty of any Brexit outcome. Nevertheless, Marshall Motor Holdings' (MMH) management is displaying confidence in its robust financial position by continuing investment and increasing the dividend. The resultant yield provides significant support for the shares, which like those of its peers continue to be rated for sharp declines in profitability.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/17**	2,232.0	25.4	26.9	6.40	6.2	3.8
12/18	2,186.9	25.7	27.4	8.54	6.1	5.1
12/19e	2,201.9	24.1	24.6	8.54	6.8	5.1
12/20e	2,257.4	24.3	24.9	8.54	6.7	5.1

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles and exceptional items. **Restated following the disposal of Leasing in FY17.

FY18 delivered despite challenges

In 2018 UK car markets were subject to considerable challenges. Supply-side constraints caused by the introduction of the new WLTP emissions testing regime in September, a sharp reduction in diesel vehicle sales, and the overriding uncertainty caused by Brexit all served to dampen new car demand. MMH's ongoing activities delivered a record underlying profit before tax of £25.7m despite this, aided by a strong used car performance towards the end of the year.

Outlook uncertain but expect robust performance

Brexit continues to weigh on prospects, and the SMMT is forecasting a further modest fall in new car sales in 2019. The supply-side issues caused by WLTP should unwind in H119, but this could remove some of the supportive elements seen in used car markets in Q418. MMH's management's confidence in its strong balance sheet is reflected in high ongoing levels of investment in sites, renewed appropriate M&A, such as the recently announced purchase of Skoda franchises, as well as the dividend cover policy revision that allocates more cash to shareholders. Clearly a more recessionary environment could hurt car retailers, but for the present we expect delivery of robust profitability against the assumed fall in volumes. We expect a flat year in 2020, with subdued demand and continuing cost pressures, offset to a degree by reduced losses at the recently acquired sites.

Valuation: Discounting a sharp contraction

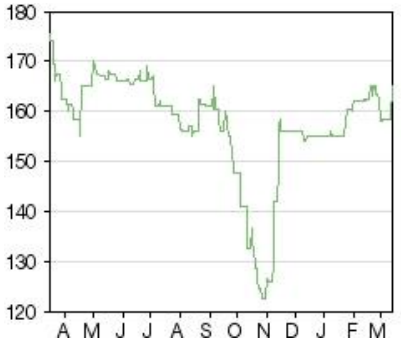
All the valuation metrics continue to suggest there is significant opportunity should current uncertainties wane. In the meantime, the 33% increase in historical yield with the revised dividend cover policy of 2.5x to 3.5x cover provides added support while investors await the unwinding of outstanding car market issues including the economic uncertainty induced by Brexit. The NAV stands at 257p per share at the end of FY18. Our DCF rolled forward to a 2019 base stands at 194p share.

14 March 2019

Price	**168p**
Market cap	**£131m**

Net debt (£m) at 31 December 2018	5.1
Shares in issue	77.9m
Free float	34.9%
Code	MMH
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	1.9	6.5	(1.2)
Rel (local)	2.0	1.7	(0.7)
52-week high/low		176p	123p

Business description

Marshall Motor is the seventh largest UK motor retailer, operating 106 franchises spread across 23 brands at 89 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

AGM	21 May 2019

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FY18 results summary

Despite a market that remained less favourable throughout the second half of the year, MMH has announced FY18 results that met expectations. The main highlights are summarised below:

Exhibit 1: Marshall Motor Holdings FY18 key data

Year to December (£m)	2017*	2018	% change
Revenue	2,232.0	2,186.9	-2.0
EBITDA	42.0	41.4	-0.9
EBIT (underlying)	32.9	32.0	-2.7
Profit before tax (underlying continuing)	25.4	25.7	1.2
EPS (p) – (underlying continuing)	26.9	27.4	1.9
DPS (p)	6.40	8.54	33.4
Net debt	2.2	5.1	
NAV per share (p)	**247**	**257**	**3.6**

Source: Marshall Motor reports. Note: *Restated following disposal of Leasing in FY17, now discontinued.

Group revenues fell by 2.0% to £2.19bn in large part reflecting the closure of some underperforming sites in late 2017. On the company defined like-for-like basis revenues increased by 1.2%, a significant outperformance against UK market declines of 6.8% for new cars and 2.1% for used. Underlying PBT for the continuing businesses grew modestly to a record £25.7m, the FY17 numbers having been restated to reflect the movement of the Leasing business to discontinued activities following its sale in Q417. The company also increased net assets per share by 4% once again to 257p at the end of 2018, supported by 160p per share of long-term and freehold property assets.

Group gross profit fell by 1.0% in FY18 as new car market declines and an adverse mix in aftersales reduced contributions by 9.2% and 1.5%, respectively. The used car segment saw a significant 11.4% increase in contribution benefiting from the strength of performance in the second half of the year as new car supply constraints bolstered used activity and margins. Overall group gross margin increased. Retail gross margins finished some 12bps up for the year, with the improvement in used cars more than offsetting the slight weakness in aftersales margins due to a higher proportion of lower-margin parts sales. On a like-for-like basis, group gross profit fell just £0.6m to £250.5m, with margins 17bp lower at 11.7%.

Exhibit 2: Marshall Motor Holdings gross margin analysis

Year to 31 December (£m)	H117	H217	FY17	H118	H218	FY18	% change		
Revenues									
New Car	611.2	555.3	1,166.5	584.6	480.3	1,064.8	-4.4%	-13.5%	-8.7%
Used Car	458.2	411.6	869.7	474.6	445.7	920.2	3.6%	8.3%	5.8%
Aftersales	123.3	119.8	243.1	126.4	119.7	246.1	2.5%	-0.1%	1.3%
Intra group	(24.8)	(22.5)	(47.3)	(22.7)	(21.6)	(44.3)	-8.5%	-4.0%	-6.3%
Group revenue	**1,167.9**	**1,064.0**	**2,232.0**	**1,162.9**	**1,024.0**	**2,186.9**	**-0.4%**	**-3.8%**	**-2.0%**
Gross profit									
New	45.1	39.0	84.1	40.8	35.6	76.3	-9.6%	-8.8%	-9.2%
Used	31.2	28.7	59.9	34.1	32.7	66.8	9.3%	13.7%	11.4%
Aftersales	57.3	56.7	114.0	58.3	54.0	112.3	1.8%	-4.7%	-1.5%
Internal/Other	0.1	0.2	0.3	0.1	0.2	0.3	-11.3%	-17.2%	-14.6%
Group gross profit	**133.7**	**124.6**	**258.3**	**133.3**	**122.4**	**255.7**	**-0.3%**	**-1.8%**	**-1.0%**
Gross margins									
New	*7.4%*	*7.0%*	*7.2%*	*7.0%*	*7.4%*	*7.2%*			
Used	*6.8%*	*7.0%*	*6.9%*	*7.2%*	*7.3%*	*7.3%*			
Aftersales	*46.5%*	*47.3%*	*46.9%*	*46.1%*	*45.1%*	*45.6%*			
Group	***11.45%***	***11.71%***	***11.57%***	***11.46%***	***11.95%***	***11.69%***			

Source: Marshall Motor reports

In new car markets, the persistent weakness of diesel sales combined with Brexit concerns were exacerbated by supply-side disruption in the second half caused by the introduction in Europe of

the Worldwide Light Vehicle Test Procedure (WLTP) emissions testing regime from September. As a result, UK car registrations finished the year down by 6.8% at 2.37m units, with retail units falling by 6.4% and fleet sales by 7.2%.

Against this market background, MMH recorded a new vehicle unit sales decrease of 13.3% to 46,213 cars (FY17: 53,308), which represented a like-for-like decline of 8.2%. Like-for-like retail unit sales were down by 8.4%

Fleet unit sales dropped 19.4%, in part reflecting the withdrawal from some lower-margin fleet activities as well as site closures. On a like-for-like basis, unit sales fell by 7.7% against a market decline of 7.2%.

Overall new car segment like-for-like gross profit fell by £7.3m or 8.9% to £75.0m, a contraction of 34bp in margin to 7.2%.

In common with other large motor dealership groups, the use of personal contract purchase plans (PCPs) remains an important tool for MMH in the affordability of new cars for customers. In 2018 there was a slight decline in the proportion of new vehicles being bought on finance from MMH using PCPs to 81% (FY17: 83%), but the number of active PCP contracts increased to 69.4k from almost 67.5k at the end of 2017. Previous concerns over PCP utilisation have now largely abated, although the recent FCA report may lead to some restriction on the types of commission models for some dealers.

PCPs are regarded as beneficial in retaining customer engagement when renewals are due. In addition, PCPs provide a forecastable and high-quality source of vehicles for used car operations, as well as supporting aftersales service volumes.

MMH's performance in the used car segment was once again impressive. Volumes fell 2.1% in line with the market to 43,302 units (FY17: 44,237), but on a like-for-like basis this represented an increase of 2.3%. The gross margin improved by 36bps on revenues up by 5.8% (8.1% like-for-like), as new car market constraints benefited both margin and mix. Like-for-like gross profit for the used car segment rose £7.5m (13.1%) to £65.4m, with margins rising 32bp to 7.3%

Aftersales remains the highest gross margin activity of the group and contributes 44% of group gross profit despite some modest margin pressure. Segment revenues grew by 1.3% or by 2.3% on a like-for-like basis. Like-for-like gross profits declined £0.9m to £110.1m, with margins 144bp lower at 45.7%.

Exhibit 3: Earnings estimates revisions

Year to December (£m)	2018e	2018		2019e		
	Prior	Actual	% change	Prior	New	% change
New Car	1,086.4	1,064.8	-2.0%	1,186.2	1,068.2	-9.9%
Used Car	916.9	920.2	0.4%	926.4	929.7	0.4%
Aftersales	250.4	246.1	-1.7%	257.9	249.2	-3.4%
Intra group	(45.9)	(44.3)	-3.4%	(46.8)	(45.2)	-3.4%
Group revenues	2,207.8	2,186.9	-0.9%	2,323.7	2,201.9	-5.2%
EBITDA	**41.6**	**41.4**	**-0.5%**	**40.8**	**39.2**	**-3.9%**
Underlying EBITA	**32.7**	**32.0**	**-2.1%**	**31.8**	**30.6**	**-3.6%**
Underlying PBT	**25.7**	**25.7**	**-0.1%**	**24.3**	**24.1**	**-1.1%**
EPS - underlying continuing (p)	**26.3**	**27.4**	**4.0%**	**24.9**	**24.6**	**-1.2%**
DPS (p)	6.8	8.5	26.5%	7.0	8.5	22.8%
Net debt/(cash)	3.5	5.1	46.9%	(1.4)	9.8	N/M

Source: Marshall Motor reports, Edison investment Research estimates

Outlook

The trends apparent through the second half of 2018 are likely to remain in place in Q119, and the outlook for the remainder of the year is clouded by Brexit considerations as well as further emission testing changes in H219. The SMMT forecast for UK car registrations in 2019 is for a further modest decline of 2.3% in new cars to 2.31m units, still representing a healthy level of demand in a historical context, but challenging for car retailers nevertheless. The first two months of the year have seen signs of retail market stabilisation although fleet sales have remained weak.

Despite the challenges, management has once again indicated no change to its expectations for FY18. However, we have reduced our FY19 PBT expectations by a further 1% following the confirmation of FY18 performance.

Our view of FY20 also remains cautious, as the continued soft market perspective and continuing cost inflation drag on performance, although we do expect the recently acquired Skoda dealerships to reach break-even in FY20.

The balance sheet remains extremely strong with only £5.1m of net debt at the year-end (FY17: £2.2m) despite high levels of investment in the sites continuing. Capex is now expected to continue at a high level of around £25m in FY19 as investment in sites continues, but should start declining from FY20 as the three-year programme of upgrading facilities since buying Ridgeway completes. MMH took a £6.0m provision in FY17 included in non-underlying items against the cost of withdrawal from the Marshall Group Executive Pension Plan and the one-off £5.5m cash settlement of this occurs in H119. We expect cash flows to improve from FY20 as these factors unwind, reducing net debt materially.

Together with its significant banking facilities, the group is thus well positioned to pursue value creating opportunities in the sector as they arise, with the recent purchases of Skoda sites in January and February confirming that this element of the strategy continues.

In terms of non underlying items, the company took a £9.3m impairment charge against BMW/Mini and Nissan goodwill values. In terms of FY18 closure and restructuring costs, there was a charge of £0.9m, but this was more than offset by a £3.3m reversal of the FY17 provision as outstanding property issues were resolved ahead of time and at a lower cost than anticipated.

The dividend increase of 33% to 8.54p for 2018 reflects a revision of the dividend cover policy from 4x–5x to 2.5x–3.5x. The increase in the payout ratio provides a highly supportive yield for investors of 5.1%, and despite expectations of a relatively flat FY19 and FY20 EPS performance we expect the payment to be maintained within the new cover limits. The dividend should continue to provide share price resilience for MMH. Auto retailers remain cautiously rated by the market compared to the more general retail sector, but we continue to believe that if the larger groups continue to display resilience in soft markets, the market should start to increasingly consider what value might be afforded as and when the economic outlook improves.

Exhibit 4: Financial summary

£m	2017	2018	2019e	2020e
Year end 31 December	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	2,232.0	2,186.9	2,201.9	2,257.4
Cost of Sales	(1,973.7)	(1,931.2)	(1,944.5)	(1,993.5)
Gross Profit	258.3	255.7	257.4	263.9
EBITDA	42.0	41.4	39.2	39.6
Operating Profit (before amort. and except).	32.9	32.0	30.6	31.1
Intangible Amortisation	(0.2)	(0.4)	(0.3)	(0.3)
Exceptionals	(12.8)	(7.0)	0.0	0.0
Other	0.0	0.0	0.0	0.0
Operating Profit	19.8	24.7	30.3	30.8
Net Interest	(7.5)	(6.4)	(6.6)	(6.8)
Profit Before Tax (norm)	25.4	25.7	24.1	24.3
Profit Before Tax (FRS 3)	12.3	18.4	23.8	24.0
Tax	(3.1)	(4.8)	(5.1)	(5.1)
Profit After Tax (norm)	20.8	21.3	19.0	19.2
Profit After Tax (FRS 3)	9.2	13.6	18.7	18.9
Average Number of Shares Outstanding (m)	77.4	77.7	77.2	77.2
EPS - normalised (p)	26.9	27.4	24.6	24.9
EPS	26.1	26.5	23.8	24.1
EPS - (IFRS) (p)	11.9	17.5	24.2	24.5
Dividend per share (p)	6.40	8.54	8.54	8.54
Gross Margin (%)	11.6	11.7	11.7	11.7
EBITDA Margin (%)	1.9	1.9	1.8	1.8
Operating Margin (before GW and except.) (%)	1.5	1.5	1.4	1.4
BALANCE SHEET				
Fixed Assets	266.6	270.6	289.9	297.5
Intangible Assets	121.6	112.2	115.6	115.6
Tangible Assets	145.0	158.3	174.3	181.9
Investments	0.0	0.0	0.0	0.0
Current Assets	499.1	465.7	471.6	490.4
Stocks	401.3	384.0	386.6	396.4
Debtors	71.5	59.5	61.7	63.2
Cash	4.9	1.2	2.2	9.2
Other	21.4	21.0	21.1	21.6
Current Liabilities	(539.3)	(503.8)	(510.4)	(523.2)
Creditors	(538.6)	(503.1)	(510.4)	(523.2)
Short term borrowings	(0.6)	(0.6)	0.0	0.0
Long Term Liabilities	(35.2)	(32.0)	(38.3)	(39.2)
Long term borrowings	(6.5)	(5.7)	(12.0)	(12.9)
Other long term liabilities	(28.7)	(26.4)	(26.4)	(26.4)
Net Assets	191.2	200.4	212.8	225.4
CASH FLOW				
Operating Cash Flow	60.1	31.8	36.0	35.0
Net Interest	(2.9)	(2.1)	(1.0)	(1.1)
Tax	(3.1)	(4.8)	(5.1)	(5.1)
Capex	(57.5)	(23.7)	(24.5)	(16.1)
Acquisitions/disposals	44.6	1.6	(3.5)	0.0
Financing	0.0	(1.0)	0.0	0.0
Dividends	(4.5)	(5.0)	(6.6)	(6.6)
Other	80.2	0.3	0.0	0.0
Net Cash Flow	116.8	(2.9)	(4.6)	6.1
Opening net debt/(cash)	119.0	2.2	5.1	9.8
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)	2.2	5.1	9.8	3.7

Source: Marshall Motor reports, Edison Investment Research estimates

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