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Marshalls

Construction & materials

20 March 2017

Attractive returns

Improved operating margins, free cash flow and group ROCE were all standout features of FY16 performance. Management is investing in the key business drivers to further enhance Marshalls' market position under a well-executed strategy and underpin expectations of further progress.

Strong returns and cash flow performance

In FY16, PBT, EPS and total DPS all rose by c 30% y-o-y, a very strong outturn in the context of a 3% revenue uplift (domestic/residential +10%, commercial/public sector was flat). Management continues to focus on the business differentiators (ie brand, range, service) to generate above market growth and drive margins ahead (improving business mix, product development, operational efficiency). Working capital – especially inventory – discipline has been a recurring feature. FY16 ROCE reached 23% with Marshalls ending the year in a net cash position. Planned increases in investment in plant and new product development are designed to sustain these financial characteristics and keep evolving the customer proposition.

Ten years on: A better, more resilient business

We note that Marshalls' revenue, PBT, EPS and share price are all currently around 2006/07 levels. Marshalls today has higher commercial/public sector revenue, with domestic around one-third lower (from a broadly even position 10 years ago) and the company goes to market under a single unified brand now. The in-house distribution model is a common thread but new product development activity appears to have greater prominence now. At the corporate level, Marshalls is debt free and no additional cash calls into the DB pension scheme are required. Taken together with some positive long-term trends (in new house building, roads, rail and water management) with more to come from the domestic sub-sector, we believe that the company has better quality earnings, greater resilience and, under the 2020 Strategy, a clear intent to continue to grow profitability.

Valuation: Premium record warrants premium rating

Marshalls' share price has travelled well from 2012 lows. That said, even with a positive response to the FY16 results, it has only just regained the level of a year ago. It remains one of the highest valued stocks in the sector but we believe that the developing financial record warrants a premium rating. The business is well positioned to continue to progress without relying on more buoyant markets to achieve this. Marshalls is set to deliver good earnings and dividend growth; cash credentials offer the potential for both to be enhanced further.

Consensus estimates

Year end	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
12/15	386.2	35.3	14.1	9.0*	25.0	2.6*
12/16	396.9	46.0	18.6	11.7*	19.0	3.3*
12/17e	413.4	48.5	19.8	10.8	17.8	3.1
12/18e	431.7	53.2	21.7	12.2	16.2	3.5

Source: Bloomberg. * Includes supplementary DPS (2.0p in 2015; 3.0p in 2016, payable with 5.8p final).

Price	352.6p
Market cap	£703m

Share price graph

Share details

Code	MSLH
Listing	LSE
Shares in issue	199.4m

Business description

Marshalls is the UK's leading manufacturer of superior natural stone and innovative concrete hard landscaping products, supplying the construction, home improvement and landscape markets. Marshalls operates its own quarries and manufacturing sites throughout the UK, and has a national network of distribution sites. Commercial/public sector accounted for 64% of FY16 revenue, domestic/residential 31% and a small international division based in Belgium the remaining 5%.

Bull

- Leading UK brand and market position.
- Integrated manufacturing and distribution service model.
- Attractive returns and cash generation.

Bear

- UK residential RMI spending still relatively subdued.
- Commercial outlook flat; infrastructure/public sector more encouraging (especially rail, highways).
- International operations less well developed.

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