EDISON

Marshall Motor Holdings

Initiation of coverage

Driving transformational growth

Automotive retail

As Marshall Motor (MMH) celebrates the second anniversary of its flotation on AIM, it can reflect positively on the continuation of its strong growth record, which has driven it to rank seventh among UK automotive retailing groups. The strong brand coverage and excellent relationships with major manufacturers should continue to deliver growth opportunities, despite potentially tougher market conditions. Our fair value for MMH currently stands at 214p per share.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15	1,232.8	15.8	15.8	3.00	10.1	1.9
12/16	1,899.4	25.4	26.2	5.50	6.1	3.4
12/17e	2,263.1	26.5	26.8	5.80	6.0	3.6
12/18e	2,289.5	27.2	27.5	6.00	5.8	3.8

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

Driving for a premier position

Under current management, MMH has grown rapidly, while strengthening both the brand and regional coverage. In 2008 the company sold just 12,188 new cars in its predominantly East Anglian franchises. By 2016 MMH sold over four times as many annually, with used car sales more than trebling over the same period. Group revenues, which exceeded £1bn for the first time in FY14, will readily surpass £2bn in FY17, boosted by Ridgeway Garages acquired last May. The geographic footprint extends to 25 counties primarily across eastern and southern England, with 103 franchises covering 24 brand partners, including the top five of both premium and volume segments. It has the second best UK brand coverage, reflecting the strength of the management team and its excellent relationships with the major car makers.

Navigating routes for growth in an uncertain market

The IPO in April 2015 provided the funding to further the expansionary ambition of management, both organically and through continuing strategic M&A. 2016 was another year of record new car registrations in the UK. Growth has continued so far in 2017, confounding uncertainty about prospects that manifested themselves following the Brexit referendum last June. MMH is positioned to continue to outgrow the market and achieve yet another record performance following the acquisition of Ridgeway. It should both enhance EPS in 2017 and create value. Organic investment to enhance the customer experience both online and in showrooms also continues at a high level. The balance sheet and unutilised funding facilities provide a strong underpinning of the dual investment strategy.

Valuation: Unwarranted discount to peers

MMH trades on an FY18e P/E ratio of 5.7x on our forecasts, 28% lower than the average for UK auto retailers (excluding Inchcape). We do not believe the discount is warranted by relative growth potential, which is supported by a progressive dividend policy. We believe an in line rating is more appropriate, which together with a potential unwinding of the sector's multiple contraction seen since the Brexit vote could drive a significant re-rating.

11 May 2017

Price	**160p**
Market cap	**£124m**

Adjusted net debt (£m) at 31 December 2016	54.5
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	(7.0)	(2.1)	7.7
Rel (local)	(7.9)	(4.6)	(10.1)
52-week high/low		213p	134p

Business description

Marshall Motor is the seventh largest UK motor retailer, operating 103 franchises spread across 24 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	23 May 2017

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Edison profile page

Marshall Motor Holdings is a research client of Edison Investment Research Limited

Investment summary

Company description: A rapidly growing car retailer

Marshall Motor Holdings (MMH) was floated on AIM in April 2015 by Marshall's of Cambridge (MCHL), with a view to encouraging value creation by providing greater autonomy for management to pursue an entrepreneurial growth strategy. MMH retained the entire proceeds from the float, since when it has made two substantial acquisitions, SG Smith and Ridgeway. These have moved it rapidly up the rankings of the highly fragmented UK vehicle retailing market. It is now the seventh largest UK car retailer, with a new car market share of 2.0% in 2016, and 83.5% brand coverage by market share. MMH operates in new vehicle sales, predominantly cars and light commercial vehicles, as well as used vehicle retailing, aftersales servicing including parts and bodyshop, as well as the provision and management of leased vehicles to corporate fleets through Marshall Leasing.

Delivering a strong growth strategy

The tenure of Daksh Gupta as CEO since 2008 has seen MMH transformed through its original five-year strategic plan from a successful East Anglian, family-owned group of car dealerships, to a balanced portfolio of brands with an expanded footprint generating revenues in excess of £1bn by 2014. The first two years of the follow-on strategy have seen no let-up in the pace of expansion. The acquisitions of SG Smith and Ridgeway for £106m in cash since the IPO have moved MMH up to yet another level, taking revenues through the £2bn barrier, strengthening brand and regional coverage, and deepening the relationships with the manufacturers it represents. The company is in the middle of a three-year £75m investment plan to enhance its dealership experience, its customer management systems and its online marketing presence. With adjusted net debt to EBITDA of just 1.2x, the balance sheet remains accommodating as management pursues the invest and grow strategy, both organic and acquired. Underlying net debt is forecast to remain broadly neutral this year despite also facilitating the progressive dividend policy. MMH also has a strong, property-backed asset freehold portfolio that has grown to over £100m, supporting a NAV of 188p per share.

Valuation: Discounts should unwind

Uncertainty over new car sales in 2017 persists. UK employment statistics are at levels not bettered since the 1970s. Consumer spending has been more volatile, but this has not been reflected in UK new car sales which set a new record through April. This is despite the distortion to April sales from the new vehicle excise duty systems that pulled forward some sales into the first quarter. Nevertheless, rising inflation has negative implications for disposable income as well as pricing of imported cars, although the SMMT has just revised its forecast to a 2.6% decline in UK new car sales in 2017 from a fall of 5% previously. Growth in the 0-6 year old UK car parc driven by the high level of new car sales in recent years and the increased penetration of financing products such as personal contract plans (PCPs) should drive organic expansion of both used car and aftersales activities. The full consolidation of Ridgeway will add five months of trading, and overall we expect MMH to grow EPS this year. The multiple contraction induced by the uncertainty following the Brexit vote last June is yet to unwind. If car markets remain healthy, we would expect this during 2017. MMH continues to trade at a 28% FY18e P/E ratio discount to its peers, which we feel is unjustified given its growth dynamics. If both factors combine then our valuation of 214p may be warranted.

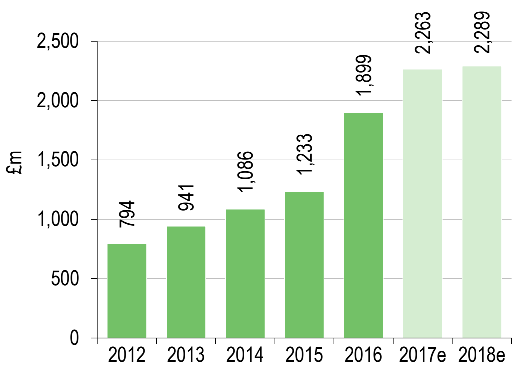
Sensitivities: New car uncertainty may be transient

The major risk for the car retail segment relates mainly to the economic issues mentioned above, and the heavy investment cycle currently in process. MMH is no different, although its increasing availability of data with respect to customers should enable it to reduce volatility.

Company description: Accelerated development

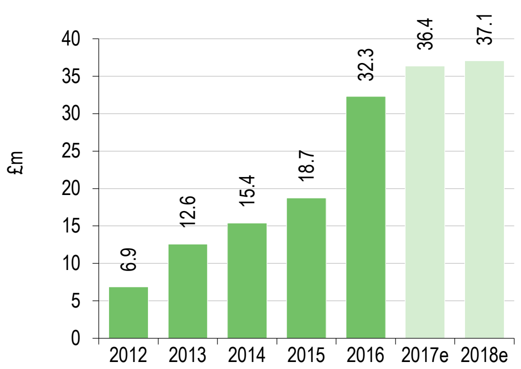
MMH is a rapidly growing integrated car retailer in the UK car market. The majority shareholder is MCHL, the Cambridge-based private holding company of the Marshall family, with businesses in four main sectors: aerospace and defence; motor retail and leasing; property; and fleet solutions. MMH was floated on AIM at the beginning of April 2015 at an initial offer price of 149p, valuing the company at £115.1m on admission. The company received the total net proceeds of £36.9m from the IPO in order to facilitate its growth strategy and since the IPO MMH has spent £130m on acquisitions. MCHL currently retains a 65% stake in MMH following the flotation. MMH operations are entirely within the UK, with four main revenue streams: new car sales, used car sales, aftermarket support and a vehicle leasing operation. Since the arrival of the current CEO in 2008, the business has more than trebled its unit sales volume (see Exhibits 5 and 6), extended its geographic presence, and rebalanced its brand portfolio. As a result, it is now the seventh largest automotive retail group in the UK, with very high brand coverage of 83.5%, which includes each of the top five volume brands as well as the top five premium brands.

Exhibit 1: MMH revenue growth



Source: MMH reports, Edison Investment Research estimates

Exhibit 2: MMH operating profit growth



Source: MMH reports, Edison Investment Research estimates

A growing player in a fragmented market

MMH has been growing rapidly this decade. In part this has been due to the health of UK car demand, both new and used, but also due to strategic M&A. Between 2008 and 2014, the end of the initial five-year strategic plan, MMH had exited 21 underperforming or non-core operations, but had acquired 51 franchises through 13 acquisitions and six start-ups. This included adding the four strategically important German brands, which have grown UK market share to c 30% in recent years. The revenue target of £1bn in the plan was attained in 2014. The second, current phase of the strategic change plan was initiated at that time and is based on "Five Key Strategic Pillars" (see page 4).

Following the acquisitions of SG Smith and Ridgeway since the IPO, MMH has moved clearly into the top 10 UK automotive retail groups measured by turnover and now ranks seventh with revenues in excess of £2bn.

In common with many of the other top ranked groups, MMH is very much a consolidating force in the highly fragmented UK market, with a new car market share of around 2% even allowing for a full year contribution from Ridgeway. We estimate the top 10 groups only account for around 28% of UK new car sales. While this has increased in recent years, it implies there are still plenty of opportunities to grow by acquisition and organically. We note the growing presence of new consolidating forces from overseas. Having taken over Sytner Group, Penske Automotive Group of the US is continuing to expand in the UK. Group 1, again US-based, is also continuing to buy dealerships in the UK. In addition, the disposal of significant city territories by Mercedes-Benz to LSH Auto, a well-established Hong Kong-based internationally diverse group of Mercedes-Benz dealerships, introduces another competitor to the fray.

Exhibit 3: Top 10 UK automotive retailing groups by revenue*

		Sales (£bn) 2016 estimates*
1	Penske Automotive Group	4.91
2	Pendragon	4.50
3	Lookers	4.45
4	Arnold Clark Automobiles	3.50
5	Inchcape	3.03
6	Vertu Motors	2.70
7	Marshall Motor Holdings	2.23
8	Jardine Motors Group	1.75
9	TrustFord	1.70
10	Mercedes-Benz Retail Group	1.65

Source: Companies House, company reports, Edison Investment Research estimates. Note: *Adjusted for full year contributions from known acquisitions/disposals.

Targeting a leading position

The group ambition remains to become the UK's premier automotive dealer group for both car retail and leasing markets, by creating a technology-led culture that enhances customer engagement and differentiates MMH from its competitors. It seeks to deliver the strategy by focusing on its Five Key Strategic Pillars:

- **Class-leading returns:** based on a range of KPIs such as return on capital employed (ROCE), like-for-like volumes and revenue growth, and gross margins.
- **Customer first:** by creating a culture that encourages the delivery of high standards of customer service that help to both retain consumers and encourage recommendations.
- **Retailing excellence:** use internally generated IT platforms and a strong online presence to compete effectively and enhance customer experience through technological applications. MMH is an industry-leading company on social media and has IP invested in the Phoenix management tools and iPad-delivered services in the showrooms.
- **People centric:** focus on colleagues, managing excellence and encouraging a positive working environment with high levels of employee satisfaction and thus retention of achievers. This has been reflected in MMH being voted the top large auto company to work for in the recent 2017 UK Great Place to Work Survey, following seven years of being highly ranked.
- **Strategic growth:** the investment in and delivery of both organic and acquired growth.

Strong OEM relationships are a key strength

It is very important given the ambitious strategy, and in light of the increasing number of large consolidating players, for MMH to continue to nurture and leverage its strong relationships with the car manufacturing groups. In this regard, its unmatched brand coverage in both the premium and volume segments validates MMH's existing credentials and provides a firm base for progression.

The relationships need to be at least maintained and preferably even strengthened further if MMH is going to be presented with opportunities to further its growth strategy. It must maintain high levels of investment in both its existing bricks and mortar asset base to present enhanced customer experiences as the representative of the brand, as well as in the IT systems to present a seamless online marketing presence and manage customer relationships, over increasing periods of time.

The current three-year investment programme of £75m is in line with this objective. As well as improving and upgrading facilities, the programme has delivered significant online and digital developments. The website marshall.co.uk was acquired last year, as was a leasing domain. In addition, the second iteration of MMH's management information system, Phoenix, has been rolled out across the enlarged group. The expectation is this will provide enhanced internal financial controls as well leveraging data acquired from customers.

Multiple revenue streams generating profit and cash

MMH presents its profitability as two distinct segments, Retail and Leasing. In fact, prior to 2009 the two businesses were run separately under MCHL. Following the strategic review in 2008, Marshall Leasing was integrated into Marshall Motors to create the business in its current form, with the Leasing arm now sourcing most of its vehicles from MMH, and providing a relatively high-quality stream of off-lease vehicles for the MMH used car network. While Leasing accounted for just 2% of MMH revenues in 2016, it generated 14% of operating profit before unallocated central costs.

In addition to this segmentation, the Retail element of the model can be broken down further into three distinct but nevertheless linked business lines: new cars, used cars and aftersales.

Exhibit 4: MMH segmental analysis

Year-end December	FY15	FY16	Variance	Like-for-like variance
Group				
Segmental revenue (£m)				
Retail	1,195.5	1,859.7	55.6%	
Leasing	37.0	39.3	6.2%	
Unallocated	0.2	0.3	50.0%	
Total	**1,232.8**	**1,899.4**	**54.1%**	
Underlying segmental PBT (£m)				
Retail	18.8	28.9	53.7%	
Leasing	4.9	4.9	0.0%	
Unallocated	(7.8)	(8.4)	7.7%	
Total	**15.9**	**25.4**	**59.7%**	
Retail				
Revenue (£m)				
New	637.8	983.3	54.2%	13.1%
Used	459.2	718.3	56.4%	8.3%
Aftersales	127.8	202.6	58.5%	5.7%
Internal	(29.3)	(44.5)		
Total	**1,195.5**	**1,859.7**	**55.6%**	**10.8%**
Unit sales				
New	35,103	48,884	39.3%	5.5%
Used	27,699	37,787	36.4%	0.4%
Total	**62,802**	**86,671**	**38.0%**	**3.3%**
Gross profit (£m)				
New	45.7	68.9	50.8%	
Used	33.3	50.7	52.3%	
Aftersales	56.9	92.3	62.2%	
Total	**135.9**	**211.9**	**55.9%**	
Gross profit margin (%)				
New	7.2	7.0		
Used	7.3	7.1		
Aftersales	44.5	45.6		
Total	**11.4**	**11.4**		

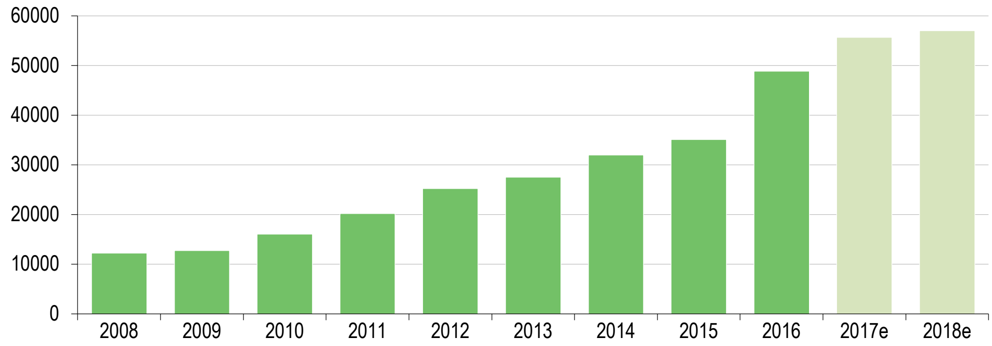
Source: MHM reports

New cars – volume growth to continue

The headline-grabbing segment in automotive terms, the new car segment is the bedrock of the dealership group. Strong new car sales tend to reflect high demand at times of stronger economic performance, although in weaker periods sales can be incentivised by a variety of dealer, manufacturer or even government initiatives. Essentially growth in new car sales tends to expand the UK car parc (the total number of cars on the road), which in turn stimulates used car sales as well as increasing the level of service activity.

Notably, in 2016 MMH achieved like-for-like sales volume growth of 5.5%, more than double the UK market growth rate. After adding the almost 12k unit sales from the acquisitions, the overall increase in new car unit sales rose by 39.3%. New cars accounted for 52% of Retail revenues and almost one-third of gross profit. Even if MMH's underlying new car performance only matches the anticipated downturn in the UK new car market this year, we still expect an additional five months of consolidation of Ridgeway to drive a further increase in unit sales in 2017.

Exhibit 5: MMH new car sales (units)



Source: MMH reports, Edison Investment Research estimates

The role of finance should not be underestimated in the performance of the new car operations. Dealers are incentivised to sell volumes against targets in order to achieve bonuses, and can also benefit from the supply of options and accessories. In addition, dealerships receive commission on utilising manufacturer-backed finance to sell vehicles.

This has led to a sharp rise in the number of vehicles being bought using finance as well as the provision of more sophisticated finance products for the retail customer. Principal among these has been the inexorable rise of personal contract plans (PCPs), whereby a customer places a deposit for a new vehicle, is guaranteed a residual value for the return of the car in a satisfactory state at the end of the contract period and finances the balance (including interest charges) by a series of equal payments on a monthly basis through the life of the contract. The contract term can vary from 24 to 48 months, but tend towards three-year durations, coincident with the first MOT requirement for new vehicles in the UK. Customers would normally have the option to buy the car outright at the end of the contract for the guaranteed residual value.

For the customer the main benefits are:

- finance cost is restricted to only part of the vehicle cost;
- capital outlay is reduced substantially to the upfront payment level; and
- finance payments are spread into stable and more affordable monthly sums.

The benefits for the manufacturers and dealers are:

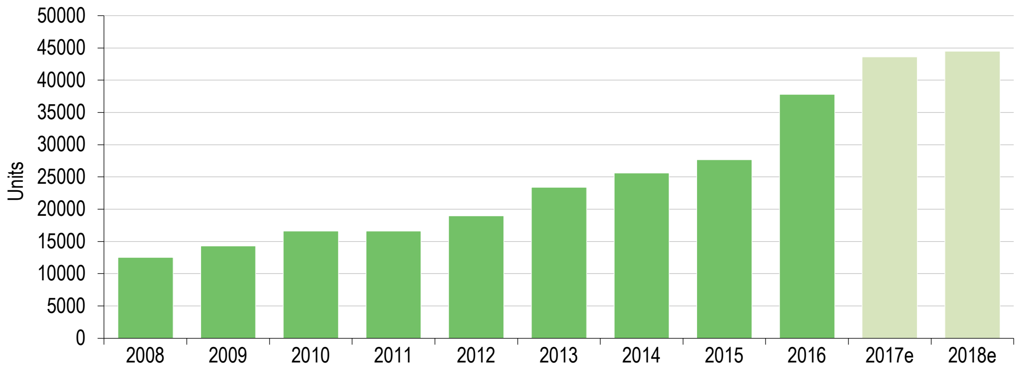
- it tends to tie customers to the manufacturer for both service requirements and when the contract comes to an end as the customer explores options to replace the vehicle;
- it increases visibility for the service and used car operations;
- it provides feedstock for the used car operations, normally of a comparatively high quality; and
- the agglomeration of contracts provides a less volatile stream of business.

In 2016, 84% of MMH's private customers who used dealer provided finance to buy a new car did so using a PCP, with an increased proportion also agreeing to buy service plans.

Used cars: Like-for-like growth set to improve

The UK used car market is roughly three times the size of the new car market in the UK, measured by numbers of transactions. For MMH in 2016, used cars generated 38% of the Retail segment's revenues and 24% of its gross profit. However, like-for-like sales growth in unit terms was only 0.4% higher than in the prior year despite healthy growth in overall UK used car sales. Given a large element of part exchange on an increasing number of PCPs where maturities together with a leasing operation are also increasing inventories of high-quality used stock, we believe this is an area where MMH may see some positive development in 2017.

Exhibit 6: MMH used car sales development (units)



Source: MMH reports, Edison Investment Research estimates

In addition, the improving quality of the used car inventory is allowing large dealers such as MMH to offer finance products more normally associated with new car purchases to customers. In this regard, PCPs are gaining traction, with 55% of non-cash used car customers using a PCP to finance a vehicle purchase in 2016.

Aftersales: A strengthening, high-return activity

Aftersales is essentially garage services involving the servicing, maintenance and repair of vehicles (including bodyshop work), together with the retail supply of spare parts and accessories. Aftersales is by far the highest return stream of MMH's activity. Revenues of £202.6m (FY15 £127.8m) were up 5.7% on a like-for-like basis, and generated gross profits of £92.3m (FY15 £56.9m), a margin of 45.6% (FY15 44.5%). This represented 43.6% of Retail's total gross profit contribution in 2016.

The high level of like-for-like sales growth was especially encouraging. Clearly boosted by the acquired growth, we expect organic development of aftersales to be supported by several factors. As with the positive dynamic for used cars that new car PCPs provide, so both new and used financing are increasingly attaching customers to dealerships' aftersales activities. MMH is no exception, with 72,000 service plans in force with customers, which increase the visibility of aftersales activity. In addition, the revived growth in the nearly new and two to six year old car parcs resulting from the rise in new vehicle sales should provide a sound basis for growth.

Leasing: Integrated, self-financing and relatively stable

Due to the large element of debt attached to the lease fleet, it is sometimes seen as a concern when investors assess motor retailers. However, it is important to note that the debt raised for leasing is essentially asset backed, is excluded from banking covenants and is thus of limited risk for investors. The management of the lease fleet is the main driver of returns.

A leasing model works by winning contracts to run sizeable vehicle fleets for corporate customers. The lessor is responsible for the purchase, management and disposal of the vehicles during the period of the lease, which is normally three years. Simplistically, the model for a single vehicle lease is similar to the example in Exhibit 7:

The actual lease contract revenue and profitability are recognised over the life of the contract with an element of contingency release on completion, with capital disposal profits recognised as incurred at the end of the lease. Clearly, there are variables that can flex within this contract, which would ultimately determine its profitability, and this is where the lessor's experience and scale provides an advantage. Experience of fleet performance allows more accurate pricing of contracts. A lessor's overall lease book is made up of thousands of such contracts, which will flex around the expectations both positively and negatively to determine overall profitability. Lessors can invest or disinvest in lease books. Term debt is raised against the vehicle assets in the fleet eliminating the capital risk for investors.

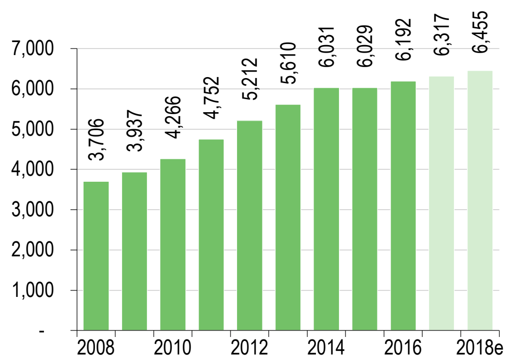
Exhibit 7: Lease example

Element	Total (£)
Initial investment – vehicle purchase	**30,000**
Revenues	
Lease payment income (£769.64 monthly for 3 years)	**27,707**
Costs	
Interest (say 6% for 3 years)	3,438
Depreciation for 3 years (c.60%)	18,000
Maintenance costs (service)	2,250
Other management costs (SG&A)	1,500
Calculated margin on lease (say 10%)	2,519
Total costs	**27,707**
Actual contract profit	**2,519**
Expected residual values (say 40% of new)	12,000
Vehicle disposal price (say 45% of new)	13,500
Vehicle profit	**1,500**
Profit on contract	**4,019**

Source: Edison Investment Research

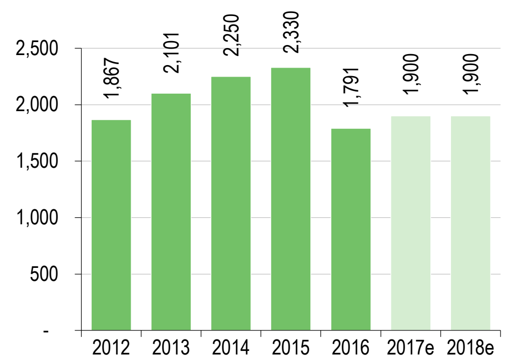
At the end of 2016, MMH's lease fleet was 6,192 vehicles, marginally up on the prior year. It had a gross valuation of £69.6m in the balance sheet, supported by asset-backed by net debt of £64.5m. Gross profit on disposal per vehicle dropped sharply in 2016 to £1,791 (FY15 £2,330) due to specific fleet renewal process issues with a limited number of customers. Nevertheless, the adjusted EBIT contribution held relatively steady at £5.7m (FY15 £6.0m) on revenues up 6.2% at £39.3m (FY15 £37.0m), a margin of 14.4% (FY15 16.2%). The adverse margin impact is not expected to repeat to such an extent in 2017, although we do not expect profit per disposal to fully recover to 2015 levels as these were deemed to be exceptional. Nevertheless, we would anticipate modest growth in the fleet, with improved profitability this year.

Exhibit 8: MMH vehicles on lease (units)



Source: MMH reports, Edison Investment Research estimates

Exhibit 9: MMH – disposal profit per unit (£)



Source: MMH reports, Edison Investment Research estimates

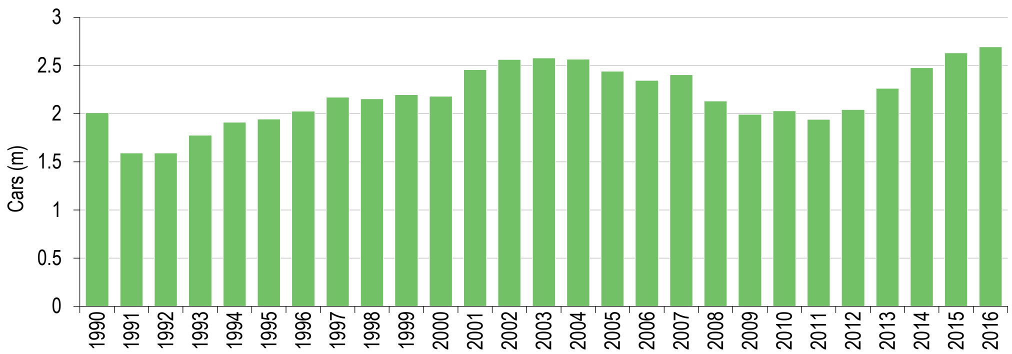
Prospects for the UK car market

In 2016, new car sales rose by 2.3% to 2.69m units, and used car sales also climbed 5.5% to 8.2m units according to the Society for Motor Manufacturers and Traders (SMMT). The record levels of UK car sales naturally create concerns that we may be close to a peak in the market. Such fears have been exacerbated by the vote last June to leave the European Union. Brexit is now in full process with Theresa May triggering Article 50 on 29 March 2017 to start the negotiation process that should lead to the UK leaving the single market.

However, so far it has had no degrading effect on UK economic performance. The main meaningful impact to date has been the depreciation of sterling, which while of benefit to UK exporters raises the prospect of domestic price inflation in markets such as the automotive segment due to the high level of imported products. In fact, both the OECD and the UK government have increased UK economic growth expectations for 2017 in March.

Dynamics of the UK car market

Exhibit 10: UK new car registrations



Source: Bloomberg, SMMT

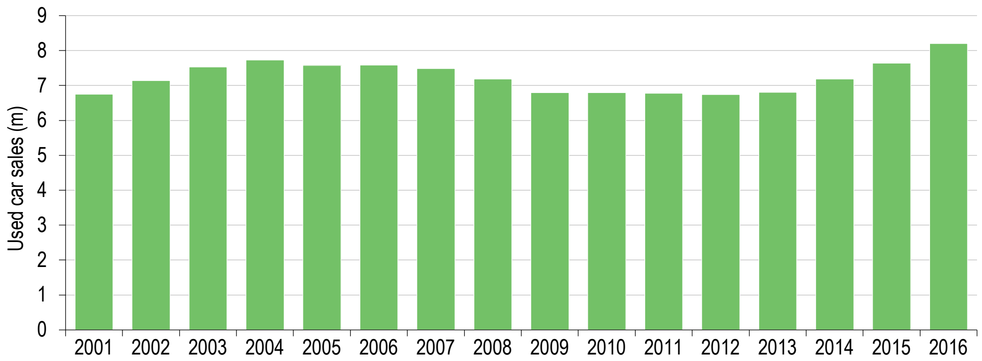
New car registrations in 2016 reached another record at 2.69m vehicles. It was the fifth straight year of progression from the low in 2011 following the global financial crisis. The previous peak was as far back as 2003, when sales reached 2.58m. In our view, consumer confidence and employment levels are the two main factors that determine customers' propensity to buy large ticket items such as cars. Employment levels continue to improve in the UK, and have been boosted by immigration over the last decade. All of the current decade's improvement in registration levels has also been supported by much lower financing costs following the financial crisis. Together with the increasing use of PCP for financing purchases, this has improved affordability of products for customers, while simultaneously increasing the pace of replacement decisions due to their relatively short-term nature.

If the improved economic projections are correct, it seems less likely that we are about to experience a significant downturn, rather that we should continue to see modest progression towards new highs. The January SMMT projection for a 5% decline in 2017 registrations was made before the revisions to economic growth, and has just been revised up to a fall of 2.6%. Nevertheless, this provides a cautious base from which to plan. New car sales were at another record level through April, up 1.1% year on year, but it is too early to say whether this trend is sustainable. The likely pull forward of some sales into Q117 arising from changes to vehicle excise duty (VED) on new cars that came into force on 1 April 2017 was confirmed by sharply lower monthly registrations in April. Q217 should provide more credible evidence of where 2017 outturn will lie, although the timing of Easter (Q217 vs Q116) will also need to be taken into account.

Currently we reflect the 5% like-for-like decline in our new car sales estimates for MMH but expect an overall increase of 1% due to an additional five months of sales from Ridgeway in 2017. We expect modest growth of 3% in 2018, implying a relatively flat two-year like-for-like development.

By comparison, UK used car sales have been comparatively stable, although there are signs of a move to a higher level apparent over the last few years. UK used car sales rose by 5.5% in 2016 according to the SMMT, and it appears to us that this was caused by the lag effect of rising new car sales combining with the increasing numbers of maturing PCPs for those sales, generally at the end of around a three-year term.

Exhibit 11: UK used car transactions



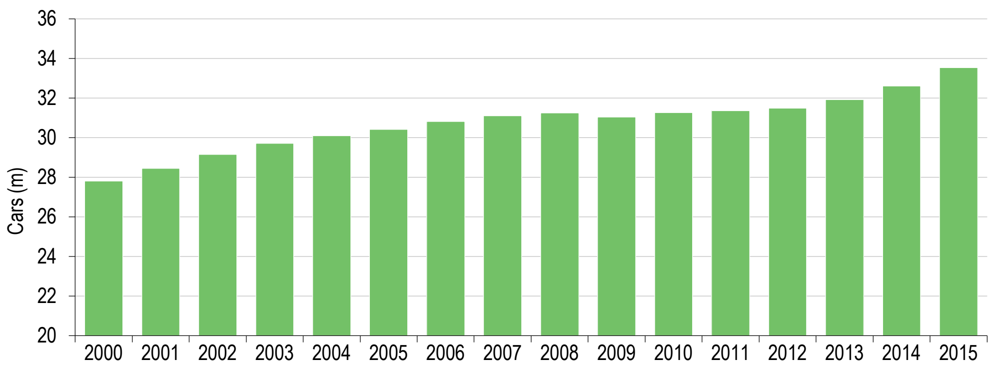
Source: SMMT

The increasing utilisation of PCPs in used car markets may also be stimulating demand, for much the same reasons as the product has proved popular in the new car segment and with much the same benefits for the dealerships. This includes the ability to manage residual values on returned vehicles. For example to increase visibility and management of a vehicle under its second owner also provides greater opportunity to interact with the third tier owner, who is likely to be buying the vehicle outright. Opportunities to provide HP type finance and service offerings through warranties appear likely to increase, largely at the expense of independents.

This therefore has positive ramifications for the aftersales activities. The UK car parc has experienced more positive growth trends over the last couple of years, having been relatively static at just above 31m units since 2007. We expect the car parc to expand further in 2017 and 2018.

The increasing use of PCPs and higher penetration of service agreements are also thought to be benefiting franchised dealerships at the expense of independent service providers. We expect this trend to continue for the time being as the ability to leverage customer relationships increases.

Exhibit 12: UK cars on the road (car parc)



Source: SMMT

Management

MMH has a very experienced management team, with a mix of both automotive and general retail backgrounds. Daksh Gupta was appointed CEO of MMH on 1 October 2008, having joined Marshall from the Ridgeway Garages (Newbury) Limited where he was group managing director. He served as a board member of MCHL until the IPO of MMH in April 2015. He has over 25 years of experience in automotive retailing, including being a franchise director for several leading brands at Inchcape Retail UK. Under his tenure, MMH has already grown dramatically through a series of acquisitions culminating in Ridgeway itself last year, where his previous involvement has helped to facilitate a relatively seamless integration into MMH. The CFO, Mark Raban, joined the company in August 2014. Mark has previously held financial director positions at Inchcape Retail UK and Selfridges Retail Limited, and was CFO for the UK and Ireland at Borders Group.

Oversight of the executive team is provided by a board with similarly strong credentials. The non-executive chairman is Peter Johnson, who served as CEO of Inchcape for seven years to 2005 as well as serving in senior retail roles at Rover Group and MCHL, where he was an NED until MMH's flotation. He has also served on the boards of Bunzl, Rank and Wates Group. His fellow non-executive directors – Alan Ferguson, Sarah Dickins, Christopher Sawyer, Christopher Walkinshaw and Francesca Ecsery – have a wealth of experience in senior corporate positions across a wide spectrum of blue-chip and start-up companies covering many market segments.

Sensitivities

As a car retailing group, MMH is exposed to factors that affect most of its peers in a similar timeframe to themselves. Few, if any, dealership groups are immune from market-driven influences, although in recent years behaviours in the market such as the increased use of PCPs may provide a greater element of stability than may have been experienced historically.

- **Macroeconomic factors** – any major downturn in UK economic performance is likely to affect consumer confidence as well as employment rates. Both are key drivers of car demand in our view, and while the used car cycle may vary from the new, in general terms the propensity to transact is likely to diminish with worsening economic performance. In addition to the adverse volume driven impacts such events might induce, there is a potentially even more damaging influence on pricing levels, with residual values being a key economic factor for dealerships in terms of new car contract roll overs to new purchases, used car stock sales and margins, as well as disposal values in the leasing business.
- **Financing costs** – interest rate fluctuations can influence the affordability of new cars and thus demand, as well as the normal costs on financing the business including stock funding. However, it should be noted that the paid rise in the use of PCPs means that even a 1% rise in financing costs would add only £16.67 a month to a the average new car financing deal. In the current low interest rate environment a 1% rise would be substantial. Concerns that have arisen in the use of PCPs are mainly in the sub-prime credit market, which is not an area where Marshall's operates.
- **FX factors** – while clearly a sterling based market, a large element of new car volumes are either imported and thus susceptible to price inflation as sterling weakens, or in the case of domestic UK production such as Jaguar Land Rover for example, subject to input cost inflation, again potentially pushing prices up. While overseas manufacturers tend to hedge currency risk up to 12 months ahead, over time any sustained depreciation of sterling is likely to increase selling prices as manufacturers look to sustain profits in Europe's second largest market, which generally should dampen demand. However, with the rise of PCP finance penetration in a generally low interest rate environment, sharp reductions in affordability may be mitigated for

dealers. Manufacturers may also increase dealer support through financial packages to help sustain volumes. Of course, FX effects can work in the opposite direction.

- **Risk relating to specific brand performance** – specific dealership performances can be influenced heavily by issues relating to the brand supported; think VW and the Dieselgate fiasco. Such issues can relate to the timing of new model introductions as much as to often transient reliability factors, public perception problems, or the effectiveness of sales incentive schemes for dealers. MMH's expansion has since 2008 reduced the specific risk such issues might have entailed through the broadening of the business across most brands as well the territorial expansion. If you are going to buy a car but get put off by a specific product risk, it is likely that you will still buy a similar level of car with a different badge on the front. The chances are MMH can offer the alternative. It also requires MMH to invest in state-of-the-art dealership facilities to support the brand partnerships, although hedging positions at the OEMs would suggest any influence of a revival in sterling would be deferred by up to a year.
- **Technology risks** – the car market is evolving rapidly with increasing use of online tools by consumers when choosing and effectively initiating transactions. Vehicle retailers must ensure that online portals offer state-of-the-art experiences for customers, and internal relationship management systems must ensure a seamless purchasing and aftersales support processes. Customer behaviours are changing, with dealership visits reducing, and more technical and financial research done prior by purchase. Retailers must ensure appropriate investment in these evolving trends and systems. MMH's current investment programmes certainly appear to be targeting a positive response to this requirement.

Valuation

The automotive retail segment continues to be considered the poor relation in the FTSE All Share general retailers. The high relative value per transaction increases the perception of risk and vulnerability to any consumer spending related slowdowns. A major question for auto retail companies such as MMH is whether the changing nature of car distribution is providing a platform for greater stability and lower volatility in the event of a downturn. If that is the case then a closing of the discount to other retailing sub groups would appear to be warranted. Nevertheless, the multiple contraction experienced by the sector in the immediate aftermath of last June's Brexit vote has yet to be unwound, despite companies reporting a healthy H2 and entering 2017 with strong Q1 positions.

In addition, when looking at MMH in isolation based on our estimates, it continues to trade at a discount on most metrics to its immediate peers in the sector, despite its rapid growth and the strengthening of its portfolio. Our EPS estimates are 2% and 3% above consensus for 2017 and 2018, respectively. Applying the peer group average rating of 8.0x to our FY18e EPS forecast would suggest a value of 219p, which we feel is more appropriate. Using a slightly constrained capped DCF methodology whereby the terminal value is calculated using average period cash flow (as an effort to reflect vulnerability to the shifts in consumer sentiment), we obtain a value of 209p. Using an average of the peer multiple and the DCF we thus calculate our fair value for MMH as 214p per share, which would place it on a marginal FY18e P/E ratio discount to its peers based on our current EPS estimates.

Clearly if sentiment towards the economy and thus the sector does continue to improve from the current expectation of the 2.6% downturn in new car sales this year, then we would expect the sector overall to recover its poise and be re-rated accordingly. Such an event would clearly also benefit MMH as one of the leading players in the sector.

While concerns of an overhang from the majority holding by MCHL may be an excuse for the lower rating, we think this is slightly circuitous. Once sold, the discount would disappear and the fundamental value of the company would not likely have changed. In fact, one could argue that MCHL might be an easier approach for a consolidator than trying to buy a majority floated dealer. In such a circumstance it is unlikely in our opinion that MCHL would entertain a change of control discount to a market valuation, again implying a positive for minority shareholders.

Peer group comparison: discount unwarranted

Exhibit 13: Peer group key metrics comparison

Company	Year end	Price (p)	Mkt cap (£m)	P/E (x)			EV/EBITDA (x)			Dividend yield (%)		
				2016	2017	2018	2016	2017	2018	2016	2017	2018
Marshall Motor Holdings*	**Dec**	**157.0**	**123.8**	**6.0**	**5.9**	**5.7**	**4.8**	**4.1**	**3.8**	**3.5%**	**3.7%**	**3.8%**
Vertu Motors**	Feb	48.3	191.7	7.7	7.5	7.1	4.7	4.3	4.0	2.9%	3.1%	3.3%
Lookers	Dec	121.5	481.8	9.3	8.0	7.7	5.5	5.0	4.8	2.8%	3.1%	3.4%
Pendragon	Dec	35.5	507.1	8.2	9.1	8.5	3.4	4.3	4.1	4.5%	4.2%	4.8%
Cambria Automobiles**	July	75.0	75.0	9.0	8.9	8.7	4.9	5.1	4.9	1.3%	1.3%	1.4%
Inchcape	Dec	852.5	3572.2	16.3	13.1	12.3	9.4	8.2	7.9	3.4%	3.2%	3.4%
Average ex MMH & INCH				**8.6**	**8.4**	**8.0**	**4.6**	**4.7**	**4.5**	**2.9%**	**2.9%**	**3.2%**

Source: Bloomberg consensus, *Edison Investment Research estimates. Note: **Calendarised. Prices as at 10 May.

The table in Exhibit 13 summarises the auto retail segment on three valuation multiples, using current market consensus forecasts for MMH's competitors and our own forecasts for MMH. We choose to exclude Inchcape from the average comparative multiples due to its very international distribution model, whereas the others have a fundamentally UK footprint like MMH. We include Inchcape's valuation metrics for information.

Capped DCF provides a solid underpinning

We have applied a capped DCF methodology to our forecast for MMH, whereby six years of cash flow forecast are used and then the terminal value is calculated on a zero growth basis, with working capital normalised to zero and capex equalled to depreciation. To further constrain the model we have averaged the terminal cash flow to equate to the average over the forecast period rather than the peak in the terminal forecast year. A calculated WACC of 8.8% derived from a cost of equity of 10% and a pre-tax debt cost of 5% is used to discount the cash flows.

This returns a value of 209p per share at present. The table below presents a sensitivity analysis to WACC and terminal growth rates. The current share price is equivalent to discounting the cash flows using a WACC of 9.9%, with zero growth.

Exhibit 14: MMH capped DCF sensitivity table to WACC and terminal growth rates (p)

		WACC					
		7%	8%	9%	10%	11%	12%
Terminal growth	0%	329	256	199	154	118	88
	1%	334	259	202	157	120	90
	2%	338	263	205	159	123	92
	3%	342	266	208	162	125	94

Source: Edison Investment Research estimates

Financials

Our forecasts for MMH are based on a like-for-like reduction in new car sales of 5% in 2017, in line with SMMT projections from January. The April forecast has been favourably revised to a 2.6% decline in 2017, with a 4.1% drop in 2018. This should be more than offset by the additional contribution from Ridgeway from a full year's consolidation.

Earnings growth delivered by M&A and car parc growth

Our forecasts reflect the incremental five-month contribution from Ridgeway in 2017, not just for new car sales, but also for the used and aftersales segments in Retail. We expect these non-new segments to continue to grow, driven by the expansion of the UK car parc, especially at the younger end, which is benefiting from the rising and record levels of new car sales seen over the last several years. We also expect a recovery in Leasing profitability on a modest expansion of the fleet.

Underlying cash flow supporting investment

As noted, MMH is in a heavy organic investment phase in both its dealership facilities and its internal systems and online customer facing technology. Overall Retail capex is thus expected to be maintained at a high level this year before starting to decline from 2018. It should be noted that £2.9m of expenditure was accrued in the accounts at the end of 2016 and this is unlikely to unwind in cash terms in the current year. Our forecasts indicate cash neutrality for the group overall in 2017 with a modest reduction in adjusted net debt. We provide the following table to clarify the movement in adjusted net debt at MMH.

Exhibit 15: MMH cash flow summaries

Year to December (£m)	2015	2016	2017e	2018e
Adjusted EBIT	18.7	32.3	36.4	37.1
Depreciation – Retail	3.6	5.8	6.8	6.8
Depreciation- Leasing	17.2	17.3	17.8	18.3
Amortisation	0.2	0.3	0.3	0.4
Working Capital	(7.6)	38.3	3.7	11.4
Other	0.0	(2.1)	0.0	0.0
Gross operating cash flow	**32.2**	**91.9**	**65.1**	**73.9**
Tax & Interest	(6.7)	(11.6)	(9.8)	(9.9)
Net operating cash flow	**25.5**	**80.3**	**55.3**	**64.0**
Capex – Leasing	(29.7)	(35.5)	(40.0)	(40.0)
Capex – Retail	(9.7)	(25.9)	(25.6)	(24.4)
Capex – Intangible	(0.2)	(0.5)	(0.5)	(0.5)
Fixed asset sales – Retail	0.3	0.7	0.0	0.0
Fixed asset sales – Leasing	8.4	10.7	13.0	13.0
Sale of businesses	0.0	3.1	0.0	0.0
Free cash flow	**(5.4)**	**32.9**	**2.1**	**12.1**
Acquisitions	(21.5)	(94.5)	0.0	0.0
Equity issues	66.9	0.0	0.0	0.0
Dividends	(15.4)	(3.3)	(4.3)	(4.6)
Other (including FX)	0.0	(27.0)	0.0	0.0
Movement in group net debt	**24.5**	**(91.8)**	**(2.2)**	**7.5**
Opening group net debt	(51.7)	(27.2)	(119.0)	(121.1)
Closing group net debt (A)	**(27.2)**	**(119.0)**	**(121.2)**	**(113.7)**
Cash flow from leasing operations	1.9	12.1	8.0	3.0
Leasebook debt – opening	(51.7)	(51.4)	(64.5)	(72.5)
Leasebook debt – closing (B)	**(51.4)**	**(64.5)**	**(72.5)**	**(75.5)**
Adjusted group net debt [(A)-(B)]	**(78.6)**	**(54.5)**	**(48.7)**	**(38.2)**

Source: MMH reports, Edison Investment Research estimates

We exclude the asset backed lease debt from our underlying consideration of MMH as this is unlikely to have recourse to MMH shareholders. We expect the asset backed debt to rise by around £8m in the current year as the fleet expands modestly.

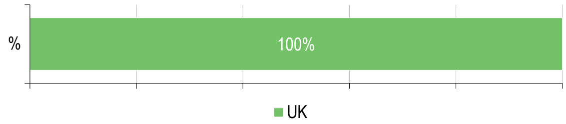
On the underlying debt, the £120m revolving credit facility (RCF) is currently £35m drawn. The drawing shows in the balance sheet as a current year liability although the RCF is in place until 2018 (with a one-year extension to 2020), and the drawing would thus automatically extend as necessary. With an FY17e adjusted net debt to EBITDA ratio excluding leasing of 1.2x, MMH retains significant flexibility to pursue its invest and grow strategy.

Exhibit 16: Financial summary

£m	2014	2015	2016	2017e	2018e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	1,085.9	1,232.8	1,899.4	2,263.1	2,289.5
Cost of Sales	(959.7)	(1,087.5)	(1,678.9)	(1,996.1)	(2,019.3)
Gross Profit	126.2	145.3	220.5	267.0	270.2
EBITDA	19.1	22.8	38.6	43.9	44.2
Operating Profit (before amort. and except.)	15.4	18.7	32.3	36.4	37.1
Intangible Amortisation	0.0	(0.2)	(0.3)	(0.3)	(0.4)
Exceptionals	(0.2)	(0.5)	(3.3)	(0.1)	(0.1)
Other	0.0	0.0	0.0	0.0	0.0
Operating Profit	15.2	18.0	28.8	36.0	36.6
Net Interest	(2.4)	(2.9)	(6.9)	(9.8)	(9.9)
Profit Before Tax (norm)	13.1	15.8	25.4	26.5	27.2
Profit Before Tax (FRS 3)	12.9	15.1	21.9	26.2	26.8
Tax	(3.0)	(3.6)	(4.4)	(5.8)	(6.0)
Profit After Tax (norm)	10.1	9.4	20.2	20.7	21.2
Profit After Tax (FRS 3)	9.9	11.5	17.5	20.3	20.8
Average Number of Shares Outstanding (m)	3.5	59.4	77.2	77.2	77.2
EPS - normalised (p)	286.1	15.8	26.2	26.8	27.5
EPS - normalised and fully diluted (p)	286.1	15.3	25.5	26.2	26.8
EPS - (IFRS) (p)	282.7	19.3	22.6	26.3	26.9
Dividend per share (p)	439.9	3.0	5.5	5.8	6.0
Gross Margin (%)	11.6	11.8	11.6	11.8	11.8
EBITDA Margin (%)	1.8	1.8	2.0	1.9	1.9
Operating Margin (before GW and except.) (%)	1.4	1.5	1.7	1.6	1.6
BALANCE SHEET					
Fixed Assets	115.0	150.0	326.4	354.5	380.9
Intangible Assets	22.1	40.8	122.0	122.2	122.2
Tangible Assets	93.0	109.2	204.4	232.4	258.7
Investments	0.0	0.0	0.0	0.0	0.0
Current Assets	238.1	307.5	475.2	481.4	474.7
Stocks	163.0	240.6	380.0	384.7	381.4
Debtors	19.4	28.9	71.0	67.9	64.1
Cash	1.8	24.1	0.1	0.1	0.1
Other	53.9	13.9	24.1	28.7	29.0
Current Liabilities	(251.4)	(290.1)	(584.9)	(601.1)	(611.8)
Creditors	(223.1)	(263.4)	(507.2)	(523.1)	(533.8)
Short term borrowings	(28.3)	(26.7)	(77.7)	(78.0)	(78.0)
Long Term Liabilities	(35.6)	(37.6)	(71.1)	(73.0)	(65.4)
Long term borrowings	(25.2)	(24.7)	(41.4)	(43.3)	(35.8)
Other long term liabilities	(10.4)	(12.9)	(29.7)	(29.7)	(29.6)
Net Assets	66.2	129.9	145.7	161.8	178.4
CASH FLOW					
Operating Cash Flow	71.1	29.6	98.9	64.0	74.0
Net Interest	(4.5)	(1.1)	(1.4)	(2.9)	(4.0)
Tax	(22.9)	(3.0)	(17.3)	(5.8)	(6.0)
Capex	(33.2)	(39.6)	(61.9)	(66.1)	(64.9)
Acquisitions/disposals	(15.8)	(21.5)	(91.4)	0.0	0.0
Financing	0.0	66.9	0.0	0.0	0.0
Dividends	(4.5)	(15.4)	(3.3)	(4.3)	(4.6)
Other	8.4	8.6	(15.5)	13.0	13.0
Net Cash Flow	(1.3)	24.5	(91.8)	(2.2)	7.5
Opening net debt/(cash)	50.4	51.7	27.2	119.0	121.2
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Closing net debt/(cash)	51.7	27.2	119.0	121.2	113.7

Source: Marshall Motor reports, Edison Investment Research

EDISON

Contact details	Revenue by geography
Airport House The Airport Cambridge, CB5 8RY UK +44 (0) 1223 377000 www.mmhplc.com	

Management team

Chairman: Peter Johnson	CEO: Daksh Gupta
Peter has over 45 years' experience in the automotive sector; he spent 40 years in senior roles in retail and distribution with the Rover group, Marshall and Inchcape plc, where he was CEO between 1999 and 2005. He served on the Bunzl plc board from 2006 to 2015 as its senior independent director. He also chaired Rank plc from 2007 to 2012 and served on the Wates Group Limited board from 2003 to 2013. He is currently chair of the Retail Motor Industry Federation and president of BEN, the Motor and Allied Trades Benevolent Fund. He was a non-executive director of MCHL until 2 April 2015.	Daksh has over 25 years' experience in the automotive retail sector and joined the company in 2008 as CEO. He was a franchise director for Inchcape for seven years, where he was responsible for the Volkswagen, Audi and Mercedes-Benz brands, and also served as COO of Accident Exchange Group plc. Prior to joining MMH he was group managing director for Ridgeway Group. Daksh was a director of MCHL until 2 April 2015 and is vice chairman of the UK automotive industry charity BEN.
CFO: Mark Raban	
Mark was appointed CFO of MMH on 2 April 2015. He has 25 years' of general retail experience, including three as the finance director of Inchcape Retail Limited. He spent three years as CFO for the UK and Ireland at Borders Group and was the interim financial director at Selfridges Retail Limited. He has also held senior finance roles at public companies such as Safeway and Burton.	

Principal shareholders	(%)
Marshalls of Cambridge Holdings	65.11
Union Investments & Development	9.05
Schroders	5.05
Henderson Group	4.46
Polar Capital Partners	3.99
Daksh Gupta (CEO)	1.09
Columbia Threadneedle	0.61

Companies named in this report

Cambria Automobiles (CAMB LN), Inchcape (INCH LN), Group 1 Automotive (GPI US), Lookers (LOOK LN), Pendragon (PDG LN), Penske Automotive Group (PAG US), Vertu Motors (VTU LN)

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