Norcros

Interim results

UK margins up materially, South Africa stabilising

Construction and materials

Norcros's compelling investment case was underpinned at the half year where underlying operating profit was down less than 3% despite material revenue pressure. Group operating margins rose 60bp, the UK business reported record underlying profits and Norcros continued to take market share in both the UK and South Africa. We believe that Norcros's key strengths are underappreciated and that legacy issues, notably the pension deficit, have been resolved. We retain our estimates and value the shares at 246p, implying c 50% upside.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/22	396.3	39.3	38.2	10.0	4.3	6.1
03/23	441.0	41.8	37.4	10.2	4.4	6.3
03/24e	411.7	36.7	31.5	10.2	5.2	6.3
03/25e	412.0	37.9	32.5	10.2	5.0	6.3

Note: *Underlying PBT and underlying EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. EPS is 'diluted'.

H1 pressures, but strategic progress evident

H1 revenue declined 8.3% y-o-y at the headline level to £201.6m, but was down only 4.1% on a constant currency, like-for-like basis. Underlying operating profit was down only 2.7%, largely reflecting the decline in revenue, but the underlying operating margin rose 60bp to 10.6% despite the revenue pressure due to strategic management action that included the closure of the adhesives operation and the 50% capacity reduction at Johnson Tiles. Underlying PBT declined 9.0% as interest costs rose and diluted EPS slid 12.4% to 15.6p. An interim dividend of 3.4p was declared, flat year-on-year. Strong cash generation contributed to the reduction of net debt, from £58.9m a year ago to £46.6m. The net debt to EBITDA ratio at the half year was 1.0x, which implies material headroom.

Compelling investment case underlined

Norcros's successful growth strategy has remained consistent and largely unchanged for many years, focusing on the development of leading market positions with strong brands in highly fragmented markets. Its capital light structure and targeting of the more resilient mid to premium section of the repair, maintenance and improvement (RMI) market reduces volatility. The strong focus on new product development and its 25% 'vitality' rate (sales of products launched in the last three years), coupled with its leading supply chain, implies it is winning market share from smaller competitors. One new product example is the Triton Envi shower, a behind-the-wall digital shower with strong environmental credentials.

Profit forecasts and valuation maintained

While we have reduced our FY24 and FY25 revenue forecasts by c 7–8%, we have maintained our profit estimates and therefore our valuation of Norcros. Our P/E based valuation implies a value of 236p/share based on our diluted underlying FY24 EPS estimate, while our DDM implies a value of 255p/share. The average is 246p, implying c 50% upside. Norcros is trading at the lower end of its long-term consensus forward P/E range on 5.4x (Edison forecast P/E: 5.2x), suggesting that a lot of negativity is priced in. As and when we begin to see recovery in the UK and/or South Africa, the company may well attract a higher multiple.

4 December 2023

Price	**163p**
Market cap	**£145m**
	ZAR23.1/£
Net debt (£m) at 30 September 2023	46.6
Shares in issue	89.3m
Free float	98%
Code	NXR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	12.5	12.2	(10.3)
Rel (local)	9.1	11.5	(9.3)
52-week high/low		223p	136p

Business description

Norcros is a leading supplier of showers, enclosures, 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 events

FY24 trading update	April 2024
FY24 preliminary results	June 2024

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Edison profile page

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New record for UK profits despite tough markets

Norcros's H124 results highlighted the resilient nature of Norcros. Although total revenue declined 8.3%, underlying operating profit was down just 2.7%, benefiting from strategic management actions (described below), which resulted in the achievement of record UK operating margins. We are maintaining our FY24 and FY25 profit estimates, though we have reduced revenue estimates, reflecting current trends. Norcros is a leading player in its field and, with the stock trading on a P/E of just 5.2x, we believe there could be significant upside from the current depressed price level. Furthermore, one of the key historical issues faced by Norcros, that of its historically large pension deficit, remains well under control as the fund has been in an accounting surplus for the last two years.

Group margins up despite issues in South Africa

H1 revenue declined 8.3% y-o-y at the headline level to £201.6m, driven down by a combination of modest revenue growth in the UK and weaker demand in South Africa. Revenue was down only 4.1% on a constant currency, like-for-like basis, but was up 11.3% versus H120 (a pre-pandemic period) in total terms. Underlying operating profit was down only 2.7% y-o-y, largely reflecting the decline in revenue, but was up 23% versus the same period in CY19 (fiscal H120). The underlying operating margin rose 60bp y-o-y to 10.6%, despite the revenue pressure, as the benefits of management action to exit the underperforming adhesives business and the 50% capacity reduction at Johnson Tiles were felt. The inclusion of the higher margin Grant Westfield business was a further positive.

Underlying PBT declined 9.0% as interest costs rose due to the higher average levels of net debt during the period reflecting M&A financing and higher interest rates, and diluted EPS slid 12.4% to 15.6p. An interim dividend of 3.4p was declared, flat year-on-year. Net debt was reduced from £58.9m a year ago, reflecting the acquisition of Grant Westfield, to £46.6m. Net debt stood at £49.9m at 31 March 2023. The net debt to EBITDA ratio at the half year was 1.0x, which implies material headroom to the committed £130m revolving credit facility.

Exhibit 1: H1 results summary, last five years

£m	H120	H121	Y-o-y % chg	H122	Y-o-y % chg	H123	Y-o-y % chg	H124	Y-o-y % chg
Total revenues	181.2	135.3	-25.3%	200.9	48.5%	219.9	9.5%	201.6	-8.3%
Operating profit (underlying)	17.4	12.8	-26.4%	22.0	71.9%	22.0	0.0%	21.4	-2.7%
Underlying operating margin	9.6%	9.5%	-	11.0%	-	10.0%	-	10.6%	-
Underlying PBT	15.6	10.7	-31.7%	20.9	96.2%	19.9	-4.8%	18.1	-9.0%
Profit before tax (post exceptionals and other)	13.3	3.4	-74.4%	17.7	420.6%	14.0	-20.9%	11.7	-16.4%
EPS - diluted underlying (p)	15.1	10.6	-30.2%	20.0	89.8%	17.8	-10.9%	15.6	-12.4
Dividend per share (p)	3.1	0.0	-100.0%	3.1	N/A	3.4	9.7%	3.4	0.0%
Underlying net cash/(debt)	(41.1)	(7.3)	N/A	1.0	-113.7%	(58.9)	N/A	(46.6)	N/A

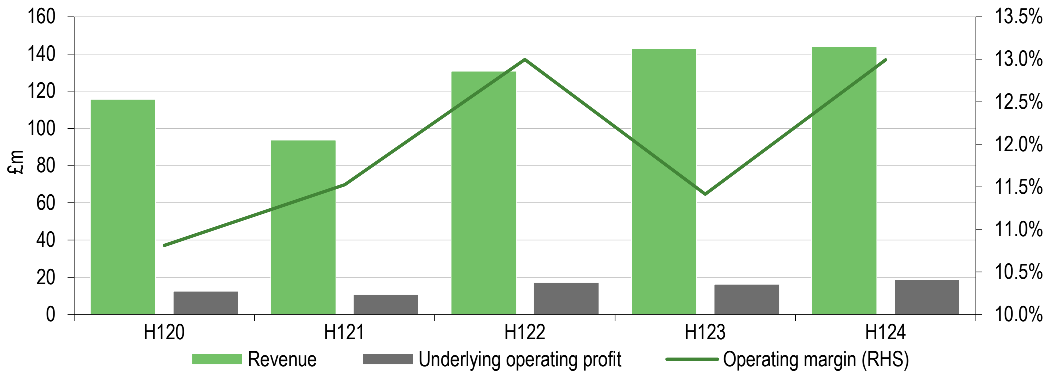
Source: Norcros, Edison Investment Research

UK profits hit record, South Africa hit by power outages

In the UK, which now accounts for 71% of revenue, Norcros generated revenue of £143.9m, up 0.8%. On a like-for-like basis, and excluding Grant Westfield (acquired in May 2022) and Norcros Adhesives, which was closed, revenue slipped just 0.8% with lower volumes almost completely offset by price increases. In particular, the key brands of Triton, Merlyn and Grant Westfield performed well, driven by new product launches, excellent stock availability and great customer service, although Vado was negatively hit by delayed new product launches. RMI demand remained the key driver of revenue. Export revenue increased driven by demand from Ireland, France and the Middle East.

H1 operating profit rose 14.7% or £2.4m, to £18.7m, a record level, and implied that margins rose 160bp to 13.0% in the period. The growth reflects the efforts made to improve the brand portfolio.

Exhibit 2: UK – H1 revenue, operating profit and margin

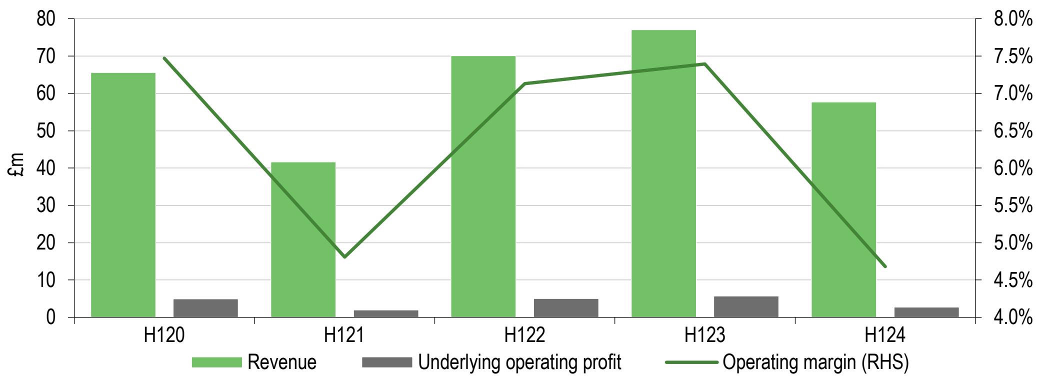


Source: Norcros, Edison Investment Research

The South African business, which makes up 29% of revenue, fell 25% in absolute terms and declined by 11% on a constant currency basis, as higher levels of energy rationing hit consumer confidence and demand. The 'loadshedding' has had a minimal impact on Norcros's own operations and retail stores as they have been equipped to operate during these periods of interruption. Despite the headwinds, Norcros maintained its market share gain momentum by focusing on product development and customer service in the region.

TAL, the leading adhesives business in the region, was able to grow market share, as did House of Plumbing despite flat revenues in a challenging market. Johnson Tiles and Tile Africa were both affected by market slowdowns, particularly in the new housebuilding sector. The market turbulence mentioned resulted in a decline in operating profit, from £5.7m to £2.7m, which implies a decline in margins from 7.4% to 4.7%.

Exhibit 3: South Africa – H1 revenue, operating profit and margin



Source: Norcros, Edison Investment Research

Despite the tough market conditions, Norcros continues to take market share and should benefit from the national roll out of House of Plumbing in South Africa. We anticipate it should also begin to see the market stabilise as energy constraints become less of an issue.

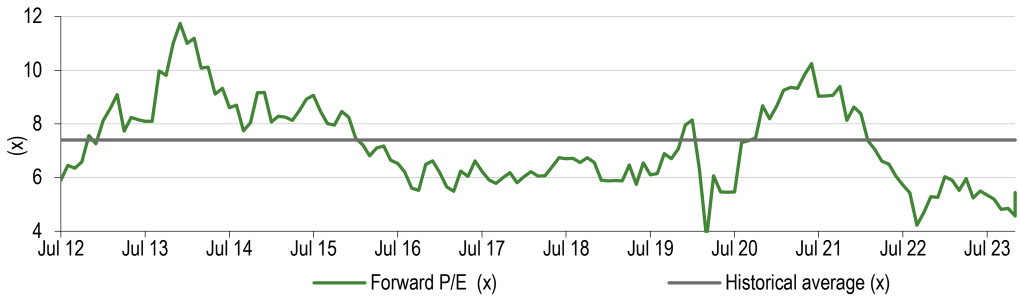
Valuation suggests c 50% upside

Following the H124 results, we have essentially maintained our profit estimates and therefore our valuation of Norcros. Our P/E based valuation implies a value of 236p/share based on our diluted underlying FY24 EPS estimate of 31.5p/share, while our dividend discount model (DDM) implies a value of 255p/share, and if we take the average of the two, we arrive at 246p, implying c 50% upside. Norcros is trading at the lower end of its long-term consensus forward P/E range on 5.4x (Edison forecast P/E: 5.2x), suggesting that a lot of negativity is priced in. As and when we begin to see recovery in the UK and/or South Africa, the company may well attract a higher multiple.

Simple forward P/E multiple valuation implies 236p/share

The chart below details the progression of Norcros's forward P/E over the last cycle. The range at the extremes is a low of 4x reached briefly post COVID-19 and again in 2022, and the high is c 12x at the end of 2013, before the Brexit hiatus. Over this period and outside the extreme ratings, the 'real' range has arguably been 6–9x and the average over the whole period is 7.4x.

Exhibit 4: Norcros – forward P/E ratio (x)



Source: Refinitiv

If we apply the 7.4x forward P/E multiple to our estimate of FY24e diluted underlying EPS of 31.5p, we arrive at a value of 236p/share, implying c 45% upside to the share price. Arguably, this method gives little credit for future potential acquisitions, which are part of the company's strategy and may be forthcoming.

Exhibit 5: Implied valuation based on a range of P/E multiples

P/E target (x)	5.0	6.0	7.0	7.5	8.0	9.0
Implied valuation (p/share)	158	189	221	236	252	284

Source: Edison Investment Research

Dividend discount model implies a valuation of 255p

Our DDM valuation of 255p lends support to the P/E valuation above of 236p/share. We have maintained the base dividend of 10.2p/share, which is more than three-times covered by diluted and underlying earnings. We are confident that forecasts are likely to rise in the longer term given the numerous growth channels available to Norcros, justifying our 5% long-term dividend growth estimate. We remind readers that dividends grew 10.7% pa between 2015 and 2019, which further supports our dividend growth assumptions.

Exhibit 6: Implied valuation (p/share) based on a range of inputs

		Dividend growth rate (%)				
		3.0%	**4.0%**	**5.0%**	**6.0%**	**7.0%**
Cost of equity	**12.0%**	113.3	127.5	145.7	170.0	204.0
	11.0%	127.5	145.7	170.0	204.0	255.0
	10.0%	145.7	170.0	204.0	255.0	340.0
	9.0%	170.0	204.0	**255.0**	340.0	510.0
	8.0%	204.0	255.0	340.0	510.0	1020.0

Source: Edison Investment Research

Exhibit 7: Financial summary

£'m	2021	2022	2023	2024e	2025e	2026e
Year end 31 March	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
Revenue	324.2	396.3	441.0	411.7	412.0	417.2
EBITDA	39.2	47.0	52.3	49.3	49.8	50.3
Normalised operating profit	33.8	41.8	47.3	43.2	43.7	44.2
Operating profit - Underlying	33.8	41.8	47.3	43.2	43.7	44.2
IAS 19R Pension scheme expenses	(1.4)	(1.7)	(1.6)	(1.7)	(1.7)	(1.7)
Impairment and acquisition related costs	(3.7)	(4.8)	(8.4)	(8.2)	(8.2)	(8.2)
Other	(3.8)	0.9	(9.8)	0.0	0.0	0.0
Reported operating profit	24.9	36.2	27.5	33.3	33.8	34.3
Net Interest	(6.4)	(3.2)	(5.8)	(7.9)	(7.2)	(6.4)
Profit Before Tax (norm)	27.4	38.6	41.5	35.3	36.5	37.8
PBT - 'Underlying'	30.6	39.3	41.8	36.7	37.9	39.2
Profit Before Tax (reported)	18.5	33.0	21.7	25.4	26.6	27.9
Reported tax	(3.5)	(7.3)	(4.9)	(7.9)	(8.2)	(8.6)
Profit After Tax (norm)	23.9	31.3	36.6	27.4	28.3	29.1
Profit After Tax (Underlying)	25.1	31.5	36.9	28.8	29.7	30.5
Profit After Tax (reported)	15.0	25.2	16.8	17.5	18.4	19.2
Net income (normalised)	23.9	31.3	36.6	27.4	28.3	29.1
Net income (Underlying)	25.1	31.5	36.9	28.8	29.7	30.5
Net income (reported)	15.0	25.2	16.8	17.5	18.4	19.2
Basic average number of shares outstanding (m)	81	81	88	89	89	89
EPS - basic normalised (p)	29.65	38.70	41.53	30.70	31.65	32.62
EPS - diluted normalised (p)	29.58	37.99	40.89	30.00	30.92	31.87
EPS - Diluted, 'underlying' (p)	31.06	38.23	37.43	31.53	32.45	33.41
EPS - basic reported (p)	18.61	31.15	19.06	19.61	20.56	21.53
Dividend (p)	8.20	10.00	10.20	10.20	10.20	10.50
Revenue growth (%)	(-5.2)	22.2	11.3	(-6.6)	0.1	1.3
EBITDA Margin (%)	12.1	11.9	11.9	12.0	12.1	12.1
Normalised Operating Margin (%)	10.4	10.5	10.7	10.5	10.6	10.6
BALANCE SHEET						
Fixed Assets	141.2	158.8	226.8	215.7	205.0	193.4
Intangible Assets	93.6	90.3	167.1	159.5	151.9	144.3
Tangible Assets	28.0	29.0	24.8	27.6	30.8	33.1
Investments & other	19.6	39.5	34.9	28.6	22.3	16.0
Current Assets	171.0	200.7	216.2	214.3	218.5	220.9
Stocks	78.1	100.6	103.9	107.1	111.2	112.6
Debtors	64.6	71.1	83.3	78.2	78.3	79.3
Cash & cash equivalents	28.3	27.4	29.0	29.0	29.0	29.0
Current Liabilities	(104.1)	(110.8)	(112.7)	(106.1)	(106.2)	(107.4)
Creditors	(95.4)	(102.4)	(99.2)	(92.6)	(92.7)	(93.9)
Tax and social security	(1.0)	(2.7)	(0.9)	(0.9)	(0.9)	(0.9)
Other	(7.7)	(5.7)	(12.6)	(12.6)	(12.6)	(12.6)
Long Term Liabilities	(59.7)	(48.4)	(119.9)	(101.4)	(82.1)	(58.1)
Long term borrowings	(17.8)	(18.8)	(78.9)	(69.0)	(58.3)	(42.9)
Other long term liabilities	(41.9)	(29.6)	(41.0)	(32.4)	(23.8)	(15.2)
Net Assets	148.4	200.3	210.4	222.4	235.2	248.8
Shareholders' equity	148.4	200.3	210.4	222.4	235.2	248.8
CASH FLOW						
Op Cash Flow before WC and tax	39.2	47.0	52.3	49.3	49.8	50.3
Working capital	21.8	(23.6)	(13.3)	(4.6)	(4.2)	(1.2)
Tax	(3.5)	(6.5)	(7.7)	(7.9)	(8.2)	(8.6)
Other	(2.0)	(0.9)	(2.5)	(0.9)	(0.9)	(0.9)
Net operating cash flow	55.5	16.0	28.8	35.9	36.5	39.5
Capex	(2.8)	(5.4)	(6.0)	(8.5)	(9.0)	(8.0)
Acquisitions/disposals	0.0	0.0	(78.3)	0.0	0.0	0.0
Net interest	(3.2)	(2.5)	(5.5)	(4.8)	(4.1)	(3.3)
Dividends	0.0	(9.1)	(9.2)	(9.0)	(9.1)	(9.1)
Other	(3.2)	(2.5)	14.6	(3.7)	(3.7)	(3.7)
Net Cash Flow	46.3	(3.5)	(55.6)	9.9	10.6	15.4
Opening net debt/(cash)	36.4	(10.5)	(8.6)	49.9	40.0	29.3
FX	0.6	1.6	(2.9)	0.0	0.0	0.0
Other non-cash movements	0.0	0.0	0.0	0.0	0.0	0.0
Closing net debt/(cash)	(10.5)	(8.6)	49.9	40.0	29.3	13.9

Source: Norcros accounts, Edison Investment Research

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