EDISON

Norcros

Capital markets day

Vast opportunity and new targets revealed

Construction and materials

Norcros is the UK's leading design-led sustainable kitchen and bathroom products group. Its compelling investment case was highlighted at its May 2024 capital markets day (CMD), where its unique, asset-light, design-led model was clearly illustrated. The CMD also indicated the enormous scale of the opportunity that is available in terms of entering adjacent unaddressed markets in the UK and South Africa, as well as the potential presented by other attractive geographies. Furthermore, revised medium-term targets were introduced that should further excite investors. Our profit forecasts are unchanged, but we have raised our valuation from 246p to 251p as we have rolled forward our P/E valuation and increased our FY25 dividend estimate.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/22	396.3	39.3	38.2	10.0	5.7	4.6
03/23	441.0	41.8	37.4	10.2	5.8	4.7
03/24e	411.7	36.7	31.5	10.2	6.9	4.7
03/25e	376.7	37.9	32.5	10.4	6.7	4.8

Note: *PBT and EPS are on an underlying reported basis, excluding exceptional items. EPS is diluted.

Unaddressed markets offer almost unlimited potential

Norcros operates in large, very fragmented and growing markets, which offer both organic growth and M&A opportunities. The company estimates that it has a c 15% market share of its addressable UK markets and c 7% of its markets in South Africa. Combined, these markets amount to c £3.5bn, but if other unaddressed segments are included the market could be c £6bn. Adding in other attractive geographies in Europe, Africa and the Middle East, the potential addressable market outside of the UK and South Africa could be over three times the size of its potential existing markets.

New, more demanding medium-term targets revealed

Norcros recently announced a revised set of medium-term targets that we believe the company has a good chance to achieve. These include: 1) organic revenue growth c 2–3% ahead of market levels, which is likely to be augmented by timely and targeted M&A, 2) an operating margin of 15% over the medium term, 3) cash conversion of over 90%, 4) a return on capital employed of over 20%, and 5) the achievement of the company's science-based carbon emissions targets by 2028.

Valuation: Raised to 251p, with potential upside

Following the CMD, we have reduced our revenue estimates from FY25 to reflect the sale of Johnson Tiles, but maintained our profit estimates. Our revised P/E based valuation implies a value of 243p/share, based on our diluted underlying FY25 EPS estimate of 32.5p, while our dividend discount model (DDM) implies a value of 260p/share. If we take the average of the two, we arrive at 251p, implying c 15% upside. The Norcros share price has bounced in recent weeks and is trading on a forward P/E of 6.7x in FY25e, still below the historical average. As the strategy gains momentum, a higher multiple could potentially be justified.

28 May 2024

Price	**218p**
Market cap	**£195m**
Net debt (£m) at 31 March 2024	c 37
Shares in issue	89.3m
Free float	98%
Code	NXR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	27.4	26.7	31.8
Rel (local)	24.2	17.0	20.6
52-week high/low		228p	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

Preliminary results	13 June
AGM	24 July

Analyst

Andy Murphy +44 (0)20 3077 5700

industrials@edisongroup.com

Edison profile page

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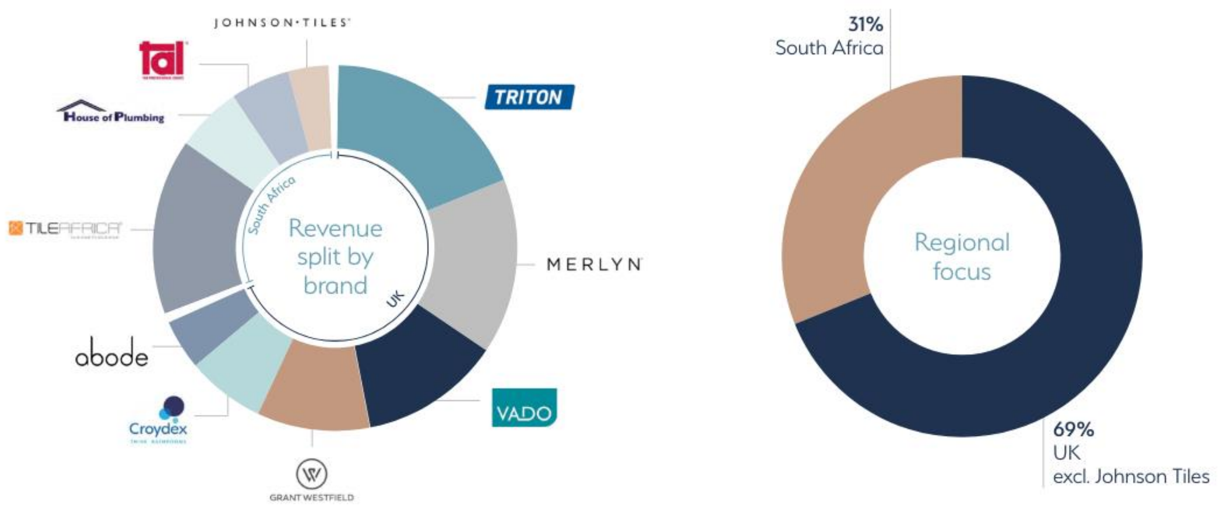
CMD key takeaways

At its recent CMD, Norcros went to great lengths to highlight why it is very different to many, if not all, of its competitors and why it is likely to grow considerably faster than its underlying markets. This includes its design-led, sustainable, asset-light model that focuses on product, relationships and customer service, among other aspects. The model is likely to result in the achievement of the company's revised financial targets, which include above market growth, expanding margins and the maintenance of a strong balance sheet. Ultimately this is designed to drive above-average shareholder returns, which also benefit from a progressive dividend policy.

Norcros today: What it IS and what it is NOT

Norcros is the UK's leading design-led, sustainable bathroom and kitchen products group. It performs the same function in its other chosen market, South Africa, where it is the number two player. Overall, the UK, excluding Johnson Tiles, accounts for 69% of group revenue, while South Africa accounts for 31%.

Exhibit 1: Revenue by brand and geography



Source: Norcros

Norcros is different from many other suppliers of bathroom and kitchen products because it designs and curates its own products, which are manufactured on its behalf, mainly in China, by partner companies that share the same vision of quality, attention to detail and customer service. It owns numerous brands such as Triton (showers) and Merlyn (shower enclosures), which have been acquired periodically to build a portfolio of businesses that address different aspects of the home.

The brand proposition is positioned at the mid-market and premium ends of the market (collectively c 71% of the UK bathroom products market, according to BRG), which is mainly driven by more resilient and higher-margin repair, maintenance and improvement (RMI) demand, rather than new build, where sales can be more volatile and usually lower margin, although it does have strong underlying medium-term growth drivers. According to BRG, the UK bathroom products market is 80% RMI, with residential new build accounting for 13% and commercial RMI and new build accounting for the rest.

Furthermore, because Norcros's manufacturing is effectively outsourced, capital demands are much lower and cash generation is better.

Conversely, Norcros is therefore not, nor will it become:

- a traditional distributor selling other suppliers' products,
- a capital-intensive manufacturer, only carrying out some light assembly activities,
- a heavy-side building products supplier, nor
- a low-margin, economy product supplier.

Exhibit 2: Customer relationships in the UK and Ireland

Source: Norcros, excluding Johnson Tiles and Norcros Adhesives

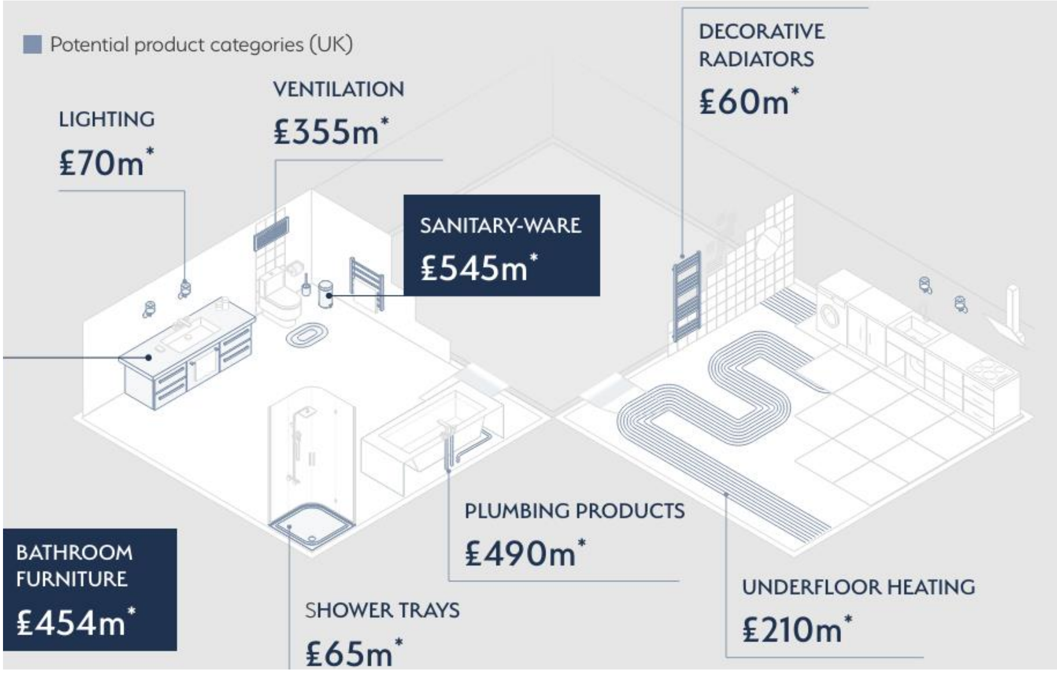
The opportunity and Norcros's investment case

Norcros operates in large, very fragmented and growing markets, which offer both organic growth and M&A opportunities. Furthermore, customers are becoming more aware of and demanding more products that offer better sustainability credentials, such as water and energy savings in use for example. As the group grows, it can extract synergies and share best practice around the group, which offers cross-selling opportunities and higher margins.

Currently, Norcros estimates that the combined core markets of the UK and South Africa have an addressable market of c £3.5bn, of which Norcros claims a 15% share in the UK (excluding bathroom furniture and sanitary-ware) and a c 7% share in South Africa. The geographies have similar underlying growth drivers, including RMI in both the residential and commercial space and from design, sustainability and service drivers.

In addition to the core UK market discussed above, there are many product categories to which Norcros has zero or only limited exposure. These include the sanitary-ware and bathroom furniture sectors, which combined have sales of c £1bn in the UK, which implies that the total addressable market in the UK and South Africa could amount to c £6bn. Other significant unaddressed UK sectors include plumbing products, ventilation and underfloor heating.

Exhibit 3: Unaddressed and under-addressed UK bathroom product categories



Source: Norcros

In Continental Europe, Norcros sees similar opportunities, particularly in West Europe (France, Italy, Spain and Portugal), and in the DACH markets (Germany, Austria and Switzerland). It estimates that both of these country groupings have addressable markets of over £5bn each and they are regions that it currently exports product to. Sub-Saharan Africa and the Middle East are smaller markets but also attractive geographies where Norcros also exports to. Collectively, these four regions are thought to offer an addressable market of c £14bn in addition to the £6bn of existing addressable markets mentioned above.

The growth plan: Three keys to success

Norcros has a three-pronged plan to grow the business, via M&A, organic growth and operational excellence. These initiatives are not new and have all been part of the Norcros success story for many years. We discuss each in turn below.

Targeted M&A

Norcros has a well-developed 'play book' for M&A targets, having assessed numerous opportunities over the last 10 years and executed six, which are detailed in the table below. Given the level of activity, we believe Norcros is seen as the 'go to' buyer of businesses that are looking for new owners, typically good, well-run operations, but that often have succession issues, rather than having operational issues. Norcros is not attracted to 'turnaround' situations, preferring high-growth, high-quality businesses that complement its existing high-quality activities.

Exhibit 4: Summary of M&A activity

Date	Company	Country	Activity	Consideration (initial plus deferred) (£m)	Revenue (£m)	EBITDA (£m)	Revenue multiple (x)	EBITDA multiple (x)
April '13	Vado	UK	Manufacturer and distributor of bathroom controls	11.9	25.6	2.5	0.5	4.8
June '15	Croydex	UK	Design, manufacturer and distributor of bathroom furnishings and accessories	20.0	19.9	3.1	1.0	6.5
April '16	Abode	UK	Designer and distributor of kitchen and bathroom taps and kitchen sinks	4.4	9.9	0.8	0.4	5.5
Nov. '17	Merlyn	UK	Designer and distributor of high-end shower enclosures	60.0	30.7	6.8	2.0	8.8
Jan '19	House of Plumbing	RSA	Specialist plumbing supplier	9.7	22.0	1.9	0.4	5.1
May '22	Grant Westfield	UK	Supplier of bathroom and kitchen products	80.0	42.2	10.1	1.9	7.9

Source: Norcros, Edison Investment Research

Target companies need to be strategically aligned and earnings accretive at the point of acquisition. They also need to be growing and offer additional routes to market that pave the way for organic growth in other businesses in the group. This cross-selling requirement is discussed in the next section, and is an important requirement.

Norcros believes that much of its long-term success with acquisitions is based around four key factors:

- its own dedicated in-house corporate development team,
- keen alignment of target company strategy and culture,
- the focus on successful, value-add targets, and
- only targeting growth companies with operational synergies.

Furthermore, Norcros is happy to make divestments, where necessary, of operations that are unable to fit its criteria. The closure of Norcros Adhesives in 2023 and the disposal of Johnson Tiles in 2024 are examples of this 'housekeeping' activity, which helps pave the way to achieving the company's revised medium-term targets, also discussed below.

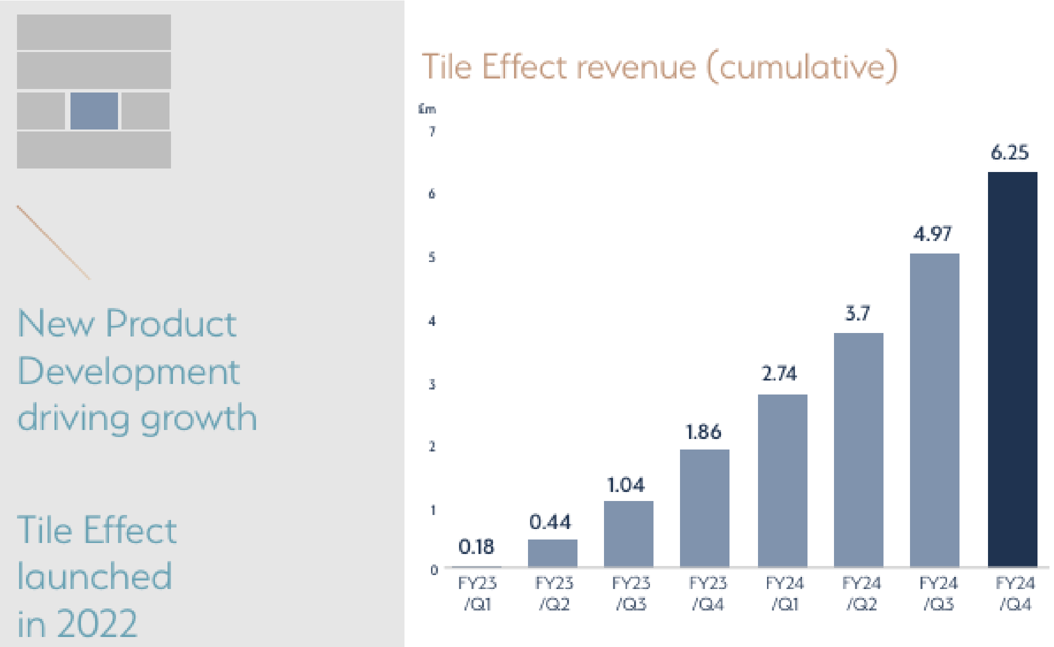
Sustainable organic growth

Norcros is able to drive organic growth in a number of complementary ways:

- new product development,
- cross-selling by brand and channel,
- key account management excellence, and
- top-quality customer service

Norcros retains its own in-house design team, which focuses on developing products that fit with customer demands and trends, such as the drive for more sustainable products such as water saving showers for example. This has resulted in a well-invested new product development (NPD) pipeline, with the NPD Vitality Index (ie the percentage of sales driven by products launched in the last three years) standing at 25%. An example of this is illustrated below, showing sales of Norcros's new waterproof bathroom panel, Tile Effect. From a standing start, sales in FY23 amounted to £3.5m, and in FY24 sales expanded fivefold to £17.7m, with a strong trend suggesting further growth in the current year.

Exhibit 5: Tile Effect sales



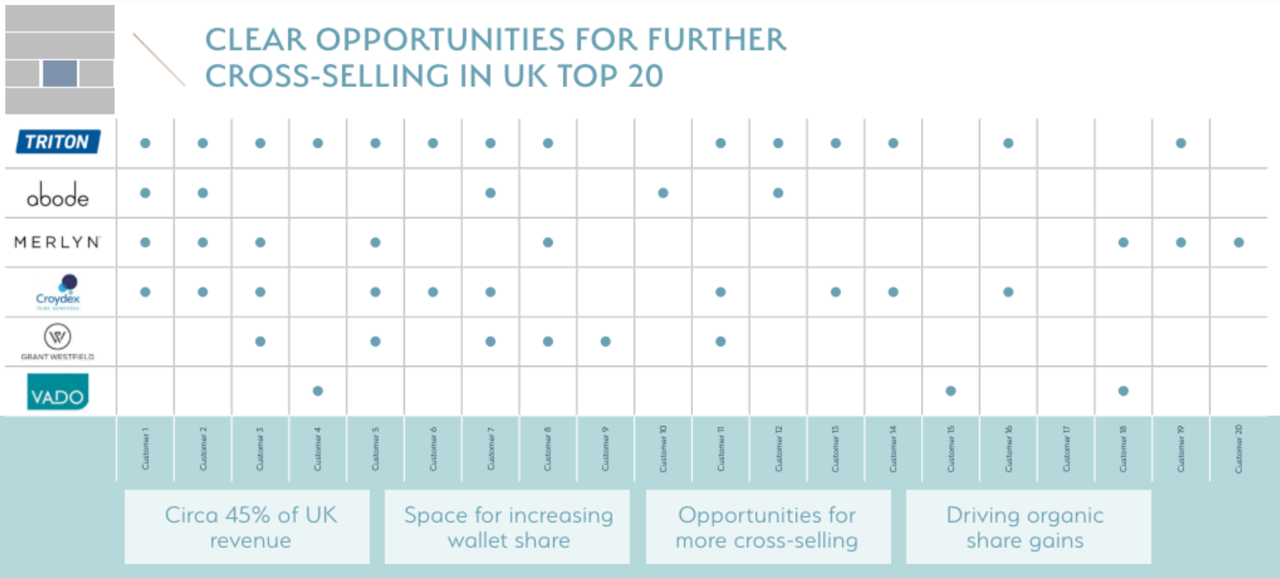
Source: Norcros

Key account management, where Norcros develops and nurtures strong long-term relationships with customers, is viewed as a significant differentiator, as is its first-class dedicated customer service operations, which provide customers with the support and confidence to choose Norcros as a trusted supplier.

Exhibit 6 below gives a clear indication of the opportunity available to Norcros simply by harvesting sales of products to existing group customers, which is facilitated by the account management and customer service operations mentioned above. Sales to existing top-20 customers account for c 45% of UK sales and are represented by the dots in the boxes.

The gaps therefore represent potential opportunity. It is also worth noting that four of the top five customers take product from four Norcros brands. However, only one of the ‘bottom’ five takes more than a single product brand, thus highlighting the substantial potential to drive sales into these existing customers.

Exhibit 6: Cross-selling opportunities

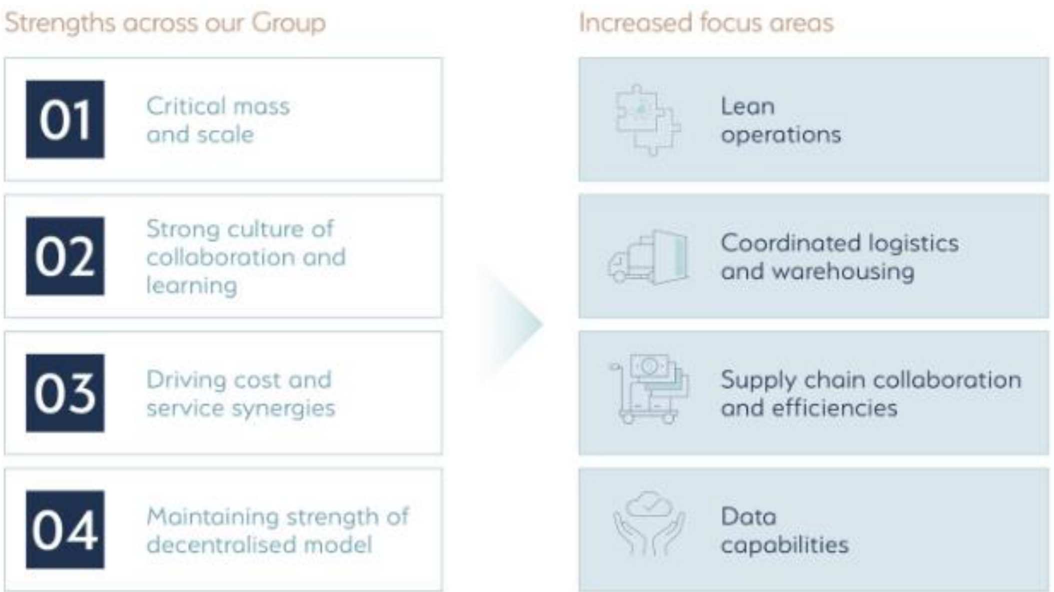


Source: Norcros

Operational excellence

Norcros prides itself on having sufficient scale to facilitate sufficient capital expenditure to differentiate it from its peers. It also has a strong culture of collaboration between the group companies, which share best practice, and therefore there are better outcomes for the company and its customers. This includes simplifying operations and sharing logistics and warehousing, which drives cost and service synergies as well as boosting the margin. It also offers customers better access to data systems, which contributes to service and efficiency.

Exhibit 7: Areas of operational excellence across the group



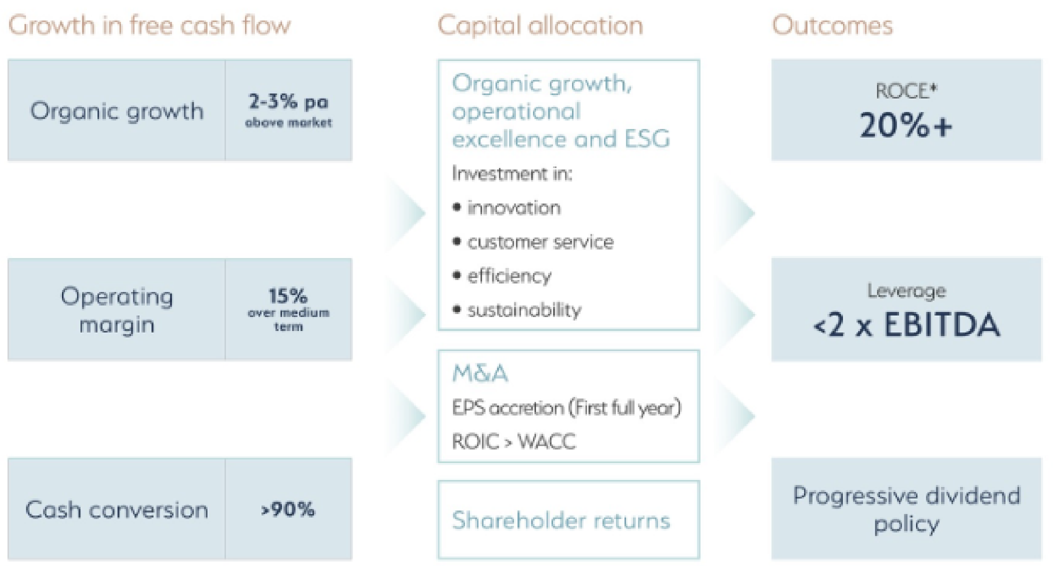
Source: Norcros

New medium-term targets

At the CMD, Norcros announced a revised set of medium-term targets, which we believe the company has a good chance to achieve. These include:

- Organic revenue growth of c 2–3% ahead of market levels, driven by the advantages and investments discussed above. This is likely to be augmented by timely and targeted M&A.
- Achieving an operating margin of 15% over the medium term, compared to 10.7% in FY23. This will be driven by the exit of Johnson Tiles, which is expected to add c 1% to the margin, scale-based efficiencies, organic growth of higher-margin products and finally operational leverage. Again, margin-enhancing M&A is expected to help drive margins.
- Cash conversion of over 90%.
- A return on capital employed of over 20%.
- The achievement of the company's science-based carbon emissions targets by 2028, which is a 33.6% reduction in Scope 1 and 2 emissions and a reduction of 20% in Scope 3 emissions compared to the base year of 2023.

Exhibit 8: Summary of medium-term targets



Source: Norcros

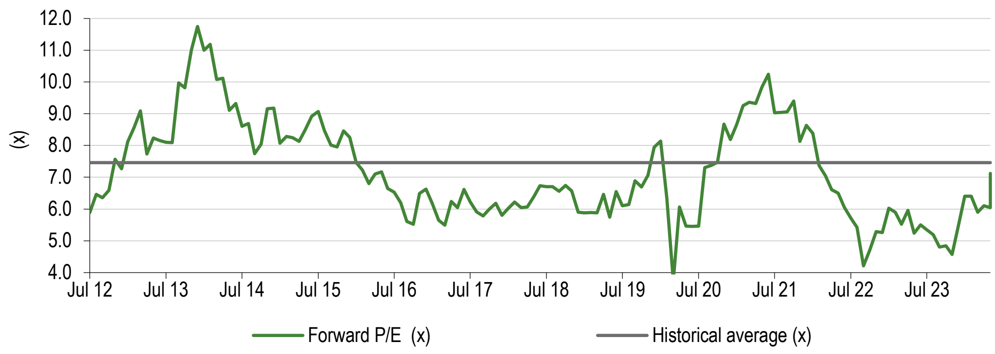
Valuation suggests c 15% upside, plus potential

Following the CMD, we have reduced our revenue estimates from FY25 to reflect the sale of Johnson Tiles, but maintained our profit estimates. Our revised P/E based valuation implies a value of 243p/share (from 236p) based on our diluted underlying FY25e EPS estimate of 32.5p/share, while our DDM implies a value of 260p/share (from 255p). If we take the average of the two, we arrive at 251p (from 246p), implying c 15% upside. The Norcros share price has bounced in recent weeks and is trading on a forward P/E of 6.7x in FY25, still below the historical average. As the strategy gains momentum, a higher multiple could potentially be justified.

Simple forward P/E multiple valuation implies 243p/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 7.5x.

Exhibit 9: Norcros – forward P/E ratio (x)



Source: LSEG, Edison Investment Research

If we apply the 7.5x forward P/E multiple to our estimate of FY25e diluted underlying EPS of 32.5p (previously FY24e diluted underlying EPS of 31.5p), we arrive at a value of 243p/share, implying c 11% upside to the share price, which has bounced in recent weeks following the CMD. It is entirely possible that the strategy outlined will be successful and looking at the historical average forward P/E ratio may 'under-club' what is possible in the future. Each one-turn of P/E ratio adds c 30p to the valuation, so it is possible that higher organic growth could attract a higher multiple, which in turn could be augmented by future potential acquisitions, which are part of the company's strategy. Higher growth could in turn lead to higher dividend payments, which has implications for the DDM discussed below.

Exhibit 10: 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)	162	195	227	243	260	292

Source: Edison Investment Research

Dividend discount model implies a valuation of 260p

Our DDM valuation of 260p lends support to the P/E valuation above of 243p/share. We have lifted the base FY25e dividend to 10.4p/share (from 10.2p), which is more than three-times covered by diluted and underlying earnings. We are confident in the long term outlook 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 11: 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%**	115.6	130.0	148.6	173.3	208.0
	11.0%	130.0	148.6	173.3	208.0	260.0
	10.0%	148.6	173.3	208.0	260.0	346.7
	9.0%	173.3	208.0	**260.0**	346.7	520.0
	8.0%	208.0	260.0	346.7	520.0	1,040.0

Source: Edison Investment Research

Exhibit 12: 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	376.7	381.5
EBITDA	39.2	47.0	52.3	49.3	49.9	50.4
Normalised operating profit	33.8	41.8	47.3	43.2	43.7	44.2
Share-based payments	0.0	0.0	0.0	0.0	0.0	0.0
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)
Exceptionals	0.0	0.0	0.0	0.0	0.0	0.0
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)	(8.7)
Profit After Tax (norm)	23.9	31.3	36.6	27.4	28.3	29.2
Profit After Tax (Underlying)	25.1	31.5	36.9	28.8	29.7	30.6
Profit After Tax (reported)	15.0	25.2	16.8	17.5	18.4	19.3
Net income (normalised)	23.9	31.3	36.6	27.4	28.3	29.2
Net income (Underlying)	25.1	31.5	36.9	28.8	29.7	30.6
Net income (reported)	15.0	25.2	16.8	17.5	18.4	19.3
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	31.66	32.66
EPS - diluted normalised (p)	29.58	37.99	40.89	30.00	30.93	31.91
EPS - Diluted, 'underlying'	31.06	38.23	37.43	31.53	32.46	33.44
EPS - basic reported (p)	18.61	31.15	19.06	19.61	20.57	21.57
Dividend (p)	8.20	10.00	10.20	10.20	10.40	10.50
Revenue growth (%)	(-5.2)	22.2	11.3	(-6.6)	(-8.5)	1.3
EBITDA Margin (%)	12.1	11.9	11.9	12.0	13.2	13.2
Normalised Operating Margin	10.4	10.5	10.7	10.5	11.6	11.6
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	209.9	212.9
Stocks	78.1	100.6	103.9	107.1	109.4	111.4
Debtors	64.6	71.1	83.3	78.2	71.6	72.5
Cash & cash equivalents	28.3	27.4	29.0	29.0	29.0	29.0
Other	0.0	1.6	0.0	0.0	0.0	0.0
Current Liabilities	(104.1)	(110.8)	(112.7)	(106.1)	(98.2)	(99.3)
Creditors	(95.4)	(102.4)	(99.2)	(92.6)	(84.7)	(85.8)
Tax and social security	(1.0)	(2.7)	(0.9)	(0.9)	(0.9)	(0.9)
Short term borrowings	0.0	0.0	0.0	0.0	0.0	0.0
Other	(7.7)	(5.7)	(12.6)	(12.6)	(12.6)	(12.6)
Long Term Liabilities	(59.7)	(48.4)	(119.9)	(101.4)	(81.5)	(58.1)
Long term borrowings	(17.8)	(18.8)	(78.9)	(69.0)	(57.7)	(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
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
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	49.9	50.4
Working capital	21.8	(23.6)	(13.3)	(4.6)	(3.6)	(1.8)
Tax	(3.5)	(6.5)	(7.7)	(7.9)	(8.2)	(8.7)
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	37.2	39.0
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	11.2	14.8
Opening net debt/(cash)	36.4	(10.5)	(8.6)	49.9	40.0	28.7
FX	0.6	1.6	(2.9)	0.0	0.0	0.0
Closing net debt/(cash)	(10.5)	(8.6)	49.9	40.0	28.7	13.9

Source: Norcros accounts, Edison Investment Research

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