Numis Securities Ltd

Building & Property

9 July 2009

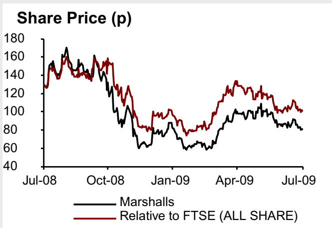
BUY

Marshalls

Company Update

Current Share Price	81p
Target Price	104p
Market Capitalisation	£160m
Shares In Issue	197m
RIC/BLBG	MSLH.L/MSLH LN
Avg. Daily Volume (3M)	264,461
Net Cash (Debt) (12/09F)	£(65.0)m
Broker	Yes

Current share price(s) timed at 3:30PM on 09/07/09



Performance %	1M	3M	12M
Absolute	-5	-17	-36
Relative	1	-21	-16

Source: Datastream

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Yielding assets

Marshalls has endured tough trading conditions over the past 18 months, but management actions to right-size the business has limited the operational gearing of the slowdown. Furthermore, the £34m fund-raising has improved financial security and given the group the necessary financial structure to take advantage of opportunities as they arise. We base our target price of 104p on a 5% dividend yield which is firmly backed up by a strong asset base consisting of aggregate reserves, buildings and properties and well invested plant.

- H1 2009 revenue fell 19% on a like for like basis however, cost cutting actions and the closure of plants limited operational gearing and supported margins. We forecast a 70/30 H1/H2 PBT mix and given the weak H2 2008 comparisons we feel this is achievable. Net debt stands at £74m (down from £111m in Dec 2008) following the fund raising, lower cap-ex and a reduction in working capital. Management cite the outlook as uncertain although lead indicators point to a flatter demand profile.

- The successful £34.2m fund raising was well received and this has materially reduced the risk profile of the company and also positioned Marshalls to take advantage of opportunities as they arise. We have no covenant concerns and Marshalls has long dated bank maturities with competitive rates of interest. This, alongside management actions should enable the company to increase market share and emerge as the dominant force in the landscaping sector.

- We have adjusted forecasts in light of the H1 trends and we forecast a 5% price rise and a 19% volume drop in 2009, and a flat profile in 2010. However, with uncertainty prevalent in all end -markets we have performed a sensitivity analysis showing that for each 1% change in volume or price it leads to a change in EBITA of £0.9m and £3.8m respectively. We do not feel that Marshalls will be capacity constrained and the group could facilitate a c.30% uplift in volume without the need for fixed cost investment.

- We have raised our target price from 84p previously to 104p, which reflects a 5% dividend yield. This is backed up by a solid tangible asset position of 108p (aggregate reserves, property, buildings and plant) and in our view given Marshall's makes an economic return on assets through the cycle this should provide good support. Whilst the P/E ratio is high this is on depressed earnings and looking at a more normalised earnings profile suggests the group is trading below historic ratios.

Year to Dec	Sales (£m)	PBT (£m)	EPS (p)	DPS (p)	Gearing (%)	P/E (x)	Div. Yield (%)	Dividend cover
2007A	402.9	42.1	18.4	11.64	0.5	4.4	14.4	1.6
2008A	378.1	22.5	10.0	12.02	0.6	8.1	14.8	0.8
2009F	324.9	12.3	5.0	5.21	0.3	16.3	6.4	1.0
2010F	324.9	12.3	4.5	5.21	0.3	18.1	6.4	0.9

Source: Marshalls (historical) and Numis Securities Research Department (forecast)

For important disclosure information relating to Numis Securities Limited, including analyst certification, investment banking relationships, if any, with companies mentioned in this report, and potential conflicts of interest, please refer to pages 15 - 16, especially analyst certification on page 15, the important disclosure section on page 15 and the additional disclosure on page 15.

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Investment case

Marshalls announced the successful completion of its rights issue on the 16th June with valid acceptances received for 90.4% of the newly issued share capital, with the remaining 9.6% placed with institutions. In our view this has materially reduced the risk profile and given management the financial flexibility to pursue opportunities as they arise.

Current trading and management actions

Marshalls' management team has been quick to right-size the business and limit the operational gearing feeding through from the unprecedented slowdown in demand for building related products. This has mainly been focussed on defensive factors such as cutting the cost base, reducing operating capacity and conserving cashflow but management efforts to shore up the demand profile are also taking place.

Current trading and first half trading update

Marshalls H1 trading update contained few surprises, given management updated the market at the time of the rights issue in mid May. Below we show our forecasts for H1 2009 versus 2008.

Table 1. First half estimates

	H1 2009E	H1 2008	% change
Sales	166	211	(21)
Costs	(155)	(184.2)	(16)
EBITA	11	26.8	(59)
Net finance	(2.5)	(4.1)	
Profit before tax	8.5	22.7	(63)
Tax	(2.4)	(6.3)	
Net income	6.1	16.4	
EPS	4.2	11.8	(64)
DPS	1.8	4.6	

Source: Company & Numis Securities Research Department

The table shows that we do expect a large decline in profits against what was a strong comparative in 2008. The driver of the fall is lower volumes and we estimate a c.24% fall in H1 which is offset by a 5% price rise. However, adjusting for two less working days (in H1 2009) the underlying revenue trend was -19%.

Elsewhere, net debt has fallen from £111m in December 2008 to £74m in June, as a result of the £34.2m net fund raising proceeds, lower cap-ex and positive working capital movements. We forecast net debt will fall to £65m by the year end giving the group comfortable covenant headroom and providing financial flexibility to take advantage of market opportunities.

Marshalls describe the outlook as uncertain, but with the Domestic order book showing an increasingly flat profile (the installer order book stood at 7.1 weeks at the end of June, flat on April 2009 and ahead of February) and the lead indicators in Public Sector and Commercial levelling out in H2 2009, we believe that conditions are getting less worse. This H1 performance was broadly in line with expectations and the trends Marshalls is seeing are similar to those emerging from the UK focused merchants (such as Travis Perkins). In our view this is a better performance than Marshalls' (landscaping) peer group, and the group is likely to emerge from the downturn with a higher level of market share.

Cost cutting

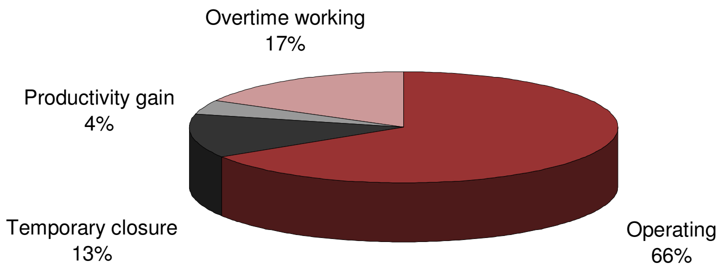
This involved two initiatives; closing down manufacturing plants and reducing investment in managed installations.

- **Works closure** – management has closed 4 less efficient manufacturing sites - Sawley, Cannock, Hambrook and Llay - reducing operating capacity by c.21% and enabling higher capacity utilisation in the remaining plants. This is estimated to reduce fixed costs by £8m per annum (of which £1.5m was witnessed in 2008) and facilitate Marshalls in releasing c.£10m of cash from excess inventories. Marshalls will still maintain a geographically economic distribution capability and it is estimated that the closures will result in a one-off P&L charge of £17.6m (£12.6m in 2008 and a further £5m in 2009, for an all in cash cost of £13m).
- **Managed installations** –Marshalls has built up a network of branches which performed design and installation of landscaped products, but given the lower level of activity currently being witnessed management thought it appropriate to reduce this cost. The charge of doing this is £5.1m which relates to redundancies, site closures and lease terminations.

Reducing operating capacity

The effect of the four plant closures on the group's operating capacity can be seen below:

Figure 1. Medium term manufacturing capacity



Source: Numis Securities Research Department

The chart shows Marshalls is currently operating at 66% of 2007 capacity. This could be be increased through bringing mothballed capacity back-on stream (13%), productivity gains (4%) and also reinstating overtime working. In our view this shows that the group still retains significant manufacturing capacity and will be highly operationally geared to an increase in volume given it will not involve any meaningful increase in the fixed cost base of the business.

Cash conservation

As well as the efforts to reduce costs, management have also implemented various initiatives to conserve cashflow and enable Marshalls to take advantage of opportunities which emerge as a result of the economic downturn. The table below highlights how the cash outflows of Marshalls is expected to change in 2009, versus 2007 and 2008.

Table 2. Expected cash outflows

	2007A	2008A	2009E
Cap-ex	31.7	22	10
Acquisitions	12.8	6.1	0.8
Change in working capital	13.8	7.7	-6
Tax	9.3	4.7	0
Pension payments	4.4	6.6	2.1
Dividends	19.1	19.4	5.5
Total	**91.1**	**66.5**	**12.4**

Source: Company

The table emphasises the materially different cashflow profile expected in 2009 (and this should be the case in 2010 as well) with lower cap-ex, an inflow from a reduction in stocks, zero tax, reduced pension payments in 2009 and lower dividend costs. The dividend costs relate to the 1.45p final 2008 dividend paid on c.140m shares (not the new shares in existence post fund raising) and our expectation that 1/3 of the 5.2p forecast dividend will be paid at the interim on 196m shares - giving a cost of £5.5m. Overall, we expect outflows of £12.4m in 2009 which is materially less than the previous 5 years and should enable the group to throw off more than £10m of internally generated cashflow. We estimate that this internally generated cashflow alongside the net £34.2m placing proceeds will result in net debt falling from £111m in 2008 to £65m in 2009.

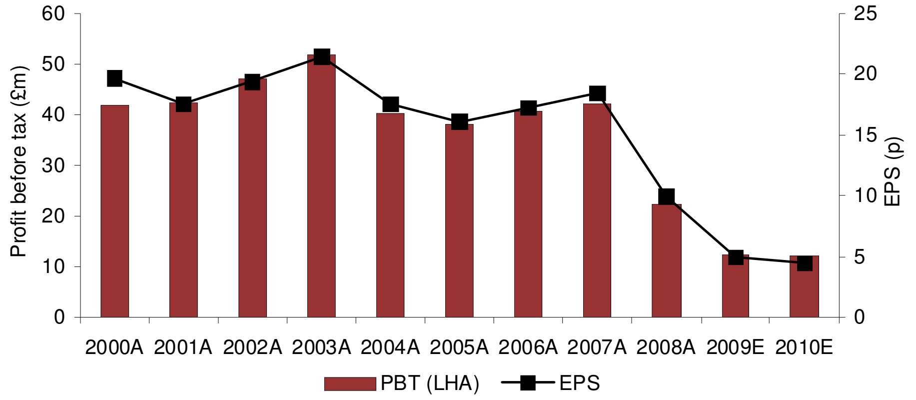
Valuation

We look at three valuation metrics when considering Marshalls; earnings, dividend yield and the asset value of the company.

Earnings

Given the cyclical nature of earnings we need to consider the longer term earnings potential of Marshalls. Below we show both PBT and EPS from 2000 including our estimates for 2009 and 2010 (these are shown on both an UK GAAP and IFRS basis and therefore are not wholly consistent).

Figure 2. Long term profit before tax and EPS profile



Source: Company & Numis Securities Research Department estimates

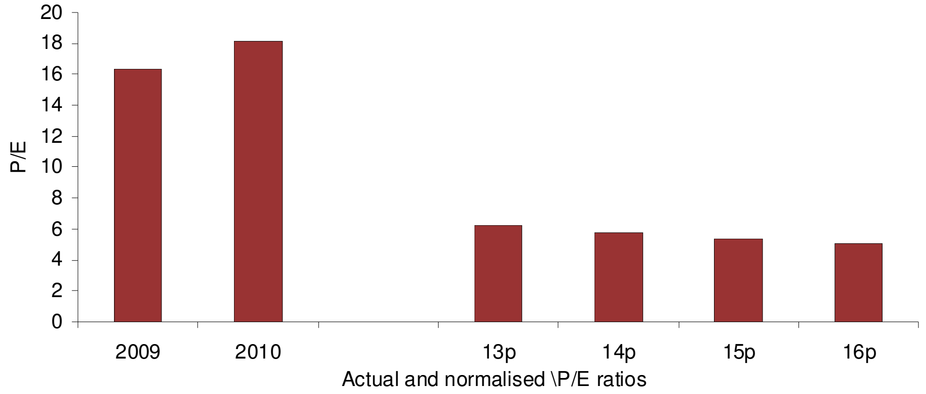
The table shows the sharp fall-off in profits in 2008 and Numis' expectation that earnings will remain depressed through 2009 and 2010. The fall off in 2004 relates to the sale of the Clay Products Division to Hanson which followed the £75.4m of cash to shareholders.

Therefore, post 2004 we have a more representative example of Marshalls current business profile, although it should be borne in mind that the group has spent £130m on cap-ex and acquisitions between 2005 and 2008 in growing the reserve base, increasing the street furniture offer and also on various other demand initiatives. Cumulative cap-ex over this time was £81m and therefore this implies expansionary spend of £49m over a 4 year period – c.£12m per annum.

Taking this investment and also the increased market share currently being won into account, it should enable Marshalls to drive a higher sustainable level of earnings once the market returns to normal. However, just a reversion to the 2005 - 2007 level (without the incremental benefits mentioned and adjusting for the increased number of shares in existence) suggests EBIT margins of 12-13% against sales of c.£400m – implying EBIT of c. £48m-£52m and EPS of 16-17p.

The table below shows the current P/E ratio forecast for 2009 but how this changes under a more normal earnings profile - which given the reduction in costs could be achieved under a relative modest increase in volume.

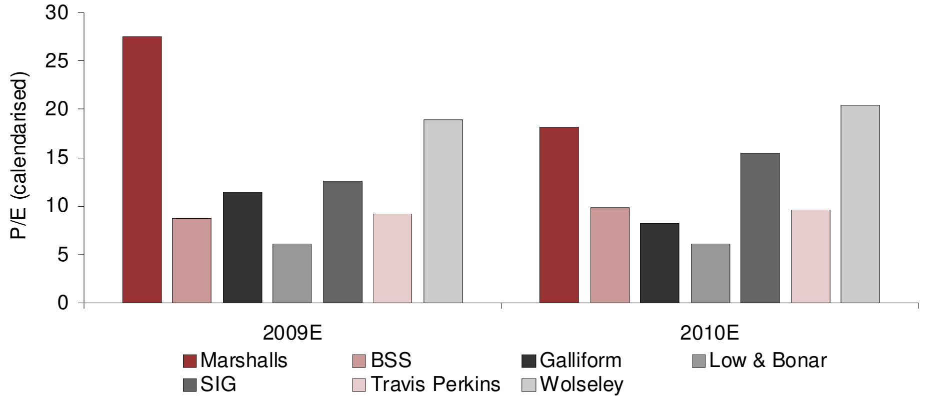
Figure 3. Current P/E rating and P/E on normalised earnings (adj. for rights)



Source: Numis Securities Research Department estimates

The table shows that whilst the rating on Marshalls is currently high, for a well invested business with good market share a normalised rating of c.6x does not look overly aggressive. Below we show how Marshalls rating compares with its closest peers the builders merchants and Low & Bonar:

Figure 4. Marshalls relative rating



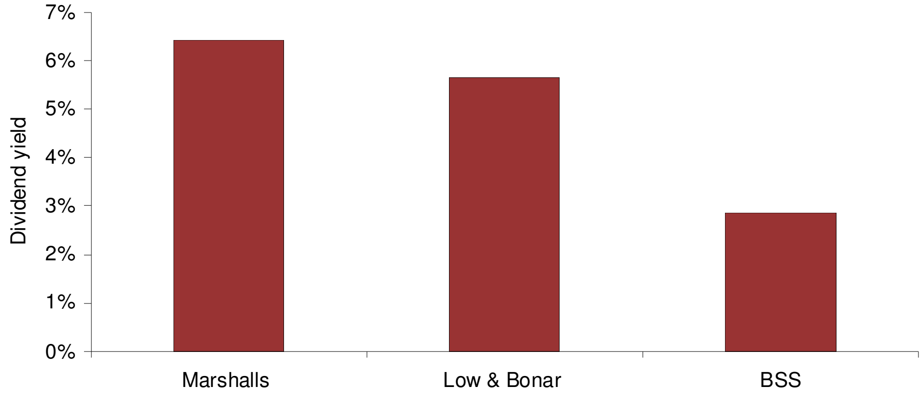
Source: Numis Securities Research Department estimates

The chart shows that Marshalls rating is the second highest in the sector on a P/E footing. We feel this relates to both the yield support and that Marshalls is perceived to be closer to the bottom of the cycle given its bias to the repair and maintenance sectors, the strong income yield and the asset support.

Dividend yield

Whilst the dividend was rebased from 13.4p in 2007 to 6p in 2008 and management intends to pursue a progressive dividend policy (subject to earnings, cashflow and other factors), it needs to be adjusted for the bonus share issue on the rights issue. Therefore the 2008 dividend is adjusted by a factor of 0.868 which implies the ongoing dividend will be 5.2 pence. Of the peer group shown in the PE chart above, only BSS and Low & Bonar are forecast to pay a dividend in 2009 and therefore these are the only comparators shown

Figure 5. Dividend yield comparison



Source: Numis Securities Research Department estimates

The chart shows that Marshalls is forecast to be paying a 6.2% yield at the current share price (5.2p per share). This is the highest in the sector and whilst not covered by earnings, management remain committed to a progressive dividend policy given the cash generative nature of the business, adequate distributable reserves and management's acknowledgement of the income focused funds on the share register.

Asset backed valuation

In considering the valuation of Marshalls the longer term potential of the group needs to be considered and therefore looking at the underlying asset value should give a good underpinning to the share price. Below we show a breakdown of the group's assets and liabilities.

Table 3. Asset breakdown

	2008A
Property and minerals	87.4
Plant / machinery / vehicles	129.5
Goodwill	34.3
Intangible assets	7.1
other non-current assets	19.4
Total non-current assets	**277.6**
Inventories	89.8
Receivables	32.2
Cash	0.5
Total assets	**400.2**
Borrowings (post fund raise)	(77.7)
Payables	(61.8)
Tax (current and deferred)	(33.3)
Total liabilities	**(172.8)**
Pro-forma NAV	**227.4**
Net tangible asset value (NTAV)	**186.1**
Additional mark to market value of assets	25
Real NTAV	**211.1**
Real NTAV per share	**107.8**

Source: Company & Numis Securities Research Department estimates

The table shows the breakdown of Marshalls asset position updated on a pro-forma basis for the net £34.2m fund-raising (i.e we have adjusted net debt down by £34.2m). We would make several points:

Property and minerals – this is the area where the most upside exists given that property and reserves are held at historic cost. In 2007 management estimated that if re-valued it would add a further £40m to the net asset value of the business. However, given several of these assets were sold in 2008, some of the value has been realised and we estimate that £25m of the upside value remains (this can be seen at the bottom of the table in the mark to market line).

Plant, machinery & vehicles – whilst these assets may be difficult to realise money from at present, given the excess capacity in the block paving and associated markets. Marshalls plant, machinery and vehicles are well invested and depreciated at a prudent rate (fixed plant and machinery at between 5-25% per annum and mobile plant and vehicles at 14-30%).

Real NTAV per share – after deducting the liabilities from pro-forma total assets we get to the pro-forma NAV. In our view it is then necessary to strip out the goodwill and intangibles (stripping out intangibles is more contentious given that this contains factors such as software development etc) gives the net tangible asset value. However, as we have previously mentioned this fails to reflect the true value of property and reserves and adding back an estimate of the real value of property is necessary. This then gives what we have termed 'real NTAV' and divided by the new higher number of shares in existence gives the real NTA per share of 107.8p.

We use a slight discount to real NTAV as the basis for our target price and establish this at a 5% dividend yield – implying a target price of 104p.

Risks

We feel the main risk to this target price on the downside is if macro conditions worsen considerably from here and management is not able to mitigate the cost base fast enough. Equally, on the upside, if volume or pricing exceeds our expectation (without associated cost uplift) then the operational gearing will be large given the headroom in operating capacity and the regional distribution capabilities.

Revised forecasts

P&L forecasts

Below we show our forecasts adjusted for the recent fund-raising

P&L

Table 4. P&L considerations

	2007A	2008A	2009E	2010E
Price (%)	*3.9*	*5.0*	*4.7*	*3*
Volume (%)	*0.0*	*(11.5)*	*(18.8)*	*(3)*
Acquired (%)	*2.7*	*0.3*	*0.0*	*0*
Total (%)	*6.6*	*(6.2)*	*(14.1)*	*0*
Sales	402.9	378.1	324.9	324.9
Costs	(354.1)	(347.4)	(308.6)	(309.6)
EBITA	48.8	30.6	16.3	15.8
Exceptional items	0	(27.0)	(5)	0
Net finance	(6.7)	(8.2)	(4.0)	(3.5)
Clean pre-tax profit	42.1	22.5	12.3	12.3
Taxation	(11.9)	(6.25)	(3.5)	(3.4)
Net income	30.3	16.2	8.9	8.8
No of shares	163.6	141.2	179	195.9
EPS (p)	18.5	11.5	5.0	4.5
DPS (p)	11.6	11.6	5.2	5.2

Source: Company & Numis Securities Research Department estimates

The table shows the profit and loss profile from the peak in 2007, with price rises more than offset by falling volumes in both 2008 and 2009.

Price & volume – we forecast a c.19% revenue decline between 2007 and 2009 and then a flat profile into 2010. Price has been, and will continue to be a positive driver as the concrete product producers seek to offset the energy and other cost pressures in the system. Travis Perkins recently commented that it expects 11-13% price growth in concrete products in 2009 and therefore our 4.7% growth looks conservative. Volume trends are more difficult to determine (as destocking is adding a further complication) although our c.19% drop in 2009 looks adequate given that lead indicators point to a flatter demand profile in Public Sector and Commercial and the domestic order book had recovered slightly to 7.1 weeks at the end of June (up from 5.6 weeks in Feb 2009).

Costs – we forecast that the group will endure underlying cost growth of c.4.5%, however as a result of fixed/variable cost mix and the c.19% volume decline estimate; actual costs are forecast to fall from £347m to £309m.

Exceptional items – in 2008 the £27m (£11m cash, £16m non-cash) exceptional related to works closure costs, redundancies and the impairment of goodwill. In 2009 we forecast an exceptional cost of £5m which relates to the closure of the Llay manufacturing facility in January 2009.

Net finance – due to the seasonal working capital requirements the year end net-debt forecast gives little insight into the finance costs of the business. We forecast a £4m charge in 2009 (£2.5m in H1) which is forecast to fall to £4.0m in 2010 – as the group gets a full year benefit from the placing proceeds and internally generated cash feeds through.

Sensitivity

Given the uncertain outlook in all areas of the market (domestic, commercial and public) we feel it is appropriate to look at the sensitivity of Marshalls P&L. In our analysis we flex both prices and volumes.

Volumes have been the big casualty of the slowdown, and Marshalls estimates these fell 11% in 2008 (20% domestic, 4% public sector) and we forecast a further 19% fall in 2009. This volume fall is forecast to be mainly driven by the Public and Commercial market place (-20% volume for 2009) with the decline in the Domestic market getting less worse (-14% compared to 20% in 2008). This view is backed by the increased uncertainties in the commercial and public sector market place and the fact that Domestic demand appears to be stabilising as evidenced by the installer order book rising from 5.6 weeks in February 2009 to 7.1 weeks at the end of April. Given that the Public Sector and Commercial market is forecast to accounted for 59% of revenue in 2008 this leads to a group volume decline of c.19%.

Prices have been much more robust during the downturn as concrete product (and other building material suppliers) companies look to offset the energy driven cost inflation. In 2008 prices rose by 5% and we expect a similar increase in the year ahead - this should be broadly equal to cost inflation.

Below we show the business breakdown of Marshalls to emphasise the operational gearing of the business to changes in revenue. In the example below we assume that only volumes adjust (for simplicity purposes), but this is supplemented by a sensitivity matrix showing the EBIT impact of differing price and volume variations.

Table 5. Fixed and variable cost overview*

	Price	5%	5%	5%	5%	5%
	Volume	-15%	-17%	-19%	-21%	-23%
Change in revenue	**2008A**	**-10%**	**-12%**	**-14%**	**-16%**	**-18%**
Revenue	378	339	332	325	316	309
Fixed costs	(62.4)	(62.4)	(62.4)	(62.4)	(62.4)	(62.4)
Variable costs	(293)	(256)	(250)	(245)	(239)	(233)
Total costs	(355)	(318)	(313)	(308)	(301)	(295)
EBIT	**31**	**21**	**19**	**17**	**16**	**14**

** - figures may not add due to rounding*

Source: Numis Securities Research Department estimates

The table shows the EBIT impact of varying volumes against the static assumption of a 4.7% increase in price (our projection for 2009) – our 2009 estimate can be seen in the shaded area of the table. This shows that the cost base is 20% fixed, 80% variable and therefore the group is highly operationally geared to changes in revenue and this can be seen from the matrix below highlighting the impact on EBITA to changes in both prices and volume:

Table 6. Sensitivity of EBITA to changes in prices and volumes

		Volume fall				
		-22%	**-20%**	**-18%**	**-16%**	**-14%**
Price increase	**3%**	7.0	8.7	10.5	12.2	14.0
	4%	10.8	12.5	14.3	16.0	17.8
	5%	14.5	16.3	18.0	19.8	21.5
	6%	18.3	20.1	21.8	23.6	25.3
	7%	22.1	23.9	25.6	27.4	29.1

Source: Numis Securities Research Department estimates

The table shows a matrix of potential outcomes for EBITA under various price increases and volume declines. The table highlights that the group is most geared to changes in prices (as this has no associated cost impact) with a 1% move leading to a c.£3.8m change in EBITA. Volume changes have less impact with a 2% change leading to £1.8m change in EBIT (i.e. 1% = £0.9m).

Cashflow and balance sheet

Table 7. Cashflow and Balance sheet

	2007A	2008A	2009E	2010E
Cash inflow from continuing operations	49	31	16	16
Depreciation	21	21	19	19
Amortisation	1	1	1	1
Gain on disposal of assets	0	3	2	2
SBP and hedging	0	1	0	0
Op profit before working cap	**71**	**56**	**38**	**38**
Working capital moves	(21)	(2)	7	2
Change in provisions	0	0	0	0
Cash from operations	**49**	**54**	**45**	**40**
Interest paid	(7)	(8)	(4)	(4)
Taxation paid	(9)	(5)	(3)	(3)
Finance servicing	(16)	(13)	(7)	(7)
Dividends paid	(19)	(19)	(6)	(12)
Cap-ex + intangibles	(32)	(22)	(10)	(10)
Net Acquisitions	(13)	(6)	0	0
Disposals	3	11	0	0
Other	(6)	(19)	(9)	(7)
Cash flow from investing activities	(48)	(36)	(19)	(17)
Net cash movement pre financing	**(34)**	**(14)**	**12**	**4**
Ord Shares issued	(8)	(1)	34	0
Incr. net cash	**(42)**	**(14)**	**46**	**4**
Opening debt	55	97	111	65
Closing net debt	**97**	**111**	**65**	**61**
Net asset value	**201**	**193**	**230**	**218**
Tangible net asset value	140	152	190	179
Gearing (%)	*48*	*58*	*28*	*28*

Source: Company & Numis Securities Research Department estimates

The table shows our cashflow and net asset value forecast for Marshalls. The main point to note is that whilst EBIT is forecast to fall £15m; due to working capital inflows, lower cap-ex and reduced dividend payments we expect a £12m cash inflow, which alongside the £34m net placing proceeds should reduce debt by 42% to £65m (gearing of 28%). Overall, with £230m of net asset value forecast for 2009 we do not believe the balance sheet covenant requiring net assets to remain over £100m will be an issue. We discuss the balance sheet in more detail in the valuation section of the note where we analyse the underlying value of reserves and other tangible assets.

Details and driver of the rights issue

On the 13th May 2009 Marshalls announced that it was undertaking a fully underwritten 2 for 5 rights issue to raise £34.2m (net of expenses) to put the group on a firmer financial footing and increase financial flexibility to take advantage of strategic and value enhancing deals. The new shares were priced at 65p which was a 37.9% discount to the theoretical ex-rights price (TERP) and a 46.1% discount to the 122p closing price on the 12th May 2009. The new shares are not entitled to the final 2008 dividend of 1.45p per share, but will rank pari passu going forward. Below we show the dilutive effect of the fund raising.

Table 8. Pre, post and now

	No of shares	Share price	Market cap	PF 2008 NAV	P/NAV
Pre placing	141	122	172	193	0.89
Rights (net of expenses)	56	65	37	34	1.07
Post rights	197	106	208	227	0.92
Current	197	81	160	227	0.71

Source: Company & Numis Securities Research Department estimates

The table shows the dynamics of the fund-raising. Emphasising, that the share price has slipped 24% from the TERP, the market cap has been boosted and the net tangible asset value has risen from £193m to £227m. Given that the share price has fallen 24% from the TERP, the current P/NAV rating stands at 0.71x. We have not shown the dilution to EPS from the fund raising due to the complications of pro-rating the finance charge, but in the table below we show the impact to past EPS and DPS ratios from bonus share issue.

Deeply discounted rights issues are treated as a bonus issue of shares and an issue of fully paid shares. This requires that the historic EPS and DPS are adjusted to reflect this bonus element – below we show the calculation and impact of the bonus share issue.

Table 9. Bonus issue of the fund raising

	Price	Shares
Cum rights price	122	141
New shares	65	56
TERP	106	197
Bonus element	1.151	
2008A EPS(p)	10.0 (11.5)	
2008A DPS(p)	12.0 (13.9)	

Source: Numis Securities Research Department estimates

The table shows the workings of the bonus share element which is the difference between the TERP and the cum rights price (i.e 1.151). This is then used to adjust 2008 EPS (from 11.5p to 10.0p) and DPS ratios (from 13.9p to 12.0p in 2008).

Application

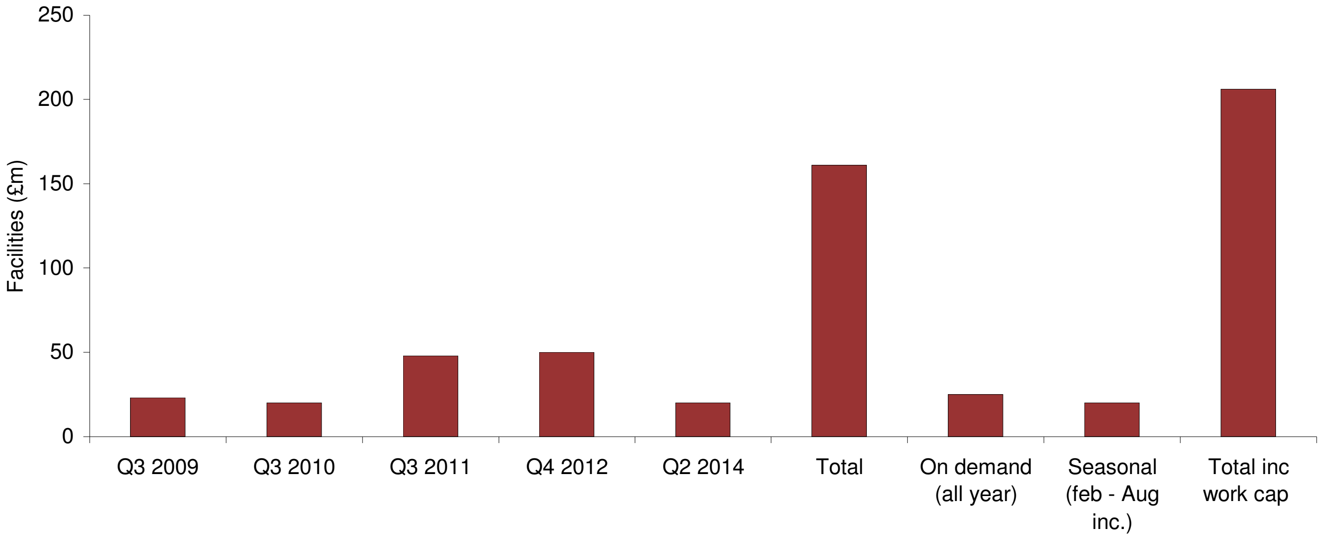
Despite Marshalls management already taking decisive action to conserve cash, cut costs and focus on demand initiatives the fund raising provided two clear benefits:

1. **Gearing and finances** - whilst management felt comfortable with the level of financial indebtedness the rights issue has provided additional flexibility in the event trading deteriorated further. This management decision is further supported by the current high corporate bond spreads which could have come into play (as has been the case with many building companies in the last year) if Marshalls needed to renegotiate covenants from a position of weakness.
2. **Strategic options** – given the severity of the economic downturn management wanted to position the business to take advantage of opportunities which may arise. This applies both to organic growth initiatives and acquisitions and we watch this space with interest, particularly given the uncertainties currently prevalent in many of the large European building materials conglomerates with UK operations.

Banking facilities and covenants

Marshalls has always maintained a good relationship with its lending banks and this continues to be the case. The group has facilities of £206m, of which £161m is committed and the group has two seasonal working capital facilities totalling £45m (£25m which can be drawn all year and £20m which can be drawn between February and August inclusive). This can be seen from the table below:

Figure 6. Borrowing facilities and covenants



Source: Company

The table shows the long maturity profile of the group's facilities which is supplemented by the on-demand facilities. We forecast year end net debt of £65m and therefore the headroom is substantial and should not prove an issue unless management source a strategically important deal of magnitude (this can be seen in the cashflow section of the note). The group's two main lenders are RBS and Lloyds TSB and the coupon on facilities varies between 50-105 basis points above LIBOR.

Below we show the covenant detail and how, following the fund-raising, Marshalls has substantial headroom.

Table 10. Key covenants and actual/forecast covenant ratios

Covenants				
Net debt / EBITDA (x)	3.0			
Interest cover (x)	2.5			
Minimum net asset value	>100m			
Actual ratios	**2007A**	**2008A**	**2009E**	**2010E**
net debt / EBITDA	1.4	2.1	1.5	1.2
Interest cover	7.3	3.8	3.3	3.8
Minimum net asset value	201	193	230	218

Source: Company & Numis Securities Research Department estimates

The table shows the financial covenants and also the actual and forecast ratios. This shows that we forecast significant headroom with net debt /EBITDA now fully covered by depreciation (post the fund raising), interest cover building in 2010 as the full year effect from the fund raising takes effect and the additional £34m of proceeds will lift the NAV from £193m in 2008 to £232m in 2009. It is worth noting that the interest cover covenant is calculated before expensing exceptional items. On the basis of the above we feel that the risk of covenant breach has gone and the investors focus should switch to the income yield, asset value and longer term earnings potential of the company.

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Add	> +10% to +19.99%
Hold	0% to +/-9.99%
Reduce	-10% to -19.99%
Sell	> -20%

Distribution of Ratings

	US Requirement 01/07/08 - 30/06/09		UK Requirement 01/04/09 - 30/06/09	
	All Securities	Corporate Clients	All Securities	Corporate Clients
Buy	35.9%	57.1%	34.7%	3.8%
Add	24.4%	28.6%	26.8%	2.2%
Hold	28.6%	14.3%	24.7%	0.0%
Reduce	5.9%	0.0%	7.5%	0.0%
Sell	5.2%	0.0%	6.3%	0.0%
	100%	100%	100%	
	The above table shows the split of recommendations based on the last recommendation for each research stock during the last four calendar quarters.		*The above table shows the split of recommendations based on all recommendations during the last calendar quarter.*	

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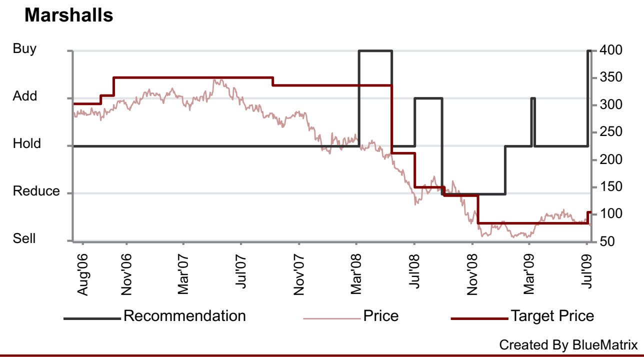
Three Year - Recommendation, Target Price, Share History



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