Restore plc

Management actions driving profit growth

21st November 2024

Restore's ten-month trading update reiterates profit expectations for both FY24 and FY25. Excellent progress is being made in delivering cost savings and driving profit margins, a clear priority for this management team. This has offset some market softness around the Autumn Budget as well as a £3m headwind for FY25 relating to increases in employer National Insurance Contributions and the National Living Wage. Absent these changes, we believe Restore would have been primed for an earnings upgrade looking into next year.

A recent investor site visit provided a reminder of Restore's quality, as well as medium term growth ambitions. In our view, this is not yet reflected in an FY25 P/E rating of <14x. We reiterate our 400p Fair Value estimate with confidence in the Groups' growth trajectory.

FY24 trading update – profit and cashflow in line with expectations

Today's update reiterates full year profit and cashflow expectations. FY24 revenue is now expected to be broadly flat year on year (5% lower than previously expected) but this has been offset by improving profit margins as a direct result of cost saving actions. These include the property consolidation and the integration of scanning within Information Management. Revenue growth has been delivered across Box storage, Technology and Datashred, whist scanning and Harrow Green revenues are down year on year.

Margin strength offsetting payroll headwinds (NICs) in FY25

The excellent progress on cost saving actions will offset a significant headwind in FY25 relating to increased employer National Insurance Contributions (NICs) following the Autumn Budget. Absent these changes in the Budget, we believe Restore would have been primed for an earnings upgrade looking into FY25.

Recent site visit highlighted cultural change and growth potential

The recent investor site visit provided a reminder of the progress that has been made over the past year. There are plenty of example of this including the major streamlining of Head Office functions; the ongoing integration of Records Management and Digital; and ambitious property rationalisation plans. There has also been a clear cultural change under the current management team, which we expect to underpin medium term growth ambitions.

Key Financials & Valuation metrics

Year-end Dec, £m	2021A	2022A	2023A	2024E	2025E	2026E
Sales	234.3	279.0	277.1	277.3	287.2	297.3
EBITDA	74.2	81.5	77.1	81.1	84.2	86.8
Adjusted Operating Profit	46.2	51.9	44.3	48.6	51.7	54.3
Operating Margin %	20%	19%	16%	18%	18%	18%
Adjusted PBT	38.1	41.0	30.3	33.5	37.0	40.0
FD EPS (p)	22.4	24.1	16.9	18.1	19.9	21.4
DPS (p)	7.2	7.4	5.2	5.5	5.8	6.0
Net Cash/(Debt)*	-217.8	-218.4	-201.3	-197.5	-178.7	-158.1
Net Cash/(Debt)**	-100.8	-103.5	-97.8	-94.0	-75.2	-54.6
P/E	12.1x	11.3x	16.1x	15.0x	13.7x	12.7x
EV/EBITDA*	8.0x	7.3x	7.4x	7.0x	6.5x	6.1x
Dividend yield	2.6%	2.7%	1.9%	2.0%	2.1%	2.2%
FCF yield	5.6%	4.7%	4.5%	3.8%	7.1%	7.7%

*Source: ED analysis, IFRS 16 basis * including leases ** excluding leases, Shares priced at COB 26/07/24*

Company Data

EPIC	RST
Price (last close)	272p
52 weeks Hi/Lo	290p/196p
Market cap	£372m
ED Fair Value/share	400p
Proforma net cash (debt)	(£94.0m)
Avg. daily volume	390,000

Share Price, p

Source: ADVFN

Description

Restore is a leading provider of records management (physical document archiving), digitisation (scanning/digital mailroom) and secure recycling of paper and technology assets.

In all these areas, it has a strong market position (either number 1 or 2 in the UK) and an excellent reputation across a customer base of blue-chip businesses and government/ public sector organisations. Restore is also the UK market leader in commercial relocations via its Harrow Green business.

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Divisional highlights

Information Management – consolidation and integration on track

The integration of the Restore Digital business into Information Management is progressing well. Most of the cost saving actions will be complete by the end of the current year, driving annualised savings of c.£3m. The cost of the integration is now expected to be lower than the £3m originally anticipated.

Box storage revenue continues to benefit from index-linked pricing on broadly unchanged box numbers, consistent with the messaging in recent periods. Meanwhile, scanning revenue was lower year on year, reflecting a reduced level of public sector activity around the change in Government and, more recently, the Autumn Budget.

The property consolidation is on track. This is a key driver of the Group's margin improvement programme as boxes are relocated from older, less advantaged facilities as their leases come up for renewal, bringing significant savings in terms of cost and efficiencies. The new 100k sq. ft Markham Vale warehouse near Doncaster is approximately half full, following the relocation of around 700,000 boxes from two sites in the South East (Redhill and Paddock Wood). In the next stage of the property consolidation, heads of terms have been agreed for a large, 85k sq. foot warehouse with capacity for 1 million boxes in the North East of England. This will be racked out in early 2025 with boxes starting to move in shortly thereafter.

Technology – signs of market recovery

Technology has seen good revenue growth, recovering from a challenging prior year. Companies are returning to a normalised hardware refresh cycle and outsourcing more IT services to value added resellers (Restore's customers). It is encouraging that this anticipated market recovery is now coming through and the medium-term margin target of 15% for this business has been restated (substantially higher than current year profitability).

Datashred – back on the front foot under new management

Last month's investor site visit and presentation gave the clear impression of a business that is back on the front foot after a disappointing period of trading through COVID and into FY23. This is reflected in improving revenues in the current year, driven by an increase in service visits as well as a stabilisation in recycled paper prices.

Harrow Green – challenging year, reflecting market uncertainties

Whilst Harrow Green's activity picked up after the General Election, it slowed again ahead of the Autumn Budget and full year revenue for this division will be below the prior year.

Group performance – on track for FY24 and FY25 expectations

The outlook statement reaffirms profit expectations for FY24 and FY25. This reflects excellent progress in Restore's margin improvement programme, notably the property consolidation and Information Management integration (bringing scanning together with Records Management).

This has enabled the Group to absorb the impact of weaker trading in some areas in H2'24 (particularly at Harrow Green) and a significant headwind in FY25 relating to increased employer National Insurance Contributions (NICs) following the Autumn Budget, as well as increases to the National Living Wage (a combined £3m headwind).

Our forecast changes are summarised in the table below. The revenue reduction in FY24 reflects recent softer trading at Harrow Green, as well as the impact of lower public sector activity within Information Management around the Autumn Budget.

We increase our profit margin assumptions to reflect good progress on a number of divisional and group-wide initiatives, resulting in unchanged expectations on all profit and cashflow metrics.

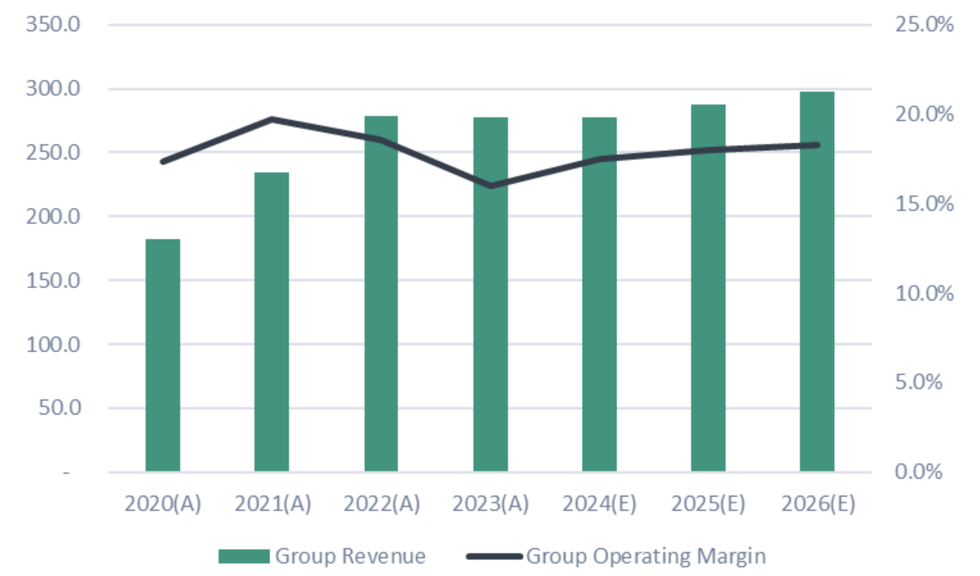
Forecast overview – Margin improvement underpinning in-line performance

Year End Dec, £m	2024(E) Revised	2024(E) Old	Change	2025(E) Revised	2025(E) Old	Change	2026(E) Revised	2026(E) Old	Change
Revenue £m	277.3	290.7	-5%	287.2	300.4	-4%	297.3	310.3	-4%
Group EBITDA £m	48.6	48.6	0%	51.7	51.6	0%	54.3	54.3	0%
PBT (underlying) £m	33.5	33.5	0%	37.0	37.0	0%	40.0	40.0	0%
EPS fully diluted p	18.1	18.1	0%	19.9	19.9	0%	21.4	21.4	0%
Net cash/ (debt) £m	-94.0	-94.0	0%	-75.2	-75.2	0%	-54.6	-54.6	0%
Net cash/ (debt) ex. leases £m	-197.5	-197.5	0%	-178.7	-178.7	0%	-158.1	-158.1	0%

Source: Equity Development estimates

As we discussed at length in our initiation note, the focus is now very much on growing operating margins whilst delivering steady organic revenue growth. The chart below highlights the recent operating margin trend and our forecasts for a steady improvement towards management's strategic target of 20%, which we consider stretching but certainly achievable (versus a current year forecast of 17.5%).

Revenue and operating margin profile 2020(A) to 2026(E)



Source: ED analysis

Company overview (recap from recent initiation note)

Restore is a leading provider of records management (physical document archiving), digitisation (scanning/digital mailroom) and secure recycling of paper and technology assets. In all these areas, it has a strong market position (either number 1 or 2 in the UK) and an excellent reputation across a customer base of blue-chip businesses and government/ public sector organisations. Restore is also the UK market leader in commercial relocations via its Harrow Green business.

The core Records Management business is rock-solid. It contributed 45% of Group revenue in FY23 and, we estimate, almost 80% of Group operating profit. We expect box volumes to remain stable over the medium term and see good revenue growth potential from pricing increases. In our view, this provides an excellent foundation for profitable growth across the Group.

Charles Skinner (originally CEO from 2009 to 2019) returned in September 2023 and has quickly set out new strategic priorities to return the Group to earnings growth and deliver shareholder value after a period of underperformance.

Investment Highlights

- Number 1 or 2 player in all key markets
- Long-term track record of revenue and earnings growth
- Return of former CEO has steadied ship and refocused the Group
- Attractive KPIs – high margins, recurring revenue, cash generation
- Defensive characteristics, high barriers to entry
- Clear strategy with operational decisions delegated to experienced business leaders
- Delivery of margin targets would drive significant earnings growth

Risk Factors

- Mixed track record away from core Records Management
- 2019-2023 impacted by COVID, inflation, and M&A missteps
- Shredding activity has some exposure to commodity pricing (waste recycled paper)
- Sensitivity to inflation and interest rates
- Cyclicality within Technology division
- Limited organic volume growth potential in core market
- Threat of "paperless" office/ hybrid working, but evidence points to market stability

Forecast Drivers

- Revenue growth in Records Management driven by pricing opportunity
- Market share growth potential across all businesses
- Public sector outsourcing - track record of contract success
- Management targets 20% margin, well ahead of our 17.5% forecast
- Margin growth potential in all businesses (with possible exception of Harrow Green)
- Cross-selling to increase as customers look to trusted partners
- Significant M&A unlikely in near term
- Net debt £94m in FY24E or £198m inc. leases.

Valuation

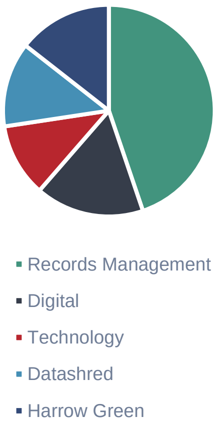
- Shares bounced back strongly from low point of mid-2023 as confidence returned
- But Restore shares have still underperformed all direct peers over the past three years
- Iron Mountain's stunning performance over that period offers some cause for optimism
- Restore shares are trading at a marked discount to their historic average ratings
- Our Fair Value estimate is 400p
- This represents an FY25 P/E rating of 20x, in line with Restore's historic average rating and peer group multiples
- Leverage of c.1.6x for FY24E (c.1.9x FY23), comfortably within target range of 1.5x-2.0x

Web and social media links

https://www.restoreplc.com/

Equity Development Initiation Note

Revenue breakdown FY23 £m



Financials and Forecasts

Income statement							
Year-end Dec, £m	**2020A**	**2021A**	**2022A**	**2023A**	**2024E**	**2025E**	**2026E**
Group revenue	182.7	234.3	279.0	277.1	277.3	287.2	297.3
% growth	-15%	28%	19%	-1%	0%	4%	3%
COGS	-105.9	-127.1	-155.4	-160.7	-155.3	-160.8	-166.5
% of revenue	58%	54%	56%	58%	56%	56%	56%
Gross profit	**76.8**	**107.2**	**123.6**	**116.4**	**122.0**	**126.4**	**130.8**
% margin	42%	46%	44%	42%	44%	44%	44%
Segmental admin expenses	-39.6	-53.0	-67.4	-69.3	-69.9	-70.7	-72.1
% of revenue	22%	23%	24%	25%	25%	25%	24%
Central admin expenses	-5.5	-8.0	-4.3	-2.8	-3.5	-4.0	-4.4
% of revenue	3%	3%	2%	1%	1%	1%	1%
Adj. Operating profit	**31.7**	**46.2**	**51.9**	**44.3**	**48.6**	**51.7**	**54.3**
% margin	17%	20%	19%	16.0%	17.5%	18.0%	18.3%
Depreciation	25.7	28.0	29.6	32.8	32.5	32.5	32.5
Amortisation	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adj. EBITDA	**57.4**	**74.2**	**81.5**	**77.1**	**81.1**	**84.2**	**86.8**
% margin	31%	32%	29%	28%	29%	29%	29%
Net interest	-8.5	-8.1	-10.9	-14.0	-15.1	-14.7	-14.3
Adj. PBT	**23.2**	**38.1**	**41.0**	**30.3**	**33.5**	**37.0**	**40.0**
% margin	13%	16%	15%	11%	12%	13%	13%
Impairments	-8.6	0.0	0.0	-36.3	0.0	0.0	0.0
Amortisation	-8.3	-10.7	-12.1	-12.2	-12.0	-12.0	-12.0
Acquisition transaction costs	-0.1	-1.2	-1.4	-0.2	0.0	0.0	0.0
Restructuring and redundancy	-1.4	-2.4	-2.6	-5.9	-2.5	0.0	0.0
Property related costs	-0.8	-0.8	-0.9	-3.1	-3.0	-1.0	-1.0
Strategic IT reorganisation	0.0	0.0	-0.7	-1.6	-1.0	0.0	0.0
Reported PBT	**4.0**	**23.0**	**23.3**	**-29.0**	**15.0**	**24.0**	**27.0**
Tax	-3.8	-11.5	-6.5	-1.7	-3.8	-6.0	-6.8
Adjusted tax	-0.6	4.3	-1.3	-5.4	-4.6	-3.3	-3.3
Underlying tax rate (%)	19%	19%	19%	24%	25%	25%	25%
Adj. PAT	**18.8**	**30.9**	**33.2**	**23.2**	**25.1**	**27.7**	**30.0**
PAT	0.2	11.5	16.8	-30.7	11.3	18.0	20.3

Source: Company, Equity Development estimates

Cashflow statement							
Year-end Dec, £m	**2020A**	**2021A**	**2022A**	**2023A**	**2024E**	**2025E**	**2026E**
Adj. EBITA	31.7	46.2	51.9	44.3	48.6	51.7	54.3
Depreciation owned assets	25.7	28.0	29.6	32.8	32.5	32.5	32.5
Amortisation of Software	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gain on disposal of PPE	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals (inc IPO costs)	-2.3	-4.4	-5.6	-10.8	-6.5	-1.0	-1.0
IPO costs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other non-cash	1.1	2.2	1.9	-0.5	0.0	1.0	1.0
Working Capital Movement	10.7	-12.1	-12.6	1.1	-2.5	-4.4	-4.5
Operating Cash Flow	**66.9**	**59.9**	**65.2**	**66.9**	**72.1**	**79.8**	**82.3**
Net Interest	-8.0	-7.0	-11.4	-12.8	-15.1	-14.7	-14.3
Tax	-7.2	-5.2	-6.0	-6.3	-5.7	-6.5	-7.3
Net Operating Cash Flow	**51.7**	**47.7**	**47.8**	**47.8**	**51.3**	**58.6**	**60.8**
Purchase of PPE	-7.3	-8.8	-11.0	-10.3	-16.0	-11.0	-11.0
Total Net Capex	-7.3	-8.8	-11.0	-10.3	-16.0	-11.0	-11.0
Leases	-17.1	-18.8	-19.2	-20.7	-21.0	-21.0	-21.0
Equity Free Cash Flow	**27.3**	**20.1**	**17.6**	**16.8**	**14.3**	**26.6**	**28.8**
M&A	-3.7	-86.7	-11.5	-1.7	-0.6	0.0	0.0
Dividend	0.0	-3.4	-9.9	-9.1	-7.4	-7.7	-8.1
Share Issue	-0.8	35.5	0.1	-0.5	-2.6	0.0	0.0
Other	-0.4	-0.2	1.0	0.2	0.0	0.0	0.0
Net Change in Net Debt	**22.4**	**-34.7**	**-2.7**	**5.7**	**3.8**	**18.8**	**20.6**
Net Debt - BOP	-88.5	-66.1	-100.8	-103.5	-97.8	-94.0	-75.2
Net Debt - EOP	**-66.1**	**-100.8**	**-103.5**	**-97.8**	**-94.0**	**-75.2**	**-54.6**
Net Debt including leases	**-186.8**	**-217.8**	**-218.4**	**-201.3**	**-197.5**	**-178.7**	**-158.1**

Source: Company, Equity Development estimates

Balance sheet							
Year-end Dec, £m	**2020A**	**2021A**	**2022A**	**2023A**	**2024E**	**2025E**	**2026E**
Non-Current assets							
Intangible assets	247.4	327.2	331.9	284.7	272.7	260.7	248.7
Property, Plant & Equipment	70.6	78.8	79.7	79.4	83.9	83.4	82.9
Right of use assets	107.1	102.5	106.8	91.6	91.6	91.6	91.6
Other receivables	3.4	5.9	5.1	5.2	5.2	5.2	5.2
Sub-total NCAs	**428.5**	**514.4**	**523.5**	**460.9**	**453.4**	**440.9**	**428.4**
Current Assets							
Inventories	0.9	1.4	2.0	1.5	2.5	3.5	4.5
Trade and other receivables	41.2	56.9	64.9	63.1	65.6	70.0	74.5
Cash and cash equivalents	26.4	32.9	30.2	22.7	26.5	45.3	65.9
Current tax assets	0.3	0.0	0.0	1.2	1.2	1.2	1.2
Sub-total CAs	**68.8**	**91.2**	**97.1**	**88.5**	**95.8**	**120.0**	**146.1**
Total Assets	**497.3**	**605.6**	**620.6**	**549.4**	**549.2**	**560.9**	**574.5**
Current liabilities							
Trade and other payables	-38.8	-45.5	-49.1	-44.9	-45.9	-46.9	-47.9
Financial liabilities-lease liabilities	-16.7	-18.2	-19.2	-18.6	-18.6	-18.6	-18.6
Derivative liability	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Current tax liabilities	0.0	-1.5	-1.6	0.0	0.0	0.0	0.0
Provisions	-0.4	-0.9	-1.7	-4.4	-5.0	-5.0	-5.0
Sub-total CLs	**-55.9**	**-66.1**	**-71.6**	**-68.0**	**-69.6**	**-70.6**	**-71.6**
Non-Current liabilities							
Financial liabilities-borrowings	-92.5	-133.7	-133.7	-120.5	-120.5	-120.5	-120.5
Financial liabilities-lease liabilities	-104.0	-98.8	-95.7	-84.9	-84.9	-84.9	-84.9
Deferred tax liability	-19.8	-33.9	-30.9	-29.3	-29.3	-29.3	-29.3
Provisions	-6.5	-7.9	-15.4	-14.2	-14.5	-14.5	-14.5
Other payables	0.0	0.0	-0.1	-0.4	-0.4	-0.4	-0.4
Sub-total NCLs	**-222.8**	**-274.3**	**-275.8**	**-249.3**	**-249.2**	**-249.2**	**-249.2**
Total Liabilities	**-278.7**	**-340.4**	**-347.4**	**-317.3**	**-318.8**	**-319.8**	**-320.8**
NET ASSETS	**218.6**	**265.2**	**273.2**	**232.1**	**230.4**	**241.1**	**253.7**

Source: Company, Equity Development estimates

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