Progressive EQUITY RESEARCH

CEPS
INDUSTRIALS

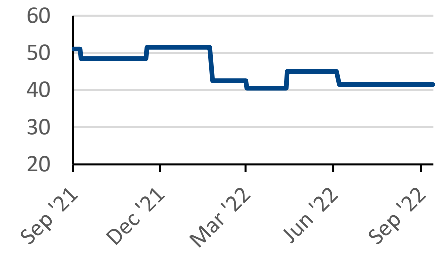
11 October 2022

CEPS.L

42p

Market Cap: £8.8m

SHARE PRICE (p)



12m high/low	52p/41p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£(6.1)m *(at 30/06/22)*
Enterprise value	£14.9m
Index/market	AIM
Shares in Issue (m)	21.0
Executive Chairman	David Horner
Finance Director	Vivien Langford

COMPANY DESCRIPTION

CEPS is a holding company that buys majority stakes in growing, entrepreneurial UK companies.

www.cepsplc.com

CEPS IS A RESEARCH CLIENT OF PROGRESSIVE

ANALYSTS

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Solid H1 22 but cautious outlook

CEPS has delivered solid H1 22 results, for the six months ended 30 June 2022, against a weaker comparative period that was impacted by lockdown restrictions. Total revenue increased by 45% to £13.0m (H1 21: £9.0m) and operating profit by 15% to £930k (H1 21: £809m). The subsidiaries have made good progress following the restructuring measures over the past three years and the 'buy and build' strategy is proving successful. However, given the worsening economic situation, management has flagged that 'caution is our watch word' and the companies are being managed accordingly. CEPS has not been immune to issues with product availability, labour shortages and sharply rising input costs. In particular, management is looking to automate processes where possible, over the longer term, to reduce costs.

- **Strong recovery in end markets.** Group revenue increased by 45% to £13.0m against a Covid-impacted comparative period (H1 21: £9.0m). Operating profit increased by a smaller proportion, up by 15% to £930k (H1 21: £809k) as the H1 21 comparator included £240k of income from Covid grants. Profit after tax was £460k (H1 21: £340k), resulting in improved earnings per share of 1.07p (H1 21: 0.73p).

- **Aford Awards is benefitting from recent acquisitions.** Three smaller businesses were acquired in September 2021 and Impact Promotional Merchandise (IPM) in April 2022 for a total consideration of £1m (£450k deferred over three years). Aford Awards' performance in H1 22 suggests that integration is progressing well, with revenue of £1.6m (H1 21: £515k) and a cost structure in place to support profitable growth.

- **Friedman's and Milano International have returned to more normal trading conditions.** The recovery at Friedman's continues to be strong, while Milano International is experiencing a slower recovery, although the sponsorship of British Gymnastics should lead to further growth and improved profitability longer term.

- **Hickton remains robust.** Revenue growth at Hickton remains strong, rising to £8.2m from £6.6m in H1 21. However, an increase in costs, to support growth and the integration of recent acquisitions, has impacted profitability. Given economic concerns, management is cautious about construction activity going into the second half, particularly the impact of rate rises on the residential market.

We are encouraged that all of the subsidiary segments have been profitable, while recent refinancing, including removal of the pension liability, provides sufficient financial headroom. Given the current economic uncertainty, we look forward to greater clarity on trading conditions at the full-year results.

Financial highlights

Group revenue in H1 22 increased by 45% to £13.0m (H1 21: £9.0m) and operating profit increased by a smaller proportion, up by 15% to £930k (H1 21: £809k) as the H1 21 comparator included £240k of other operating income that was derived from the Coronavirus Job Retention Scheme grant and similar, which are no longer available.

Group costs were held flat at £167k (H1 21: £164k). All subsidiaries showed good progress, with an increased contribution from Aford Awards following recent acquisitions. Profit after tax for the period was £460k (H1 21: £340k), which resulted in improved earnings per share of 1.07p (H1 21: 0.73p).

The construction sector has been more resilient than the retail and leisure industries through the pandemic. However, end markets for Aford Awards, Freidman's and Milano International have rebounded strongly post Covid. Given economic concerns and rising interest rates, we would expect a potential softening in construction activity in H2 22, which is likely to impact Hickton's performance, coupled with the increased costs incurred within this business.

Cash generation from operating activities improved to £825k in H1 22 from £515k in H1 21. The equity raise in September 2021, including conversion of a loan from Chairman David Horner, has improved gearing from 427% at 30 June 2021 to 158% at 30 June 2022. Net debt, at £6.1m, has remained at roughly the same level and the term of the loan from Chelverton Asset Management Limited (£2.95m as at 31 December 2021) has been extended on a rolling 18-month basis. Group cash was £1.7m at 30 June 2022 vs £2.1m at 30 June 2021.

We welcome the recent announcement regarding the transfer of the legacy pension scheme, following the buy-in contract with Aviva. As well as providing security for existing scheme members, this contract also removes investment and funding risk for CEPS.

Operational results

Hickton Group

Hickton Group comprises a group of specialist building services businesses, following the acquisition of the Cook Brown businesses in 2020.

H1 22 revenue increased to £8.2m (H1 21: £6.6m), however EBITDA (post-exceptional items) declined slightly to £820k (H1 21: £980k) due to significantly increased costs from adding senior personnel to manage the acquisitive growth. Although this has an impact on profitability short term, this investment should reap long-term benefits.

Management notes that there is still significant corporate activity in what it describes as 'a very dynamic marketplace'. Construction activity currently remains robust, however, there is an element of caution over the potential impact of rate rises, particularly on the residential market.

Aford Awards

Aford Awards, the trophies and awards business, was hit hard by Covid because of the ban on public events but has rebounded very strongly. H1 22 revenue was £1.6m (H1 21: £515k), with EBITDA at £410k (H1 21: £164k).

The new management team is committed to growth through the acquisition of smaller businesses where assets and clients can be integrated into the Aford Awards structure. Three such businesses were acquired in September 2021 and Impact Promotional Merchandise (IPM) in April 2022 for a total consideration of £1m (£450k deferred over three years). IPM is a supplier of trophies and promotional customised goods such as sports bags and mugs. We believe that Aford Awards can extract significant value from IPM by incorporating it into the Aford Awards structure.

H1 22 performance suggests that integration of the acquisitions is progressing well, with the cost structure in place to support profitable growth.

Friedman's (including Milano International)

Friedman's, the Lycra printer and stretch fabric specialist, acquired Milano International, a manufacturer of gymnastics clothing, in October 2019. Covid then hit these businesses very hard. However, Friedman's has recovered well, with Milano International experiencing a slower recovery.

In H1 22, revenue from Friedman's and Milano International was £3.2m (H1 21: £1.9m). EBITDA was £227k (H1 21: £82k). Once end markets reach a sustainable recovery, we expect strong growth in profitability underpinned by the expected benefits of the acquisition, while the sponsorship of British Gymnastics should lead to further growth for Milano International. However, the expected growth in profitability in the short term could be held back by price inflation, labour shortages and supply issues in obtaining the core lycra product, as management noted at the FY21 results.

Vale Brothers

Vale Brothers manufactures equestrian products and complements Davies Odell's range of personal protection products and strong brands. Davies Odell merged with Vale Brothers in December 2020, and a new holding company was established in which CEPS has a 33% holding and £405k of loan stock. Consequently, the new company is treated as an associate. Despite contributing £25k of profit in H1 21 and £66k of profit in FY21, Vale Brothers contributed a loss of £59k in H1 22.

Management notes significant supply chain pressures in the business, particularly recruiting skilled workers and high input-cost inflation from Far East sourced products. While price increases have been passed on, management is looking to increase prices further. Action is being taken to restructure this business.

Conclusion

Over time, we expect CEPS to grow, focusing on generating profits and cash, initially repaying debt, then introducing a steady dividend payment over the longer term. CEPS will also look to increase its shareholdings in underlying subsidiaries. The Group has emerged from its three-year restructuring with a clear strategy as to how it will grow its businesses. However, given the worsening economic situation, management has flagged that 'caution is the watch word', with the companies being managed accordingly.

We are encouraged that all of the subsidiary segments have been profitable in H1 22, and we see clear evidence that management's strategy is delivering. Recent refinancing, including removal of the pension liability, provides sufficient financial headroom. Given the current economic uncertainty, we look forward to greater clarity on trading conditions at the full-year results.

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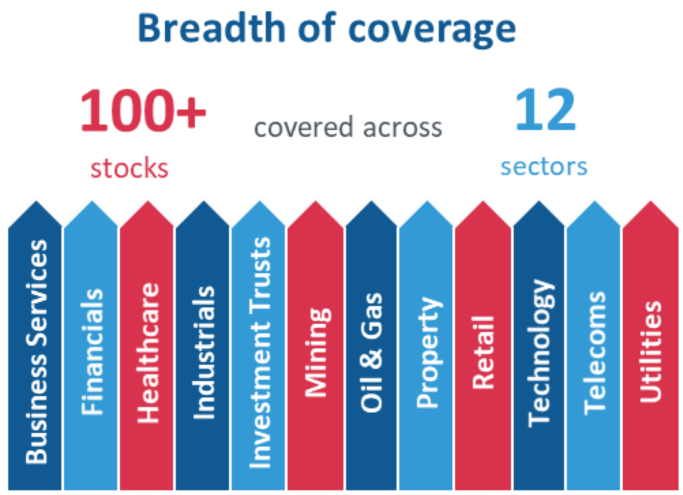

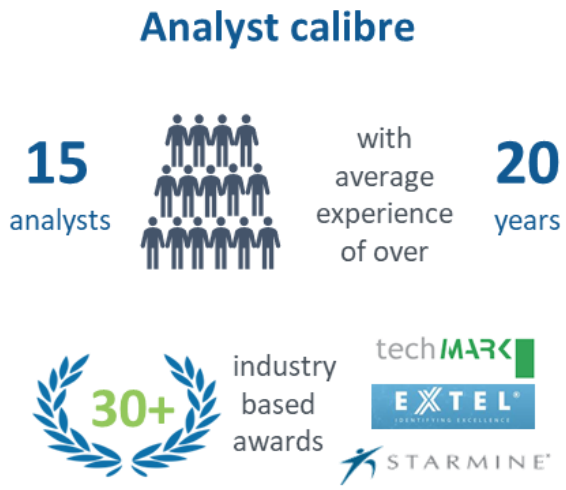

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