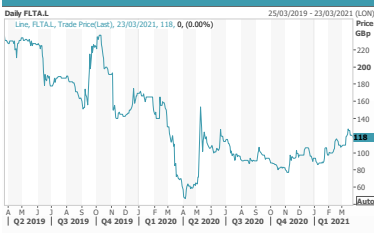




Support Services



Source: Refinitiv

Market data

EPIC/TKR	FLTA
Price (p)	154
12m High (p)	160
12m Low (p)	62
Shares (m)	29
Mkt Cap (£m)	45
EV (£m)	44
Free Float*	33%
Country of listing	UK
Market	AIM

*As defined by AIM Rule 26

Description

Filta Group (Filta) provides cooking oil filtration, fryer and drain management services in North America, the UK and Europe to commercial kitchens, primarily through franchisees.

Company information

CEO	Jason Sayers
CFO	Brian Hogan
Chairman	Tim Worledge
	+44 1788 550100
	www.filtapl.com

Key shareholders

Directors	66.4%
Gresham House	16.5%
Cannacord Genuity	4.5%

Diary

Nov'21	Interim results
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Analyst

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FILTA GROUP

Robust and necessary

Filta announced FY'20 results in line with expectations. We are not changing the forecasts we published last month. What is clear is that the business has performed robustly during COVID-19, adding new clients and becoming an important part of its clients' processes. With business levels back to 70% of pre-COVID-19 levels and with its largest clients yet to reopen, Filta is emerging from this fog stronger than ever. Assuming there is no reversion to widescale lockdowns, our forecasts should prove conservative.

- **FY'20 results:** Revenue was down by a third, and adjusted EBITDA came in at £1.05m. The company ended the year with net debt of just £0.5m, showing the effectiveness of its cash management in a very tricky period. Overheads were reduced by £1.4m, and efficiency gains were made throughout the business.
- **2021 outlook:** The US has been better than the UK, which has been better than Europe (only 3% of business). We are forecasting a 22% pickup in revenue for 2021, followed by 30% in 2022. Business is bouncing back strongly, with economic stimulus and huge pent-up demand. Filta has shifted its FOG business in the UK to a capital-light franchise model, and its Cyclone model is now well-established.
- **Valuation:** Our DCF-derived valuation delivers a central value of £49m, or 169p per share, and equates to 10x 2023E EBITDA.
- **Risks:** The clear risk for Filta is that COVID-19 returns aggressively and its customers are unable to stay open or reopen. In the UK-owned operations, the business is heavily weighted towards 20 large operations that are well-positioned to survive. Its balance sheet is relatively strong, with cash balances and low net debt.
- **Investment summary:** Filta is an attractive business, in our view, focusing on the capital-light franchise model developed in North America, and now widespread in the UK and growing in Europe. As businesses continue to reopen, the focus on cleanliness, efficiency and environmental friendliness is unlikely to be abated. This is a business that did not sit idly by while its customers were shut; it has improved efficiency across the operations, which will drive profitability this year and next. The company is currently hiring 100 staff to cope with the resurgent demand, and, with its FiltaFog Cyclone product being specified for exclusive use in some of the world's largest restaurant chains, it is here to thrive for the foreseeable future.

Financial summary and valuation

Year-end Dec (£000)	2017	2018	2019	2020	2021E	2022E
Revenue	11,547	14,213	24,923	16,402	20,000	26,000
Adjusted EBITDA	2,116	2,642	3,163	1,054	2,553	4,430
Underlying EBIT	2,059	1,941	1,504	-402	1,070	2,970
Reported EBIT	1,699	1,782	1,208	-589	1,070	2,970
Underlying PTP	1,968	1,900	1,233	-679	820	2,770
Statutory PTP	1,608	1,742	936	-866	820	2,770
Underlying EPS (p)	5.05	5.39	2.40	-2.81	2.21	7.46
Statutory EPS (p)	3.85	4.88	1.39	-3.46	2.21	7.46
Net (debt)/cash	2,992	2,040	-2,094	-516	415	2,580
Shares issued (m)	27	29	29	29	29	29
P/E (x)	30.5	28.6	64.1	-54.7	69.7	20.6
EV/EBITDA (x)	18.4	16.1	14.8	42.9	17.4	9.5

Source: Hardman & Co Research

Summary

Plenty of scope for future growth

Filta has an attractive repeat revenue business. Serving mostly commercial kitchens, it provides contracted-out services covering fryer management, replacing refrigeration seals, and fat oil and grease management (FOG). These jobs are usually left to the most junior employee, or until an emergency service is needed. Filta has little in the way of competition in the first two categories, and the FOG sector is very fragmented, with Filta's 2018 acquisition of Watbio making it probably the largest player in the UK.

The business in North America and continental Europe is run as a franchise operation, which means relatively low capital and employee requirements. The franchisees are supported by a Filta sales team, which helps them grow their businesses, and is responsible for managing the national accounts of multi-site commercial catering operations. The UK is a mixture of company-owned operations and fryer management franchises, but the franchisees are typically one-van operations, in contrast to the North American market, where the average van count is three per franchise and where top franchisees had annual revenues in excess of \$2.5m in a normal (non-COVID-19) year.

Filta had seen steady growth in its various businesses, as the number of franchises had increased and as the franchisees had grown their own businesses. With around just 2% of the addressable fryer market currently being served, we see steady growth being achievable for many years to come, once everything is open again. Large parts of the USA are now allocated to franchisees – including the largest metro areas – but the growth of the American franchisees themselves, the steady upgrading of the franchisee network, as territories are recycled, and the opportunity to repeat the US pattern in Europe provide plenty of scope for future growth.

Grease management services a promising addition

The expansion into grease management was a natural next step. There is more competition here, and Filta's acquisition of Watbio was a significant move, but it remains a very fragmented market, in which Filta is one of the largest or possibly *the* largest players in the UK. Regulation is only likely to get tougher, making Filta's FOG services even more important.

The FOG business is similar to the fryer business in that it requires regular visits to the kitchens to maintain the equipment *in situ*. The requirement for scheduled maintenance makes the organisation of the teams' rotas a critical factor in the efficient running of the business and, here, Filta believes there is substantial scope for increasing the productivity within this sector.

Filta's new grease recovery product, FiltaFOG Cyclone, was launched during the year and has had a very positive reaction from customers. It has now been specified for exclusive use in the UK in some of the world's largest restaurant chains. It produces better oil separation at a lower operating cost than any other product on the market. Filta is using its franchise network to deliver this service in areas where it doesn't have adequate in-house coverage.

Unique proposition in seal replacement market – replacing seals onsite in one visit

The fridge seal replacement operation is less suited to franchising because, typically, it needs client visits only annually, or less frequently, so the business is company-owned. Filta has a unique proposition in this market – it replaces the seals onsite in one visit, making it a very attractive solution for the kitchens by avoiding prolonged disruption. Once the clients are signed up, they should remain for as long as they stay in business. We expect the steady progress of this business to continue and its profitability to marginally outgrow sales, as scale efficiencies kick in and as clients migrate from reactive repairs to scheduled maintenance or replacement.

Has developed efficient sanitising and disinfection service

Since the spread of COVID-19, Filta has also established a sanitising and disinfecting service that eliminates all envelope viruses, flu and 99.9% of bacteria from the premises. This service has been taken up by many of Filta's existing clients, as well as some new ones.

COVID-19 action

Well-positioned in US

In the US, Filta supported its franchisees through the pandemic with reduced royalties, based on revenues. Many states are reopening, following the vaccine programmes being rolled out. We expect a rapid recovery within the restaurant and leisure sectors. The US has remained profitable and cash-generative throughout the period and, by the end of 2020, recurring revenue levels had recovered to over 65% of the levels that were achieved in 2019, despite some of the group's major existing customers, including stadia and universities, not having reopened. This has been achieved by some 20% growth in the total US customer base, and leaves Filta well-positioned to capitalise on both the additional revenues that will derive from further reopenings and from the US recovery generally.

Filta made six US franchise sales in 2020, and it continues to receive new franchisee interest. Unemployment frequently prompts greater interest in entrepreneurial types going it alone.

Has developed strong sales pipeline in UK

In the UK, margins have improved as a result of efficiency measures introduced in 2019. As with the US, the group's major UK customers are yet to reopen and, in consequence, business levels are at ca.60% of pre-COVID-19 levels. However, investment in its sales teams has seen an increase in activity, and it has developed a strong sales pipeline.

Significant scope to grow in Europe once hospitality business returns

Europe has been hit harder and taken longer to reopen. It accounts for less than 3% of group revenues, but has significant scope to grow once the hospitality business returns.

Forecasts and valuation

We use a DCF valuation, given that Filta has no comparable businesses...

Our forecasts assume that the steady reopening in the USA continues and that the UK begins to reopen from April onwards. Nevertheless, our revenue numbers for 2021 are still 20% below 2109 levels. By 2022, we estimate revenue at a new record, reflecting the growth in franchises, and the benefits of the investment in new products and in the sales teams.

We estimate a constant gross margin of 44% in both forecast years, and administration costs as a percentage of revenue to fall from 43% in 2020 to 38% in 2021 and 32% in 2022.

We expect net debt to be eliminated in 2021, excluding ca.£1m of finance leases.

With no comparable businesses, we use a DCF valuation. Using a constant discount rate of 10% derives a range of values depending on the growth rate chosen between the end of our forecast period (December 2022) and when the perpetuity calculation starts (we have used 2026).

...delivering a central value of £49m, or 169p per share

Our forecast range of values, based on the DCF methodology, gives a wide-range value of 114p to 269p per share, with a central value, at a 10% mid-term growth rate and using our 10% discount rate, of 169p. This equates to 10.5x 2022E EBITDA.

DCF sensitivity table

Mid-term growth rate	6%	8%	10%	12%
Discount rate	(p)	(p)	(p)	(p)
8%	231	243	256	269
10%	153	161	169	178
12%	114	120	126	132

Source: Hardman & Co Research

Of course, these mid-term growth rates are a fraction of what Filta has achieved in the past and what we expect it can achieve in the future. They take no account of future potential acquisitions, either.

The current share price, still using a 10% discount rate, implies and assumes no mid-term growth rate at all.

The relatively high, implied multiples of earnings and EBITDA would be justified, we believe, by the high gross margins, the low capital intensity, the lack of competition, and the persistency and widespread nature of the client base.

Income statement, 2017-22E

Year-end Dec (£000)	2017	2018	2019	2020	2021E	2022E
Revenue	11,547	14,213	24,923	16,402	20,000	26,000
Cost of sales	-5,870	-7,131	-14,756	-9,484	-11,200	-14,560
Gross profit	5,677	7,083	10,166	6,918	8,800	11,440
Other income	38	25	191	77	50	50
Distribution costs	-125	-151	-203	-88	-180	-200
Admin. expenses	-3,532	-5,015	-8,650	-7,308	-7,600	-8,320
Operating profit	2,059	1,941	1,504	-402	1,070	2,970
<i>Adjusted EBITDA</i>	<i>2,116</i>	<i>2,642</i>	<i>3,163</i>	<i>1,054</i>	<i>2,553</i>	<i>4,430</i>
Finance expenses	-91	-40	-271	-277	-250	-200
Underlying PBT	1,968	1,900	1,233	-679	820	2,770
Exceptional costs	-360	-159	-296	-187		
Tax	-590	-422	-532	-140	-164	-554
PAT	1,017	1,320	404	-1,006	656	2,216
Discontinued operations	33	19				
Net profit	1,050	1,339	404	-1,006	656	2,216
Exchange differences	-94	-29	-149	-168		
Comprehensive income	956	1,309	255	-1,174	656	2,216
Underl. EPS (fully-dil., adj., p)	5.1	5.4	2.4	-2.8	2.2	7.5
DPS (p)	0.0	1.6	1.0	0.0	0.7	2.5
Gross profit margin	49%	50%	41%	42%	44%	44%
EBIT margin	18%	14%	6%	-2%	5%	11%
Growth YoY						
Revenue	36%	23%	75%	-34%	22%	30%
Operating profit	104%	-6%	-23%	-127%	-366%	178%
EPS	38%	7%	-55%	-217%	-179%	238%

Source: Hardman & Co Research

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