Howden Joinery

Date: 30th May 2025

Summary View **Ticker: HWDN LN** **Price: £8.68**

Howden Joinery is a London-listed company which operates as a specialist supplier of kitchens to trade professionals. We introduced coverage of Howden Joinery in July 2023, since when the shares have delivered a sterling return of 49%, including reinvested dividends (FTSE All-World: 29%).

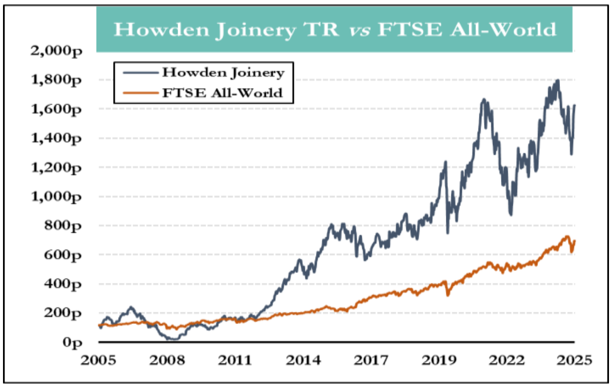

Chart 1 – Source: Bloomberg, GillenMarkets

Howden has a strong moat: (i) the 869-strong nationwide UK depot network, with 88% of trade professionals being within five miles of a depot; and (ii) very high service levels. Trade professionals are offered credit to help manage their cash flow; depots are kept fully stocked at all times; a team of 2,000 specialist designers assist in designing homeowners' kitchens; and kitchen pricing for the trade professionals is competitive and confidential, allowing them to manage their margins. These elements have allowed Howden to grow to a 20% market share in the UK, to work with one-third of all trade professionals in the UK, and to earn high margins (14.6%) and returns on capital (17.8%) on likely trough earnings.

Progress has been difficult the past two years, with flat sales reflecting a depressed UK kitchen market. While price increases have preserved gross margins, operating margins have fallen as a result of a high fixed cost base and high investment for growth, leading to a 23% decline in earnings from peak levels.

The short-term is not expected to see an improvement in UK kitchens. Nonetheless, we are optimistic about medium-term earnings growth prospects through a combination of depot growth both in the UK and internationally (perhaps 3% annually), greater sales rates in each depot, improved operating margins, and share buybacks. We find that a mid- to high-single-digit earnings growth rate, using conservative estimates, appears plausible over the long-term.

Howden's shares have re-rated since we introduced coverage and trade on 19 times earnings (15 times peak earnings). The shares offer a dividend yield of 2.4% which, with earnings growth of perhaps 6-8% annually, hold out the prospect of 8.5-10.5% annual total returns. This, combined with a competitive advantage, is an attractive proposition. We retain our 'Buy' recommendation, albeit long-term investors may want to average in over a period of time as a result of the shares' recent strong run and higher valuation. The shares remain in the Lump-sum Growth Portfolio.

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A Common Framework for Assessing Stocks

The common framework for assessing risk in companies used by GillenMarkets includes understanding:

- **The business risk:** the risk that the business model has deteriorated and that past levels of profitability are unlikely to be achieved again in the future.
- **The financial risk:** the risk of inappropriate financing and debt levels, which exposes the company to failure and investors to a potential total loss.
- **The valuation risk:** the risk of overpaying for the shares, which will lower the future returns.

The data for analysing Howden Joinery have come from the company's Annual Reports, company presentations, and Bloomberg.

Business Risks

The Basics

Howden Joinery is a London-listed company which operates as a specialist supplier of kitchens, joinery, and bedrooms to trade professionals.

The company was founded in 1995, and today operates nearly 950 depots across the UK, France, and Ireland, from which it supplies over 500,000 building professionals.

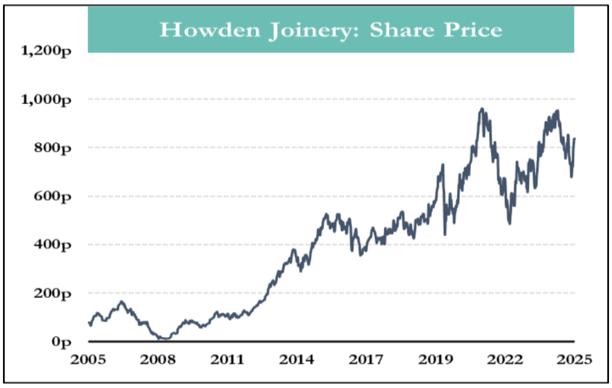

Chart 2 – Source: Bloomberg

The latest share price is £8.68 which, with 547.2 million shares in issue, means the market capitalisation is £4.6 billion.

The Business Model

Howden is a trade-only specialist supplier of kitchens to trade professionals (i.e., retail customers can't buy from Howden). The business owns a network of 947 depots, of which 869 are in the UK, 65 in France/Belgium, and 13 in Ireland. The UK depots, which are more mature, make average annual sales of £2.7 million each, while the international depots make annual sales of €1.3 million each. Younger depots tend to make lower levels of sales (*c.* 2 years for new depots to breakeven).

A kitchen is a complex installation, with multiple individual units – e.g., sinks, appliances, cabinets, drawers, surfaces, skirting – coming together to form a whole. Howden manufactures its own kitchen cabinets as well as some worktops, cabinet frontals, and skirting boards, accounting for about one-third of the total kitchen by volume. The production of the other two-thirds is done by third-party suppliers.

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There are approximately 29 million homes in the UK, of which 18 million are owned and 11 million are rented. The UK kitchen and joinery markets are estimated to be jointly worth £11.2 billion annually (kitchen: £6.0 billion / joinery: £5.2 billion). Howden's total revenues were £2.3 billion for the year to December 2024, giving it a market share of 20.1%. Sales are primarily to residential customers (90%) and to the RMI market (95%).

Howden's markets include all of the major types of housing: owner-occupied homes, private rentals, and social housing.

The kitchen market has several structural drivers which should act as tailwinds for growth:

1. The UK population is expected to increase to 73.7 million people (+8%) by 2036, adding 5.3 million new people to the market.
2. The housing stock in the UK is aging, with the average house being over 70 years old.
3. Consumers are increasingly interested in sustainable and energy efficient products for their kitchens.

More recently, Howden's management has noted the following trends which are influencing the business on a near-term basis:

1. The work-from-home change means that house interiors are more subject to wear and tear and need replacement quicker.
2. Consumers are increasingly focused on design and space maximisation, leading them to rely on trade professionals and suppliers for insights.
3. An aging population with disposable income is increasingly choosing to stay in their current homes. Baby boomers in the UK own *c.* ½ of the housing stocks (worth £2 trillion).
4. Increasing mortgage rates are incentivising homeowners to keep their current home and upgrade the interior instead.

The table on the right shows a breakdown of the group's sales, highlighting that the majority of sales come from the UK (97%), with a smaller amount from Belgium, France, and Ireland (3%).

Howden earns impressive operating margins for a supplier – 14.6%, reflecting the quality of its business model. These margins have come down from a peak of 19.2% in 2021, as the kitchen market in the UK has slowed and operating costs have risen.

Sales & Operating Profits Year to Dec-24		
Sales	**£m**	**% of total**
UK	2,247.4	97%
International	74.7	3%
Total	2,322.1	100%
Op. Profits	**£m**	**Margins**
Total	339.2	14.6%

Table 1 – Source: Annual Reports

Is There A Moat?

Like many specialist suppliers, Howden's business model relies heavily on relationships with trade professionals. It is encouraging, then, that the management team in the latest Annual Report say that "when our customers succeed, we succeed."

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In our view, Howden has a significant competitive edge.

#1 Global & Local Sourcing – Howden has operated for three decades, giving it long experience in sourcing key inputs for kitchens. It has long-term supply agreements with over three hundred global suppliers, giving it access to the latest products. It can also leverage its scale to gain favourable terms from suppliers.

Howden also makes a significant amount of its own product in-house, which gives it better control over the supply of kitchens to professionals. The decision to make goods in-house or to outsource is under constant review, and management seeks to obtain the optimal balance of cost, availability, resilience, and flexibility. Howden expanded its manufacturing capability in 2023, with new furniture, architrave, and skirting lines in its manufacturing facilities. It also bought Sheridan Fabrications, a specialist in premium worksurfaces, in 2022 (its only acquisition since listing) in order to facilitate its entry into higher-priced kitchens. It is currently in talks to expand Runcorn, its key manufacturing facility in the northwest of England. Howden also owns its own appliance brand, Lamona. Currently, about one-third of manufacturing by volume is done in-house, with ambitions to bring this to about 40%.

#2 Large & Evolving Range – Howden has a large and evolving product range, with management noting that shortening product lifecycles are a challenge to navigate. In kitchens, it has 11 'families' of kitchen styles, spread across budget (3), mid-range (4), and high-priced (4). These kitchen styles are then available in a variety of sub-styles covering finishes, colours, and handle styles. Howden's website lists 305 sub-styles available to customers.

To highlight the importance of constantly updating product ranges, management notes that new products introduced in 2023-24 accounted for 20% of UK sales, and products introduced in the last 3 years account for 30% of UK sales. This can also lead to high levels of obsolescence – 21% of inventory on the balance sheet is written-down, with the average write-down being 46%. This is a feature of the business, and we note that Howden's high operating margins and returns on capital account for these write-downs.

Howden has also been moving into new and adjacent categories in order to expand its offering for customers. It launched a bedroom range in 2023, which it believes is progressing well. It offers bedrooms across 5 'families' of styles and 25 sub-styles. The bedroom market is £1.2 billion in size. Management has commented that the bedroom market is an attractive adjacent market, and hopes to "upsell" kitchen-buying customers with bedrooms when they visit depots.

It has also moved into higher-priced kitchens, which is an area where it believes it is under-represented. In order to facilitate this move, it acquired Sheridan Fabrications (solid worksurfaces), introduced a paint-to-order service, and increased its appliance range.

It launched an own-brand flooring product (Oake & Gray) in 2023, and a door-furniture range called Fuller & Forge.

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Howden has recently been updating how it manages its stock levels. It introduced a Daily Traders initiative, which ensures that its best-selling products (the 'Daily Traders') are consistently in-stock. This helps to promote footfall, improve customer service, and increase sales. Its stock management has also been upgraded with a 'Live Stock' digital programme, which records and tracks stock levels across depots, factories and warehouses. This allows managers to more easily check stock and place new orders, allowing the managers more time to focus on other aspects of the job. The greater surety over stock provided by Daily Traders and Live Stock has allowed Howden to introduce a Click and Collect service for traders, allowing busy traders to check live stock levels and make purchases.

<u>#3 Nationwide Depot Network</u> – in the UK, Howden has 869 depots and plans to add a further 20 this year. The depots are typically located on edge-of-town premises, which are easily accessible for trade professionals and tend to be lower rent which keeps costs down. 88% of trade professionals live within 5 miles of a depot.

The depots are staffed by small teams of 13-14 staff who are incentivised with a share of profits at the depot level (managers receive 5% of operating profits, other staff split 5% of gross profit), ensuring maximum alignment between employees and managers and a decentralised management structure. Each depot can tailor its inventory to match local tastes and needs.

The depots are re-stocked on a weekly basis by a network of primary warehouses, which maintain 99.98% availability of stock. Depots can also avail of stock from cross-docking centres (XDCs), meaning that the depots are always fully stocked and professionals are always able to obtain what they need at short notice. The XDCs, a recent innovation, enable Howden to offer next-day delivery.

Howden's management team is dedicated to improving the depot centres, as these are an important way in which they interact with customers. Over the past several years, the depot centres have been undergoing refurbishment, includes a new front area format which is more pleasing for staff and professionals, as well as the introduction of vertical racking in warehouses, which allows more stock to be stored in less space and picked out easier. Management estimate it takes about 4 years for the additional profits to cover the costs of the refurbishments. About 70% of the UK estate will operate under the refurbed format by the end of 2025.

In 2022, the group finished rolling out its network of XDCs, which act as secondary distribution centres that provide more regular stock top-ups, allowing greater availability of range and the ability to offer next-day services. Both the refurbs and the cross-docking centres required significant capital expenditure, highlighting management's willingness to invest for the future. The XDCs effectively paid for themselves: prior to their development, Howden was making inter-depot transfers of 11 million units of stock annually to make sure stock was available where needed. With the new XDCs, this has been reduced to 1 million inter-depot transfers, which has cut costs, freed up depot management to focus on sales and customers, and enhanced customer experience by making sure they always get factory-fresh stock.

The focus on high availability of stock means that Howden has to hold high levels of inventory – approximately £391 million at the last reporting date, accounting for 17% of total assets. This represents about 158 days' worth of sales. While this consumes significant capital, it is a major source of competitive advantage.

#4 Relationships with Builders – Howden's relationships with trade professionals are important, and it must focus continuously on providing an excellent service to them so that they continue to promote Howden's kitchens to their own customers. Howden supports its trade professionals in a number of ways:

1. Professionals have access to trade accounts (i.e., buying on credit), which helps them to manage cash flow. Howden invests significantly in this, with £217 million of trade receivables at the end of December 2022, accounting for 10% of total assets and 30 days' worth of sales.
2. Howden employs 2,000 specialist kitchen designers who support trade professionals by visiting the end-user's home, or working remotely through digital design tools.
3. A high level of stock means that builders always have access to the products they need.
4. Howden supplies builders with marketing materials to present to homeowners.
5. Pricing is competitive and confidential, meaning that the homeowner won't know the cost of the kitchen to the builder, thus allowing the builder to manage their own margins.
6. Howden has invested significantly in building digital tools to support builders, with a new website, social media, and online accounts which allow for online ordering outside of business hours (previously, the business had been based on phone calls and in-person visits to place orders).

Put together, these elements make a strong competitive edge for Howden. Control over manufacturing and distribution allows it to have control over the quality and availability of stock. A focus on serving the key customer – the trade professional – means they become lifelong clients, and act as free advertisement for Howden when they engage with homeowners.

Evidence of a Moat

We noted previously that Howden has a 20% market share in the UK kitchen and joinery market, suggesting that it offers an attractive service which provides value for both trade professionals and homeowners.

The UK has an estimated 1.4 million trade professionals, and Howden works with 500,000 of them, again suggesting that professionals find the Howden business model attractive.

Finally, **Table 2** (next page) shows that Howden earns high gross margins (61.6%) and operating margins (14.6%), which in turn translate into very attractive returns on invested capital of 17.8% and returns on equity of 23.7%. High margins and returns are hallmarks of high-quality businesses with competitive edges.

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Competitors

The specialist kitchen manufacturing and distribution market is reasonably fragmented. According to research from Davy Stockbrokers, the next largest competitors include Wren, Symphony, Omega, and Benchmarx. The first three are private companies, so data is relatively limited, and Benchmarx is owned by Travis Perkins (publicly listed) but disclosure on this sub-segment of the overall Travis Perkins business can be irregular and limited.

Wren is the largest competitor in the market behind Howden, with an estimated market share of 8-9%. Symphony has a market share of 2% and Omega and Benchmark have a sub-1% market share each. In total, the top four competitors in the market behind Howden have a combined market share of *c.* 11% – almost half of Howden's. Operating margins for these four competitors range from 5.1%-12.6% (2023 annual results), compared to Howden's 14.7% in 2023, suggesting Howden benefits from scale and a superior operating model. It is worth noting that Wren has been growing quickly, with its revenues growing by 16% compound *per annum* between 2017 and 2023, compared to 9% c.*p.a.* for Howden over the same period. Wren saw sales declines of 9% in 2023, compared to flat sales for Howden.

Margins & Returns on Capital					
Year	Gross margins	Operating margins	Net margins	Return on… Equity	Return on… Invested Capital
2005	51.9%	8.7%	4.5%		
2006	49.5%	9.0%	5.0%		15.0%
2007	46.7%	9.0%	5.6%		37.9%
2008	53.1%	9.4%	6.3%		25.0%
2009	56.2%	10.3%	6.5%		25.1%
2010	59.8%	13.3%	8.3%		35.8%
2011	59.7%	13.5%	9.6%		45.3%
2012	61.5%	13.5%	9.9%		48.6%
2013	61.7%	14.7%	10.6%	54.1%	54.4%
2014	63.7%	17.4%	13.6%	53.4%	70.5%
2015	64.3%	18.2%	14.4%	49.0%	72.4%
2016	64.2%	18.1%	14.2%	45.3%	68.3%
2017	63.3%	16.7%	13.2%	43.5%	60.1%
2018	61.7%	15.9%	12.6%	37.3%	53.6%
2019	62.3%	16.4%	13.2%	35.4%	52.4%
2020	60.1%	12.6%	9.5%	22.1%	23.1%
2021	61.6%	19.2%	15.0%	36.7%	31.4%
2022	60.9%	17.9%	16.1%	40.2%	31.8%
2023	60.8%	14.7%	11.0%	27.5%	19.7%
2024	61.6%	14.6%	10.7%	23.7%	17.8%

Table 2 – Source: Annual Reports

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The Management Team

The key management personnel are Andrew Livingston (CEO) and Paul Hayes (CFO). The CEO was appointed in April 2018 and the CFO in December 2020.

The CEO had previously been CEO of Screwfix Direct, a retailer of trade tools, as well as COO of Wyevale Garden Centres and Commercial Director of Kitchens & Bathrooms at B&Q. The CFO previously worked as the CFO of Consort Medical, a drug and device manufacturer, and Group FD of Vitec Group, a software provider.

The CEO and CFO earn a base salary of £855k and £515k, respectively, and also participate in an annual bonus scheme and a long-term share plan. The annual bonus scheme pays out 0-200% of the base salary depending on profit before tax and cash flow targets being met, and is paid in unvested shares and cash.

The share plan provides awards based on a range of medium-term targets being achieved, including profit before tax growth, total shareholders returns' relative to the market, returns on capital employed, environmental goals, and strategic goals. The plans are measured over 3-year rolling periods, and vested shares are deferred for 2 years. The CEO and CFO can earn a maximum of 285% and 235%, respectively, of base salary. In 2024, 74% and 71% of the CEO's and CFO's pay was "at risk," respectively.

In terms of skin in the game, the CEO owns 0.5 million shares worth 6.0 times his salary. Including unvested shares, he owns 1.3 million shares worth 14.8 times his salary.

The CFO owns 0.1 million shares worth 1.9 times his salary. Including unvested shares, he owns 0.5 million shares worth 9.1 times his salary.

Directors

The Board of Directors is composed of 9 individuals, of whom 7 are independent. The directors have a range of C-suite and executive-level experience, including Berendsen, Greggs, Tyman, Barclays, Tate & Lyle, Blick, and Merrill Lynch. Directors own shares worth 0.4 times their salary, which is low, but we note that the average tenure of the Board is just 2 years so directors may build their stakes over time.

Track Record of Growth

Table 3 highlights the group's track record of growth on a per-share basis since 2005 – a period that encompasses both the global financial crisis and the COVID-19 pandemic.

Since 2005, Howden has grown sales per share at a 7.7% compound *per annum* rate. The earnings per share and cash flow per share figures are even stronger, highlighting that the group has increased operating margins from 8.7% in 2005 to 14.6% in 2024.

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Part of the long-term margin expansion came about as a result of Howden's exiting MFI Retail in 2005/6, a British furniture retail business which, most likely, was earning lower margins than the specialist kitchen distribution business.

Shorter-term results have been less good, with sales over the past year increasing by just 0.7%, and earnings per share declining 1.8% as a result of margins declining. Earnings per share are down 23.3% from peak 2022 levels as a result of margin contraction. Cash flow figures have been stronger, but this primarily reflects a recovery from 2023 levels which were impacted by larger lease payments and a partial working capital unwind.

Howden: Long-term Growth Rates (c.*p.a.*)					
	1Y	3Y	5Y	10Y	2005-24
Sales p.s.	0.7%	6.2%	9.9%	9.6%	7.7%
Earnings p.s.*	-1.8%	-5.0%	5.5%	7.0%	12.7%
Dividend p.s.	1.0%	2.7%	10.3%	9.7%	13.2%
Book value p.s.	15.4%	7.1%	14.9%	16.2%	19.8%
Cash flow p.s.	8.3%	-0.4%	13.8%	12.0%	18.4%
FCF p.s.	20.3%	-8.6%	4.2%	6.0%	13.3%

* adjusted earnings per share

Table 3 – Source: Annual Reports

Note: Table 3 uses adjusted earnings per share, which strip out certain exceptional items deemed to be non-recurring. The majority of exceptional items relate to losses incurred between 2005-2009 on the sale of its MFI Retail business. There were some exceptional items between 2010-2021 which were small in nature. In 2022, the group applied for tax refunds from HMRC relating to certain patents which provided a once-off boost to earnings through a much-reduced tax rate. A full reconciliation between adjusted and reported (GAAP) earnings per share is provided in **Appendix 1**.

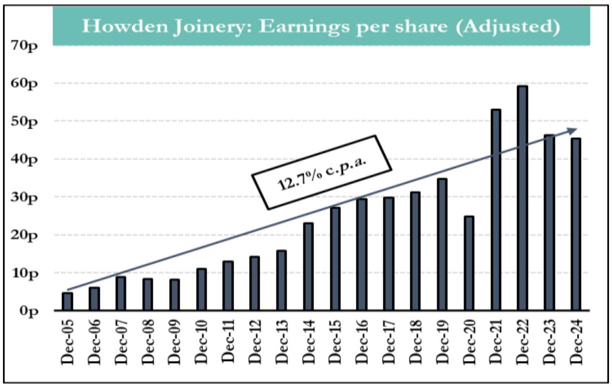

Chart 3 – Source: Annual Reports

Recent Earnings Growth & Outlook

Chart 3 shows the progression of earnings per share between 2005-2024. Over that period, Howden grew its earnings per share at an impressive 12.7% compound *per annum* growth rate.

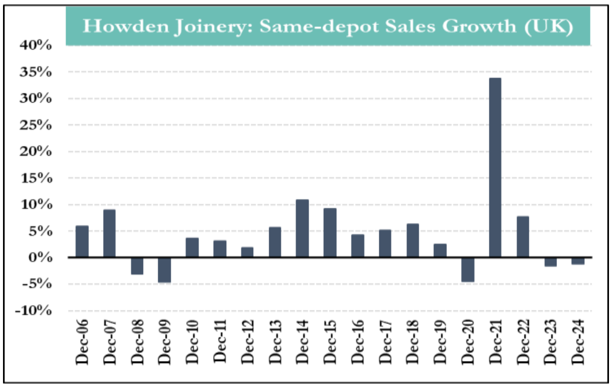

Chart 4 – Source: Annual Reports

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Earnings per share received a significant boost in 2021-22, likely as a result of consumers being restricted during the COVID-19 pandemic (no travel or socialising), and also having significant savings as a result of restrictions and generous government support programmes. Adjusted earnings reached a peak of 59.2p per share in 2022.

Since then, earnings per share have fallen 23.3% to 45.4p per share in 2024. A difficult economic backdrop in the UK – with low levels of economic growth, higher interest rates, and inflation – has resulted in many households deferring or cancelling the decision to buy a new kitchen. Data from Howden shows that the volume of new kitchens installed is well below the historic average, and below levels seen in the global financial crisis. Howden's management estimates that the kitchen market in the UK contracted by 6-7% in the UK alone.

Chart 4 (previous page) highlights that Howden's same-depot sales growth (which excludes depots opened in the last two years) has been negative for the last two years, at -1.6% in 2023 and -1.2% in 2024. Overall sales of £2,322 million are in line with 2022 sales (£2,319 million), reflecting price increases and the benefit of increasing the depot count by 8.5% over that period.

Gross margins initially declined to 60.8% in 2023 (from 61.6% in 2021), but have since recovered to 61.6% in 2024 as a combination of price increases and productivity gains have been sufficient to offset the impact of lower volumes and rising input costs. Gross profit of £1,431 million in 2024 is 1.4% ahead of 2022 levels.

Gross Profit Changes	£m
Gross Profit (2022)	1,411
Volume declines	-86
Price increases	126
Input-cost inflation	-20
Gross Profit (2024)	**1,431**

Table 4 – Source: Presentations

Operating margins, however, have declined from a peak of 19.2% in 2021 to 14.6% in 2024, reflecting a £205 million increase in operating costs over a period in which revenues have been broadly flat. (Operating profit in 2022 was £415.2 million, so this increase in operating costs was large on a relative basis.)

Table 5 highlights that the majority of this increase in costs has come about as a result of growth investment – spending costs for new UK and international depots, and strategic investments in new warehouses, refurbing existing UK depots to a new format, and spending on digital infrastructure. In total, spending on growth initiatives increased by £171 million between 2022 and 2024, and accounted for 83% of the total rise in operating costs.

Operating Costs Change 2022-2024	£m
New UK depots	49
Strategic investments*	98
International depots	24
Growth investment	**171**
Existing UK depots	29
Other costs	5
Cost increases	**34**

* Investment in warehouses, refurbs, and digital

Table 5 – Source: Presentations

Ongoing cost increases – that is, the operating cost increases attributable to existing assets – was £34 million, accounting for 17% of the total rise in operating costs. Productivity initiatives have played a role in constraining operating cost rises.

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An increase in the UK corporate tax rate from 19% to 25% in 2024, which has put further pressure on earnings. Finally, a 7.4% reduction in the share count since 2021 has provided a *c.* 8% boost to earnings per share.

Moving forward, management believes that 2025 is likely to also be a difficult year for the UK kitchen market. Against that backdrop, it seems unlikely that earnings per share will make progress, and this is reflected consensus earnings per share forecasts of 46p for 2025, in line with earnings per share achieved in 2024 (45.4p). When (or if) the UK kitchen markets recover, it is also likely that operating margins will increase as much of the business's operational costs are fixed in nature.

It is also worth noting that Howden's earnings profile is cyclical, with earnings declines in 5 years since 2005, or about 25% of the time. However, a cyclical stock can still be a growth stock, provided that we see a pattern of higher highs in earnings per share when they recover from declines, and a pattern of higher lows when they decline in difficult periods. This pattern is evident in Chart 2. Earnings per share also remain 30% above 2019 levels.

Strategic Initiatives

Howden has four areas of strategic initiative in which it is investing for growth: evolving and growing the depot network; product range & supply management; digital platforms; and international growth. We have talked about the evolution of the depot network previously (refurbs), and the product range & supply management.

Depot Growth – UK and Internationally

Chart 5 highlights the growth in the UK network of depots. The key to Howden's successful growth has been a combination of solid same-depot sales growth and the steady expansion of the depot network. Over the past 19 years, Howden has increased the depot count by 4.7% compound *per annum*, expanding the number of UK depots from 382 to 869 over that period, with Howden consistently adding 25-30 new depots each year.

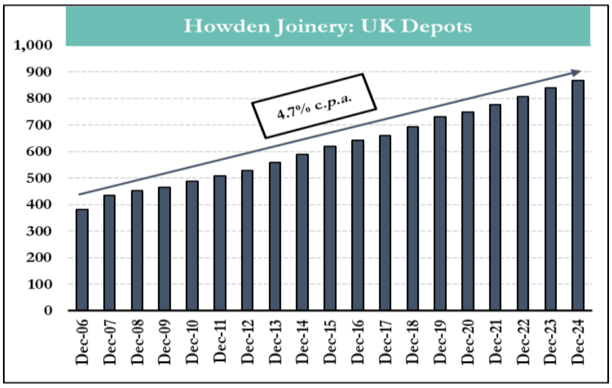

Chart 5 – Source: Annual Reports

For 2025, management plans to add another 20 depots in the UK, with additions in London being a key focus. Overall, Howden continues to target 1,000 depots in the UK, suggesting further growth of 15% over the next 7-8 years.

Howden has also been expanding internationally in France and Ireland. There are now 65 depots in France and 13 in Ireland. It has had a presence in France since 2005, although the company did not expand significantly there until 2015. It has also had a presence in the Netherlands and

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Germany (both exited in 2018). Management is typically cautious about rolling out new stores – both Netherlands and Germany only had 1 depot each, and were exited 3-4 years after the depots were set up – which we view as a sign of a conservative mindset.

Howden estimates that the French kitchen market is €4.3 billion, so the growth opportunity is large. In the 2018 Annual Report, Howden's management explained their rationale for expanding operations in France. The team observed that mature French depots performed similarly to the UK in terms of sales and number of kitchens sold, and that the French market has a lower proportion of integrated kitchens. Most kitchens in France are sold through DIY, retail and specialist shops, giving Howden an opportunity to bring its integrated kitchen offering to the French market.

The number of depots in France has been static at 65 in 2023 and 2024, and is likely to remain so in 2025. Management has commented that it expanded too quickly in France, and as a result a large number of its depots are staffed by managers who aren't experienced in managing and growing trusted trade relationships. So, management has halted growth and dedicated several years to deepening local depot managers' skills. A new CEO has been brought in – a French native with extensive experience in Kingfisher, Castorama, and B&Q. Zoran Zailan, a regional director at Howdens for 16 years, has been brought in to train up the local depot managers in France. Management appears confident that the growth issues have been overcome and expect France to return to growth and break even in 2026. In total, Howden has a target of 250 depots in France over the long-term – more than triple current levels.

Expansion in Ireland appears to be progressing well, with 13 depots today compared to zero in 2021. Management is targeting 40 depots over the long-term.

Howden approaches expansion slowly, typically one depot in a new urban area and then, as word of mouth spreads, adding further depots in small clusters to satisfy demand. A large majority (perhaps 80-90%) of Howden's kitchen products are common across the UK, France and Ireland, making inventory management easier. Over time, Howden will likely tailor its offering to more closely suit the tastes of French homeowners.

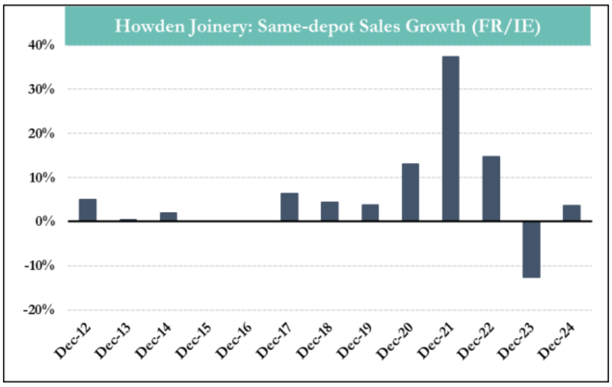

Chart 6 – Source: Annual Reports

Chart 6 highlights that same-depot sales growth has been strong historically, but turned negative in 2023 reflecting both a downturn in the French and Irish kitchen markets, and the previously flagged issues in France. Same-depot sales growth in France and Ireland turned positive again in 2024.

Digital Initiatives

Howden is investing heavily in its digital initiatives in order to better serve its trade customers. 50% of its customers now have online accounts, and those with online accounts tend to trade more frequently, spend more, and check online stock levels and confidential pricing more frequently.

As we noted earlier, Howden has also built Daily Trader and Live-Stock technologies, which help improve and track stock levels, and this surety over stock levels has in turn allowed Howden to offer a Click and Collect service for traders.

Howden also has 669,000 followers across with 5.8 million monthly engagements. Its own website attracts 23.9 million monthly visits. Finally, it is seeing growth in digitally sourced leads, which in turn tend to have above-average order values when converted to sales.

Sources & Uses of Cash

Howden's high operating margins and high returns on capital mean that it generates high levels of cash flow, and is able to both return significant amounts of capital to shareholders as well as re-invest in the business for growth.

Table 6 shows that, since 2005, Howden has generated operating cash flows of £3,342 million. Of this, it reinvested £1,417 million back into the business, with the cash flows primarily absorbed by increasing working capital (trade receivables to extend credit to builders, and inventory) and capital expenditure. Acquisitions have played almost no role in Howden's growth, with just one acquisition in 2008 (to buy out a partner's stake in a joint venture), and one in 2022 for £14.6 million (Sheridan Fabrications – premium worksurfaces).

Howden has returned £1,558 million of cash to shareholders. In total, Howden has returned 3.1 times its 2005 market cap to shareholders in buybacks and dividends. Buybacks started in 2015, and returned £350 million to shareholders between 2015-2021.

Sources & Uses of Cash	
(2005-2024)	£m
Operating cash flows (A)	3,342
Working capital	433
Capital expenditure	971
M&A	14
Cash re-invested in the business (B)	**1,417**
Buybacks	651
Dividends	907
Cash returned to shareholders (C)	**1,558**
Other (D)	-39
Total cash used (B+C+D=E)	**2,936**
Opening cash	-62
Change in cash (A - E)	406
Closing cash	**344**

Table 6 – Source: Annual Reports

Howden's share price corrected sharply in 2022, prompting the Board to increase the buyback programme – Howden bought back £250 million of shares in 2022 alone. We view this as evidence of strong capital allocation skills on the part of directors. A further £50 million was returned in

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2023, and £100 million has been authorised for 2025. The Board has a policy of returning cash balances above £250 million to shareholders via buybacks. Total shares in issue have fallen 15% since 2015, boosting earnings per share by an estimated 1.8% annually.

The annual dividend payment absorbs a further £116 million of cash. The latest annual dividend was for the year to December 2024 was 21.2p, for a dividend yield of 2.5% on the latest share price.

Despite spending £2,936 million on re-investment and returns of capital to shareholders, Howden moved from a net debt position of £62 million in 2005 to a net cash position of £344 million in 2024 (excluding leases).

Working Capital

We mentioned previously that Howden's business requires extending trade credit to professionals and high levels of inventory, both of which require high levels of working capital.

Table 7 shows the amount of working capital tied up in the business. It can be interpreted as showing how many days' worth of sales is tied up in receivables and inventory, and how many days' sales are extended as credit by the group's creditors (payables).

Howden extends 29.6 days of credit to trade professionals (about 4-5 weeks of trade credit) and has 158.4 days of inventory to hand. In turn, trade creditors have extended 72.3 days of credit to Howden.

Working Capital Cycle					
Days of…	**Dec-20**	**Dec-21**	**Dec-22**	**Dec-23**	**Dec-24**
Receivables	33.1	26.1	26.8	26.3	29.6
Inventory	143.9	126.2	135.7	152.1	158.4
Payables	-76.1	-77.1	-74.0	-73.2	-72.3
Cash conversic	**100.9**	**75.2**	**88.4**	**105.2**	**115.7**

Table 7 – Source: Annual Reports

On a net basis, it takes Howden 115.7 days to convert its investments in inventory into cash flow from sales. Or, equivalently, it shows how many days' working capital Howden must invest in.

Net working capital is £540.2 million, accounting for 24% of total assets. This is reasonably capital intensive, but unavoidable given Howden's need to have high stock levels for customer satisfaction, and the fact that extending trade credit makes trade professionals more amenable to choosing Howden as a supplier.

Growth in the Future

Looking to the future, Howden has multiple avenues for growth available to it. Ultimately, earnings growth will depend (mostly) on three factors: how many depots are opened each year, the sales

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rate for each depot, and the group's operating margins.

1. Number of depots opened each year: Currently, Howden's is opening about 30-40 depots each year. From an installed base of 947 depots, this means that Howden will likely increase its depots by about 3% annually over the next decade.
2. Sales rate for each depot: Currently, Howden generates about £2.7 million in sales per depot. This is below the 2022 peak of £2.9 million. There will be a natural increase in the sales rate per depot, as it takes about 7 years for a depot to be fully mature, meaning that about a quarter (23%) of the UK depot network is immature. Howden can increase its sales rates a number of ways: reaching more trade professionals, gaining share in higher-priced kitchens where it is underrepresented, generating additional revenues through fitted bedrooms, seeing a recovery in the UK kitchen market, and fuller maturity of the depot base. The European depots also generate about €1.3 million in sales each – far below the €2.0 million achieved in 2022. Sales rates may also be increased here through a recovery in the market, training of depot managers to build relationships, and gaining market share.
3. Operating margins: Margins are currently at depressed levels reflecting both a high level of investment and the decline in the UK kitchen market. Lower levels of investment (as digital initiatives are completed, the depots are fully refurbished, and the depot network grows more slowly) would lead to higher margins. A recovery in kitchen volumes would also help margins given the level of fixed costs in the business. The French market is also operating at a loss but is expected to break even in 2026, which would further grow margins.

Overall, we believe that mid- to high-single-digit annual earnings growth over the medium- to long-term can be achieved through a combination of depot openings, greater sales rates, and operating margin improvements.

It is also worth noting that Howden has bought back significant amounts of shares in the past, which has historically added 1-2% to earnings growth. So, taking just depot growth of 3% annually and 1-2% growth from share buybacks, earnings growth could reach 4-5% annually before factoring in margin recovery and higher sales rates at each depot.

Overall View

We view Howden as a high-quality, well-run business with a strong competitive edge, high margins and returns on capital, and a good runway of growth ahead. Management appears to have navigated the current downturn well, and is willing to sacrifice current margins to invest in the business. The business risks are, in our assessment, low.

Financial Risks

Net Debt

Howden's financial position is presented in **Table 8** (next page). The group has total cash of £343.6 million and no short- or long-term debt.

It does use a significant amount of lease finance (£681.0 million), leaving it in a modest net debt

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position of £337.4 million. The question of whether to include leases is difficult – while they do represent a commitment to pay cash for rent in the future, leases can often be renegotiated or exited, making them more of a quasi-debt instrument. We include them for conservatism's sake, although we note that management excludes them when they think about net debt and how to use cash.

Overall, even including leases, the net debt position of £337.4 million looks manageable against the 3-year average annual operating cash flows of £377.6 million.

Financial Risk	
Dec-24	**£m**
Cash	343.6
Short-term debt	-
Long-term debt	-
Leases	-681.0
Net debt	**-337.4**
3Y ave. cash flows	377.6
Dividend (2024)	-115.9
Capital expenditure	-121.9

Table 8 – Source: Annual Reports

The Pension Liability

Howden operates a defined benefit pension scheme with approximately 10,222 members (5,542 deferred; 4,680 pensioners). The plan was closed to further accrual in March 2021, meaning that there should be no further build-up of pension benefits for plan members.

Howden makes £2.5 million monthly contributions when the pension is in deficit, which it has been for the majority of the time over the past decade.

Howden's Pension Liability										
£m	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
Pension liability	1,042.3	1,283.8	1,374.6	1,281.7	1,485.3	1,641.0	1,512.5	930.5	913.6	808.0
Pension assets	993.1	1,177.8	1,265.3	1,245.7	1,428.7	1,593.3	1,653.3	889.0	900.8	805.9
Net asset/(liability)	**(49.2)**	**(106.0)**	**(109.3)**	**(36.0)**	**(56.6)**	**(47.7)**	**140.8**	**(41.5)**	**(12.8)**	**(2.1)**

Table 9 - Source: Annual Reports

Table 9 shows the development of the pension liability over the past ten years. Under accounting rules, a pension liability is calculated using actuarial assumptions about inflation rates, benefit increases, members' life expectancy, and discount rates (i.e., the investment rate of return). This liability is subtracted from the value of the pension scheme's assets, and the net asset or liability is presented on the balance sheet.

The liability increased from £857.4 million to a peak of £1,512.5 by the end of 2021, reflecting to a large extent falling interest rates which increased the present value of the liability. Similar to bonds, lower interest rates mean higher values (prices) for pension liabilities. With rising interest rates, the value of the pension liability has fallen to £808 million at the end of 2024.

The value of the pension's assets also increased between 2013-2021, as bond and equity prices performed strongly against a backdrop of ultra-low interest rates. In 2022, the pension scheme suffered a loss of £753.5 million on its assets, as rising interest rates reduced the capital value of bonds (and equity markets fell, too). The pension scheme doesn't provide a full breakdown of losses incurred in each asset class, but we suspect a large portion of the loss was due to investments in an instrument known as a "liability-driven investment (LDI)", effectively a leveraged investment in UK government bonds. This leverage magnified the losses incurred by falling bond prices.

At the last reporting date (end of December 2022), the pension scheme had a small net liability of £2.1 million. The scheme's assets are primarily invested in government bonds, commercial property, insurance-linked securities, and private assets such as infrastructure and corporate debt.

Liquidity & Solvency

Table 10 presents the Current Ratio and Acid Test Ratios for Howden. The Current Ratio measures the ratio of current assets to current liabilities, while the Acid Test Ratio measures the ratio of trade receivables and cash (i.e., the liquid elements of current assets) to current liabilities. Both ratios are in good shape and suggest no liquidity problems.

Liquidity Ratios					
	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24
Current Ratio	2.17	2.18	1.75	1.92	2.12
Acid Test Ratio	1.43	1.46	0.89	0.95	1.16

Table 10 – Source: Annual Reports

Table 11 shows the Altman Z-Score for Howden – a statistical measure that takes into account a number of factors, including: the level of working capital, the age of the business, profitability, market value, and efficiency.

Altman Z-Score					
	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24
Z-Score	4.7	5.6	4.2	5.0	4.8

Table 11 – Source: Annual Reports

These factors are combined into a single score. A score below 1.8 indicates a higher probability of bankruptcy. The table highlights that Howden is well above the cut-off point and thus (according to this score) at low risk of bankruptcy.

Overall View

Financial risks appear very low.

Valuation Risks

Price-to-Earnings Ratio

Chart 7 (next page) shows Howden's price-to-earnings ratio since 2005. Currently, the shares trade at 19.0 times a weighted average of historic 2024 and forecast 2025 earnings. The long-term average price-to-earnings ratio is 14.7, so the shares are significantly above that level.

However, it is worth remembering that Howden has experienced a cyclical decline in earnings, as the UK kitchen market has entered a downturn, costs have increased, and management have continued to invest in the business.

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Chart 8 displays the price-to-earnings ratio for Howden since 2005, but uses peak earnings for the denominator. If there is a year in which earnings have declined (e.g., 2023 and 2024), then the previous peak earnings are used. So, for example, it is currently using 59.2p of earnings per share as the denominator for 2023 onwards because that was the peak achieved in 2022, before earnings declined. The point is that using trough earnings for a cyclical, but growing, business can be misleading as it can make the shares appear overvalued. Of course, the key assumptions are that: (a) current earnings represent trough levels; and (b) the business will grow in the future.

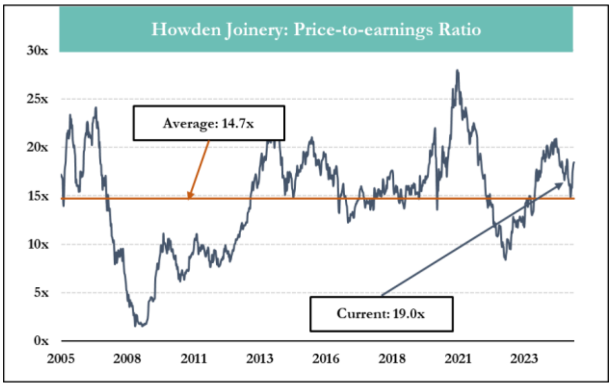

Chart 7 – Source: Bloomberg, Annual Reports

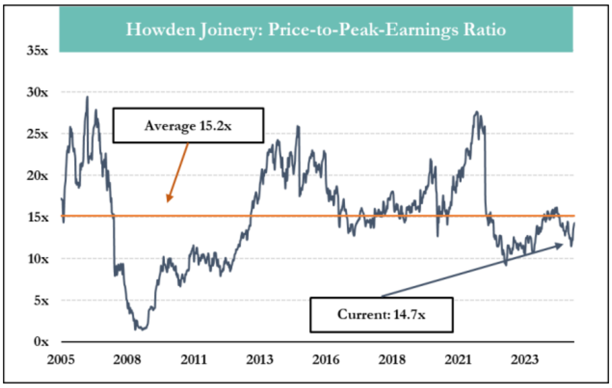

Chart 8 – Source: Bloomberg, Annual Reports

On the basis of this price-to-peak-earnings ratio, the shares are trading on 14.7 times earnings, which is slightly below the long-term average of 15.2.

Overall View

Valuation risks appear low.

Appendix 1

Reconciliation of Adjusted EPS to GAAP EPS (pence per share)											
Year	Adjusted EPS	GAAP EPS	Difference	Discont'd ops.	Restructu-ring	Factory Closures	Pension gains	Tax benefits	Other	Tax on except.	Total except.
2005	4.7	-20.9	-25.6	-22.0	-	-	-	-	-2.1	-1.5	-25.6
2006	6.0	-28.4	-34.4	-29.4	-5.0	-6.1	6.3	-	-0.6	0.3	-34.4
2007	8.9	7.2	-1.7	-1.5	-5.8	-	-	-	-	5.6	-1.7
2008	8.4	-8.4	-16.8	-17.4	-	-	-	-	0.8	-0.1	-16.8
2009	8.1	7.4	-0.7	-0.7	-	-	-	-	-0.0	-	-0.7
2010	11.0	11.0	-	-	-	-	-	-	-	-	-
2011	13.0	11.6	-1.3	-1.3	-	-	-	-	-	-	-1.3
2012	14.1	13.5	-0.6	-0.6	-	-	-	-	-	-	-0.6
2013	15.8	15.2	-0.6	-	-0.7	-	-	-	-	0.1	-0.6
2014	23.0	24.4	1.4	1.4	-	-	-	-	-	-	1.4
2015	27.2	27.2	-	-	-	-	-	-	-	-	-
2016	29.4	29.4	-	-	-	-	-	-	-	-	-
2017	29.8	29.8	-	-	-	-	-	-	-	-	-
2018	31.2	31.2	-	-	-	-	-	-	-	-	-
2019	34.8	34.8	-	-	-	-	-	-	-	-	-
2020	24.8	24.8	-	-	-	-	-	-	-	-	-
2021	53.0	53.0	-	-	-	-	-	-	-	-	-
2022	59.2	65.6	6.3	-	-	-	-	6.3	-	-	-
2023	46.3	46.3	-	-	-	-	-	-	-	-	-
2024	45.4	45.4	-	-	-	-	-	-	-	-	-
Total	**494.1**	**420.1**	**-74.0**	**-71.5**	**-11.5**	**-6.1**	**6.3**	**6.3**	**-1.9**	**4.3**	**-80.3**

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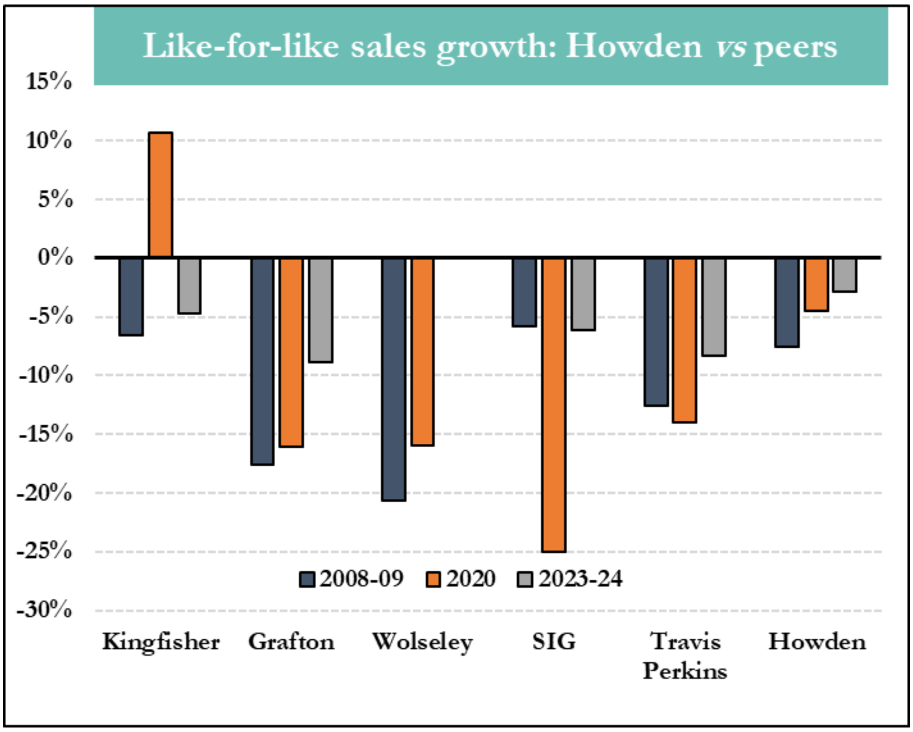
Appendix 2



The above chart highlights the same-depot (like-for-like) sales growth during three periods of stress – the global financial crisis (2008-9), the COVID-19 pandemic (2020), and the period of rising inflation and interest rates (2023-24). We can see that Howden outperformed on average on both occasions. (Note: Wolseley results presented as year to 31st July.)

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