SHARE SLEUTH

Metalrax simmers to the boil

Loss-making acquisitions in the Noughties hurt this metals company hard but Richard Beddard says it's back on track

Scratch beneath the surface of a company that looks cheap, strong and prosperous by the usual financial measures and you'll find reasons to doubt it. Even if under closer scrutiny the company meets the basic criteria for successful investment, there'll usually be other factors putting you off. The trick is to decide whether these factors are significant.

Metalrax fits the Thrifty 30 template almost perfectly. Its prosaic businesses manufacture bakeware (such as baking trays and saucepans), coated steel for industry, and engineered products such as pallet trucks and architectural metalwork. It's been profitable in the past, earning a typical return on equity of about 9 per cent, but suffered a terrifying lapse between 2007 and 2010, which current chief executive Andrew Richardson blames on four loss-making acquisitions in the middle of the last decade and the company's persistence in paying a dividend it couldn't afford.

The dividend has gone, and so have the loss-makers but the two errors together reduced the book value of Metalrax, now just £17 million, by over £40 million. I'd much rather be invested in a company that's caused its own demise though, than one facing intractable competition, so long as the new people in charge have a credible plan. Under Richardson, Metalrax is focusing on debt reduction and growth through profitable sales, which is just what I want to hear.

According to my barometer for recovery, Piotroski's F_Score, the plan is working. Metalrax scores a perfect nine, meaning it's less indebted and more profitable than it was last year (when it made a loss) across a range of nine measures.

But, and as I said in the introduction, there's usually a 'but'. Metalrax is still quite highly indebted, even though its situation is improving. Bank borrowings, which peaked at nearly £15 million last year, fell to less than £10 million this year, the lowest level since before Metalrax got itself into difficulty. Other liabilities, however, principally its pension deficit and operating leases, are on the rise. And because Metalrax has shrunk as it has sold businesses and properties to stem losses, these three liabilities together have risen from less than 20 per cent of total assets in 2006 to just under 50 per cent in 2010.

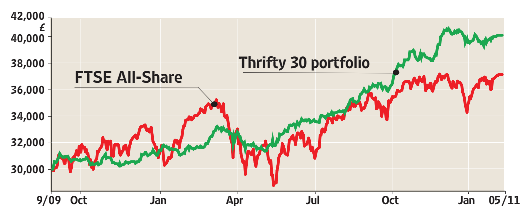
Bank debt is falling and I'm not too worried about the pension deficit. The defined benefit pension scheme is closed, and looks to be a manageable size. But the increase in operating lease commitments from £4.9 million in 2009 to £7.4 million in 2010 gives the impression Metalrax remains financially quite weak.

There are three ways Metalrax can pay off debt. It can earn more money. It can sell assets, such as property it no longer needs. Or it can sell off property it still needs and lease it back from the new landlords. Metalrax is doing all three, but the third option smacks of desperation. It isn't really paying off debt. It's making new financial commitments to landlords so it can repay old ones to bankers.

Nevertheless, liabilities in general have started to fall, and I've given Metalrax the benefit of the doubt, adding it to the Thrifty 30 at 11.9p. I like the straightforward business with its straight-talking boss. Let's hope it repays me by paying off more debt, increasing profit margins to earlier levels, and reinstituting the dividend – the next stages in its slow recovery.

For more information on the valuation techniques:
Richard Beddard is companies and markets editor of our sister website Interactive Investor. You can follow commentary on, and changes to, the Thrifty 30 portfolio at http://blog.iii.co.uk

HOW THE PORTFOLIO STACKS UP



THRIFTY 30 CONSTITUENTS

Name	Shares	Price (£)	Cost (£)	Value (£)	Return %
Alumasc	938	1.66	999	1,552	55
Armour	21,278	0.05	2,250	1,091	-52
AutoLogic Holdings	3,517	0.22	1,000	783	-22
Castings	515	2.79	999	1,434	44
Clarke (T)	706	0.98	1,000	692	-31
Dart	1,824	0.85	1,000	1,550	55
Dewhurst	735	3.80	2,244	2,793	24
French Connection	2,310	1.06	1,000	2,449	145
Games Workshop	348	4.38	998	1,523	53
Haynes Publishing	539	2.42	999	1,304	31
Holders Technology	1,437	1.22	999	1,753	75
International Greetings	1,696	0.70	1,097	1,187	8
Johnson Service	5,035	0.33	1,000	1,681	68
Mallett	1,591	0.71	1,000	1,130	13
Metalrax	11,036	0.12	1,330	1,269	-5
Northamber	2,276	0.61	1,200	1,394	16
Northgate	511	3.34	1,099	1,707	55
Printing.com	2,940	0.36	1,000	1,058	6
Quadnetics	643	2.00	999	1,286	29
Ricardo	386	3.73	999	1,440	44
Solid State	1,950	0.99	1,000	1,931	93
Thorpe (F W)	166	7.95	1,193	1,320	11
Titon Holdings	2,493	0.53	1,000	1,309	31
Trifast	3,112	0.50	1,130	1,540	36
Waterman	2,431	0.42	1,000	1,021	2
Total current holdings			28,532	36,196	27
Cash				3,696	
Total portfolio			**30,000**	**39,892**	**33**

Notes: £10 broker fee charged for all transactions, and 0.5 per cent stamp duty for purchases. Cash earns no interest. Dividends and sale proceeds are credited to the cash balance. £30,000 invested on 9 September 2009 was worth £39,892 on 3 May 2011. £30,000 invested in a FTSE All-Share ETF was worth £38,424 (dividends reinvested). **Objective:** To beat a FTSE All-Share ETF handsomely over any five-year period. **Source:** Sharescope, May 2011