Titon

Titon, manufacturers of house ventilation products ranging from simple ducts to heat recovery systems, has a balance sheet which suggests a net current asset value investing (NCAV) bargain. However, we need some reassurance with regard to (a) the industry economics, (b) managerial quality and (c) financial stability.

Market capitalisation is £3.9m at a share price of 39p. The interim results to March 2013 show inventory of £3m, receivables of £3.2m and cash of £2.1m. There is no bank debt and only £3m of payables and £0.2m of deferred tax to deduct to arrive at NCAV of £5.1m. Even if inventory and receivables are marked down as suggested by Graham M.Cap is less than NCAV. Also consider that £3.3m of property, plant and equipment is shown in the BS, over £2m of which is freehold land and buildings. No pension deficit.

(a) Industry economics. Titon operates in a very competitive industry and I see no reason for this to change. There is easy industry entry by new firms and little customer captivity. It is largely a commoditised sector. This is reflected in the poor profits over five years: roughly breakeven on average. However, even commoditised sectors can improve and allow leading players to raise ROCE to an acceptable (or even above acceptable) level in a rising demand situation. The highly cyclical house building and construction sector may allow this to occur over the next three years or so. In addition, Titon have developed products (R&D budget of c. £400,000 pa) for the whole house ventilation with heat recovery market. This is likely to be a growth sector as building regulations get ever tighter regarding air-tightness (buildings are almost air sealed, therefore oxygen has to let in from somewhere; opening a window seems wasteful so heat-exchanged fresh air makes sense for many (currently too expensive to install for the houses I'm building though). There is a high degree of free entry to even this industry, but at least Titon are established. The recent improvement of the company's fortunes in its overseas markets might indicate what happens to profits in an economic upswing to commoditised cyclical business.

(b) Managerial quality. In the recession costs were cut and senior managers/directors pay was restrained with the highest paid director receiving £108,000 pa: not evidence of scamming the shareholders there. A younger team of directors is now leading the company with advice from the founder and other old hands. All the directors have many years of experience in this industry in this firm. The CEO joined in 1988, joined main board in 1997 as FD, becoming CEO in 2002. While over the past five years the combined record is merely break-even, the company stayed sufficiently financially strong and cash generative to pay for over £1m of dividends, £0.5m of new computer equipment and £0.4m pa of R&D. And yet, throughout this period PPE only declined from £4.4m to £3.5m, cash declined from £2.6m to £2.1m, net current assets (as defined by firm) declined from £5.8m to £5.1m, and shareholder's funds declined from £10.2m to £9m. If this managerial team are simply managing decline then this has to count as very slow decline – and at a time of enormous general economic pressure.

(c) Financial stability. With no debt other than payables and a very high NCAV this company does not seem like a candidate for solvency or liquidity trouble. Profits (or rather break-evenness) is also stable.

WHAT MIGHT CAUSE A RECOVERY IN SHARE PRICE?
(a) General economic/industry improvement? Most likely of the four.

(b) Managerial turnaround? Possible. Still investing in innovation. Still cost cutting. Korea and other overseas performances are encouraging.
(c) Takeover? Possible (management control around 40% of shares)
(d) Liquidation. Unlikely

Questions

(1) Will margins recover?
(2) Will cash/NCAV/shareholder equity remain a downward course year after year while director continue to offer jam tomorrow?
(3) Will they be competed out of existence by a bigger beast in the industry?