Polypipe

FY16 results

Delivering in line with strategy

General industrials

Polypipe has expounded a consistent strategy since its return to the market in April 2014. The latest set of results further demonstrates that its above market growth focus is delivering good year-on-year profit progress while at the same time occupying strong positions in sectors exhibiting favourable long-term trends. Following recent share price rises, the FY17 P/E rating has risen to 14.7x and we expect Polypipe to sustain a premium rating.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15	352.9	48.0	19.4	7.8	19.9	2.0
12/16	436.9	61.8	25.0	10.1	15.5	2.6
12/17e	459.5	66.0	26.4	10.6	14.7	2.7
12/18e	475.5	70.8	28.7	11.1	13.5	2.9

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles and exceptional items.

Results slightly above estimates

FY16 came in slightly ahead of our expectations with PBT of £61.8m, EPS 25.0p and DPS 10.1p (vs estimates of £61.3m, 24.6p and 10.0p respectively). Polypipe achieved underlying revenue growth in all three reported operating segments, enhanced by the Nuaire acquisition (annualised) and some FX translation benefits. We also note the margin expansion achieved in UK operations. Investment and new product development have consistently underpinned the company's strategy of aligning the business with themes and segments offering long-term growth prospects. Year-end net debt of c £164m was also better than anticipated with a good working capital outturn in H2.

Focusing on growth segments

As indicated by the company and referenced in our recent initiation note, Polypipe has a balanced UK construction sector exposure. Industry estimates continue to favour infrastructure as having the best outlook, with new residential housing also expected to continue to grow. We have modestly changed our EBIT mix in favour of Polypipe's UK infrastructure-facing division, but assumed a flat year-on-year overall group margin in FY17 reflecting the work-through of higher input prices. Otherwise, we have trimmed net finance cost expectations consistent with the lower-end FY16 net debt position, leaving our group PBT and EPS expectations slightly higher than before. FY17 has started well and management remains confident that the company will continue to grow ahead of its markets.

Valuation: Moving ahead

Polypipe's share price has risen by 54p (+16%) since we initiated. Around half of this rise has come since the FY16 results announcement and total ytd uplift is now 19%. As estimates have risen less quickly in the near term, the company's current year P/E and EV/EBITDA have increased to 14.7x and 10.1x, respectively, and we expect them to trend steadily lower thereafter. We continue to believe that the company's market positions and prospects warrant a premium rating.

13 April 2017

Price	**386.90p**
Market cap	**£767m**
	€1.14/£
Net debt (£m) at end December 2016	164.3
Shares in issue	198.3m
Free float	93%
Code	PLP
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	13.7	16.9	25.4
Rel (local)	13.1	14.9	6.8
52-week high/low		386.9p	221.5p

Business description

Polypipe is a leading European supplier of plastic building products and ventilation systems. UK operations (c 87% of annualised FY16 net revenue and c 98% of EBIT) address a broad range of sectors including residential, commercial and civil building demand and a number of subsectors within them. Overseas operations are located in France and Italy with a new manufacturing facility in the Middle East.

Next events

AGM	24 May 2017

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Edison profile page

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FY16 results overview

Reported revenue, EBIT, PBT, EPS and DPS all came in slightly ahead of our estimates, with UK operations responsible for all of the achieved year-on-year gains. Both UK divisions made good headline and underlying revenue and profit progress, even with upward polymer price pressure (aiding the top line but constraining profit development) towards the end of the year. A strong H2 cash performance reduced year-end net debt to c £164m (down c £30m y-o-y). Our estimates have increased modestly due to lower finance cost assumptions.

Exhibit 1: Polypipe Group interim and divisional splits

£m	H1	H2	2015	H1	H2	2016	H1	FY	H1	FY
							Reported	Reported	Est l-f-l	Est l-f-l
Group revenue – net	**170.4**	**182.5**	**352.9**	**223.3**	**213.6**	**436.9**	**31.0%**	**23.8%**	**9%**	**9%**
Residential Systems	90.2	92.4	**182.6**	105.4	102.2	**207.6**	16.9%	**13.7%**	6%	**7%**
Commercial & Infrastructure Systems	85.6	96.3	**181.9**	124.2	117.9	**242.1**	45.1%	**33.1%**	11%	**12%**
CIPS – UK	59.1	72.4	**131.5**	92.7	91.5	**184.2**	56.9%	**40.1%**	13%	**16%**
CIPS – Europe	26.5	23.9	**50.4**	31.5	26.4	**57.9**	18.9%	**14.9%**	8%	**3%**
Inter-company	-5.4	-6.2	**-11.6**	-6.3	-6.5	**-12.8**				
Group operating profit – reported	**25.7**	**28.5**	**54.2**	**37.7**	**31.7**	**69.4**	**46.7%**	**28.0%**	**19%**	**11%**
Residential Systems*	15.4	17.4	**32.8**	21.5	17.5	**39.0**	39.6%	**19.2%**	27%	**11%**
Commercial & Infrastructure Systems**	10.3	11.1	**21.4**	16.2	14.2	**30.4**	57.3%	**42.1%**	5%	**8%**
CIPS – UK**	9.4	10.7	**20.1**	15.2	13.9	**29.1**	61.7%	**44.3%**	5%	**10%**
CIPS – Europe	0.9	0.4	**1.3**	1.0	0.3	**1.3**	11.1%	**0.0%**	0%	**-15%**

Source: Company, Edison Investment Research. Note: *We have excluded £0.3m H216 profit on asset disposal. **Includes £0.8m Middle East set up costs, largely in H116.

Residential Systems – solid revenue performance and some margin expansion: headline financial performance partly benefited from the inclusion of Nuaire's residential ventilation activities for a full 12 months in FY16. Underlying revenue growth was good, supplemented by modest price inflation in H2. Ex-UK materials costs rose by more than 10% due to weak sterling following the Brexit result in June. Unsurprisingly then, year-on-year EBIT progression slowed in H2. That said, achieving an improved margin for the year as a whole was a very creditable performance. Demand from the new build housing sector was the primary driver of top line growth. We understand that some of the newer product lines (including ventilation and underfloor heating), as well as ongoing product substitution in favour of plastic piping materials, also supported revenue growth and, most probably, margin improvement. RMI sector demand remains stubbornly sluggish and we do not believe that this is likely to change to any material extent in the near term.

Commercial & Infrastructure – UK: at acquisition, c 70% of Nuaire's revenue was in commercial and it is a more material contributor to this division (we estimate around one quarter of revenue) with above-average margins. Hence, FY16 results also benefited from the annualised effect of this acquisition. We estimate that CIPS UK saw strong underlying demand across the year with an increasingly favourable mix weighted towards infrastructure (especially roads) as the year progressed. This included pull-through for water management products; we note that group RoW sales jumped (to £34.9m vs £22m in the prior year) and this was partly due to the commissioning of a new Polycell/storm cell manufacturing facility in Dubai, which accounted for c £4m of direct sales. Polypipe is taking a measured approach to further development of this facility, which could service further revenue growth. Note that £0.8m of costs was incurred here above the line in H1, which influenced the pattern of reported margins.

Commercial & Infrastructure – Europe: this division achieved modest underlying revenue progress over the year, supplemented by favourable translation effects. An H1 bias resulted from distributors pulling sales forward, although this did not follow through in H2. Consequently, H2 profitability was affected and, for the full year, we estimate that local currency EBIT was slightly below the previous year.

Strong cash flow driving net debt reduction

Polypipe generated cash in both halves of FY16, including another strong H2 performance. End-December net debt of £164.3m (versus £194.3m a year earlier) was c £8m lower than we had anticipated, chiefly due to a neutral working capital movement (we had expected a £5m outflow).

EBITDA was £17m higher y-o-y (at £86.4m), reflecting both annualised acquisition effects and underlying progress in both UK divisions. As noted previously, we believe that Polypipe's reported EBIT is a relatively clean number with minimal adjustment required through the cash flow statement. Rising polymer prices and a busy end to the year did require some investment in inventory and debtors compared to the prior year, but this was offset by an increase in payables. Taken together, the trading cash flow was effectively equivalent to 100% EBITDA conversion.

Higher year-on-year cash interest and tax outflows again reflected full year acquisition funding costs, as well as higher levels of profitability respectively. By contrast, net capex of £18.7m (versus £16m depreciation) was in line with the previous year. Management had previously flagged more caution for H2 capex in the light of the Brexit decision, but is now intending to step this up in FY17 (see below). Free cash flow of just over £50m covered cash dividend payments c 3x in the year. There were no outflows relating to acquisition consideration in the year.

Cash outlook: while allowing for some working capital absorption on rising activity and revenues, we assume that our expected EBITDA uplifts over the next three years translate to incremental annual improvements in trading cash flow. Guidance is for c £25m capex in FY17; continuing investment in replacement and new product capex is being further boosted by deferred capacity expansion projects that were put on hold following the Brexit outcome. We assume c £20m annual spend thereafter. (With group ROCE of 14%+, further business investment looks a sound strategy to us.) This is the primary reason why we anticipate a small dip in free cash flow in the current year but rising to above £50m again from FY18 onwards. This is sufficient to fund a rising cash dividend payout, covered c 2.3x this year, rising thereafter and, in the absence of acquisitions, continuing the downward trend of net debt. With this cash profile, we see net debt:trailing 12-month EBITDA falling from 1.9x in FY16 to below 1x by FY19. Polypipe has a £300m RCF to 2020 in place and, hence, retains significant financial flexibility should further bolt-on acquisition opportunities arise.

Market progress projected, estimates nudged up

The Construction Products Association's (CPA) latest quarterly (dated February) contained growth forecasts across all UK construction sectors of +0.8% in 2017, +0.7% in 2018 and +2.2% for 2019. Within this, private house building starts are projected to rise at a steady +2% pa across this time frame while infrastructure spending – not all in Polypipe's sectors – is above this in 2017 and accelerating further to 2019. Partly offsetting this, activity in the commercial, industrial and retail subsectors is forecast to decline in each of the next two years. The CPA also echoes higher input cost risks; the quoted building materials companies have all largely stated their positions on this.

We have only made modest changes to the estimates in our initiation note. Our headline EBIT estimates are unchanged with a small UK rebalancing in favour of commercial/infrastructure. Below this, we have reduced our net interest expectations and this is reflected in revised group PBT and EPS estimates, as shown in Exhibit 2. We have also introduced FY19 estimates in this note.

Exhibit 2: Polypipe estimate revisions

	EPS (p)			PBT (£m)			EBITDA (£m)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2016	24.6	25.0	+1.7	61.3	61.8	+0.9	86.2	86.4	+0.3
2017e	26.2	26.4	+0.8	65.5	66.0	+0.8	90.8	90.8	---
2018e	28.6	28.7	+0.4	70.6	70.8	+0.4	96.0	96.0	---
2019e	N/A	30.7	N/A	N/A	74.9	N/A	N/A	100.2	N/A

Source: Edison Investment Research

Exhibit 3: Financial summary

£m	2014	2015	2016	2017e	2018e	2019e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	327.0	352.9	436.9	459.5	475.5	489.8
Cost of Sales	(202.4)	(210.0)	(256.8)	(271.1)	(279.1)	(286.5)
Gross Profit	124.6	142.9	180.1	188.4	196.4	203.2
EBITDA	60.8	69.3	86.4	90.8	96.0	100.2
Operating Profit (underlying)	46.3	54.2	70.4	74.5	79.5	83.4
SBP	0.0	0.0	(1.0)	(1.2)	(1.3)	(1.3)
Operating Profit (reported)	46.3	54.2	69.4	73.4	78.2	82.1
Net Interest	(7.7)	(5.3)	(6.6)	(6.4)	(6.4)	(6.3)
Other finance	(1.0)	(0.9)	(1.0)	(1.0)	(1.0)	(1.0)
Intangible Amortisation	0.0	(3.0)	(6.8)	(6.3)	(6.3)	(6.3)
Exceptionals	(20.7)	(3.5)	(0.6)	0.0	0.0	0.0
Profit Before Tax (norm)	37.6	48.0	61.8	66.0	70.8	74.9
Profit Before Tax (FRS 3)	16.9	41.5	54.4	59.7	64.6	68.6
Tax	(5.4)	(9.2)	(11.8)	(13.2)	(13.5)	(13.5)
Profit After Tax (norm)	32.2	38.8	50.0	52.8	57.3	61.4
Profit After Tax (FRS 3)	11.5	32.3	42.6	46.5	51.1	55.1
Average Number of Shares Outstanding (m)	199.9	199.3	198.9	198.9	198.9	198.9
EPS - normalised (p)	16.1	19.4	25.0	26.4	28.7	30.7
EPS - FRS 3 (p)	5.8	16.2	21.4	23.4	25.7	27.7
Dividend per share (p)	4.5	7.8	10.1	10.6	11.1	11.7
Gross Margin (%)	38.1	40.5	41.2	41.0	41.3	41.5
EBITDA Margin (%)	18.6	19.6	19.8	19.7	20.2	20.4
Operating Margin (underlying) (%)	14.2	15.4	16.1	16.2	16.7	17.0
BALANCE SHEET						
Fixed Assets	324.2	476.5	472.6	474.6	471.8	468.8
Intangible Assets	235.0	378.4	371.6	364.8	358.6	352.3
Tangible Assets	89.2	98.1	101.0	109.8	113.3	116.5
Investments	0.0	0.0	0.0	0.0	0.0	0.0
Current Assets	103.9	99.6	119.5	151.0	185.2	222.2
Stocks	39.9	47.5	52.2	55.1	56.7	58.2
Debtors	20.2	29.3	38.4	40.0	41.6	42.9
Cash	43.1	21.6	26.5	51.3	81.9	115.6
Current Liabilities	(69.8)	(87.2)	(104.5)	(111.0)	(111.9)	(112.4)
Creditors	(69.8)	(87.2)	(104.5)	(111.0)	(111.9)	(112.4)
Short term borrowings	0.0	0.0	0.0	0.0	0.0	0.0
Long Term Liabilities	(120.6)	(227.9)	(200.2)	(201.5)	(202.6)	(203.8)
Long term borrowings	(118.0)	(215.9)	(190.8)	(190.8)	(190.8)	(190.8)
Other long term liabilities	(2.6)	(12.0)	(9.4)	(10.7)	(11.8)	(13.0)
Net Assets	237.7	261.0	287.4	313.1	342.4	374.8
CASH FLOW						
Operating Cash Flow	50.6	72.6	86.5	88.3	93.1	97.3
Net Interest	(10.4)	(5.7)	(7.3)	(6.4)	(6.4)	(6.3)
Tax	(3.7)	(5.2)	(10.1)	(10.0)	(13.2)	(13.5)
Capex	(14.9)	(18.9)	(18.7)	(25.0)	(20.0)	(20.0)
Acquisitions/disposals	(0.3)	(149.5)	0.0	0.0	0.0	0.0
Financing	(1.7)	0.0	(2.9)	(1.5)	(1.5)	(1.5)
Dividends	(3.0)	(10.6)	(17.1)	(20.6)	(21.4)	(22.4)
Net Cash Flow	16.6	(117.3)	30.5	24.8	30.6	33.7
Opening net debt/(cash)	84.7	74.9	194.3	164.3	139.5	108.9
HP finance leases initiated	(9.6)	(1.7)	0.0	0.0	0.0	0.0
Other	2.8	(0.4)	(0.5)	0.0	0.0	0.0
Closing net debt/(cash)	74.9	194.3	164.3	139.5	108.9	75.2

Source: Polypipe accounts, Edison Investment Research