

Polypipe

FY16 results

Delivering in line with strategy

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 Nuairé 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.

General industrials

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

Analysts

Toby Thorrington +44 (0)20 3077 5721

Roger Johnston +44 (0)20 3077 5722

industrials@edisongroup.com
[Edison profile page](#)

**Polypipe is a research client of
Edison Investment Research
Limited**

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	FY		FY	
							Reported	Reported	Est I-f-I	Est I-f-I
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 Nuairé'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 Nuairé'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)							
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
Margins							
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

Edison is an investment research and advisory company, with offices in North America, Europe, the Middle East and AsiaPac. The heart of Edison is our world-renowned equity research platform and deep multi-sector expertise. At Edison Investment Research, our research is widely read by international investors, advisers and stakeholders. Edison Advisors leverages our core research platform to provide differentiated services including investor relations and strategic consulting. Edison is authorised and regulated by the [Financial Conduct Authority](#). Edison Investment Research (NZ) Limited (Edison NZ) is the New Zealand subsidiary of Edison. Edison NZ is registered on the New Zealand Financial Service Providers Register (FSP number 247505) and is registered to provide wholesale and/or generic financial adviser services only. Edison Investment Research Inc (Edison US) is the US subsidiary of Edison and is regulated by the Securities and Exchange Commission. Edison Investment Research Limited (Edison Aus) [46085869] is the Australian subsidiary of Edison and is not regulated by the Australian Securities and Investment Commission. Edison Germany is a branch entity of Edison Investment Research Limited [4794244]. www.edisongroup.com

DISCLAIMER

Copyright 2017 Edison Investment Research Limited. All rights reserved. This report has been commissioned by Polypipe and prepared and issued by Edison for publication globally. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of Edison at the time of publication. The securities described in the Investment Research may not be eligible for sale in all jurisdictions or to certain categories of investors. This research is issued in Australia by Edison Aus and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act. The Investment Research is distributed in the United States by Edison US to major US institutional investors only. Edison US is registered as an investment adviser with the Securities and Exchange Commission. Edison US relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. As such, Edison does not offer or provide personalised advice. We publish information about companies in which we believe our readers may be interested and this information reflects our sincere opinions. The information that we provide or that is derived from our website is not intended to be, and should not be construed in any manner whatsoever as, personalised advice. Also, our website and the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. This document is provided for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. Edison has a restrictive policy relating to personal dealing. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report. Edison or its affiliates may perform services or solicit business from any of the companies mentioned in this report. The value of securities mentioned in this report can fall as well as rise and are subject to large and sudden swings. In addition it may be difficult or not possible to buy, sell or obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (ie without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision. To the maximum extent permitted by law, Edison, its affiliates and contractors, and their respective directors, officers and employees will not be liable for any loss or damage arising as a result of reliance being placed on any of the information contained in this report and do not guarantee the returns on investments in the products discussed in this publication. FTSE International Limited ("FTSE") © FTSE 2017. "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under license. All rights in the FTSE indices and/or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and/or FTSE ratings or underlying data. No further distribution of FTSE Data is permitted without FTSE's express written consent.