Polypipe

Trading updates & FY19 results

In cautious recovery mode

Building & construction

Polypipe remains a strategically well-placed business with leading positions in its building materials market segments supported by long-term drivers. Actions taken – including the £120m equity raise in May – will aid the company's ability to absorb the disruptive effects of COVID-19 while retaining operational flexibility to rebuild revenues. The companies forward guidance and our estimates are also remain withdrawn for the time being.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/18**	433.2	67.1	28.1	11.6	15.2	2.7
12/19	447.6	70.8	29.2	4.0	14.6	0.9

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles and exceptional items. **Continuing operations only. FY19 dividend represents the H1 payment only; no final dividend was declared.

Responding to FY20 challenges after resilient FY19

FY19 normalised PBT of £70.8m was c £1m better than we had estimated, driven by a better than expected Residential Systems (RS) EBIT margin (at 20.2%) and a smaller net bank interest charge. FY19 net bank debt of £150m (pre IFRS 16) was c £15m better than expected with a number of small items contributing to this outturn. FY20 started in line with management expectations, but the UK COVID-19 lockdown severely impacted trading around the beginning of Q2 before starting to recover before the quarter end. A broad range of actions to control costs – latterly extending to headcount reductions – manage cash flows and retain operational and financial flexibility have been taken including no FY19 final dividend payment, raising fresh equity and increasing borrowing options.

Revenues recovering from lockdown lows

Polypipe's end H1 trading update reconfirmed the sharp reduction seen in activity levels around the beginning of Q2 and quantified the subsequent recovery. For H120 as a whole revenues were down 24% y-o-y; this included a June run rate of -30% compared to -66% in April and all main factories are operational again. The company's broad sector exposure in Commercial & Infrastructure has been beneficial, while Residential performance has been more affected. Prospective headcount reductions will partly reflect current run rates and uncertainties regarding the shape of further recovery as reflected in recent industry projections.

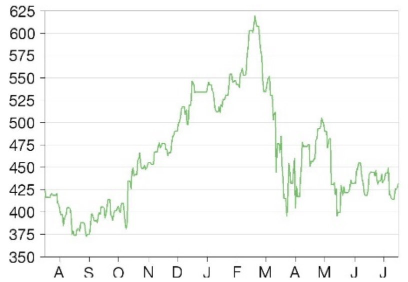
Positioned to respond to market conditions

Polypipe has added c £270m additional liquidity capability – through new equity and additional borrowing facilities – since its year end. Reduced peak borrowings under its Prudent outlook scenario (to 2.5x EBITDA in 2021) and expected compliance with banking covenants are the result. We believe that Polypipe has flexibility in both reducing its cost base and in being able to rebuild production activity as market conditions dictate within this financial framework.

17 July 2020

Price	**426.5p**
Market cap	**£972m**
	€1.10/£
Net debt (£m) at end March 2020 (exc IFRS 16 lease liabilities)	184
Shares in issue	228m
Free float	93%
Code	PLP
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(2.2)	(4.3)	2.7
Rel (local)	(2.1)	(14.1)	22.9
52-week high/low		619p	373p

Business description

Polypipe is a leading supplier of largely plastic building products and systems. Operations in the UK (c 90% of revenue) address a broad range of sectors including residential, commercial and civil building demand and a number of subsectors within them. Overseas revenues are generated through exports, particularly to the Middle East, and a small Italy-based specialist fittings business.

Next events

H120 results	15 September 2020

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Edison profile page

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Retaining flexibility to move forward

Polypipe's latest trading update (7 July) coincides with its half year end and confirms a recovering trend towards the end of Q2 as the UK emerged from COVID-19 related lockdown. There is still uncertainty regarding the shape of the recovery from here; industry estimates have been revised downwards and Polypipe is taking steps to reduce headcount. That said, in the context of wider actions taken we believe that the company has retained operational and financial flexibility to respond to market demand developments as they evolve.

Industry outlook revised down

Prior to the UK coronavirus lockdown, the **Construction Products Association'**s winter estimates (published in January) projected a small overall 2020 market contraction of 0.3%, followed by growth of 1.2% in 2021. Infrastructure spending was expected to be the strongest segment, private new housebuilding declining and then picking up again (by 2% in both years) and commercial building activity lower in both years. The CPA's Spring (May 2020) update is unsurprisingly more bearish and included a number of different scenarios all of which involved sharp contractions in total construction activity in 2020 and material rebounds in 2021, as shown in Exhibit 1.

Exhibit 1: Construction Product Association Spring forecasts

Total construction output, % change y-o-y	2020	2021
Optimistic	-25%	26%
Second wave I	-31%	17%
Second wave II	-33%	25%

Source: Construction Products Association, May 2020. Note Second wave I occurs whilst emerging from the initial lockdown period leading to a longer and lower recovery. Second wave II is based on a separate/distanced outbreak in winter 2020.

Behind these figures, the CPA expects private housebuilding, office and retail segments to face tougher challenges, while infrastructure (including roads, rail and water sub-segments) fares better. Lockdown restrictions have varied across the UK so regional differences may also emerge.

Revenue run rates improve from April lows to the end of Q2

Polypipe's H120 group revenue is reported to have been 24% below H119. This period included:

- a relatively undisturbed first three months of the year – the first ten weeks or so of which were in line with management expectations (unquantified),
- major lockdown effects in April (y-o-y sales were down 66%, consistent with the May 7 update),
- a recovery phase beginning in May, continuing into June (-30% y-o-y).

Interestingly, the current run rate for June is well ahead of the company's operating and prudent case scenarios outlined previously (for both Q2 and Q3) and nearer to the Q4 prudent case scenario which assumed a more gradual recovery from Q2 lows.

Exhibit 2: Polypipe scenario analysis

Group sales as % of FY19 equivalent	Q220	Q320*	Q420	2021
Operating case	30%	57.5%	85%	90%
Prudent case	30%	52.5%	75%	80%

Source: Polypipe. Note: *Edison illustrative interpretation of phased recovery as the mid-point between Q2 and Q4 run rates.

The headline 24% group revenue reduction in H120 was the net result of a relatively resilient Commercial & Infrastructure divisional performance and a weaker Residential/newbuild outturn. The latter is unsurprising given widespread site closures at the beginning of the lockdown phase and newsflow from quoted housebuilder peers noting their return to operation during May.

Active manufacturing footprint, headcount reductions likely

After a phased closure of certain operations from the end of March – save for some essential ongoing product requirements in support of NHS facilities plus more typical repair and maintenance demand – Polypipe is now manufacturing again at all main sites again. Understandably, given the above sales run rate production levels overall are below full utilisation levels, though we note that no factories have been earmarked for closure.

As a multi-location business (including 11 UK manufacturing sites and two overseas) with a flexible production footprint (eg c 100 extruders, c 200 injection moulding machines) Polypipe is able to do rebuild activity levels gradually as appropriate. The group also potentially has the ability to move some of its production to alternative sites to concentrate activity though practical considerations (such as die and mould sizes) mean that tooling move options have their limitations.

While the proportion of furloughed staff has reduced to 25% (from c 60% at peak), Polypipe has entered a consultation phase with a view to reducing headcount by up to 250 (c 8%) to reduce costs. Other P&L cost actions such as 20% reductions in board members' salaries and fees (until further notice) and non-engagement of agency staff or consultants have been previously announced (7 May).

As well as current activity levels – which may reflect an element of satisfying pent-up demand - we conclude that these actions are informed by forward visibility that the company has in its sales channels and caution regarding the rate of further recovery. Larger commercial new building activity levels were already expected to reduce before the COVID-19 outbreak. Polypipe's Commercial and Infrastructure division revenues are split broadly across a number of sub-sectors, client types and with a larger international angle (c 20% of FY19 revenue). In contrast, in Residential, private sector sales accounts for c 90% of the divisional total split equally between newbuild and repair, maintain or improve (RMI) activity last year. Notwithstanding sustained low borrowing costs, government incentives (eg Help to Buy, stamp duty relief and Green Homes Grants) and some pick-up from lockdown lows, we feel that rising unemployment (and the fear of) is likely to impinge on housing starts and transactions (ie affecting new housebuilding volumes and RMI spending) making Polypipe's Residential division potentially the most exposed to lower activity levels.

More clarity required on end H120 financing position

Frustratingly, no further update on the company's period end net debt/liquidity or average net debt positions was provided with the end H120 trading statement.

Core net debt at the end of March had increased to £184m, up £34m from the end FY19 level. At the beginning of May, Polypipe placed almost 27m new shares with institutional investors at 445p per share, raising c £120m gross proceeds for the company. (The placing price was at a 7.7% discount to the preceding day's closing price and the new shares represented a 13.4% increase in the number of shares in issue to c 228m). Crudely, **net debt reduced to a pro forma £64m on 7 May,** prior to taking into account cash flows from the end of March up to that point.

In addition, the following variations to the company's end FY19 borrowing arrangements were announced:

- suspension of the June 2020 covenant test (on the existing £300m RCF, to November 2023),
- a £50m additional committed RCF for a 12-month period and,
- a £100m Euro Commercial Paper programme (to be held by the Bank of England on behalf of HM Treasury; sub 12-month term, investment grade pricing)

As a result of these actions, management believes that peak gearing under its prudent scenario would be 2.5x EBITDA during FY21 and there would be no banking covenant breaches either in the current financial year or the next one.

Some seasonality observations: In normal **Q1** trading conditions in the early part of the year, we would expect to see a payables outflow and some seasonal inventory build initially with receivables steadily increasing also. So, the increase in net debt to the end of March should not have been particularly surprising and not entirely representative of underlying organisational cash burn.

During the **Q2** market conditions experienced, we would expect this overall working capital position to have been stable at worst. The ability to sell the more standard items from stock while also replenishing at a much lower rate provides the opportunity to unwind inventory, though sharply reduced sales in April and May would have restricted the rate at which this could be achieved. Receivables would have dipped in mid Q2 (ie cash collected) before starting to rise again towards the period end. Conventionally, lower manufacturing activity would result in payables outflows, though Polyipe's reduced usage of early payment supplier terms – with possible margin impacts here – will have lengthened terms to some extent.

Furlough cash should have been received from May onwards, which reverses some of the employment cash costs incurred from March onwards. The extent to which other cost reduction and cash preservation actions taken in the earlier phases of lockdown in Q2 are difficult to quantify. Discretionary items such as reduced capex and marketing budgets are very much within management control and, of course, the absence of a FY19 final dividend payment – which would normally be made in May - conserved c £16m within the business. Some of the other actions are of a more temporary nature with March PAYE/NIC payments deferred until June this year (so flowed out in H1 anyway) and VAT payments deferred to March 2021 (as agreed with HMRC). There have also been some temporary adjustments to certain lease terms (unspecified)

Scenario analysis and some business model observations

In this section, we make some observations on the company's business model to provide a framework to see how reduced revenues can feed into the P&L.

The company's P&L structure includes **gross margins in a low 40% range** (43% in FY19), while **EBIT margins have been in a 17–18% range** in each of the last four years. Hence, COGS and opex are in the order of high 50% and c 25% of revenues, respectively.

In its FY19 annual report, Polypipe states that the cost of inventory recognised as expense was equivalent to COGS (at c £255m). We assume this to be the full loading of production costs; though the primary constituent parts are not split out, a significant proportion is likely to be variable (eg cost of materials, energy, transport) but some semi-variable (eg staff) and fixed (eg depreciation, utility services, insurances, rates for factory premises) will be included also. We estimate that around one-third of COGS (c 20% of sales) is raw materials related. Polypipe consumed c 114,000 tonnes of polymers in FY19 (split c 58% virgin resin, c 42% recycled) and management stated that the company is not overly exposed to imported materials, though recycled (eg HDPE milk bottles) could be more so, we believe.

Total staff costs (excluding directors) of c £109m in FY19 were almost one-quarter of revenues, or c 30% of total costs, and will have been split between direct (COGS) and indirect (opex) costs. With UK staff in excess of 3,000, the implied average cost (in the mid £30k) is above the UK government furlough threshold (ie £2.5k month, £30k per annum maximum), but the scheme could cover a significant proportion of cash costs incurred where activated.

Total underlying opex was c £114m (ie SG&A £72m, administration £42m) in FY19. Staff aside, we would expect there to be a higher proportion of semi-variable and fixed costs within opex. In the more discretionary spending areas such as sales/marketing there should be the greatest scope for temporarily lowering the cost run rate.

FY19 results overview

Polypipe's reported FY19 results came in ahead of our forecasts – with PBT up c 5% y-o-y – though below best expectations earlier in the year due to moderating H2 demand from a combination of political and economic uncertainty and an adverse weather spell. Strategic progress was made with the integration of acquisitions (one in-year, one prior year) and the introduction of new service solutions. The spread of COVID-19 has accelerated since Polypipe reported FY19 results and influenced the board's decision not to pay an FY19 final dividend. End FY19 (pre-IFRS 16) net debt was £150m, a reduction of £15m over the year and equivalent to 1.5x EBITDA. At this point, headroom under existing banking facilities was approaching £200m.

Exhibit 3: Polypipe divisional & interim splits

Year end 31 December, £m	H1	H2	2018	H1	H2	2019	% change reported		% change l-f-l*	
							H119	FY19	H119	FY19
Group revenue	**210.2**	**223.0**	**433.2**	**223.3**	**224.3**	**447.6**	**6.2%**	**3.3%**	**1.0%**	**-1.6%**
Residential Systems	121.3	128.6	**249.9**	131.6	133.2	**264.8**	8.5%	**6.0%**	0.8%	**-0.1%**
Commercial & Infrastructure Systems	95.0	102.2	**197.2**	99.3	97.8	**197.1**	4.5%	**-0.1%**	1.1%	**-3.5%**
Inter company	(6.1)	(7.8)	**(13.9)**	(7.6)	(6.7)	**(14.3)**				
Group operating profit – reported	**36.3**	**37.7**	**74.0**	**39.3**	**38.8**	**78.1**	**8.3%**	**5.5%**	**-1.7%**	**-3.4%**
Residential Systems	23.8	22.5	**46.3**	26.6	26.8	**53.4**	11.8%	**15.3%**	-2.1%	**3.1%**
Commercial & Infrastructure Systems	12.5	15.2	**27.7**	12.7	12.0	**24.7**	1.6%	**-10.8%**	-0.8%	**-13.5%**

Source: Polypipe, Edison Investment Research. Note: *EBIT % change like-for-like (l-f-l) are Edison estimates. The adoption of IFRS 16 leases benefited FY19 EBIT by £0.3m, with a neutral impact on group PBT.

Residential Systems: A resilient outturn in variable markets

Reported divisional revenue and profitability moved ahead well in FY19 (+6.0% and +15.3%, respectively) against a backdrop of growing but slowing new housebuilding activity (ie flat to declining starts, low single-digit completions growth) and evidence of periodic de-stocking/re-stocking among the merchant customer base during the year around Brexit deadlines. Manthorpe made a strong contribution in its first full year with the group, together with some underlying improvement in profitability; we estimate that around one-third of the +170bp reported EBIT margin increase (to 20.2%) was organic.

Underlying performance: Selling price increases of c 3% y-o-y effectively compensated for a similar drop in volume to leave like-for-like divisional revenue flat for the year. H1 (+0.8% l-f-l) saw some benefit from a weather-weakened H118 comparator, but merchant demand pull-forward at the end of H218 provided a tougher H2 comparator. A weak Q419 generally also contributed to an implicit modest reduction in underlying revenue (c 1%) in the second half. In absolute terms revenue was slightly higher in H2 and we believe that underlying profitability and EBIT margins were fairly stable in each half year. This is an important point as it affirms that actions taken to remedy operating inefficiencies towards the end of 2018 have delivered. (Exhibit 3 suggests that year-on-year, like-for-like EBIT margin dipped slightly in H119 and expanded in H219; this was more a reflection of 2018 margin development – a good start, weaker finish.) The inefficiencies were primarily caused by site constraints (in H218); management was rewarded for taking decisive investment steps (ie additional extrusion capacity and mobilising adjacent land for ongoing storage and logistics use) together with other cost reduction measures.

Manthorpe Building Products (acquired October 2018) has fitted in very well, making a strong incremental contribution to divisional revenue and profitability in 2019 at above-average margins. We believe that annualised turnover rose by 4–5% y-o-y and generated EBIT margins in excess of 30%. This acquisition broadened Polypipe's residential product offer (with more above ground lines in roofing, ventilation, loft access and air leakage) and most likely benefited from introductions from the wider group. We visited the company's impressive Ripley facility towards the end of last year. The focus on product and process innovation at the business is clear and there are options to raise capacity both within existing buildings and on adjacent owned land to accommodate further growth at the appropriate time.

Sustaining competitive advantage: Polypipe and Manthorpe both have an embedded new product development culture. This ongoing process can apply to improved existing or innovative new products that enhance the company's offering, support revenue growth, provide scope to engineer better margins and reinforce customer relationships/competitive positions. Examples launched in 2019 include PolySoil (soil pipe connections with improved seal longevity, two-shot moulding process), Surestop-i (stopcock with remote and mobile device switching) and Thru…air (a newbuild telescopic airbrick system). The group is also able to benefit through a lower tax charge from so-called Patent Box relief on profits generated from sales of patent-protected products.

In addition to new products, a new Offsite Solutions service activity was formally established within the Residential Systems division in FY19. Polypipe already supplies pre-packaged component kits and undertakes some assembly activity (eg in ventilation systems) to add value to customer processes, essentially through simplifying the supply chain and site installation. Offsite takes this a step further by aiming to engage with the growing modular construction sector to provide already made up sub-assemblies (eg hot and cold water feed and waste pipework) into customers' offsite factory production processes. If executed successfully, this would have the effect of pulling through bundles of components, increasing product volume sales and capturing a larger share of wallet project spend by housebuilders and/or their suppliers.

Commercial & Infrastructure Systems: A tough H2

This division experienced a tougher year generally. Headline net revenue (after excluding inter-segment revenue) was effectively flat year-on-year at £187.3m; taking account of some year-on-year pricing benefit, divisional volumes were flat in H1 prior to weakening in H2, leading to a year-on-year reduction for the year as a whole. Reported EBIT came in £3m lower at £24.7m (an EBIT margin of 12.5%). We believe that acquisitions had a modestly dilutive impact on margins – particularly as Alderburgh made no noticeable profit contribution in its seasonally quiet year-end period – but the bigger effect arose from lower underlying divisional sales volumes.

Underlying performance: Excluding the full-year effects of Permavoid[1] and a part-year contribution from Alderburgh[2] (see below), as shown in Exhibit 3 underlying divisional revenues were modestly ahead at the interim stage and lower on a full-year basis. These figures (+1.1% and -3.5%, respectively) are also included in Exhibit 4 along with splits between domestic UK and export sales.

Exhibit 4: Commercial & Infrastructure division – like-for-like revenue development in 2019

	H118	H218	FY18	H119	H219	FY19
Division	**-6.6%**	**5.3%**	**-0.9%**	**1.1%**	**-7.9%**	**-3.5%**
UK	-6.4%	7.7%	**0.4%**	2.7%	-9.6%	**-3.6%**
Export	-8.5%	-2.9%	**-5.8%**	-5.3%	-0.7%	**-3.0%**

Source: Polypipe (unshaded areas), Edison Investment Research estimates (shaded areas)

In the **UK**, the prior year sales pattern was affected by a cold weather spell (the 'Beast from the East') and delays to road programme contract activity in H1. There was an element of catch up demand in both regards in H2. Consequently, the base periods for half year comparisons distort the interpretation of 2019 results somewhat. Including year-on-year pricing benefits, flat underlying volumes in the context of a weak H118 was probably on the disappointing side. By the same token,

1 Permavoid (acquired September 2018) designs and supplies shallow void-forming sub-base water management solutions that receive, store and manage surface water flows using interlocking cells.

2 Alderburgh Ltd (acquired October 2019) designs, manufactures and installs below ground stormwater management cell products and solutions and various barrier materials & systems (eg gas, waterproofing and ground stabilisation).

unusually strong H218 trading exaggerated weak UK market effects in H219 leading to a marked year-on-year revenue reduction. Brexit uncertainties weighed on general private sector economic activity levels as the year progressed. This included new housing starts, which dropped significantly in Q4 (-10%) and, with a rising share of completions for houses rather than multi-occupancy flats in 2019 as a whole, starts in the latter sub-segment could have been affected more. There may also have been a slowing in public sector decision-making (eg Highways England entering the strategic funding transition period from RIS1 to RIS2), while rainfall records in some regions also affected access to certain sites for a period. Polypipe management stated that the commercial newbuild market was patchy by sub-sector and lower overall in value terms for the second year running. In addition, road infrastructure spend was cited as being slightly down year-on-year. Overall, this added up to a challenging year like-for-like comparison for this division in the UK, especially in H2.

Export activity (around 20% of sales) has traditionally been large project-oriented and, with a smaller number of contracts, subject to lumpiness from timing effects. The Middle East was a strong sales region in 2016 and the beginning of 2017, but regional trading conditions deteriorated due to a local trade embargo and Polypipe transitioned from direct manufacturing locally to sub-contracted production during 2018. Some sales were achieved using this model in that year but 2019 represented a second consecutive year of lower sales. This justifies the decision to reduce the cost base to serve the region while also maintaining a capability to do so. European sales (c 40% of divisional exports) did improve again in 2019 though not sufficiently to offset softness elsewhere. Nevertheless, we estimate that export revenue like-for-like sales were only modestly negative in H2, an improvement on the -5.3% reported at the interim stage.

Acquisition effects: In 2019, these included the annualised benefit from the prior year Permavoid deal and a maiden two-month contribution from Aldeburgh Group. In total, these businesses added c £5.9m to divisional sales (ie an incremental c £3.2m and an initial £2.7m, respectively). Permavoid is said to have delivered a good export performance – including the US, we believe – while Alderburgh is a UK-oriented supplier.

Business development: Undeterred by weaker market conditions, Polypipe has continued to invest in extending its commercial product offer and launched a new customer service. Alderburgh brought in its modular rainwater management systems and related membranes, which complement the Permavoid portfolio. Polypipe also added to its Polystorm range to accommodate updated regulations and permit deeper below ground installation. Encouraged by success of Fuze (pre-assembled soil-stacks, launched in 2018), late in the year the company introduced its innovative new MecFlow multi-layer pressurised hot and cold water distribution system, a segment where it has traditionally been under represented. Coinciding with this, Polypipe Advantage was launched as the umbrella brand – encompassing Fuze and MecFlow – for a broader business service incorporating design, technical support and supply of prefabricated and assembled product packages either via merchants or direct to site. This brings together front-end project capability – which has largely serviced commercial projects – and export markets from its Aylesford, Kent, base – using the group manufacturing and distribution network, including its own vehicle fleet. Most obviously, this service brings the opportunity for earlier engagement with customers on projects and the potential to be specified into the supply chain. To develop this business line successfully requires co-ordinated, agile production scheduling and flexible cell capability especially as order book volumes build. Given Polypipe's extensive stormwater management product portfolio and technical expertise, we think that this could be a natural addition to the Polypipe Advantage service offer at some point. We also note that Aldeburgh brought an installation capability into the group that could also be broadened out across the Polypipe range in this sub-sector.

Free cash flow stability funds investment and reduces net debt

Core net bank debt stood at £150m at the end of December, £15m better than we had expected and down £14m over the course of the year overall. IFRS 16 leases on hand at the year-end were £14.8m. As the adoption of IFRS 16 changes the cash flow statement presentation, we have stripped these effects out and comment separately, though there is no net difference in overall net cash movement at the group level.

Operating cash flow: On a pre-IFRS 16 basis, group EBITDA was c £95m for the year, an increase of c £5m y-o-y, reflecting the Residential Systems profit uplift. (After recent investment, the owned asset depreciation charge rose by over £1m on a continuing basis, with an uplift in both divisions.) Adjustments for non-underlying cash outflow – mainly relating to M&A activity (see below) – and non-cash items was modestly above the P&L level at £3.8m but slightly below that seen in the prior year (restructuring as well as M&A in FY18). Working capital movements in the year reflected the normal seasonal H1 absorption, H2 release pattern. These effects were amplified in both halves compared to FY18 and, in contrast, the year ended showing a c £6m net working capital cash outflow compared to a c £4m inflow in the prior year. The key driver here was the payables reverse of c £18m, which chiefly reflected unwinding of an advance materials purchase position at the end of FY18 and possibly lower activity levels at the end of FY19. This payables swing was partly offset by good receivables collection at the year end and a small improvement in debtor days overall. Despite the year-on-year working capital swing, **operating cash flow (again pre-IFRS 16) for FY19 at c £86m** was only £4m below the prior year.

Other cash flow items: Cash interest and tax line items were both slightly above their P&L equivalents and totalled almost £20m. Capex plans were moderated during the year as market conditions weakened in H2, but the c £22m gross spend focused in higher growth areas was only slightly lower than the prior year and still 1.3x the owned asset depreciation charge in the year. A sale and leaseback of distribution fleet tractor units and some rigid vehicles in H2 realised c £4m cash proceeds and reduced net capex to c £18m for the year. As a result, **free cash flow at c £48m** was only marginally lower than in FY18. The acquisition of Alderburgh in October resulted in an actual £12.2m cash consideration outflow. Cash dividends paid in the year were c £23.7m and £2.4m was received from share options exercised during the year.

IFRS 16 leases: The cash flow statement presentation changes under IFRS 16 (including a £0.3m benefit to EBIT and recognition of a right of use asset depreciation charge of £3.2m) but the actual cash movement is not affected. For the record, lease liability cash payments were £3.5m in FY19. End FY19 IFRS 16 leases of £14.8m were split 20% current and 80% long-term liabilities.

Facilities: At the end of FY19, Polypipe had the following bank borrowing arrangements:

- £300m committed RCF to November 2023 initially (plus two annual renewal options to 2025)
- £50m uncommitted accordion facility (same duration as the RCF)

Factoring in cash on hand of c £48m at the year end, headroom at that time was just under £200m including the uncommitted accordion, and at 1.5x net debt to EBITDA and 11.3x interest cover for the trailing 12 months, the company was comfortably within associated covenants (of less than 3x and above 4x, respectively). The company commented that all but £15m of the £300m RCF was drawn down at the end of March and held on deposit for liquidity purposes.

It is worth noting that Polypipe does not operate a defined benefit pension scheme and therefore is not exposed to potential deficit positions from the recent equity and bond market swings nor therefore required to make any cash deficit recovery payments.

Exhibit 5: Financial summary

£m	2014	2015	2016	2016*	2017*	2018	2019
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue	327.0	352.9	436.9	387.2	411.7	433.2	447.6
Cost of Sales	(202.4)	(210.0)	(256.8)	(219.1)	(236.0)	(251.9)	(255.2)
Gross Profit	124.6	142.9	180.1	168.1	175.7	181.4	192.4
EBITDA	60.8	69.3	86.4	84.5	88.3	90.6	99.1
Operating Profit (underlying)	46.3	54.2	70.4	69.5	73.4	75.0	79.3
SBP	0.0	0.0	(1.0)	(1.0)	(0.8)	(1.0)	(1.2)
Operating Profit (reported)	46.3	54.2	69.4	68.5	72.6	74.0	78.1
Net Interest	(7.7)	(5.3)	(6.6)	(6.6)	(5.8)	(5.8)	(6.2)
Other finance	(1.0)	(0.9)	(1.0)	(1.0)	(1.1)	(1.1)	(1.1)
Intangible Amortisation	0.0	(3.0)	(6.8)	(6.8)	(5.5)	(5.9)	(7.5)
Exceptionals	(20.7)	(3.5)	(0.6)	(0.6)	(4.6)	(2.7)	(3.2)
Profit Before Tax (norm)	37.6	48.0	61.8	60.9	65.7	67.1	70.8
Profit Before Tax (statutory)	16.9	41.5	54.4	53.5	55.6	58.5	60.1
Tax	(5.4)	(9.2)	(11.8)	(10.1)	(11.8)	(10.5)	(11.9)
Profit After Tax (norm)	32.2	38.8	50.0	49.2	53.9	56.5	58.9
Profit After Tax (statutory)	11.5	32.3	42.6	43.4	43.8	49.1	49.6
Average Number of Shares Outstanding (m)	199.9	199.3	198.9	198.9	198.4	199.0	199.3
EPS - normalised (p)	16.1	19.4	25.0	24.6	26.9	28.1	29.2
EPS - statutory (p)	5.8	16.2	21.4	22.2	22.1	24.7	24.9
Dividend per share (p)	4.5	7.8	10.1	10.1	11.1	11.6	4.0
Gross Margin (%)	38.1	40.5	41.2	43.4	42.7	41.9	43.0
EBITDA Margin (%)	18.6	19.6	19.8	21.8	21.4	20.9	22.1
Operating Margin (underlying) (%)	14.2	15.4	16.1	17.9	17.8	17.3	17.7
BALANCE SHEET							
Fixed Assets	324.2	476.5	472.6		455.1	520.3	542.4
Intangible Assets	235.0	378.4	371.6		356.5	401.9	401.8
Tangible Assets	89.2	98.1	101.0		98.6	118.4	140.6
Investments	0.0	0.0	0.0		0.0	0.0	0.0
Current Assets	103.9	99.6	119.5		147.7	141.7	148.2
Stocks	39.9	47.5	52.2		53.5	58.1	59.7
Debtors	20.2	29.3	38.9		32.6	37.2	40.5
Cash	43.1	21.6	26.5		35.7	46.2	47.7
Current Liabilities	(69.8)	(87.2)	(104.5)		(108.8)	(108.7)	(108.1)
Creditors	(69.8)	(87.2)	(104.5)		(108.8)	(108.7)	(108.1)
Short term borrowings	0.0	0.0	0.0		0.0	0.0	0.0
Long Term Liabilities	(120.6)	(227.9)	(200.2)		(192.0)	(222.1)	(221.1)
Long term borrowings	(118.0)	(215.9)	(190.8)		(184.1)	(210.4)	(197.7)
Other long term liabilities	(2.6)	(12.0)	(9.4)		(7.9)	(11.7)	(23.4)
Net Assets	237.7	261.0	287.4		302.0	331.2	361.4
CASH FLOW							
Operating Cash Flow	50.6	72.6	86.5		79.2	90.0	89.4
Net Interest	(10.4)	(5.7)	(7.3)		(6.6)	(6.1)	(7.4)
Tax	(3.7)	(5.2)	(10.1)		(12.6)	(11.2)	(12.4)
Capex	(14.9)	(18.9)	(18.7)		(22.0)	(23.2)	(18.0)
Acquisitions/disposals	(0.3)	(149.5)	0.0		0.0	(42.5)	(12.2)
Financing	(1.7)	0.0	(2.9)		(0.7)	0.3	2.4
Dividends	(3.0)	(10.6)	(17.1)		(21.0)	(22.3)	(23.7)
Net Cash Flow	16.6	(117.3)	30.5		16.3	(15.1)	18.1
Opening net debt/(cash)	84.7	74.9	194.3		164.3	148.4	164.2
Finance leases initiated	(9.6)	(1.7)	0.0		0.0	(1.6)	0.0
Other	2.8	(0.4)	(0.5)		(0.4)	0.8	(3.9)
Closing net debt/(cash)	74.9	194.3	164.3		148.4	164.2	150.0
Lease finance (under IFRS16)							14.8

Source: Company accounts, Edison Investment Research. Note: *Continuing operations only.

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