

Severfield

H121 results

Robust position, encouraging outlook

COVID-19 market disruption has dented FY21 profitability, but we still expect Severfield to end the year by maintaining dividend levels and with a good net cash position. Consequently, with an optimistic view of pipeline opportunities, it remains well positioned to secure business in core market sectors and deliver a steady earnings recovery by FY23.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/19	274.9	25.1	6.8	2.8	10.4	3.9
03/20	327.4	29.1	7.9	2.9	9.0	4.1
03/21e	353.0	22.2	5.9	2.9	12.1	4.1
03/22e	343.6	25.0	6.7	3.0	10.7	4.2

Note: *PBT and EPS are Edison normalised, excluding pension net finance costs, intangible amortisation and exceptional items.

PBT slightly ahead, despite COVID-19 impacts

Following on from a strong H220 performance, H121 maintained high activity levels and showed good revenue progress against its prior year comparator. The COVID-19 lockdown did have some impact on the construction industry in Q1, which fed into a constrained EBIT margin, though this was still above 5% and similar to the level achieved in H120. More restrictive local lockdown conditions led to the Indian JV breaking even at the EBIT level and generating a post-tax loss (of which Severfield's share was £0.7m). After maintaining its FY20 final dividend previously, Severfield also declared an unchanged 1.1p interim dividend. The company's net cash position improved to £19.5m at the end of H1 and its latest UK/Europe order book for November at £287m was slightly up from the declared level in June.

Steady recovery from FY21 anticipated

The second UK lockdown has caused no new business disruption to date in H2, though Indian construction activity has yet to normalise. There are some near-term market risks – given references to decision delays and pricing – but the construction industry has emerged from earlier restrictions in reasonable shape. Severfield's UK order book position (85% for delivery in the next 12 months) provides company visibility into H222. Robust commentary with the H121 results points to full year EBIT of at least £20m (being an improvement on the £9.5m reported in H1). Our reinstated estimates are in excess of this for FY21 – while also reflecting COVID-19 disruption – and show a measured rate of recovery by FY23.

Valuation: Solid 4% yield ahead of earnings recovery

Severfield's share price is down c 15% ytd and has underperformed the FTSE All Share Index by c 2% over this time period. In the preceding three months, it traded at or below the company's 58p NAV before rallying during November to the current 71p level. Factoring in a gradual earnings recovery back towards FY20 levels (historical P/E of 9.0x and EV/EBITDA of 6.0x) by FY23, the current rating reflects the impact of COVID-19 on FY21 trading and perhaps some caution regarding the rate of recovery. A dividend yield in excess of 4% backed by net cash and expected cash generation are clear investor attractions.

Construction & materials

8 December 2020

Price 71p

Market cap £218m

Core net cash (£m) at end September 2020 19.5

Shares in issue 307.6m

Free float 100%

Code SFR

Primary exchange LSE

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 29.6 20.3 (2.7)

Rel (local) 16.6 8.3 5.9

52-week high/low 93.0p 51.8p

Business description

Severfield is a leading UK structural steelwork fabricator operating across a broad range of market sectors. An Indian facility undertakes structural steelwork projects for the local market and was expanded in FY20.

Next events

H121 DPS 1.1p ex-dividend 10 December

H121 DPS to be paid 8 January

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H121 results overview

Exhibit 1: Severfield interim splits

£m	H120	H220	2020	H121	Change y-o-y
					H120
Group Revenue	131.7	196.5	327.4	186.0	41.3%
Group Operating Profit - reported	7.0	20.0	27.0	9.5	35.6%
Operating Margin %	5.3%	10.2%	8.2%	5.1%	-20bp
Group Operating Profit - adjusted*	8.0	21.2	29.3	9.8	21.8%
Operating Margin %	6.1%	10.8%	8.9%	5.3%	-80bp
Order book**	323		271	287	-11.1%

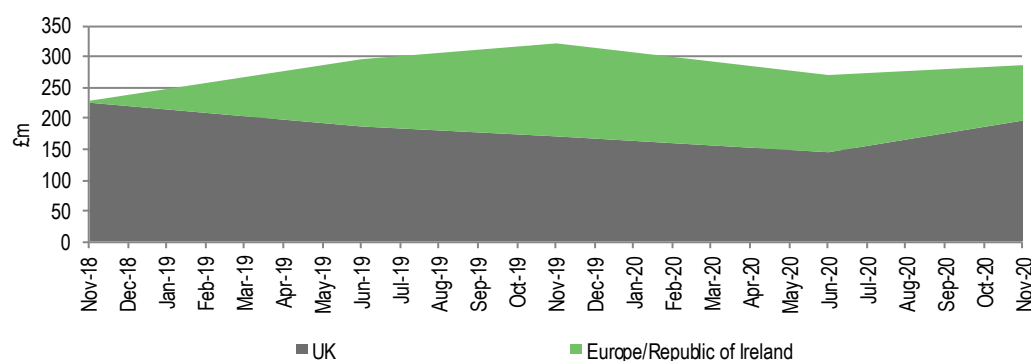
Source: Company, Edison Investment Research. Note: *We adjust underlying reported operating profit for share-based payments and estimated pension net finance costs. Neither profit line includes any contribution from JVs and associates. **UK and Europe, at date of reporting results.

UK: Strong H1 revenues, EBIT margin reflects COVID-19 impact

Reflecting the preceding order book development and project timings, FY20 had a distinct H2 skew (c 40:60 H1:H2 in revenue terms). Hence, the 41% y-o-y revenue increase seen in H121 was somewhat flattered by a relatively weak comparator. Nonetheless £186m revenue represents a strong trading period and followed on from the £196m delivered in H220. As previously noted, the early part of H121 saw some temporary project site closures due to COVID-19 impacts; all had resumed activity by the end of Q1 albeit with some required changes to site operations. The achieved operating margin of 5.1% was not dissimilar to the prior year and management attributed the cost of COVID-19 business disruption in Q1 as having a £3–4m EBIT impact (c 190bp at the mid-point of this range). It should be noted that the H121 results did not derive any benefit from government employment support schemes introduced to protect businesses and jobs affected by COVID-19. No significant contract completions were flagged for the period, so we assume that final account activity was at normal levels.

It is encouraging to see the UK/Europe order book pick up a little latterly (£287m at 1 November vs £271m in June), especially given the strong H1/Q2 revenue performance. Having expanded rapidly to reach c £150m (or just under half of the November 2019 total), European orders on hand have declined by over one-third as project work has been executed in the last year and, at this point, not replaced at the same rate. UK orders were seeing a similar pattern until the latest reading, which showed a c £50m uplift to just below £200m in November 2020 (and now accounting for 68% of the total). The sector trends behind the order book development are described below Exhibit 2.

Exhibit 2: Severfield UK facilities – geographic order book split



Source: Company data. Note: Harry Peers (acquired October 2019) added c £20m to the UK order book at that time.

Management specifically referenced new **nuclear** business accessed through Harry Peers, acquired at the beginning of H220; based on the disclosed order book split – with the nuclear proportion rising from 4% to 17% – net orders on hand for this subsector have risen by c £38m (to c £49m) since June. In **transport**, a first HS2 bridge package was won with a value of c £7m. Severfield developed its specialist bridge capability in 2015 when taking on a team from Mabey Bridge and also has a number of rail station projects in its portfolio (including work undertaken at London Bridge, Manchester Victoria and Birmingham New Street). In total, there are 70 bridge structures and four main station interchanges to be built under Phase I of the HS2 programme with sections allocated across four consortia. Severfield is optimistic that further packages can be won.

In percentage and value terms, the **industrial/distribution** and **data centres/other** sectors have both declined since June; some large projects have featured in both distribution and data centres in the recent past and the latest movement most likely reflects the cycle through of these contracts. Both of these sectors retain a positive outlook underpinned by the way technology is facilitating changing work practices and online retail behaviours. Business and domestic responses to the impacts of COVID-19 have served to illustrate the importance of these already well-established trends. Lastly, we note that the value of orders on hand in the **commercial office** subsector rose (by c £12m to c £77m) and now include an Argyle Street, Glasgow development. In general terms, Severfield comments positively on pipeline prospects – especially in transport, stadia/leisure and industrial/distribution with the outlook for others currently stable – though also caveats this by referencing longer investment decision making and some price competition. Neither of these points should come as a major surprise; the extent of any impact on activity levels and margins remains to be seen but appears to have been limited to date.

India: EBIT break-even under more restrictive conditions

India's more restrictive lockdown conditions contributed to a small loss for Severfield's JV (50% share equal to £0.7m). Behind this figure, volumes and revenues were sharply lower (-64% at 18,000 tonnes and -41% at £23.1m respectively) though the JV managed to break even at the EBIT level. Consequently, the underlying loss was attributable to carried interest costs net of a tax credit.

A national lockdown was initially successful in containing the spread of new COVID-19 cases but successive unlocking phases starting in June were followed by a significant rise and peak in new case activity to the middle of September. An encouraging subsequent reduction – currently to below half of the peak level and back to July levels – has been tempered by a recent rise and increasing restrictions again are understood to be under consideration in a number of states. While India has entered a technical recession following two quarters of negative GDP growth, a recent government initiative to stimulate investment in a number of sectors including specialty steel has been welcomed by industry players. The country's repo rate has been maintained at 4% since May, having been lowered to that level in two moves earlier in the year.

The Indian JV order book at £98m is slightly up from September (£94m) though lower than seen in June £110m. This remains high by historical standards and while lower in value terms, the mix continues to favour commercial work (at 80% of the total) which typically attracts higher margins compared to the industrial sector. In outlook and pipeline terms, Severfield sees significant ongoing opportunities in the data and distribution centre segments while new office demand is expected to be stable in the near term. The JV has an established project presence in the medical centre/hospital sector and management considers this an area for future growth as capacity constraints have been highlighted by the COVID-19 pandemic. It remains to be seen whether the government's steel industry incentives result in additional investment in that sector.

Healthy underlying cash flow funds dividends and investment

At the end of September, Severfield had a net cash position of £19.5m. This represented an uplift of c £3m since March; this broadly corresponded with permitted VAT payment deferrals under governmental support measures. In underlying terms, the first half trading period saw a healthy free cash inflow substantially applied to the FY20 final dividend payment and further business investment.

Operating cash inflows (before working capital items) rose by £3.5m y-o-y to £11.8m driven mainly by the EBIT increase shown in Exhibit 1 with a modestly higher depreciation charge also. In addition, a reduction in non-trading cash items including incentive-related payments contributed over £1m to the noted year-on-year improvement. H120 and H121 were very different trading periods that flowed from the order development that preceded them. Specifically, the reported order book positions ran at or slightly above £230m between June 2017 and November 2018 before rising strongly to £323m by November 2019. Consequently, H120 activity levels were broadly similar to prior six-month periods then ramping up in H220 as the aforementioned order build moved into production, continuing into H121. So while the working capital inflows for those first halves were similar (H120 +£2.2m, H121 +£3.1m) the composition was different. For the latest period, the c £7m debtor inflow and c £5m creditor outflow partly reversed significant opposing movements at the end of the prior year. Overall, **cash generated from operations in H121 was almost £15m.**

Among the other usual cash flow movements we note only that capex was understandably temporarily restrained in H1 (at £1.6m versus £2.2m depreciation on owned assets) as the industry generally absorbed the implications of COVID-19 restrictions before adjusting working practices. We note c £0.3m was spent on in-licensing to add Severstor and Seversilo to the Products & Processing service offer. Allowing for interest, tax and capex outflows, **H1 free cash flow was just above £10m.** The FY20 final dividend absorbed £5.5m of this. Severfield also invested £0.9m into CMF (a JV supplier of specialist cold formed steel construction products) to part fund an expansion of its operations into a new facility. Lastly, c £0.8m IFRS 16 lease payments were made in the period. Consequently, after all of the above items, the group net cash movement was a favourable c £3m. We note that Severfield repaid the c £15m revolving credit facility funding drawn down as a precaution at the end of FY20 as the COVID-19 UK lockdown period began. The facility (£25m committed plus a £20m accordion) remains in place until October 2023. At the end of H121, the company still held a c £30m cash balance and a c £10.5m amortising term loan relating to the prior year acquisition of Harry Peers.

Cash flow outlook: Period end balance sheet financing can be influenced by the timing of payments relating to project progress especially where contractual completion occurs. At this stage, on our reintroduced estimates (see below), we project that Severfield will end FY21 in a c £11m core net cash position (before IFRS 16 leases). This is after some catch-up capex spend, the H121 dividend payment (c £3.4m), a second tranche of investment to part fund expansion at CMF (c £1m) and expected deferred consideration for Harry Peers (c £6m) all flowing out in H2. Beyond this, we project a small FY22 cash inflow (after taking into account the c £3m deferred VAT outflow) and further cash generation in FY23, at the end of which we expect net cash of around £20m.

With this cash profile and the existing banking facilities in place, Severfield appears to be in a financially robust position. which is an important metric for developers and clients, especially during less certain trading environments.

Earnings to recover from COVID-19 affected FY21 trading

The **Construction Product Association's** (CPA's) autumn projections offer the view that the sector is set to outperform UK GDP expectations both on the way down in 2020 (-14.5%) and in recovery

next year (+13.5%). In Severfield's areas of interest, infrastructure is highlighted as being relatively resilient currently with good growth to come save for airport projects unsurprisingly. The CPA also echoes wider concerns on the potential long-term effects of increased homeworking (on commercial office and physical retail space demand) and potential Brexit disruption to the industry. In the latter regard, we believe that the Irish sea border regulations when agreed will need to be navigated for certain projects delivered from Severfield's Northern Irish facilities though other cross border flows (eg inbound steel plate or outbound fabricated steel into Europe) are not expected to be disrupted.

Separately, the **British Constructional Steelwork Association (BCSA)** is forecasting market increases of 12.1% and 7.1% for 2021 and 2022, respectively. Included within this, the BCSA quantifies its view for downside in the commercial office sector as -5.4% followed by -6.2% for these years. More positively, as well as a favourable outlook for road and rail infrastructure, the BCSA sees low double-digit increases in demand for industrial/distribution shed facilities; as well as the aforementioned online fulfilment network expansion, prospective defensive growth in manufacturing (and possibly port facilities) may evolve in post-Brexit UK.

Severfield's own market and pipeline comments suggest mostly stable sectoral outlook views with more favourable prospects in transport (especially HS2 rail), stadia/leisure, power/energy (nuclear) and process industries. As ever, success in winning targeted contracts on acceptable terms is a key driver of future prospects and we will continue to monitor order book development in this regard and in the context of the above comments.

Our reinstated estimates reflect COVID-19 market effects in the current year (through unrecovered overhead in Q1, some project delays and price competition) and a steady recovery thereafter, regaining FY20 EBIT levels by FY23. Management has flagged a particularly large industrial project in the Republic of Ireland (which contains a bespoke paint package), the progression of which does distort underlying revenue and margin progression to some extent. Guidance is for the Indian JV to achieve a post-tax break-even position for H221. Beyond this, local market demand is likely to see a slower and lagged post-COVID-19 recovery and this is also reflected in our estimates, accounting for a third (FY21) to a half (FY22 and FY23) of the reduction in PBT shown in Exhibit 3.

Exhibit 2: Severfield estimate revisions

	EPS FD norm (p)			PBT norm (£m)			EBITDA (£m) IAS 17		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
FY21e	8.1	5.9	-27.5%	29.8	22.2	-25.3%	35.0	28.4	-18.7%
FY22e	8.5	6.7	-22.0%	31.3	25.0	-20.2%	36.7	31.3	-15.2%
FY23e	N/A	7.5	N/A	N/A	27.9	N/A	N/A	34.3	N/A

Source: Edison Investment Research. Note: Edison normalised basis; old estimates were set prior to the FY20 results announcement and were suspended from March 2020 pending greater clarity on the impacts of COVID-19 on the trading environment.

Dividends: We expect Severfield to maintain unchanged DPS for FY21 as a whole followed by growth of 3% and 10% in FY22 and FY23 respectively, backed here by an improving net cash position and dividend cover remaining over 2x. Historically, Severfield has considered and paid special dividends when net cash has risen beyond £20m, but we think it would be premature to anticipate such a payout under our estimates and time horizon.

Exhibit 4: Financial summary

	£m	2014	2015	2016	2017	2018	2019	2020	2021e	2022e	2023e
Year end 31 March		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS											
Revenue		231.3	201.5	239.4	262.2	274.2	274.9	327.4	353.0	343.6	353.0
Cost of Sales		(217.8)	(186.7)	(219.6)	(236.3)	(244.9)	(244.6)	(292.6)	(321.5)	(310.2)	(317.0)
Gross Profit		13.5	14.9	19.8	25.9	29.3	30.3	34.7	31.5	33.5	36.0
EBITDA		12.0	13.6	18.9	25.7	29.1	29.0	33.2	28.4	31.1	34.3
Operating Profit - Edison adjusted		8.4	10.0	15.2	22.1	25.4	25.3	29.3	24.0	26.2	28.9
SBP		(0.2)	(0.5)	(1.1)	(2.0)	(2.0)	(1.6)	(1.8)	(0.5)	(1.0)	(1.5)
Pension Net Finance Costs		(0.5)	(0.5)	(0.5)	(0.5)	(0.6)	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)
Operating Profit - company norm		7.6	9.0	13.7	19.6	22.9	23.3	27.0	23.101	24.762	26.995
Net Interest		(0.6)	(0.5)	(0.2)	(0.2)	(0.2)	(0.2)	(0.7)	(0.9)	(0.8)	(0.8)
Associates		(3.0)	(0.2)	(0.2)	0.5	0.9	1.7	2.4	(0.5)	0.6	1.3
Intangible Amortisation		(2.7)	(2.6)	(2.6)	(2.6)	(1.3)	0.0	(1.4)	(2.9)	(2.9)	(2.9)
Exceptionals		(5.3)	(5.9)	(0.9)	0.8	0.0	0.0	(1.4)	(0.4)	0.0	0.0
Profit Before Tax (norm) - Edison		4.5	8.8	13.7	20.3	24.1	25.1	29.1	22.2	25.0	27.9
Profit Before Tax (norm)		4.0	8.3	13.2	19.8	23.5	24.7	28.6	21.8	24.6	27.5
Profit Before Tax (statutory)		(4.1)	(0.2)	9.6	18.1	22.2	24.7	25.8	18.5	21.7	24.6
Tax		1.4	0.3	(1.0)	(2.7)	(4.1)	(4.5)	(5.4)	(4.2)	(4.5)	(4.9)
Profit After Tax (norm)		3.1	7.4	11.4	17.0	19.6	20.6	24.1	18.0	20.5	23.0
Profit After Tax (statutory)		(2.6)	0.1	8.6	15.3	18.0	20.2	20.4	14.3	17.2	19.7
Average Number of Shares Outstanding (m)		295.8	297.5	297.5	298.9	299.7	303.1	305.4	307.2	307.6	307.6
EPS - normalised (p) - Edison		1.05	2.47	3.84	5.70	6.53	6.80	7.89	5.87	6.66	7.48
EPS - normalised (p)		0.88	2.31	3.67	5.53	6.35	6.66	7.75	5.73	6.52	7.34
EPS - statutory (p)		(0.89)	0.05	2.89	5.13	6.02	6.66	6.68	4.66	5.59	6.41
Dividend per share (p)		0.0	0.5	1.5	2.3	4.3	2.8	2.9	2.9	3.0	3.3
Gross Margin (%)		5.8	7.4	8.3	9.9	10.7	11.0	10.6	8.9	9.7	10.2
EBITDA Margin (%)		5.2	6.7	7.9	9.8	10.6	10.5	10.1	8.1	9.0	9.7
Operating Margin - Edison (%)		3.6	4.9	6.4	8.4	9.3	9.2	8.9	6.8	7.6	8.2
BALANCE SHEET											
Fixed Assets		147.7	145.1	149.3	148.3	154.5	163.0	203.8	209.4	209.8	210.3
Intangible Assets		64.6	61.8	59.2	56.3	54.8	54.7	78.1	81.7	78.9	76.0
Tangible Assets		74.1	76.6	77.4	78.9	81.2	84.0	99.0	100.4	102.5	104.1
Investments		9.0	6.7	12.7	13.1	18.5	24.3	26.7	27.3	28.4	30.2
Current Assets		72.2	76.3	75.1	107.1	99.2	91.8	127.4	113.5	117.7	131.0
Stocks		5.8	4.8	5.3	7.8	9.6	8.9	6.9	8.5	9.2	10.4
Debtors		60.8	64.6	50.7	66.5	56.4	57.7	76.1	83.3	84.8	90.3
Cash		5.5	6.9	19.0	32.8	33.1	25.2	44.5	21.7	23.6	30.2
Current Liabilities		(57.9)	(59.7)	(58.2)	(78.7)	(66.1)	(58.6)	(106.4)	(96.0)	(92.4)	(96.1)
Creditors		(52.7)	(59.5)	(58.1)	(78.5)	(65.9)	(58.6)	(87.0)	(92.5)	(88.9)	(92.6)
Short term borrowings		(5.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.0)	(19.4)	(3.5)	(3.5)	(3.5)
Long Term Liabilities		(18.5)	(21.1)	(17.9)	(22.5)	(18.7)	(21.2)	(41.2)	(42.3)	(42.3)	(42.3)
Long term borrowings		(0.0)	(0.6)	(0.4)	(0.2)	(0.0)	0.0	(8.8)	(7.0)	(7.0)	(7.0)
Other long term liabilities		(18.5)	(20.5)	(17.5)	(22.3)	(18.6)	(21.2)	(32.4)	(35.3)	(35.3)	(35.3)
Net Assets		143.4	140.6	148.2	154.2	169.0	175.0	183.7	184.5	192.7	202.9
CASH FLOW											
Operating Cash Flow		2.1	11.4	24.8	27.4	22.9	18.0	28.0	23.4	28.1	30.6
Net Interest		(0.8)	(0.8)	(0.2)	(0.1)	(0.2)	(0.4)	(0.6)	(0.8)	(0.8)	(0.8)
Tax		0.4	(1.0)	(0.9)	(2.4)	(3.9)	(3.4)	(6.0)	(2.4)	(7.2)	(4.5)
Capex		(1.5)	(1.3)	(4.3)	(5.3)	(5.4)	(6.3)	(6.2)	(6.9)	(7.0)	(7.0)
Acquisitions/disposals		(3.5)	(1.7)	(4.1)	(0.4)	(5.5)	(4.2)	(13.4)	(8.0)	(0.5)	(0.5)
Financing		44.8	0	0	0	0	1.7	0	0	0	0
Dividends		0.0	0.0	(3.0)	(5.1)	(7.5)	(13.4)	(8.9)	(8.9)	(9.1)	(9.5)
Net Cash Flow		41.5	6.7	12.4	14.0	0.4	(8.0)	(7.0)	(3.6)	3.6	8.3
Opening net debt/(cash)		41.2	(0.3)	(6.1)	(18.4)	(32.4)	(32.9)	(25.2)	(16.4)	(11.2)	(13.1)
Finance lease - cash		(0.2)	(0.3)	(0.2)	(0.2)	(0.2)	(0.2)	(1.8)	(1.6)	(1.6)	(1.6)
Other		0.2	(0.6)	0.2	0	0.2	0	(0)	(0)	(0)	(0)
Closing net debt/(cash)		(0.3)	(6.1)	(18.4)	(32.4)	(32.9)	(25.2)	(16.4)	(11.2)	(13.1)	(19.7)
IFRS 16 leases								11.4	10.6	10.6	10.6

Source: Company accounts, Edison Investment Research

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