Severfield

H119 results

Developing in line with expectations

Construction & materials

Well-flagged H119 results contained few surprises with a solid UK performance backed by gathering momentum in the Indian JV. Order book and margin development will continue to be tracked closely; management commentary on this and market developments have been consistently good and existing guidance is unchanged. We believe that Severfield's well-financed, market-leading position will continue to be beneficial and steady growth in earnings and dividends is an attractive proposition for investors.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS** (p)	P/E (x)	Yield** (%)
03/17	262.2	20.3	5.7	2.3	12.6	3.2
03/18**	274.2	24.0	6.5	4.3	11.0	6.0
03/19e	279.2	25.0	6.8	2.8	10.5	3.9
03/20e	285.9	27.3	7.4	3.0	9.7	4.2

Note: *PBT and EPS are normalised, excluding pension net finance costs, intangible amortisation and exceptional items. **FY18 DPS includes a 1.7p special dividend.

UK steady, India growing

Severfield's first half results were comparable to the prior year and slightly ahead overall at the PBT and EPS levels with an 11% increase in the interim dividend declared. Behind the headline numbers, UK revenues grew 9% with stable underlying EBIT margins, while associate operations made a stronger contribution y-o-y. Within this, the Indian JV has clear revenue and order book momentum and capacity expansion there should get underway this year. Severfield ended H119 with £25m net cash.

Pursuing profitable opportunities

While general nervousness regarding the UK economic outlook remains – especially on a short-term view – Severfield's breadth of capabilities is continuing to provide healthy pipeline opportunities. As ever, rigour in project selectivity and execution will determine financial performance; in the context of the wider construction sector its recent record is very good in this regard. Management has flagged a more even split of profitability in FY19 compared to FY18 and existing, pre-results guidance has been maintained. Based on this and H1 performance, we have made no changes to our estimates.

Valuation: Attractive business attributes

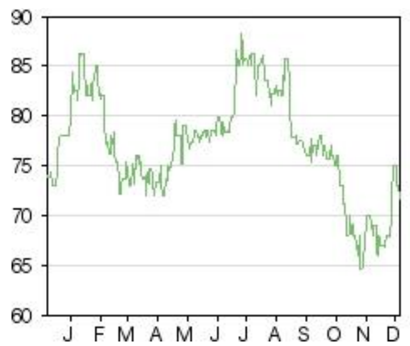
Severfield's share price has traded in a fairly broad 62p to 89.4p range YTD and currently sits right in the middle after rallying from a low in October. It is down slightly more than the FTSE All Share Index since the beginning of the year (-10% versus -9% respectively) and, as our estimates have not changed during 2018, the current year P/E and EV/EBITDA have compressed to 10.5x and 6.4x, respectively. A longer UK order book might benefit sentiment in our view, but the company's record in building margins while retaining a prudent balance sheet position and investing in some higher growth areas, including India, represent sound fundamental reasons to invest.

6 December 2018

Price	**71.6p**
Market cap	**£218m**

Net cash (£m) at end September 2018	25
Shares in issue	303.9m
Free float	100%
Code	SFR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	2.3	(7.7)	(0.6)
Rel (local)	5.3	(0.8)	5.8
52-week high/low		88.2p	64.6p

Business description

Severfield is a leading UK structural steelwork fabricator operating across a broad range of market sectors. An Indian facility currently undertakes structural steelwork projects for the local market and is fully operational.

Next events

H119 DPS 1.0p ex dividend	13 December 2018
H119 DPS to be paid	11 January 2019

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Edison profile page

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H119 results overview

In the context of existing guidance and a flagged more even split to FY19 profitability, H119 results were well framed in advance. In the event, UK operations achieved revenue growth with stable underlying margins. In addition, associate interests (ie the Indian JV and CMF) together contributed c £0.7m to group PBT, versus £0.3m in H118, and Severfield declared an 11% uplift in the interim dividend. The company ended H119 with £25m net cash on the balance sheet.

UK operations: Stable performance, changing order book mix

Exhibit 1: Severfield interim splits

Year end March, £m	H118	H218	FY18	H119	H119 v H118
Group revenue	**137.1**	**137.1**	**274.2**	**149.1**	**8.7%**
Group operating profit – reported	**12.7**	**10.2**	**22.9**	**12.5**	**-1.7%**
Operating margin %	9.3%	7.4%	**8.3%**	8.4%	-90bp
Group operating profit – adjusted*	**13.5**	**11.1**	**24.5**	**12.8**	**-5.5%**
Operating margin – adjusted %*	9.8%	8.1%	**8.9%**	8.6%	-120bp
Order book**	245		**242**	230	

Source: Company, Edison Investment Research. Note: *Reported operating profit is adjusted for share-based payments and estimated pension net finance costs. Neither profit line includes any contribution from JV/associates. **At date of reporting results.

Severfield's order book has settled in the £230–245m range over the past 18 months, down from a large-project intake peak of £315m in November 2016. This did not preclude almost 9% headline revenue progress in the first half of FY19 and we understand this was largely volume driven with pricing considered to have been stable during the period. A 90bp reduction in the headline operating margin catches the eye but adjusting the y-o-y comparator for unusual items (being asset disposal profits and favourable contract completion outcomes, which together contributed c £1.5m), suggests that underlying margins remained stable at around 8.4%.

Although the UK order book has shortened, this reflects project mix (ie more smaller, shorter cycle projects and fewer larger, longer ones) rather than a reduction in demand as such. For example, the value of commercial office work on hand has remained robust due to securing a number of mid-sized and regional jobs as some major schemes (eg 22 Bishopsgate) approach completion. The transport segment saw the largest subsector order increase with several airport and highway bridge contracts. Management maintains that contracted and potential pipeline projects represent high-quality workflows and remains confident that current operating margins are sustainable.

Indian operations: Growing order book supports capacity investment

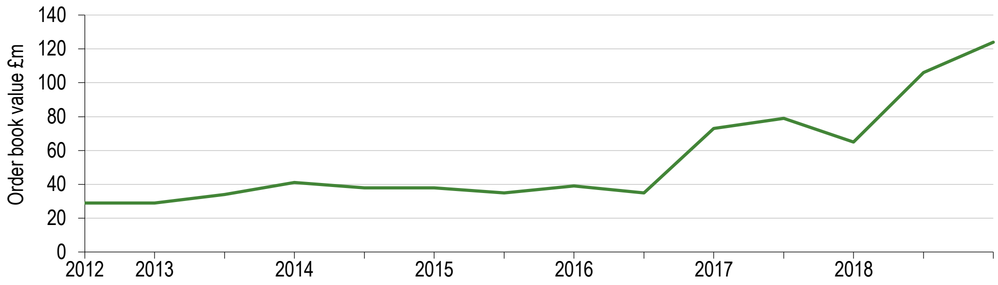
Exhibit 2: Indian JV (JSSL or JSW Severfield Structures) interim splits

Year end March, £m	H118	H218	FY18	H119	H119 v H118
Revenue*	**21.8**	**26.8**	**48.6**	**31.8**	**45.9%**
Operating profit*	**2.0**	**2.5**	**4.5**	**2.2**	**11.0%**
Operating margin %	9.2%	9.3%	**9.3%**	7.0%	-90bp

Source: Company. Note: *Total entity performance. Severfield equity accounts its 50% share of PAT.

As shown in Exhibit 3 below, the Indian JV order book has risen to record levels, standing at £124m at the end of November and this has driven sequential revenue growth in the last two six month periods. Operating profit growth was constrained by the dominance of industrial segment work in the mix, although still rose by 10% y-o-y. The repayment of term debt in July 2017 (partly partner-funded) reduced entity interest costs by £0.7m y-o-y and, after taking tax into account, Severfield's share of PAT rose by £0.3m to £0.4m in H119. The bigger picture appears to include growing acceptance of steel-framed construction methods versus traditional concrete ones, bringing both faster build rates and potentially scope for more iconic building structures. Healthcare/hospitals appear to be a particularly active subsector and new city plans also represent good opportunities.

Exhibit 3: Severfield: Indian JV reported order book development



Source: Company data

The latest order book includes a c 22,000 tonne office steelwork package and this is driving an increasing share of higher-margin commercial work (now up to 30% of the total from 20% previously) although industrial is also clearly growing. A new hall containing two further fabrication lines will add c 30,000 tonnes (or c 50%) to existing capacity at Bellary. The total capital cost of £16m is to be equally funded by equity and debt. Severfield will be injecting its £4m share during the current financial year and construction of the new facility is expected to be complete before the end of FY20.

Generating and deploying cash

Net cash at the end of September stood at c £25m, down from £33m at the beginning of the year (and £31m at the end of H118). Underlying EBITDA was comparable to the prior year at £14.7m but the primary operational difference was a c £10m working cash outflow versus sub £1m in the equivalent H118 period. This was partly explained by an unwinding of c £1.3m advance payments on hand at year-end, although was more driven by a timing and revenue increase-related swing in receivables absorbed c £8m in H119. After a £1m tax payment and c £2m net capex, the net result of these features was a £1m free cash inflow. This, together with existing cash balances, went towards funding c £10m cash dividend payments (split equally between the declared FY18 final and special DPS). After taking into account £1.7m of equity proceeds relating to employee share schemes, the overall net cash outflow approached £8m in the first half.

Cash outlook: we project a partial reversal in working capital performance during H2, subject to the usual project timing caveats. The company is on track to spend up to £7m capex in the current year with ongoing investment in operational efficiency targeted. This sum excludes the £4m Indian JV investment mentioned above, which is also now in our estimates. Hence our anticipated year-end 2019 net cash position of c £31m represents a modest y-o-y reduction. Bearing in mind that the year includes c £5m special dividend payments, capex at 1.6x depreciation and JV expansion funding, it is clear the company is able to both reinvest in the business and provide good returns to shareholders while at the same time maintain a prudent balance sheet funding position.

No change to our guidance or estimates

Management has retained existing FY19 guidance and our estimates for FY19 and beyond are unchanged. We may be slightly conservative on the Indian JV contribution based on current run rates and new capacity feeding in from FY21 depending on ramp up rates following commissioning. Otherwise, we anticipate modest reported operating margin accretion (from 8.3% in FY18 to 9.1% by FY21) on compound revenue growth in the order of 2% across our estimate horizon. In the absence of acquisitions or further special dividend declarations, the group net cash position will have risen to in excess of £50m by the end of FY21, under our estimates.

Exhibit 4: Financial summary

£m	2011	2012	2013	2014	2015	2016	2017	2018	2019e	2020e	2021e
Year end 31 March	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
	12m to Dec	12m to Dec	15m to Mar	12m to Mar	12m to Mar	12m to Mar	12m to Mar	12m to Mar	12m to Mar	12m to Mar	12m to Mar
PROFIT & LOSS											
Revenue	267.8	256.6	318.3	231.3	201.5	239.4	262.2	274.2	279.2	285.9	292.5
Cost of Sales	(246.9)	(268.8)	(330.9)	(217.8)	(186.7)	(219.6)	(236.3)	(244.9)	(249.0)	(253.2)	(258.9)
Gross Profit	20.9	(12.2)	(12.7)	13.5	14.9	19.8	25.9	29.3	30.3	32.7	33.6
EBITDA	19.5	(13.6)	(13.6)	12.0	13.6	18.9	25.7	29.0	30.2	32.9	34.1
Operating Profit - Edison	15.0	(17.7)	(18.6)	8.4	10.0	15.2	22.1	25.4	26.1	28.3	29.0
Net Interest	(1.6)	(1.6)	(2.0)	(0.6)	(0.5)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.1)
Associates	(2.5)	0.2	(0.3)	(3.0)	(0.2)	(0.2)	0.5	0.9	1.1	1.2	1.3
SBP	(0.3)	(0.0)	(0.1)	(0.2)	(0.5)	(1.1)	(2.0)	(2.0)	(2.0)	(2.0)	(2.0)
Intangible Amortisation	(2.7)	(2.7)	(3.5)	(2.7)	(2.6)	(2.6)	(2.6)	(1.3)	0.0	0.0	0.0
Pension Net Finance Costs	(0.5)	(0.5)	(0.6)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Exceptionals	(0.6)	(1.0)	(3.8)	(5.3)	(5.9)	(0.9)	0.8	0.0	0.0	0.0	0.0
Profit Before Tax (norm) - Edison	10.6	(19.1)	(20.9)	4.5	8.8	13.7	20.3	24.0	25.0	27.3	28.1
Profit Before Tax (norm)	10.1	(19.6)	(21.5)	4.0	8.3	13.2	19.8	23.5	24.5	26.8	27.6
Profit Before Tax (FRS 3)	6.8	(23.3)	(28.9)	(4.1)	(0.2)	9.6	18.1	22.2	24.5	26.8	27.6
Tax	(0.9)	3.9	5.7	1.4	0.3	(1.0)	(2.7)	(4.1)	(4.4)	(4.8)	(5.0)
Profit After Tax (norm)	7.7	(16.2)	(17.9)	3.1	7.4	11.4	17.0	19.5	20.6	22.5	23.2
Profit After Tax (FRS 3)	5.8	(19.4)	(23.1)	(2.6)	0.1	8.6	15.3	18.0	20.1	22.0	22.7
Average Number of Shares Outstanding (m)	89.3	89.3	89.3	295.8	297.5	297.5	298.9	299.7	301.7	303.5	303.5
EPS - normalised (p) - Edison	4.51	(9.42)	(10.42)	1.05	2.47	3.84	5.70	6.52	6.83	7.40	7.64
EPS - normalised (p)	4.21	(9.72)	(9.45)	0.88	2.31	3.67	5.53	6.35	6.66	7.24	7.47
EPS - FRS 3 (p)	3.41	(11.33)	(13.49)	(0.89)	0.05	2.89	5.13	6.02	6.66	7.24	7.47
Dividend per share (p)	5.0	1.5	0.8	0.0	0.5	1.5	2.3	4.3	2.8	3.0	3.3
Gross Margin (%)	7.8	-4.8	-4.0	5.8	7.4	8.3	9.9	10.7	10.8	11.4	11.5
EBITDA Margin (%)	7.3	-5.3	-4.3	5.2	6.7	7.9	9.8	10.6	10.8	11.5	11.7
Operating Margin - Edison (%)	5.6	-6.9	-5.8	3.6	4.9	6.4	8.4	9.2	9.3	9.9	9.9
BALANCE SHEET											
Fixed Assets	156.9	155.6	154.9	147.7	145.1	149.3	148.3	154.5	162.6	166.7	170.3
Intangible Assets	72.9	70.4	69.8	64.6	61.8	59.2	56.3	54.8	54.7	54.7	54.7
Tangible Assets	79.6	76.2	76.1	74.1	76.6	77.4	78.9	81.2	83.8	86.2	88.0
Investments	4.4	8.9	8.9	9.0	6.7	12.7	13.1	18.5	24.1	25.8	27.5
Current Assets	100.5	69.8	80.5	72.2	76.3	75.1	107.1	99.2	101.2	114.0	127.1
Stocks	9.1	7.1	8.2	5.8	4.8	5.3	7.8	9.6	10.8	11.0	11.2
Debtors	89.2	61.2	71.6	60.8	64.6	50.7	66.5	56.4	59.1	61.0	62.9
Cash	2.3	1.4	0.7	5.5	6.9	19.0	32.8	33.1	31.3	42.0	53.0
Current Liabilities	(103.6)	(97.0)	(112.5)	(57.9)	(59.7)	(58.2)	(78.7)	(66.1)	(66.4)	(67.8)	(69.1)
Creditors	(70.3)	(66.1)	(70.9)	(52.7)	(59.5)	(58.1)	(78.5)	(65.9)	(66.3)	(67.7)	(69.0)
Short term borrowings	(33.3)	(30.9)	(41.7)	(5.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.1)	(0.1)	(0.1)
Long Term Liabilities	(21.6)	(21.7)	(20.4)	(18.5)	(21.1)	(17.9)	(22.5)	(18.7)	(18.1)	(18.1)	(18.1)
Long term borrowings	(0.3)	(0.3)	(0.2)	(0.0)	(0.6)	(0.4)	(0.2)	(0.0)	0.0	0.0	0.0
Other long term liabilities	(21.3)	(21.4)	(20.2)	(18.5)	(20.5)	(17.5)	(22.3)	(18.6)	(18.1)	(18.1)	(18.1)
Net Assets	132.3	106.6	102.4	143.4	140.6	148.2	154.2	169.0	179.4	194.8	210.2
CASH FLOW											
Operating Cash Flow	(5.4)	12.9	3.1	2.1	11.4	24.8	27.4	22.9	26.0	31.3	32.6
Net Interest	(2.0)	(1.3)	(1.7)	(0.8)	(0.8)	(0.2)	(0.1)	(0.2)	(0.1)	(0.1)	(0.1)
Tax	(3.7)	(2.7)	(2.3)	0.4	(1.0)	(0.9)	(2.4)	(3.9)	(4.6)	(4.4)	(4.8)
Capex	(1.5)	(0.2)	(1.4)	(1.5)	(1.3)	(4.3)	(5.3)	(5.4)	(6.7)	(7.0)	(7.0)
Acquisitions/disposals	(0)	(2)	(3.0)	(3.5)	(1.7)	(4.1)	(0.4)	(5.5)	(4.5)	(0.5)	(0.5)
Financing	0	0	0.0	44.8	0	0	0	0	2	0	0
Dividends	(3.6)	(4.5)	(4.5)	0.0	0.0	(3.0)	(5.1)	(7.5)	(13.4)	(8.6)	(9.3)
Net Cash Flow	(16.3)	1.7	(9.7)	41.5	6.7	12.4	14.0	0.4	(1.7)	10.6	11.0
Opening net debt/(cash)	15.0	31.3	31.3	41.2	(0.3)	(6.1)	(18.4)	(32.4)	(32.9)	(31.2)	(41.8)
HP finance leases initiated	0.0	0.1	0.0	(0.2)	(0.3)	(0.2)	(0.2)	(0.2)	(0.1)	0.0	0.0
Other	(0)	(0)	(0)	0.2	(0.6)	0.2	0	0	0	(0)	0
Closing net debt/(cash)	31.3	29.7	41.2	(0.3)	(6.1)	(18.4)	(32.4)	(32.9)	(31.2)	(41.8)	(52.8)

Source: Severfield accounts, Edison Investment Research

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