EDISON

Low & Bonar

H117 results

Good growth delivered and anticipated

Construction & materials

Good overall progress was achieved in H117 – although market conditions and business unit performance were somewhat mixed – and full year expectations are unchanged. A business strategy of increasing focus on better performing niche markets and margin enhancement is consistent with our double-digit earnings growth expectations. The rating acknowledges this and perhaps anticipates further improvement.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
11/15	362.1	27.4	5.8	2.8	13.8	3.5
11/16	402.2	29.2	6.0	3.0	13.4	3.7
11/17e	440.0	35.4	7.2	3.2	11.1	4.0
11/18e	440.9	39.2	8.0	3.3	10.0	4.1

Note: *PBT and EPS (fully diluted) are normalised, excluding amortisation of acquired intangibles and exceptional items. Excludes disposed grass yarns business.

Good H1 progress

First half results showed a good increase compared to the prior period with reported normalised PBT and normalised EPS both up by more than 20% (10%+ on a constant currency basis). Strong volume growth in Building & Industrial and improved operating efficiencies in Coated Technical Textiles were the primary drivers of underlying performance. Civil Engineering sector prospects appear to be improving though H1 was adversely affected by project timing delays. This also had an impact on net debt, amplifying the seasonal working capital outflow, leaving period end net borrowings at £149m. The 5% interim dividend increase was as expected.

Unchanged guidance

Management expectations for the full year are unchanged, with historic seasonal trading patterns supportive of this outturn. Our own estimates include higher H2 EBIT contributions from all four business units compared to H1 and for them to show a double-digit increase in aggregate over H216. Within the mix, a reduced current year EBIT estimate for Civil Engineering is made up by better contributions elsewhere. The intended disposal of the agro-textiles operations is a further illustration of increased focus on improving margins and returns at both individual business unit and group levels.

Valuation: Factoring in earnings growth

Low & Bonar's share price has risen by c 24% since the beginning of the year but has settled back towards the bottom of its 80-90p trading range seen since the end of April. A good expected uplift in profitability this year reduces the FY17 P/E to 11.1x with an EV/EBITDA (after pension deficit recovery cash) of 7.0x. Taking a three-year view, a 2016-19 EPS CAGR of 12.2% at the current rating equates to a PEG ratio of 1.1x. We interpret this as a market view that achievable growth rates are slightly better than currently assumed. A prospective dividend yield approaching 4% adds to the investment case.

20 July 2017

Price	**80.25p**
Market cap	**£265m**
	€1.11/£
Net debt (£m) at end May 2017	149
Shares in issue	329.4m
Free float	99%
Code	LWB
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(7.8)	(4.8)	34.9
Rel (local)	(6.7)	(8.3)	20.2
52-week high/low		89.8p	60.0p

Business description

Low & Bonar produces specialist performance materials for a variety of end-markets by combining polymers with specialty additives and pigments. It now reports as four global business units: Civil Engineering (23% of FY16 revenue), Building & Industrial (18%), Interiors & Transport (26%), and Coated Technical Textiles (33%).

Next events

H117 DPS ex dividend	25 August 2017
H117 DPS 1.05p paid	22 September 2017

Analysts

Toby Thorrington +44 (0)20 3077 5721

Roger Johnston +44 (0)20 3077 5722

industrials@edisongroup.com

Edison profile page

Low & Bonar is a research client of Edison Investment Research Limited

EDISON

H117 results overview

In variable market conditions, Low & Bonar achieved underlying revenue growth boosted by translation effects on a reported basis. Underlying EBIT showed year-on-year progress despite a net drag from exogenous macro factors (ie favourable FX and adverse input cost movements); better volumes and improved operating efficiencies contributed to this outturn. Working capital outflows were greater than normal during the first half but are expected to unwind during H2. The company continues to invest in capacity, capability and new product development.

Exhibit 1: Low & Bonar interim and divisional splits

£m	H116	H216	FY16	H117	Reported % change	CER % change	Volume % change
Group revenue	**180.6**	**221.6**	**402.2**	**210.3**	**16.4%**	**4.6%**	**3%**
Building & Industrial	31.8	41.6	**73.4**	40.9	28.6%	14.2%	13%
Civil Engineering	39.5	51.3	**90.8**	45.8	15.9%	5.0%	9%
Coated Technical Textiles	60.1	71.9	**132.0**	66.5	10.6%	-0.2%	-6%
Interiors & Transport	49.2	56.8	**106.0**	57.1	16.1%	3.8%	4%
Group EBIT – reported (post SBP)	**13.3**	**21.4**	**34.7**	**15.5**	**16.5%**	**3.3%**	
Building & Industrial	4.5	6.4	**10.9**	6.0	33.3%	17.6%	
Civil Engineering	1.0	`3.2	**4.2**	0.0	-100.0%	-100.0%	
Coated Technical Textiles	3.5	5.2	**8.7**	4.9	40.0%	32.4%	
Interiors & Transport	7.3	9.8	**17.1**	7.9	8.2%	-3.7%	
Unallocated central costs	-3.0	-3.2	**-6.2**	-3.3			

Source: Low & Bonar

Building & Industrial

Technical textiles, mats, composites, systems and screens for a range of applications

Building & Industrial (B&I) was the standout performer, driven by volume progression with building (especially roofing-related) markets in North America and cabin air filtration carrier media both showing healthy year-on-year gains. This gave a slightly more favourable product mix than the prior year and it also achieved some pass through of rising input prices. As a consequence of these features, this business unit overall achieved a 50bp margin increase (to 14.7%). Walflor (acquired in January 2017) contributed £0.4m revenue and £0.1m to EBIT in the period. Agricultural film lines (crop and greenhouse covers) have experienced production problems in recent periods and management has decided to dispose of this business and its Lokeren site. The expected completion date is September so there will be a limited impact on FY17 results; the business generates annualised revenue of c £20m and negligible profitability. Gross proceeds of c €7m/£6.1m (£5.1m net) are to be used to reduce group debt.

Civil Engineering

Geotextiles and construction fibres contributing to groundworks integrity in infrastructure projects

Since acquiring Texiplast in FY13, this business unit has sought to increase its presence in the more technical, project-oriented specification segments but has struggled for momentum in relatively lacklustre markets. Latterly, greater emphasis has been placed on creating closer relationships with customers, specifiers and contractors. Volumes were indeed more encouraging in H1 and enquiries arising from higher-margin specification projects are understood to have been good. However, the phasing of these projects is H2 weighted. In the more competitive transactional or stock lines it has been more difficult to pass through input cost increases and, taken together, this resulted in an adverse product mix in H1 and a break-even reported position. It is anticipated that these effects will reverse in H2 – through both mix and pricing – to generate a better H2 profit performance. That said, the likely full year outturn is probably not up to earlier expectations in our view.

Coated Technical Textiles

Specialist coated woven carrier fabrics for a range of primarily outdoor applications

A reassuringly strong result from Coated Technical Textiles (CTT) confirmed that the regained manufacturing stability seen in H216 was sustained. The slightly counterintuitive combination of lower volume and improved profitability reflected better product mix, some pass through of rising input costs and re-embedded operating efficiencies. Consequently, CTT saw much improved profitability and, including FX translation benefits also, the business unit was a significant contributor to the uplift in underlying group EBIT. A higher proportion of tensile architectural membrane project work should have been beneficial for both manufacturing (ie longer volume runs) and margin. This business unit is still restoring customer goodwill from production problems a year earlier. In the trailer side-curtain market indications are understood to be positive for overall demand and management's expectation is for a continuing recovery in volume in this segment in H2.

Interiors & Transportation

Leading provider of technical non-woven carpet-backing materials, branded as Colback

Revenue rose in line with volume; with mix considered to have been a neutral factor it seems likely that higher input costs were largely absorbed and perhaps partially offset by operating efficiencies, especially in China. The divisional EBIT margin came in at 13.8%; this was 100bp below the prior year and stated as being within a normal, sustainable range. That said, Interiors & Transportation (I&T) has typically reported higher H2 margins and we expect the FY17 level to be above the H117 level. Interiors (ie commercial flooring backing materials) is the dominant sub-segment and in H1 itself demand in North America and China has remained strong. China has also seen rising export sales such that the Changzhou greenfield plant commissioned in H116 is now running at full capacity. Consequently, construction of phase II (a second manufacturing line) is now underway, as previously flagged, and is expected to be commissioned in early 2018. The Transportation sub-segment has been less buoyant; this has been attributed to a combination of marque specific-issues as well as some platform changes though we suspect that underlying European demand has been patchy. Nevertheless, with input cost pressures easing and continuing momentum in Interiors this business unit looks set to again deliver a good H2 profit contribution.

H1 cash outflow expected to reverse in H2

Low & Bonar normally experiences an increase in working capital during its first half trading period, primarily reflecting the pattern of demand in the building and construction markets that it addresses. This effect was apparent again in H117 and to a slightly greater extent than in the prior year. Reported net debt at the end of May was £149m, up from £111m at the end of FY16 (and compared to c £140m a year earlier). Of the £38m increase in H1, the majority reflected underlying cash flow items with just over £2m due to FX translation effects.

At the trading level, the c £3m EBITDA uplift (to £24.7m) was substantially absorbed by c £2m higher working capital outflow (to £27.8m), being the primary components of the c £4m overall operating cash outflow. There was a £2-3m impact on working capital from rising input prices though we believe that the primary difference compared to H116 was due to the pattern of demand for civil engineering projects leading to higher than normal inventory levels in that business unit.

Below this, interest and cash tax outflows together matched the prior year level albeit with a different mix with beneficial debt refinancing (in H216) and rising profit/rising tax effects offsetting each other. As expected, business investment continued at relatively high levels in H1 with I&T's China phase II project boosting capex to £12.8m (vs depreciation £8.0m) and the implementation of a new ERP system (in Europe initially) costing a further £2.2m. M&A transactions (ie the acquisition of Walflor for £2.9m and initial grass yarns disposal proceeds of £1.5m) resulted in a small net cash outflow in the period while rising dividend cash payments reflected previously declared payouts.

Cash outlook: Management's expectation is for net debt to reduce to the 1.8x to 2.0x EBITDA range by the end of FY17 (compared to a company-defined c 2.5x on a trailing 12-month basis at the interim stage). Our model indicates an outturn at the upper end of this range and, in monetary terms, this equates to net debt of c £118m. The major elements of this expected H2 cash inflow are:

- **Seasonal EBIT uptick** – our estimates are consistent with the split of profitability seen in the last two years, with just under 40% coming in H1 and just over 60% in H2. As mentioned before, this H2 bias is most pronounced in B&I and Civil Engineering but is also a feature of I&T profit performance.
- **Seasonal WC inflow** – management has stated that it expects substantially all of the H1 outflow to reverse in H2 with normal trading effects and some project-specific shipments. Our model factors in a full year outflow of £3.5m compared to the £27.8m outflow seen in H1.
- **Ongoing investment** – as referenced above, the construction and equipment cost of the second phase of Low & Bonar's Changzhou facility will substantially fall into H217 and the roll-out of the company's new ERP system will be ongoing. Consequently, we assume that total FY17 fixed investment will be £35m (unchanged), split c £31m capex and c £4m on intangibles. This requires a c £20m capital outlay in H2.

Taking account of all items (including pension deficit recovery cash in line with the prior year) we anticipate that Low & Bonar will be broadly free cash flow neutral overall in FY17. Below this, c £10m dividend payments will be substantially offset by net M&A proceeds (ie c £3m Walflor consideration less proceeds from grass yarns of £3m and Lokeren/agro-textiles £5.1m net) to leave a small underlying outflow for the year overall. Further out, we are currently projecting c £19m free cash generation in each of the following two years or c £8m at the net level, suggesting a modest rate of net debt reduction. Management is understood to be actively considering potential acquisitions; any new transactions will need to be incorporated into the above cash flow profile.

FY17 guidance unchanged

Management outlook comments accompanying H1 results pointed to similar market conditions (and 'no sustained pick-up') but reiterated previous group level guidance with benefits to come from internal actions taken. These include manufacturing efficiencies, new product introductions and the successful pass-through of higher year-on-year input prices. Given the range of markets and geographies that Low & Bonar's operating companies are exposed to, we interpret this as being mildly supportive overall with a range of outcomes at individual business unit level.

Our estimates have been adjusted for a slightly different mix of profit contributions with enhanced B&I and CTT offset by lowered Civil Engineering expectations in FY17. In subsequent years, we have taken out c £20m of annualised revenue from our B&I revenue projections (to reflect the agro-textiles disposal) with no impact on profitability. Clearly, this has a beneficial impact on group and business unit margins. In all other respects, we have made no substantive changes and headline PBT is unchanged.

Exhibit 2: Low & Bonar estimate revisions

	EPS FD normalised (p)			PBT normalised (£m)			EBITDA (£m)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2017e	7.3	7.2	-1.4%	35.4	35.4	---	59.1	59.4	+0.5%
2018e	8.1	8.0	-1.2%	39.2	39.2	---	63.9	64.2	+0.5%
2019e	8.5	8.4	-1.2%	41.2	41.2	---	66.7	67.0	+0.4%

Source: Edison Investment Research

Note there has been a small increase in the number of share in issue.

Exhibit 3: Financial summary

£m	2014	2015	2015	2016	2017e	2018e	2019e
Year end 30 November	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS	**IAS19R**	**IAS19R**	**Restated IAS19R**	**IAS19R**	**IAS19R**	**IAS19R**	**IAS19R**
Revenue	410.6	395.8	362.1	402.2	440.0	440.9	456.3
Cost of Sales	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Gross Profit	N/A	N/A	N/A	N/A	N/A	N/A	N/A
EBITDA	45.6	46.9	46.0	52.8	59.4	64.2	67.0
Operating Profit (ex SBP)	32.3	33.4	32.5	35.6	41.2	45.0	46.8
Net Interest	(5.0)	(4.2)	(4.3)	(5.4)	(4.5)	(4.5)	(4.3)
SBP	(0.6)	(0.6)	(0.6)	(0.9)	(1.2)	(1.2)	(1.2)
Saudi JV	(1.1)	(1.8)	0.0	0.0	0.0	0.0	0.0
PNFC	(0.4)	(0.2)	(0.2)	(0.1)	(0.1)	(0.1)	(0.1)
Profit Before Tax (company norm)	25.2	26.5	27.4	29.2	35.4	39.2	41.2
Intangible Amortisation	(5.2)	(4.1)	(4.1)	(4.0)	(4.0)	(4.0)	(4.0)
Exceptionals	(3.3)	(10.1)	(1.9)	0.7	(11)	0	0
Profit Before Tax (FRS 3)	16.7	12.4	21.4	25.9	20.8	35.2	37.2
Tax	(4.9)	(6.3)	(6.2)	(8.2)	(10.2)	(11.8)	(12.4)
Minorities	(0.3)	(0.5)	(0.5)	(0.6)	(0.6)	(0.6)	(0.6)
Other			(9.0)	(3.2)			
Profit After Tax (norm)	18.3	18.6	19.0	19.9	24.2	26.9	28.3
Profit After Tax (FRS 3)	11.8	6.1	5.7	13.9	10.0	22.8	24.2
Average number of shares outstanding (m)	327.0	328.1	328.1	329.0	329.3	329.3	329.3
EPS FD – normalised (p)	5.4	5.5	5.8	6.0	7.2	8.0	8.4
EPS – FRS 3 (p)	3.5	1.7	1.7	5.2	3.0	6.9	7.3
Dividend per share (p)	2.7	2.8	2.8	3.0	3.2	3.3	3.5
Gross Margin (%)							
EBITDA Margin (%)	11.1	11.8	11.8	13.1	13.5	14.6	14.7
Operating Margin (before amort. and except) (%)	7.9	8.4	8.4	8.9	9.4	10.2	10.2
BALANCE SHEET							
Fixed Assets	230.2	232.0		261.2	266.1	272.1	275.1
Intangible Assets	105.8	89.9		104.8	110.5	109.5	106.5
Tangible Assets	119.3	132.0		150.3	149.0	156.0	162.0
Investments	5.1	10.1		6.1	6.6	6.6	6.6
Current Assets	192.0	187.6		202.9	212.2	217.4	228.4
Stocks	90.9	82.6		97.5	99.2	97.4	98.8
Debtors	62.8	62.9		70.3	75.0	74.1	75.7
Other	12.5	8.2		8.7	10.3	10.3	10.3
Cash	25.8	33.9		26.3	27.7	35.6	43.7
Current Liabilities	(87.7)	(114.4)		(88.9)	(97.5)	(100.3)	(105.6)
Creditors	(87.7)	(82.9)		(88.8)	(97.3)	(100.3)	(105.6)
Short term borrowings	0.0	(31.5)		(0.1)	(0.2)	0.0	0.0
Long Term Liabilities	(147.6)	(133.3)		(171.5)	(175.2)	(170.7)	(166.2)
Long term borrowings	(113.8)	(104.5)		(137.2)	(146.0)	(146.0)	(146.0)
Other long term liabilities	(33.8)	(28.7)		(34.3)	(29.2)	(24.7)	(20.2)
Net Assets	186.9	171.9		203.6	205.6	218.5	231.8
CASH FLOW							
Operating Cash Flow	34.1	35.3		33.9	50.7	63.4	62.3
Net Interest	(4.5)	(4.5)		(4.9)	(4.5)	(4.5)	(4.3)
Tax	(7.7)	(7.5)		(10.8)	(10.7)	(11.8)	(12.4)
Capex	(20.2)	(33.7)		(22.2)	(35.0)	(28.0)	(26.0)
Acquisitions/disposals	3.0	0.0		21.7	5.1	(0.5)	0.0
Financing	0	(1)		(0)	(1)	0	0
Dividends	(8.8)	(9.0)		(9.2)	(10.1)	(10.5)	(11.5)
Net Cash Flow	(4.0)	(20.2)		8.4	(5.1)	8.1	8.1
Opening net debt/(cash)	86.8	88.0		102.1	111.0	118.5	110.4
HP finance leases initiated	0.0	0.0		0.0	0.0	0.0	0.0
Other	2.8	6.1		(17.3)	(2.4)	0.0	0.0
Closing net debt/(cash)	88.0	102.1		111.0	118.5	110.4	102.3

Source: Low & Bonar accounts, Edison Investment Research

EDISON

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
295 Madison Avenue, 18th Floor
New York, NY10017
US

Sydney +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia