EDISON

Epwin Group

FY17 results

Doing a decent job in tough markets

Construction & materials

FY17 was a difficult trading year for Epwin – and some effects flow into this financial year – but management has stuck resolutely to a business improvement programme from which the benefits should also be progressively felt. Slightly lower estimates and a reduced prospective near-term dividend payout are our interpretation of the latest newsflow. As before, Epwin does have the financial flexibility to enhance earnings prospects via acquisitions, which may refocus investor attention back on to low current earnings multiples.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/16**	293.2	24.3	14.7	6.6	5.7	7.9
12/17**	298.3	20.5	12.4	6.7	6.8	8.0
12/18e	282.6	18.1	10.3	5.3	8.1	6.3
12/19e	285.8	19.1	10.9	5.5	7.7	6.5

Note: *PBT and EPS (fully diluted) are normalised, excluding intangible amortisation and exceptionals. ** FY16 and FY17 EPS benefited in part from recovered tax losses.

Lower profitability, but some operational progress

On a normalised basis, FY17 PBT came in 14.2% lower y-o-y with EPS fully diluted -10.1% and DPS +1.4%. Compared to our expectations, this outturn was slightly better at the EPS (due to a lower underlying tax charge) and DPS levels. Market conditions have been well flagged, as have specific customer issues that added to management challenges during the year. An existing programme of site consolidation and operational improvement continued. Trading highlights included progress from most of the Extrusion & Moulding divisional product lines and a post-consolidation improvement in the Epwin Glass performance. Year-end net debt was broadly as expected – with increased working capital and exceptional cash items – and the company remains conservatively geared, in our view.

Tough markets, dividends rebased

Market conditions are not expected to change materially in 2018 or 2019, with some growth segments (in newbuild) probably more than offset by ongoing weakness in secondary demand for building products. Epwin should see some benefit from the footprint actions taken to date, although the annualised customer effects referred to above will also be washing through. We have elected to trim margin expectations slightly in both divisions based on higher input costs at the beginning of the year. The re-framed c 2x dividend cover policy implies c 20% reductions in dividends compared to our previous expectations and this is now reflected in our model.

Valuation: Near-term yield attraction dominates

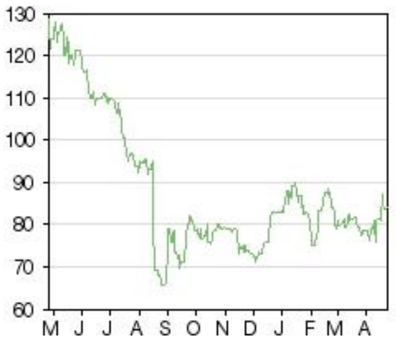
The 4.46p final dividend alone represents a 5.3% yield. While our future dividend expectations have been reduced, the prospective FY18 yield is still 6.3%. In terms of earnings multiples, the current year P/E and EV/EBITDA of 8.1x and 5.1x, respectively, are low by conventional standards. A period of trading stability will help to restore investor confidence in the earnings outlook once the immediate income attraction on the FY17 final dividend has passed.

24 April 2018

Price	**83.9p**
Market cap	**£120m**

Net debt (£m) at end-December 2017	25.1
Shares in issue	142.9m
Free float	67%
Code	EPWN
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	5.5	(0.7)	(30.1)
Rel (local)	(0.9)	3.3	(32.9)
52-week high/low		128.5p	65.5p

Business description

Epwin supplies functional low-maintenance exterior building products (including windows, doors, roofline and rainwater goods) into a number of UK market segments and is a modest exporter. It has a vertically integrated model in windows and doors and a leading market position in roofline products.

Next events

FY17 final DPS 4.46p ex dividend	10 May 2018
AGM	22 May 2018
FY17 final DPS paid	4 June 2018

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Edison profile page

Epwin Group is a research client of Edison Investment Research Limited

FY17 results overview

The financial performance in FY17 was primarily affected by rising input costs. A change of ownership at two significant customers and soft market conditions were also unhelpful. Broadly flat revenues and mitigated EBIT reduction through consolidation and cost-saving activities was a reasonable outturn in these circumstances. We have modestly reduced our estimates for FY18 and FY19; under a revised dividend policy, this implies a c 20% reduction in dividend declarations compared to our previous FY18 and FY19 expectations. That said, Epwin has financial headroom to make further acquisitions to boost earnings and dividend prospects.

Exhibit 1: Epwin Group divisional and interim splits

Year-end December (£m)	H1	H2	2016	H1	H2	2017	% chg y-o-y		
							H117	H217	FY17
Group revenue	**143.3**	**149.9**	**293.2**	**149.9**	**148.4**	**298.3**	**4.6%**	**(1.0%)**	**(1.8%)**
Extrusion & Moulding	90.5	91.4	**181.9**	91.5	92.1	**183.6**	1.1%	0.8%	**0.9%**
Fabrication & Distribution	52.8	58.4	**111.3**	58.4	56.3	**114.7**	10.6%	(3.7%)	**3.1%**
Group operating profit	**11.8**	**13.8**	**25.6**	**11.1**	**11.2**	**22.3**	**(5.9%)**	**(18.5%)**	**(12.7%)**
Extrusion & Moulding	11.6	12.9	**24.5**	10.9	10.6	**21.5**	(6.0%)	(17.5%)	**(12.1%)**
Fabrication & Distribution	1.1	1.8	**2.9**	1.1	1.3	**2.4**	0.0%	(27.8%)	**(17.2%)**
Group costs	(0.9)	(0.9)	**(1.8)**	(0.9)	(0.7)	**(1.6)**			

Source: Company, Edison Investment Research

Extrusion & Moulding (E&M): primarily PVC-based window profile systems, roofline and rainwater goods extrusion activities, with wood composite decking products and glass reinforced plastic building products also in the portfolio.

E&M's FY17 revenues were slightly above the prior year but operating margin experienced a 170bp reduction in the year (to 11.7%), including a 260bp reduction in the seasonally important H2 trading period. Input cost price inflation affected both metrics, contributing c £1.5m to top-line growth, but was this was only a partial pass through to customers of the underlying increase. In this regard lags are common (in both rising and falling price environments), but we believe that competitive markets also made for a challenging customer pricing environment. In addition, SIG's disposal of its 66 depot building plastics distribution business to vertically integrated competitor GAP Plastics (46-depot, pre-deal network) has resulted in a lower rate of product sales to a previously important customer. The main casualty appeared to be roofline extrusion (volumes -2% y-o-y). Taking this into account and noting increased volumes in other categories (eg decking +16%, rainwater/drainage +9% and window systems +4%), underlying activity showed signs of good progress in rather flat overall markets. Within window systems, the relatively new Profile 22 Optima line appears to have been well received with volumes up 10% y-o-y; implicitly, other window systems lines were flat overall and we believe that this was due to some impact from lower sales to Entu (see below). Stormking's trading performance is understood to have been comparable to the prior year. During the year, E&M moved to an enhanced warehouse facility at Scunthorpe and began the relocation of lines at Macclesfield into other group facilities which, when complete, will consolidate extrusion activities on to three sites (ie Telford, Scunthorpe and Tamworth). Further warehousing consolidation in Telford is planned for FY18/FY19.

Fabrication & Distribution (F&D): downstream manufacture of glass sealed units and finished windows and doors (using profiles from E&M) and multi-channel B2B distribution – including own branches – of these and other group finished products.

Full-year effects from the acquisition of National Plastics (in June 2016) benefited reported F&D results. We estimate that this added an incremental £6.2m revenue and £0.2m operating profit (obviously with a more pronounced H1 benefit, supporting divisional revenue +10.6%, EBIT flat). On this basis, underlying FY17 revenues declined by c 3% and EBIT by c 21%, respectively, versus reported +3.1% and -17.2%, respectively.

Revenue from fabrication activities fell by 4% y-o-y as a result of two unrelated factors. Weaker glazed sealed unit trading in H1 led to the consolidation of production and increased market focus during Q3. Sales of window frames from Indigo Product's Walsall fabrication facility to Entu, its leading customer, were disrupted in the run up to Entu's Q3 administration and sale process. As reported in December, Indigo was sold to Kairos (the new owners of some of the Entu businesses) and a new three-year window profile supply agreement was put into place alongside the transaction. In terms of profitability, including exceptional items Indigo incurred a £2.7m pre-tax loss in the year, which included a small trading profit. We believe that the financial performance of Epwin Glass was much improved in H2.

Underlying distribution revenue rose by c 3% overall in the year and so, implicitly, was slightly lower y-o-y in underlying terms (ie excluding National Plastics). We have already referred to competitive market conditions in this channel in the E&M section due to a combination of soft demand, rising input prices and pricing behaviour across a very fragmented independent distributor industry spectrum. Epwin has been selectively expanding here in order to sustain a strong presence for its products in a changing environment. The post-year-end acquisition of Amicus Building Plastics (15 branches, broadening regional coverage) takes the total number of owned trade outlets to c 80, adding to the c 30 brought in by National Plastics.

Net debt up; gearing levels modest and expected to reduce

Year-end net debt was £1m lower than we had anticipated at £25.1m, but increased £4.5m y-o-y. In summary, this increase was similar to but slightly higher than deferred cash consideration for acquisitions, although there were a number of differences compared to prior year performances, which we discuss below.

We have already noted the decline in operating profit in earlier sections and corresponding EBITDA was £3m lower y-o-y at £30.3m. In keeping with most companies in the UK building materials space, Epwin has a seasonal trading pattern, with the middle two quarters of the year typically being the largest. In prior years, Epwin's working capital profile has seen a material H1 working capital outflow substantially reversing in H2. This effect was not seen in FY17, with a much lower second-half receivables flow back resulting in a £5.6m working capital outflow for the year overall. Coupled with a net c £3.5m+ cash outflow relating to exceptional items (ie relocation and redundancy costs), group operating cash flow was £19.9m versus the c £31m achieved in FY16.

With similar average net debt, cash interest costs were in line with the prior year at £1m while cash tax payments were lower at £2.7m, consistent with the underlying tax charge in the year. Following the development and introduction of the new Profile 22 Optima window system over the previous two years (aggregate capital cost c £9.5m, including c £5m in FY16), capex stepped down to similar underlying levels to FY17 at £7.1m. Just over half of this represented maintenance capex spend and c 10% on intangibles, relating to IT systems. In the event, total capex was below the level that we had anticipated and, taking all of the above items into account, free cash flow (FCF) for the year came in at just over £9m. Hence, the committed £9.5m cash dividend payment (ie FY16 final and H117 interim) and £3.9m deferred acquisition payments (for Ecodeck and Stormking, seen in the first half), drove the full-year cash movement noted at the beginning of this section.

Cash flow outlook: net debt of £25.1m represented 0.8x FY17 EBITDA, while gross debt of c £32m was well within year-end banking arrangements (being a £35m RCF, £15m amortising term loan and £5m overdraft facility, all out to December 2019). On our revised estimates (see below), FCF is little changed at £15m or above in each of our forecast years. Given that more strategic site consolidation moves have been flagged – to include certain window and door fabrication and warehousing operations – our £0.5m expected exceptional cash outflow could possibly be exceeded. We have included a £0.5m cash cost related to the post year-end acquisition of Amicus Building Products. We discuss the prospective profile of dividend payments below Exhibit 2; based on our new earnings estimates and 2x dividend cover guidance cash dividends are currently set to step down in FY19 and allow Epwin to have only modest gearing by the end of FY20.

Similar market themes, slightly reduced estimates

Continuing recent market themes, the latest Construction Product Association forecasts project subdued repair, maintain and improvement spending and low single-digit growth in newbuild starts (for both private and social sectors) over the next two years. Epwin management has flagged higher virgin PVC costs at the beginning of 2018 and an intention to pass these through to customers, albeit with a lag.

Taking these market comments and reported FY17 performance into account, we have trimmed our divisional profit expectations slightly on modestly higher revenues. We have included small expected contributions from Amicus within these headline movements, so our underlying profit reduction is a little understated compared to the figures in Exhibit 2 (on broadly flat revenues).

Exhibit 2: Epwin Group revised estimates

	EPS (p)			PBT (£m)			EBITDA (£m)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2017	11.9	12.4	3.7%	20.8	20.5	(1.4%)	30.6	30.3	(1.0%)
2018e	10.5	10.3	(2.0%)	18.8	18.1	(3.7%)	28.5	27.8	(2.5%)
2019e	11.2	10.9	(2.8%)	19.7	19.1	(3.3%)	29.5	28.9	(2.2%)
2020e	N/A	11.3	N/A	N/A	19.7	N/A	N/A	29.6	N/A

Source: Epwin accounts, Edison Investment Research. Note: PBT and EPS (fully diluted) are normalised. Normalised excludes amortisation of acquired intangibles and exceptionals. 2017 old = expected, new = actual.

Dividends policy amended: following a board review, a revised dividend policy is now in place, which is ‘progressive, while being approximately twice covered by earnings’. On our new estimates, this implies a rebasing to levels c 20% below our previous estimates. Up until the end of Q317, our DPS projections were almost twice covered but the September update reduced prospective cover to around 1.6x.

Our rebased dividends only have a modest cash impact in FY18 (as it includes the FY17 final) but knocks just over £2m pa compared to our previous estimates thereafter. Therefore, while we can understand the move it does not significantly change the balance sheet funding position – which was already conservative – over the next couple of years, in our view.

We note that Epwin’s year-end balance sheet gross debt duration had shortened (ie with £21m current and £11.4m under longer liabilities). Any prospective review of banking facilities – due to expire in December 2019, as noted above – will be closely linked to discretionary capital allocation decisions including growth capex, dividends and expected acquisition activity over the short and medium terms. It seems reasonable to expect greater clarity on intentions here to emerge over the next six to 12 months. So, while our ‘as presented’ estimates indicate a lower dividend y-o-y in FY18, any acquisition(s) could of course boost earnings.

Exhibit 3: Financial summary

£m's	2012	2013	2014	2015	2016	2017	2018e	2019e	2020e
December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS		**Restated**							
Revenue	294.4	255.3	259.5	256.0	293.2	298.3	282.6	285.8	289.8
Cost of Sales	(209.9)	(185.8)	(186.7)	(178.6)	(200.6)	(207.5)	(197.2)	(199.5)	(202.3)
Gross Profit	84.5	69.5	72.8	77.4	92.6	90.8	85.3	86.3	87.5
EBITDA	21.8	21.4	24.5	25.6	33.3	30.3	27.8	28.9	29.6
Operating Profit (before GW and except.)	15.4	15.6	19.5	20.1	25.6	22.3	19.6	20.4	20.8
Intangible Amortisation	(1.7)	(1.7)	(1.7)	(0.0)	(1.1)	(1.1)	(1.1)	(1.1)	(1.1)
Exceptionals	(4.3)	(5.1)	2.3	(0.6)	(0.2)	(7.4)	0.0	0.0	0.0
Other	0.0	0.0	(0.8)	(0.4)	(0.3)	(0.6)	(0.3)	(0.3)	(0.3)
Operating Profit	9.4	8.8	19.3	19.1	24.0	13.2	18.2	19.0	19.4
Net Interest	(1.9)	(1.0)	(0.7)	(0.5)	(1.0)	(1.2)	(1.2)	(1.0)	(0.8)
Profit Before Tax (norm)	13.5	14.6	18.0	19.2	24.3	20.5	18.1	19.1	19.7
Profit Before Tax (FRS 3)	7.5	7.9	18.6	18.6	23.0	12.0	17.0	18.0	18.6
Tax	(2.2)	(1.3)	(3.5)	(3.3)	(3.4)	(1.9)	(3.3)	(3.4)	(3.5)
Profit After Tax (norm)	10.4	12.4	14.4	15.9	20.9	17.6	14.8	15.6	16.2
Profit After Tax (FRS 3)	4.5	5.1	15.1	15.3	19.6	10.1	13.7	14.5	15.1
Average Number of Shares Outstanding (m)	122.3	122.3	128.0	135.2	141.5	142.6	143.2	143.2	143.2
EPS - normalised (p)	8.5	10.1	11.2	11.8	14.8	12.4	10.3	10.9	11.3
EPS - normalised (p) FD			11.2	11.7	14.7	12.4	10.3	10.9	11.3
EPS - FRS 3 (p)	3.7	4.2	11.8	11.3	13.8	7.1	9.6	10.1	10.5
Dividend per share (p)	0.0	0.0	4.2	6.4	6.6	6.7	5.3	5.5	5.7
Gross Margin (%)	28.7	27.2	28.1	30.2	31.6	30.4	30.2	30.2	30.2
EBITDA Margin (%)	7.4	8.4	9.4	10.0	11.3	10.2	9.8	10.1	10.2
Operating Margin (before GW and except.) (%)	5.2	6.1	7.5	7.9	8.7	7.5	6.9	7.1	7.2
BALANCE SHEET									
Fixed Assets	56.9	54.7	53.8	93.5	108.5	106.2	105.1	103.8	102.2
Intangible Assets	27.9	26.4	24.7	59.7	70.2	69.6	68.5	67.4	66.3
Tangible Assets	26.1	25.1	26.2	33.1	37.9	36.0	36.0	35.8	35.3
Other	2.8	3.2	2.9	0.7	0.4	0.6	0.6	0.6	0.6
Current Assets	59.9	62.1	62.3	87.2	82.6	82.2	81.6	82.4	83.4
Stocks	20.9	21.7	22.4	23.6	28.2	29.6	30.1	30.5	30.9
Debtors	37.4	40.1	37.6	41.5	41.4	45.3	44.2	44.6	45.2
Cash	1.6	0.3	2.3	22.1	13.0	7.3	7.3	7.3	7.3
Current Liabilities	(53.2)	(54.5)	(49.0)	(68.8)	(79.2)	(79.2)	(78.0)	(75.6)	(69.1)
Creditors	(49.1)	(51.5)	(48.6)	(53.2)	(62.9)	(58.2)	(54.4)	(54.9)	(55.9)
Short term borrowings	(4.1)	(3.0)	(0.4)	(15.6)	(16.3)	(21.0)	(23.6)	(20.7)	(13.2)
Long Term Liabilities	(32.0)	(25.7)	(4.3)	(31.8)	(21.0)	(15.5)	(10.5)	(5.5)	(4.1)
Long term borrowings	(20.6)	(16.0)	(0.8)	(20.9)	(17.3)	(11.4)	(6.4)	(1.4)	0.0
Other long term liabilities	(11.4)	(9.7)	(3.5)	(10.9)	(3.7)	(4.1)	(4.1)	(4.1)	(4.1)
Net Assets	31.5	36.6	62.8	80.1	90.9	93.7	98.2	105.1	112.3
CASH FLOW									
Operating Cash Flow	15.7	12.1	19.8	23.8	30.8	19.9	24.6	28.0	29.1
Net Interest	(1.4)	(0.9)	(0.7)	(0.5)	(1.0)	(1.0)	(1.2)	(1.0)	(0.8)
Tax	(1.6)	(0.9)	(1.7)	(2.3)	(3.8)	(2.7)	(2.8)	(2.9)	(3.0)
Capex	(4.6)	(4.9)	(5.6)	(9.0)	(12.7)	(7.1)	(8.5)	(8.5)	(8.5)
Acquisitions/disposals	(28.2)	(0.2)	0.0	(20.9)	(10.2)	(3.9)	(0.5)	0.0	0.0
Financing	0.0	0.0	10.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividends	0.0	0.0	(1.9)	(6.7)	(9.1)	(9.5)	(9.3)	(7.6)	(7.9)
Net Cash Flow	(20.2)	5.2	19.9	(15.6)	(6.1)	(4.3)	2.4	7.9	8.9
Opening net debt/(cash)	0.5	23.2	18.7	(1.1)	14.4	20.6	25.1	22.7	14.8
HP finance leases initiated	(2.5)	(0.5)	(0.3)	0.4	1.9	(1.4)	0.0	0.0	0.0
Other	0.0	(0.1)	0.2	(0.3)	(2.1)	1.2	0.0	(0.0)	0.0
Closing net debt/(cash)	23.2	18.6	(1.1)	14.4	20.6	25.1	22.7	14.8	5.9

Source: Epwin accounts, Edison Investment Research. Note: FY13 to FY16 EPS benefited in part from recovered tax losses.

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