

FORTERRA

BUILDING MATERIALS

11 March 2022

FORT.L

223p

Market Cap: £504.2m

SHARE PRICE (p)



12m high/low

316p/209p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£40.9m (at 31/12/21)
Enterprise value	£463.3m
Index/market	LSE
Next news	AGM, 24 May
Shares in Issue (m)	226.6
Chairman	Justin Atkinson
Chief Executive	Stephen Harrison
Finance Director	Ben Guyatt

COMPANY DESCRIPTION

UK's second largest brick maker, inc. high margin 'Fletton'; also leading manufacturer of concrete building products

forterrapl.co.uk

FORTERRA IS A RESEARCH CLIENT OF
PROGRESSIVE

ANALYSTS

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FY results 'beat' with ambitious growth plans

Brick and concrete products manufacturer Forterra has delivered FY2021 results slightly ahead of our and market expectations, with a 27% rise in revenue to £370m and an 86% increase in adjusted EBITDA to £70.4m (vs our £67.5m). The FY2021 dividend of 9.9p was also ahead of our forecast of 9.2p, supported by net cash of £41m. FY2022E has started well, with market conditions "remaining highly supportive" amid continuing demand for housing and construction. We introduce FY2022E forecasts that assume further growth, to be accelerated by the new Desford plant.

- Profitability ahead of expectations.** Revenue was just ahead of our £366m estimate, but EBITDA came in 4.3% above our forecast – with both Brick & Block and Bespoke Products divisions ahead of expectations – and 2.2% above consensus of £68.9m. Adjusted PBT rose from £17.4m to £50.7m. This was despite H2 cost inflation not being fully recovered relative to FY2019. Brick volumes were 1% ahead of pre-pandemic 2019. Pre-IFRS 16 net cash was £40.9m.
- Forecasts for 2022E introduced.** We have introduced forecasts for FY2022E. These assume further revenue growth of 21% to £450m and 14% in EBITDA to £79.9m. Pre-IFRS 16 net debt goes to £54m with capex and buybacks. We have started on a possibly over-conservative footing regarding margins, due to current uncertainties. However, the group points out that c.70% of FY2022E energy use has been hedged and that selling price increases leave business well-placed to recover cost inflation.
- Further progress ahead.** Looking beyond FY2022E, the group has outlined further growth projections. The Desford plant, on track for commissioning at the end of this year, is now expected to deliver an enhanced 22% increase in group brick production. It has announced a highly cost-effective £12m investment to manufacture clay brick slips at Accrington. (We believe slips – narrow bricks for surfacing – will be greatly in demand due to offsite construction.) And the group has secured a 15-year agreement for 70% of its electricity requirement from a dedicated Forterra solar farm, securing costs and buttressing its 'ESG' credentials.
- Strongly positioned.** The group's attractions, in our view, include: brick being used by most housebuilders; long-term growth prospects for housebuilding and other end markets; a consolidated brick industry; and its highly efficient operations and record of cash generation (page 6)

FYE DEC (£M)	2018	2019	2020	2021	2022E
Revenue	367.5	380.0	291.9	370.4	449.7
Adj EBITDA	78.8	82.7	37.9	70.4	79.9
Fully Adj PBT	64.8	62.5	17.4	50.7	60.2
Fully Adj EPS (p)	26.1	25.4	6.6	17.3	20.7
Dividend per share (p)	10.5	11.5	2.8	9.9	11.5
PER (x)	8.5x	8.8x	33.7x	12.9x	10.7x
EV/EBITDA (x)	5.9x	5.6x	12.2x	6.6x	5.8x

Source: Company Information and Progressive Equity Research estimates.

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Please refer to important disclosures at the end of the document.

Figure 1: Divisional performance

Year-end December (£m)	2016	2017	2018	2019	2020	2021	2022E
Revenue							
Bricks & Blocks	221.3	249.5	277.5	279.1	223.1	298.1	371.7
<i>Change (%)</i>	1.5%	12.7%	11.2%	0.6%	-20.1%	33.6%	24.7%
Bespoke Products	74.8	83.6	92.2	103.5	71.7	76.1	81.8
<i>Change (%)</i>	1.4%	11.8%	10.3%	12.3%	-33.0%	6.1%	7.5%
Intersegment	(1.6)	(2.1)	(2.2)	(2.6)	(2.9)	(3.8)	(3.9)
Group revenue	294.5	331.0	367.5	380.0	291.9	370.4	449.7
<i>Change (%)</i>	1.5%	12.4%	11.0%	3.4%	-23.2%	26.9%	21.4%
EBITDA							
Bricks & Blocks	63.6	69.1	75.8	80.4	40.3	70.5	79.9
<i>Margin (%)</i>	28.7%	27.7%	27.3%	28.8%	18.1%	23.6%	21.5%
Bespoke Products	7.0	6.3	3.0	2.3	(2.4)	(0.1)	-
<i>Margin (%)</i>	9.4%	7.5%	3.3%	2.2%	-3.3%	-0.1%	0.0%
EBITDA	70.6	75.4	78.8	82.7	37.9	70.4	79.9
<i>Margin (%)</i>	24.0%	22.8%	21.4%	21.8%	13.0%	19.0%	17.8%
Depreciation & amort.	(10.4)	(10.9)	(11.7)	(17.7)	(17.1)	(16.4)	(17.2)
EBIT, pre-exc	60.2	64.5	67.1	65.0	20.8	54.0	62.7
<i>Margin (%)</i>	20.4%	19.5%	18.3%	17.1%	7.1%	14.6%	13.9%
Exceptionals	(8.9)	(1.8)	-	(4.3)	(22.8)	6.1	-
Net interest	(14.2)	(3.4)	(2.3)	(2.5)	(3.4)	(3.3)	(2.5)
PBT, reported	37.1	59.3	64.8	58.2	(5.4)	56.8	60.2
PBT, pre-exc	54.3	61.1	64.8	62.5	17.4	50.7	60.2

Source: Company Information and Progressive Equity Research estimates.

Figure 2: P&L and per share data

Year-end December (£m)	2016	2017	2018	2019	2020	2021	2022E
Group revenue	294.5	331.0	367.5	380.0	291.9	370.4	449.7
Gross profit	119.3	134.2	137.3	136.2	66.1	129.7	135.8
Operating expenses	(59.1)	(69.7)	(70.2)	(71.2)	(41.9)	(69.6)	(73.1)
Group operating profit	60.2	64.5	67.1	65.0	20.8	54.0	62.7
Exceptionals	(8.9)	(1.8)	-	(4.3)	(22.8)	6.1	-
Interest	(14.2)	(3.4)	(2.3)	(2.5)	(3.4)	(3.3)	(2.5)
PBT, reported	37.1	59.3	64.8	58.2	(5.4)	56.8	60.2
Reported tax	(9.6)	(11.8)	(12.0)	(11.4)	(0.2)	(11.3)	(12.8)
Net attrib. profit	27.5	47.5	52.8	46.8	(5.6)	45.5	47.4
PBT, pre-exc & g/w	54.3	61.1	64.8	62.5	17.4	50.7	60.2
Period end shares (million)	200.0	200.6	200.4	200.4	228.6	228.6	226.6
Wtd. ave. shares (million)	200.0	200.0	199.2	197.9	214.8	228.6	226.6
Diluted shares (million)	200.8	202.9	202.3	198.7	215.0	230.9	228.9
EPS, basic (p)	13.8	23.8	26.5	23.6	(2.6)	19.9	20.9
EPS, diluted, pre-exc (p)	21.4	24.3	26.1	25.4	6.6	17.3	20.7
DPS - declared (p)	5.8	9.5	10.5	11.5	2.8	9.9	11.5
Dividend cover (x)	3.7	2.6	2.5	2.2	2.4	1.8	1.8
EBITDA	70.6	75.4	78.8	82.7	37.9	70.4	79.9
Free cash flow	28.8	69.2	49.5	30.1	16.8	71.8	48.6
FCFPS (p)	14.4	34.6	24.8	15.2	7.8	31.4	21.4
TNAV (p)	27.8	44.3	58.3	68.8	84.5	86.8	(5.6)

Source: Company Information and Progressive Equity Research estimates.

Figure 3: Cashflow and Balance Sheet

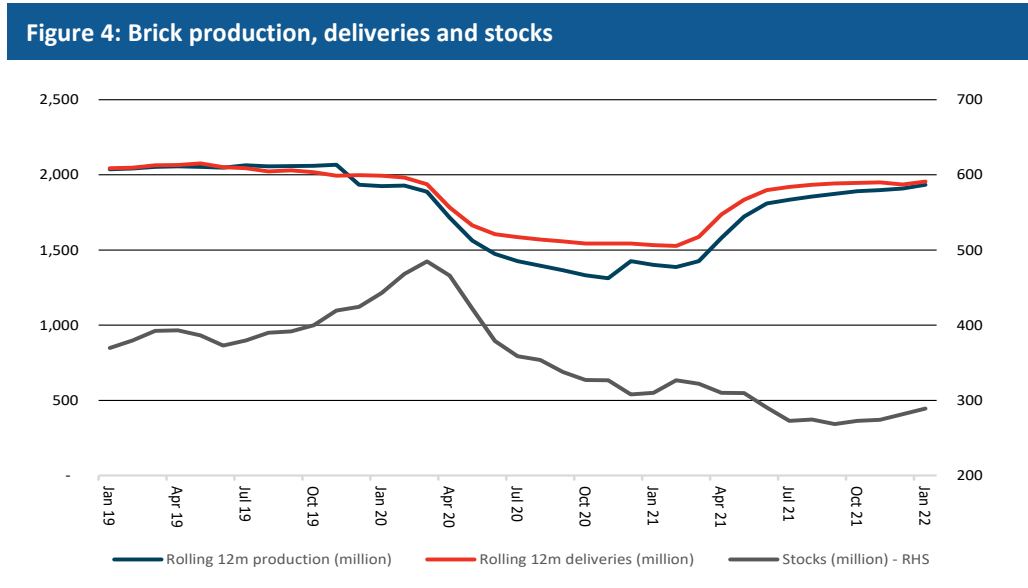
Year-end December (£m)	2016	2017	2018	2019	2020	2021	2022E
Adjusted cashflow statement							
Op profit pre-exceptionals	60.2	64.5	67.1	65.0	20.8	54.0	62.7
Depreciation, amortisation	10.4	10.9	11.7	17.7	17.1	16.4	17.2
Cash exceptionals, other	(13.4)	4.2	(1.7)	(1.7)	(3.9)	(0.8)	-
Changes in working capital	(1.0)	10.6	2.7	(17.2)	14.3	11.0	(18.0)
Operating cash flow	56.2	90.2	79.8	63.8	48.3	80.6	61.9
Capex (maintenance)	(8.7)	(8.4)	(16.3)	(22.5)	(23.5)	3.6	(3.0)
Interest, net	(12.4)	(3.3)	(2.2)	(2.4)	(2.8)	(2.8)	(3.0)
Tax	(6.3)	(9.3)	(11.8)	(8.8)	(5.2)	(9.6)	(15.8)
Free cashflow	28.8	69.2	49.5	30.1	16.8	71.8	40.1
Expansionary capex (f-cast)	-	-	-	-	-	(22.0)	(55.0)
Acquisitions	(0.1)	(21.8)	(2.1)	(1.8)	(1.4)	(1.6)	-
Dividends - paid	(4.0)	(13.8)	(19.3)	(22.0)	-	(13.7)	(23.5)
Financing, other	7.3	(60.8)	(31.1)	(5.7)	(10.5)	(24.5)	(50.0) ¹
Chg cash (hist)/net debt	32.0	(27.2)	(3.0)	0.6	4.9	10.0	(88.4)
Summary balance sheet							
Intangible fixed assets	13.7	15.8	17.3	18.2	11.0	17.7	17.7
Tangible fixed assets	147.2	165.2	170.5	196.3	196.1	217.9	258.7
Investments	0.4	-	-	-	-	-	-
Working capital	18.4	8.1	3.3	16.7	4.9	(3.7)	17.8
Provisions, others	(18.2)	(23.6)	(18.1)	(17.7)	(14.5)	(45.3)	(35.3)
Retirement benefit liabilities	-	-	-	-	-	-	-
Net cash/(debt) - post-IFRS16	(92.3)	(60.8)	(38.8)	(57.3)	6.6	24.4	(64.0)
Net assets	69.2	104.7	134.2	156.2	204.1	211.0	194.8
Net cash/(debt) - pre-IFRS16				(43.2)	16.0	40.9	(54.0)

Source: Company Information and Progressive Equity Research estimates. ¹ £40m share buybacks; £10m into Employee Benefit Trust

Brick market: supply still tight but pressures easing?

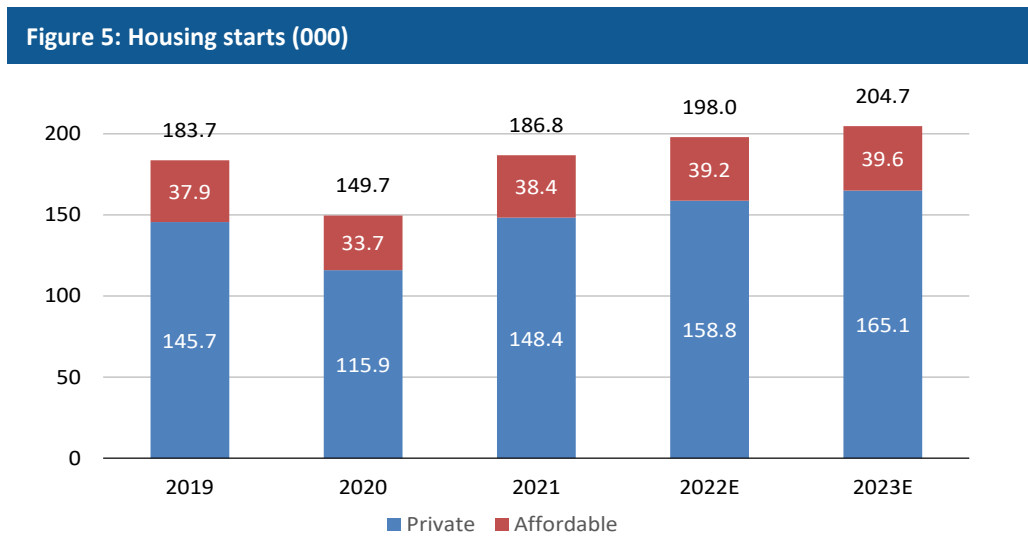
Total inventory levels across the UK industry had fallen from a recent peak of 485 million in March 2020 to a multi-decade low of 269 million in September 2021 – 37% below the 10-year average of 424 million and equivalent to 7.2 weeks of supply at average delivery rates (the 10-year average is 12.4 weeks).

There has been some evidence that the situation is stabilising, with the 12-month average for production exceeding that for deliveries for the first time since late 2019, possibly explaining the edging up in stock levels over the past few months.



Source: BEIS, Progressive Equity Research

Housing starts and the wider housing market have remained healthy despite rising interest rates and the end of the Stamp Duty holiday. The Construction Products Association expects further steady growth this year and next.



Source: Construction Products Association

Investment overview: basic attractions

Second largest brick maker, aiming mainly at 'mid-market'

Forterra is the UK's second biggest brick maker, with nine plants having an annual capacity of 590 million bricks pa and further expansion planned for the Desford plant in Leicestershire (commissioning due in Q4 2022) and for Wilnecote (Q2 2023), with the latter increasing the group's presence in the commercial and specification market from 2023. It is also a major producer of concrete and specialist products for housing in particular. The former Hanson Building Products returned to the stock market in April 2016.

Its main brick ranges are economical 'mid-market' products aimed at volume housebuilders. It has a unique niche in high margin 'Fletton' bricks, which were used to build around 5 million homes in the post-war housebuilding boom, approximately a quarter of the current housing stock of England and required by many planners for repairs and extension of homes built during the era. The concrete blocks, including the lightweight and energy-efficient Thermalite range, are widely used for the inner sections of walls in newbuild housing. Other specialist components in the Bespoke Products range are used in other sectors, including Commercial and Infrastructure.

Basic products, in consolidated market, with long-term growth prospects

We highlight the basic attractions of Forterra and its positioning:

- **A fundamental product.** Brick is the overwhelming product of choice for UK housebuilding.
- **Consolidated, disciplined industry.** The industry is dominated by three main players: Ibstock, Forterra and Austria's Wienerberger, plus the more niche Michelmersh. There are fewer competitors than in past cycles and, we believe, a greater focus on cashflow and returns rather than on expanding market share.
- **Long-term growth prospects.** The Government is committed to significantly boosting housebuilding volumes. HS2 and other infrastructure projects, and product innovations, could boost Bespoke Products.
- **High efficiency capacity increases.** Desford and Wilnecote will increase capacity by 16%, with a high degree of manufacturing efficiency.
- **Simple and low risk.** Forterra is exposed to one country, the UK. Its output is dominated by one main market, housing. There is minimal foreign currency exposure and only moderate energy risk. There is no meaningful pension deficit. There are a limited number of routes to market (direct sales or through builders' merchants of brick 'factors'), and there is a flat management structure. Although exporters and companies with foreign earnings have benefited from the current weakness of sterling, we note the relative lack of potentially risky variables in Forterra's case.
- **Efficient and cash generative.** Other than the Desford project, the company has channelled most of its investment into projects that increase either energy efficiency or fixed cost recovery, rather than increasing volumes. Several 'de-bottlenecking' projects since the IPO have raised efficiency at modest cost. Since the IPO, until the unique challenges of Covid, the company had regularly exceeded cashflow expectations.
- **Capital allocation policy announced.** The policy, communicated at the 2021 half-year results, is "to consider returning a prudent level of cash to shareholders, which reflects the strong cash generative ability of the group, while also retaining a strong balance sheet. This return is in addition to plans to invest in excess of £200m in organic growth projects over the next decade, whilst retaining the flexibility to deliver appropriate bolt-on acquisitions should opportunities arise."

Financial Summary: Forterra

Year end: December (£m unless shown)

	2018	2019	2020	2021	2022E
PROFIT & LOSS					
Revenue	367.5	380.0	291.9	370.4	449.7
Adj EBITDA	78.8	82.7	37.9	70.4	79.9
Adj EBIT	67.1	65.0	20.8	54.0	62.7
Reported PBT	64.8	58.2	(5.4)	56.8	60.2
Fully Adj PBT	64.8	62.5	17.4	50.7	60.2
NOPAT	54.7	52.4	17.0	42.5	49.3
Reported EPS (p)	26.5	23.6	(2.6)	19.9	20.9
Fully Adj EPS (p)	26.1	25.4	6.6	17.3	20.7
Dividend per share (p)	10.5	11.5	2.8	9.9	11.5
CASH FLOW & BALANCE SHEET					
Operating cash flow	79.8	63.8	48.3	80.6	61.9
Free Cash flow	49.5	30.1	16.8	71.8	40.1
FCF per share (p)	24.8	15.2	7.8	31.4	17.7
Acquisitions	(2.1)	(1.8)	(1.4)	(1.6)	0.0
Disposals	N/A	N/A	N/A	N/A	N/A
Shares issued					
Net cash flow	(3.0)	0.6	4.9	10.0	(88.4)
Net (Debt)/Cash, pre-IFRS 16	(38.8)	(43.2)	16.0	40.9	(54.0)
Lease liabilities, post-IFRS 16		(14.1)	(9.4)	(16.5)	(10.0)
Net (Debt)/Cash, post-IFRS 16		(57.3)	6.6	24.4	(64.0)
NAV AND RETURNS					
Net asset value	134.2	156.2	204.1	211.0	184.8
NAV/share (p)	67.0	77.9	89.3	92.3	81.6
Net Tangible Asset Value	116.9	138.0	193.1	217.1	0.0
NTAV/share (p)	58.3	68.8	84.5	94.9	0.0
Average equity	119.5	119.5	145.2	180.2	219.5
Post-tax ROE (%)	39.8%	44.2%	32.2%	(3.1%)	20.7%
METRICS					
Revenue growth	11.0%	3.4%	(23.2%)	26.9%	21.4%
Adj EBITDA growth	(6.3%)	4.9%	(54.2%)	85.8%	13.5%
Adj EBIT growth	4.0%	(3.1%)	(68.0%)	159.6%	16.1%
Adj PBT growth	6.1%	(3.5%)	(72.2%)	191.4%	18.7%
Adj EPS growth	7.4%	(2.8%)	(74.0%)	161.6%	19.8%
Dividend growth	10.5%	9.5%	(75.7%)	253.6%	16.2%
Adj EBIT margins	18.3%	17.1%	7.1%	14.6%	13.9%
VALUATION					
EV/Sales (x)	1.3	1.2	1.6	1.3	1.0
EV/EBITDA (x)	5.9	5.6	12.2	6.6	5.8
EV/NOPAT (x)	8.5	8.8	27.3	10.9	9.4
PER (x)	8.5	8.8	33.7	12.9	10.7
Dividend yield	4.7%	5.2%	1.3%	4.4%	5.2%
FCF yield	11.2%	6.8%	3.5%	14.1%	8.0%

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

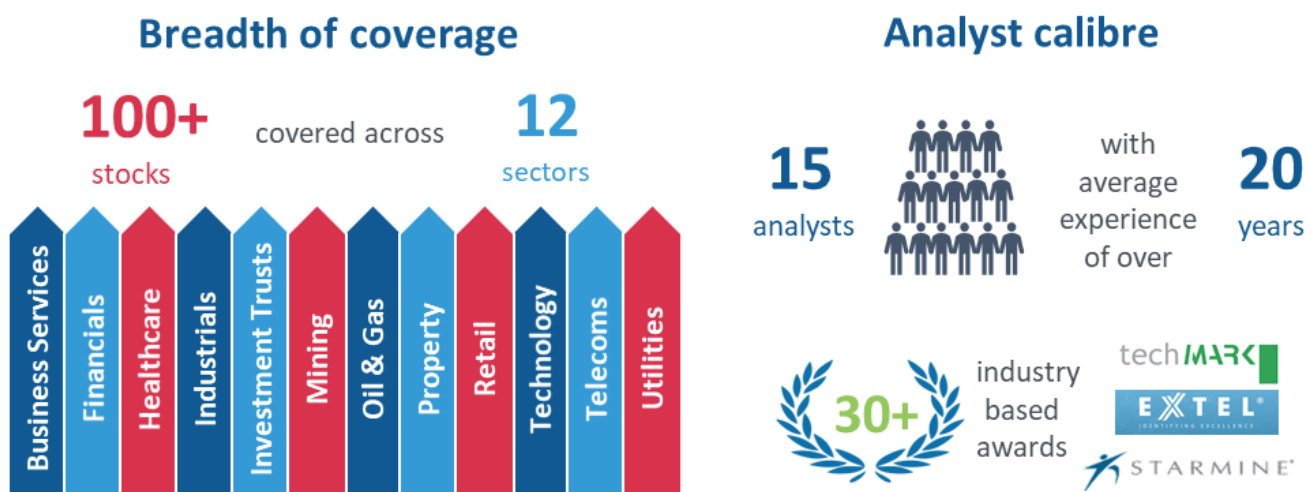
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