

FORTERRA

BUILDING MATERIALS

25 January 2023

FORT.L

206p

Market Cap: £437.3m

SHARE PRICE (p)



12m high/low 297p/186p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£(8.3)m (at 31/12/22)
Enterprise value	£445.6m
Index/market	LSE
Next news	FY results, 9 March
Shares in Issue (m)	212.8
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
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Strong FY22 performance, uncertainty ahead

Leading UK brick and concrete products group Forterra confirms in today's trading update that FY22 adjusted PBT slightly exceeded management expectations despite the housing slowdown after September's mini-budget. We are slightly ahead of consensus at £69.1m and maintain our estimate, but net debt was significantly better than our forecast. Given the uncertainties in housing, we have not yet issued forecasts for FY23E but believe more clarity may emerge at the final results in March, when we suspect the market may be healthier than many fear.

- Profits slightly better than expected, cashflow much better.** Revenue for the year to 31 December 2022 rose by c.21% to around £450m vs our estimate of £466m. We retain our PBT estimate of £69.1m, which compares to consensus of around £68m. Year-end net debt pre-leases was below £10m, despite c.£30m of strategic capital expenditure and the £40m share buyback. We have consequently cut our net debt estimate from £23.3m to £8.3m.
- Pricing offsets cost inflation capacity constraints.** Full-year brick and block volumes were broadly in line with 2021, with production capacity and low inventories a constraint on sales for much of the year. Sales volumes in Q4 remained resilient although below 2021 comparators. Cost increases were offset by cumulative brick selling price increases of c.50%, with further price increases delivered in January 2023.
- Outlook unclear but a 'softish landing'?** There are clearly uncertainties, and we will await Forterra's comments on 9 March and wider industry data before establishing formal FY23E estimates. However, during the recent round of trading updates from leading housebuilders, Forterra's core market, we sensed that buyer interest, although subdued, was beginning to pick up as January progressed. There appears to be a general assumption that housebuilding volumes will decline Y/Y by c.20% in FY23E; we believe it could be less than that, with demand picking up as the year progresses. We expect that UK manufacturers will be less impacted by any overall decline in housing volumes than importers.
- Initial thoughts on FY23E.** Our initial broad views of FY23E are that there will be volume declines of less than 10%, with costs and prices in tandem and a degree of under-recovery of overheads. We believe this could lead to PBT falling more to the upper than lower end of a £50-60m range.

FYE DEC (€M)	2018	2019	2020	2021	2022E
Revenue	367.5	380.0	291.9	370.4	450.3
Adj EBITDA	78.8	82.7	37.9	70.4	88.8
Fully Adj PBT	64.8	62.5	17.4	50.7	69.1
Fully Adj EPS (p)	26.1	25.4	6.6	17.3	25.0
Dividend per share (p)	10.5	11.5	2.8	9.9	13.9
PER (x)	7.9x	8.1x	31.1x	11.9x	8.2x
EV/EBITDA (x)	5.7x	5.4x	11.8x	6.3x	5.0x

Source: Company Information and Progressive Equity Research estimates.

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

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

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

Investment overview: basic attractions

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 five 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.

We highlight the basic attractions of Forterra and its positioning:

- **A fundamental product.** Brick is the overwhelming product of choice for UK housebuilding. Concrete products are widely used in housing and other sectors.
- **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 a flat management structure. Although exporters and companies with foreign earnings have benefitted 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 energy efficiency, 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.

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	450.3
Adj EBITDA	78.8	82.7	37.9	70.4	88.8
Adj EBIT	67.1	65.0	20.8	54.0	71.6
Reported PBT	64.8	58.2	(5.4)	56.8	71.4
Fully Adj PBT	64.8	62.5	17.4	50.7	69.1
NOPAT	54.7	52.4	17.0	42.5	57.5
Reported EPS (p)	26.5	23.6	(2.6)	19.9	26.2
Fully Adj EPS (p)	26.1	25.4	6.6	17.3	25.0
Dividend per share (p)	10.5	11.5	2.8	9.9	13.9
CASH FLOW & BALANCE SHEET					
Operating cash flow	79.8	63.8	48.3	80.6	96.1
Free Cash flow	49.5	30.1	16.8	71.8	73.0
FCF per share (p)	24.8	15.2	7.8	31.4	33.3
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	(42.7)
Net (Debt)/Cash, pre-IFRS 16	(38.8)	(43.2)	16.0	40.9	(8.3)
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	(18.3)
NAV AND RETURNS					
Net asset value	134.2	156.2	204.1	211.0	193.6
NAV/share (p)	67.0	77.9	89.3	92.3	91.0
Net Tangible Asset Value	116.9	138.0	193.1	217.1	217.1
NTAV/share (p)	58.3	68.8	84.5	84.5	82.7
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%	21.6%
Adj EBITDA growth	(6.3%)	4.9%	(54.2%)	85.8%	26.1%
Adj EBIT growth	4.0%	(3.1%)	(68.0%)	159.6%	32.5%
Adj PBT growth	6.1%	(3.5%)	(72.2%)	191.4%	36.2%
Adj EPS growth	7.4%	(2.8%)	(74.0%)	161.6%	44.9%
Dividend growth	10.5%	9.5%	(75.7%)	253.6%	40.7%
Adj EBIT margins	18.3%	17.1%	7.1%	14.6%	15.9%
VALUATION					
EV/Sales (x)	1.2	1.2	1.5	1.2	1.0
EV/EBITDA (x)	5.7	5.4	11.8	6.3	5.0
EV/NOPAT (x)	8.2	8.5	26.3	10.5	7.8
PER (x)	7.9	8.1	31.1	11.9	8.2
Dividend yield	5.1%	5.6%	1.4%	4.8%	6.8%
FCF yield	12.1%	7.4%	3.8%	15.3%	16.2%

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

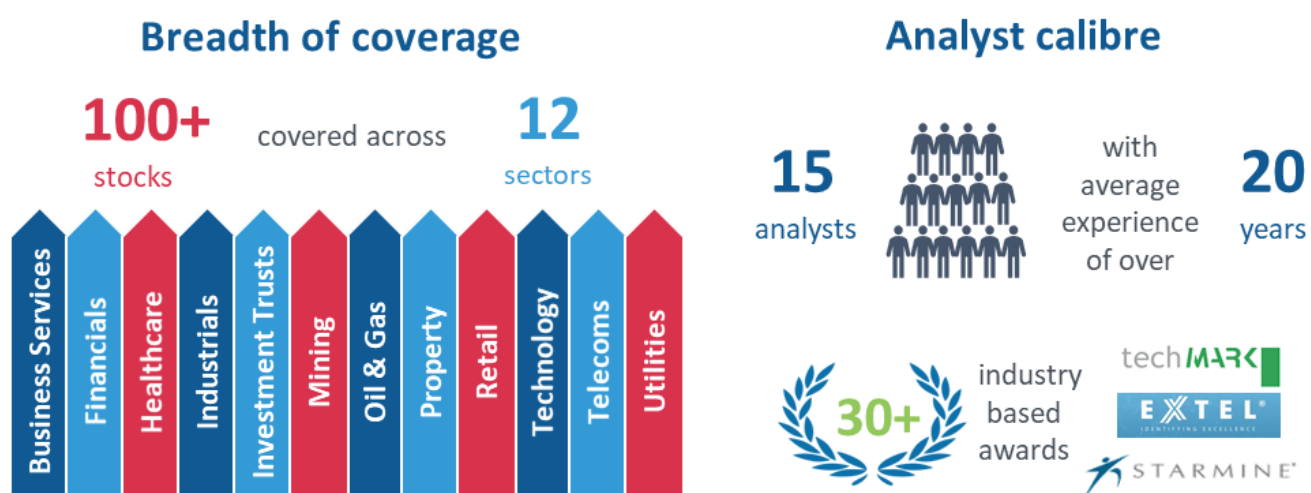
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