FORTERRA
BUILDING MATERIALS

18 May 2023

FORT.L

186p

Market Cap: £395.4m

SHARE PRICE (p)

12m high/low	297p/184p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£(5.9)m *(at 31/12/22)*
Enterprise value	£401.3m
Index/market	LSE
Next news	HY results, 27 July
Shares in Issue (m)	212.8
Chairman	Justin Atkinson
Chief Executive	Neil Ash
CFO	Ben Guyatt

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COMPANY DESCRIPTION

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

forterraplc.co.uk

FORTERRA IS A RESEARCH CLIENT OF PROGRESSIVE

ANALYSTS

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YTD 'in-line' as cutting-edge factory is unveiled

In its 16 May trading update, Forterra confirmed that it has traded in line with its expectations in the first four months of FY23E (to 30 April) despite 'challenging' market conditions, and continues to guide to a more H2-weighted result for the year driven by an improving housing market. The update was ahead of yesterday's opening of its highly efficient Desford brick factory, which, in light of recovering brick industry stock levels, has led the group to temporarily mothball its less-efficient Howley Park plant.

- **First four months of FY23E running to plan.** Revenue for the four-month period to 30 April has fallen 24% Y/Y to £109m, reflecting both the strong housing market at the start of FY22 and housebuilders cutting production in the wake of September's mini-budget. PBT for the period has been in line with its expectations, with a stabilising cost base, notwithstanding persistent inflation in certain areas, also in line with expectations.
- **Estimates unchanged, with more of an H2 weighting.** At this point, we are not changing our estimates (pages 2 and 3) and continue to expect a more H2-weighted result; possibly slightly more so than expected in March at the FY22 results. Higher inventory levels (page 5) may be leading to a more competitive market in the short term, we suspect. However, updates from the leading housebuilders in recent weeks have indicated a continuing recovery in reservation levels, which should support further demand growth in FY24. Meanwhile, brick imports fell by 45% Y/Y in Q1.
- **State-of-the-art plant unveiled, as less efficient site mothballed.** The trading update was ahead of yesterday's capital markets event being held at Forterra's new brick factory at Desford in Leicestershire (page 4) Investments at Wilnecote and Accrington are both progressing well, according to the update. With the new plant, among the most efficient in Europe, ramping up at a time of subdued demand, the group plans to temporarily reduce production from less-efficient plants, including the mothballing of Howley Park. These measures are expected to cut annualised fixed costs by c.£10m. Other cost measures, including overheads, will be 'aligned to market conditions'.
- **Attractive long-term market.** The group's attractions, we believe, 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)	2019	2020	2021	2022	2023E
Revenue	380.0	291.9	370.4	455.5	450.9
Adj EBITDA	82.7	37.9	70.4	89.2	77.9
Fully Adj PBT	62.5	17.4	50.7	70.6	54.4
Fully Adj EPS (p)	25.4	6.6	17.3	26.0	18.9
Dividend per share (p)	11.5	2.8	9.9	14.7	10.6
PER (x)	7.3x	28.1x	10.7x	7.2x	9.8x
EV/EBITDA (x)	4.9x	10.6x	5.7x	4.5x	5.1x

Source: Company Information and Progressive Equity Research estimates.

Figure 1: Divisional performance

Year-end December (£m)	2015	2016	2017	2018	2019	2020	2021	2022	2023E
Revenue									
Bricks & Blocks	218.0	221.3	249.5	277.5	279.1	223.1	298.1	370.2	370.4
Change (%)	*8.4%*	*1.5%*	*12.7%*	*11.2%*	*0.6%*	*-20.1%*	*33.6%*	*24.2%*	*0.0%*
Bespoke Products	73.7	74.8	83.6	92.2	103.5	71.7	76.1	90.1	85.6
Change (%)	*7.8%*	*1.4%*	*11.8%*	*10.3%*	*12.3%*	*-30.7%*	*6.1%*	*18.4%*	*-5.0%*
Intersegment	(1.5)	(1.6)	(2.1)	(2.2)	(2.6)	(2.9)	(3.8)	(4.8)	(5.0)
Group revenue	**290.2**	**294.5**	**331.0**	**367.5**	**380.0**	**291.9**	**370.4**	**455.5**	**450.9**
Change (%)	*8.3%*	*1.5%*	*12.4%*	*11.0%*	*3.4%*	*-23.2%*	*26.9%*	*23.0%*	*-1.0%*
EBITDA									
Bricks & Blocks	64.0	63.6	69.1	75.8	80.4	40.3	70.5	85.5	74.1
Margin (%)	*29.3%*	*28.7%*	*27.7%*	*27.3%*	*28.8%*	*18.1%*	*23.6%*	*23.1%*	*20.0%*
Bespoke Products	6.6	7.0	6.3	3.0	2.3	(2.4)	(0.1)	3.7	3.9
Margin (%)	*8.9%*	*9.4%*	*7.5%*	*3.3%*	*2.2%*	*-3.3%*	*-0.1%*	*4.1%*	*4.5%*
EBITDA	**70.5**	**70.6**	**75.4**	**78.8**	**82.7**	**37.9**	**70.4**	**89.2**	**77.9**
Margin (%)	*24.3%*	*24.0%*	*22.8%*	*21.4%*	*21.8%*	*13.0%*	*19.0%*	*19.6%*	*17.3%*
Depreciation & amort.	(9.1)	(10.4)	(10.9)	(11.7)	(17.7)	(17.1)	(16.4)	(16.5)	(19.0)
EBIT, pre-exc	**61.1**	**60.2**	**64.5**	**67.1**	**65.0**	**20.8**	**54.0**	**72.7**	**58.9**
Margin (%)	*21.1%*	*20.4%*	*19.5%*	*18.3%*	*17.1%*	*7.1%*	*14.6%*	*16.0%*	*13.1%*
Exceptionals	(11.6)	(8.9)	(1.8)	-	(4.3)	(22.8)	6.1	2.3	-
Net interest	(27.3)	(14.2)	(3.4)	(2.3)	(2.5)	(3.4)	(3.3)	(2.1)	(4.5)
PBT, reported	**22.2**	**37.1**	**59.3**	**64.8**	**58.2**	**(5.4)**	**56.8**	**72.9**	**54.4**
PBT, pre-exc	**34.1**	**54.3**	**61.1**	**64.8**	**62.5**	**17.4**	**50.7**	**70.6**	**54.4**
EPS, basic (p)	9.0	13.8	23.8	26.5	23.6	(2.6)	19.9	27.2	19.2
EPS, diluted, pre-exc (p)	**14.7**	**21.4**	**24.3**	**26.1**	**25.4**	**6.6**	**17.3**	**26.0**	**18.9**
DPS - declared (p)		**5.8**	**9.5**	**10.5**	**11.5**	**2.8**	**9.9**	**14.7**	**10.6**
Dividend cover (x)		3.7	2.6	2.5	2.2	2.4	1.8	1.8	1.8

Source: Company Information and Progressive Equity Research estimates.

Figure 2: Cash Flow and Balance Sheet

Year-end December (£m)	2017	2018	2019	2020	2021	2022	2023E
Adjusted cash flow statement							
Op profit pre-exceptionals	64.5	67.1	65.0	20.8	54.0	72.7	58.9
Depreciation, amortisation	10.9	11.7	17.7	17.1	16.4	16.5	19.0
Cash exceptionals, other	4.2	(1.7)	(1.7)	(3.9)	0.4	0.7	-
Changes in working capital	10.6	2.7	(17.2)	14.3	9.8	(0.9)	(22.0)
Operating cash flow	**90.2**	**79.8**	**63.8**	**48.3**	**80.6**	**89.0**	**55.9**
Capex (maintenance), net	(8.4)	(16.3)	(22.5)	(23.5)	10.5	(5.6)	(10.0)
Interest, net	(3.3)	(2.2)	(2.4)	(2.8)	(2.8)	(2.4)	(4.5)
Tax	(9.3)	(11.8)	(8.8)	(5.2)	(9.6)	(11.0)	(11.0)
Free cash flow	**69.2**	**49.5**	**30.1**	**16.8**	**78.7**	**70.0**	**30.4**
Expansionary capex (est)	-				(28.9)	(33.6)	(40.0)
Acquisitions	(21.8)	(2.1)	(1.8)	(1.4)	(1.6)	(2.0)	-
Dividends - paid	(13.8)	(19.3)	(22.0)	-	(13.7)	(24.2)	(21.5)
Financing, other	(60.8)	(31.1)	(5.7)	(10.5)	(24.5)	(17.4)	-
Chg cash (hist)/net debt	**(27.2)**	**(3.0)**	**0.6**	**4.9**	**10.0**	**(7.2)**	**(31.1)**
Summary balance sheet							
Intangible fixed assets	15.8	17.3	18.2	11.0	17.7	23.6	23.6
Tangible fixed assets	165.2	170.5	196.3	196.1	217.9	251.8	282.8
Investments	-	-	-	-	-	-	-
Working capital	8.1	3.3	16.7	4.9	(3.7)	(2.3)	17.1
Provisions, others	(23.6)	(18.1)	(17.7)	(14.5)	(45.3)	(28.7)	(28.7)
Retirement benefit liabilities	-	-	-	-	-	-	-
Net cash/(debt) - post-IFRS16		(60.8)	(38.8)	(57.3)	24.4	(23.9)	(55.0)
Net assets		**104.7**	**134.2**	**156.2**	**211.0**	**220.5**	**239.8**
Net cash/(debt) - pre-IFRS16				*(43.2)*	*40.9*	*(5.9)*	*(37.0)*

Source: Company Information and Progressive Equity Research estimates.

Desford transforms profitability and slashes carbon

Major investment, delivered to budget, will serve c.8% of UK market

Forterra yesterday formally opened what it believes to be the biggest and most efficient brick plant in Europe, at Desford in Leicestershire. The £95m plant, delivered to budget over a six-year project period, has a capacity of 180 bricks pa, about 8% of total UK capacity. Desford's economically-priced 'extruded' bricks are targeted primarily at volume housebuilders. (The alternative, 'soft mud' variety, are aimed at a wider market.)

25% lower carbon usage and around half the gas – cutting costs and improving environmental credentials

The facility produces 25% less carbon than Forterra's old plant on the site, now closed. Its gas use is only 32 therms per 1,000 bricks – a 45% improvement on the now-closed plant on the site and less than half the 65 therms from the Howley Park plant, which is being temporarily mothballed. Electricity use per 1,000 is 106 kwh against 152 kwh for 'old' Desford and 128 kwh for Howley Park; to produce the same number of bricks, new Desford uses one hour of labour against three for both comparators. The main rationale for mothballing Howley Park is that it makes more sense to fully utilise these efficiencies by maximising output at Desford while housebuilding is currently subdued. (Once demand recovers, Howley Park can be fully operational again within three months.)

IRR of 17% and six-year payback on investment

Once fully up and running, Desford is projected to add £25m incrementally to EBITDA, 25% of it from the greater efficiency and 75% from the extra volumes. The plant and its clay reserve have a life expectancy of 30-40 years and a payback period of six years. The project's IRR is estimated at 17 years, with a ROCE of 22%. The Desford investment is part of Forterra's 'core' strategy, aimed at housebuilders; two other investment programmes are currently underway, serving different markets. The expansion of Wilnecote, in Staffordshire, will allow a wider range of shapes and finishes for architecturally-led developments. Accrington will produce thin 'brick slips', which can be used in off-site production or in conjunction with highly insulated wall structures.

No signs of overcapacity, with imports set to fall further

Despite significant new openings from Forterra and Ibstock, total UK capacity is now 2.3 billion bricks pa, above the low of 2.0 billion in 2014 but below the 2.6 billion ahead of the global financial crisis, after which Forterra and the rest of the industry permanently closed 0.3 billion each. Moreover, imports have fallen sharply (page 5), although there appears to be an overhang of older imports that may temporarily put some pressure on pricing.

Figure 3: Desford brick plant

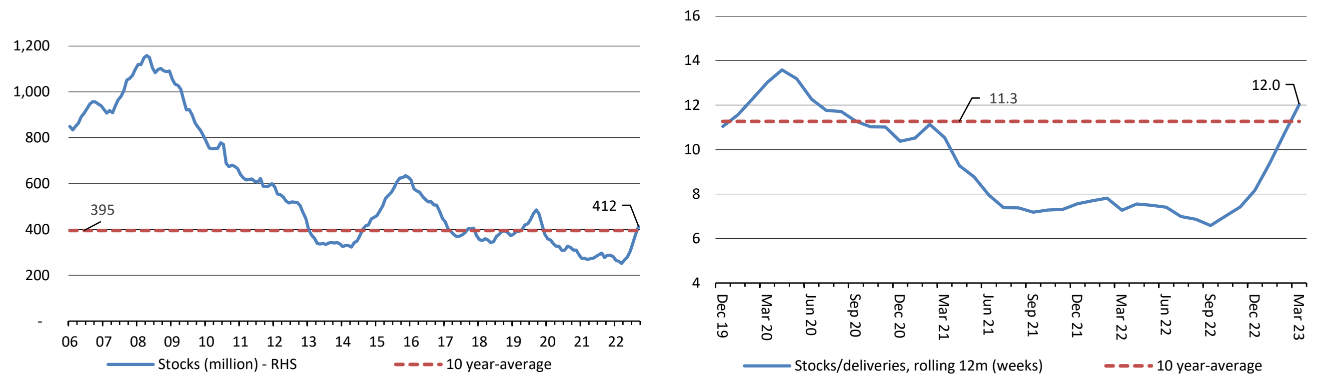
Source: Company presentation

Brick industry levels recovering but imports fall

After a long phase of relative shortages, supply and demand are now more in balance

After a long period of relative shortages, a possibly more competitive landscape appears to be emerging as stocks return to their long-term norms, according to latest government data. In March, brick stocks continued to recover from their multi-decade lows, according to the latest Monthly Statistics of Building Materials and Components from the Department for Business, Energy and Industrial Strategy (link). Inventory levels rose in March for the sixth consecutive month, to 412 million, up 64% from the 34-year low of 251 million in September 2022 but only just above the 10-year average of 395 million (see below). The latest level equates to 12.0 weeks of deliveries (based on rolling 12-month data), up from 6.6 in September but still only slightly ahead of the 11.3-week average (Figure 4).

Figure 4: UK brick inventory levels: LHS – millions; RHS – weeks



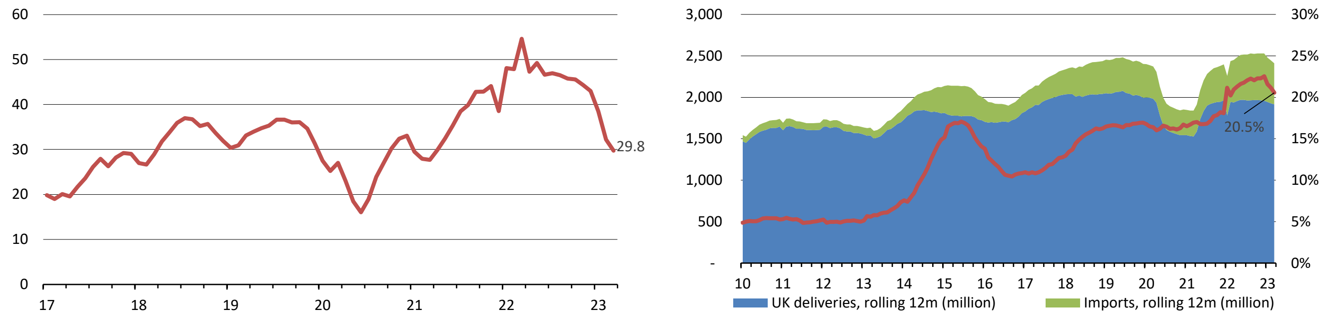
Source: Department for Business, Energy and Industrial Strategy

Imports fall – while other manufacturers address capacity issues

Other UK manufacturers to address capacity issues?

However, imports have also fallen, with volumes down by 45% in the latest quarter (Figure 5). We believe this, and an improving picture of demand reported in the largest housebuilders' recent trading statements, should rebalance supply and demand in the medium term. Moreover, we would not be surprised if other brick producers announce temporary production curbs: hard landscaping manufacturer Marshalls indicated in its 9 May update that it would 'respond flexibly to evolving market conditions to ensure that the group's manufacturing capacity and cost base are aligned to market demand'.

Figure 5: Brick imports (millions, 3m moving ave) – LHS; import volumes and market share (million, 12m %) – RHS



Source: Department for Business, Energy and Industrial Strategy

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 (now commissioned) 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. 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 cash flow 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 or 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 group 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 group had regularly exceeded cash flow expectations.
- **Capital allocation policy outlined**. 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)

PROFIT & LOSS	**2019**	**2020**	**2021**	**2022**	**2023E**
Revenue	380.0	291.9	370.4	455.5	450.9
Adj EBITDA	82.7	37.9	70.4	89.2	77.9
Adj EBIT	65.0	20.8	54.0	72.7	58.9
Reported PBT	58.2	(5.4)	56.8	72.9	54.4
Fully Adj PBT	62.5	17.4	50.7	70.6	54.4
NOPAT	52.4	17.0	42.5	58.4	44.8
Reported EPS (p)	23.6	(2.6)	19.9	27.2	19.2
Fully Adj EPS (p)	25.4	6.6	17.3	26.0	18.9
Dividend per share (p)	11.5	2.8	9.9	14.7	10.6

CASH FLOW & BALANCE SHEET	**2019**	**2020**	**2021**	**2022**	**2023E**
Operating cash flow	63.8	48.3	80.6	89.0	55.9
Free Cash flow	30.1	16.8	78.7	70.0	30.4
FCF per share (p)	15.2	7.8	34.5	32.4	14.3
Acquisitions	(1.8)	(1.4)	(1.6)	(2.0)	0.0
Disposals	N/A	N/A	N/A	N/A	N/A
Shares issued					
Net cash flow	0.6	4.9	10.0	(7.2)	(31.1)
Net (Debt)/Cash, pre-IFRS 16	(43.2)	16.0	40.9	(5.9)	(37.0)
Lease liabilities, post-IFRS 16	(14.1)	(9.4)	(16.5)	(18.0)	(18.0)
Net (Debt)/Cash, post-IFRS 16	(57.3)	6.6	24.4	(23.9)	(55.0)

NAV AND RETURNS	**2019**	**2020**	**2021**	**2022**	**2023E**
Net asset value	156.2	204.1	234.8	220.5	239.8
NAV/share (p)	77.9	89.3	102.7	103.6	112.7
Net Tangible Asset Value	138.0	193.1	217.1	196.9	216.2
NTAV/share (p)	68.8	84.5	94.9	92.5	101.6
Average equity	119.5	145.2	180.2	219.5	227.7
Post-tax ROE (%)	39.8%	36.4%	26.0%	(2.6%)	20.0%

METRICS	**2019**	**2020**	**2021**	**2022**	**2023E**
Revenue growth	3.4%	(23.2%)	26.9%	23.0%	(1.0%)
Adj EBITDA growth	4.9%	(54.2%)	85.8%	26.7%	(12.6%)
Adj EBIT growth	(3.1%)	(68.0%)	159.6%	34.6%	(18.9%)
Adj PBT growth	(3.5%)	(72.2%)	191.4%	39.3%	(22.9%)
Adj EPS growth	(2.8%)	(74.0%)	162.2%	50.0%	(27.2%)
Dividend growth	9.5%	(75.7%)	253.6%	48.5%	(28.2%)
Adj EBIT margins	17.1%	7.1%	14.6%	16.0%	13.1%

VALUATION	**2019**	**2020**	**2021**	**2022**	**2023E**
EV/Sales (x)	1.1	1.4	1.1	0.9	0.9
EV/EBITDA (x)	4.9	10.6	5.7	4.5	5.1
EV/NOPAT (x)	7.7	23.6	9.4	6.9	9.0
PER (x)	7.3	28.1	10.7	7.2	9.8
Dividend yield	6.2%	1.5%	5.3%	7.9%	5.7%
FCF yield	8.2%	4.2%	18.6%	17.4%	7.7%

Source: Company information and Progressive Equity Research estimates

Progressive EQUITY RESEARCH

18 May 2023

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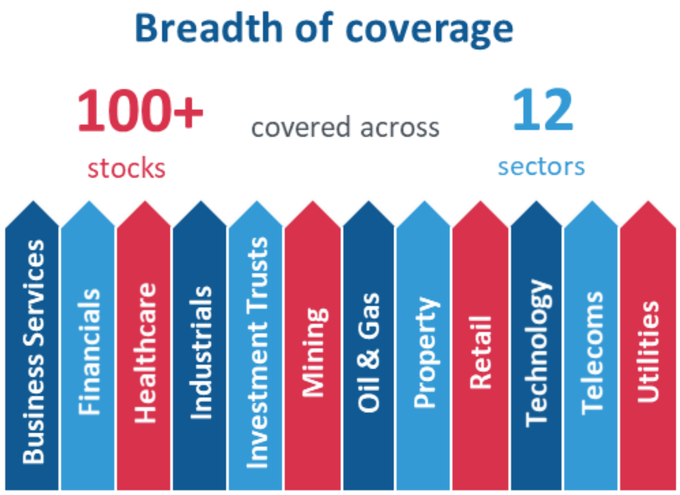

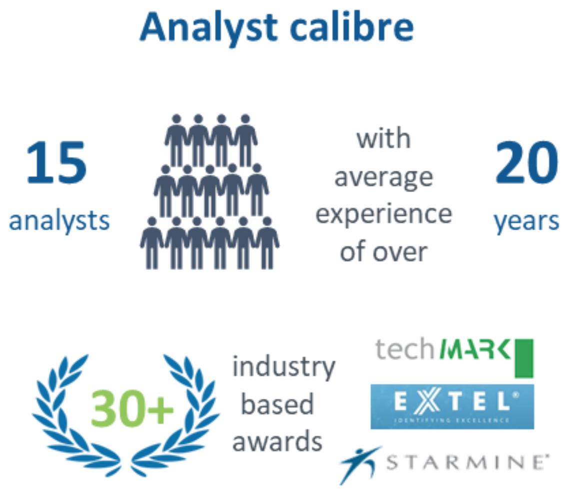

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