FORTERRA
BUILDING MATERIALS

11 October 2023

FORT.L

144p

Market Cap: £306m

SHARE PRICE (p)

12m high/low	243p/140p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (debt)/cash	£(50.1)m *(at 30/06/23)*
Enterprise value	£356.1m
Index/market	LSE
Next news	FY update, January
Shares in issue (m)	212.8
Chairman	Justin Atkinson
CEO	Neil Ash
CFO	Ben Guyatt

COMPANY DESCRIPTION

Forterra is the UK's second-largest brick maker and leading manufacturer of concrete building products.

forterraplc.co.uk

FORTERRA IS A RESEARCH CLIENT OF PROGRESSIVE

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Housebuilding slowdown dampens demand

Forterra has indicated that recent industry-wide data showing declines in brick deliveries as a result of lower housebuilding volumes is likely to impact its expected FY23 volumes, leading the group to moderate current year guidance for revenue and PBT. Forterra has responded by outlining further steps to align production with demand, but notes that heightened political focus on increasing housing supply reinforces its long-term confidence.

- **Industry-wide slowdown.** In today's autumn trading update, Forterra conceded that the signs of market improvement seen by it and other participants in May and June did not continue into H2, with market demand deteriorating in July and August. Monthly building materials and components statistics from the Department for Business and Trade showed brick deliveries in July and August were 16% lower than in June and 28% lower than in the corresponding period in 2022. August was weaker than July and the company's own despatches suggest a further softening in September. Industry volumes are now running below 2009. However, the group confirms that pricing has remained resilient overall.
- **New FY23E guidance.** July EBITDA guidance was for a more balanced H1/H2 split, assuming that demand seen in June would continue. The group now anticipates demand to remain at the levels experienced over the past quarter and accordingly expects lower EBITDA. We have cut our revenue assumptions by 9.2% to £367m, with H2 now in line with H1; our adjusted PBT falls by 25.6% to £27.9m, with corresponding percentage reductions in EPS and dividends. Our estimate for pre-IFRS16 net debt moves to £82.2m from £59.9m, reflecting inventory build-up.
- **Aligning production with demand.** The group has followed up previously announced management actions with further steps to align production levels with market demand. Consultation is currently underway on the mothballing of a further brick factory at Claughton in Lancashire, along with cuts to production in its Aircrete business.
- **Long-term political drivers.** Forterra is now managing operations on the assumption that FY24 demand will be at a similar level to FY23, and accordingly will look to align production output, limiting further inventory growth. The update states: "Growing focus on increasing housing supply ahead of a general election reinforces the Board's confidence in the long-term industry fundamentals and the Board remains confident that the Group remains well placed to benefit when market demand recovers."

FYE DEC (£M)	2019	2020	2021	2022	2023E
Revenue	380.0	291.9	370.4	455.5	367.1
Adj EBITDA	82.7	37.9	70.5	89.2	53.9
Fully Adj PBT	62.5	17.4	50.7	70.6	27.9
Fully Adj EPS (p)	25.4	6.6	17.3	26.0	9.8
Dividend per share (p)	11.5	2.8	9.9	14.7	5.5
PER (x)	5.7x	21.8x	8.3x	5.5x	14.7x
EV/EBITDA (x)	4.3x	9.4x	5.1x	4.0x	6.6x

Source: Company Information and Progressive Equity Research estimates.

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 690 million bricks pa including from the newly commissioned and highly efficient Desford plant in Leicestershire and Wilnecote, 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 recovery prospects.** Despite the short-term challenges in housebuilding, the government and, arguably, more so the Labour opposition are committed to significantly boosting housebuilding volumes. Labour's focus on affordable housing particularly applies to Forterra's range. Major infrastructure projects and product innovations could boost Bespoke Products.
- **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.
- **Clear capital allocation policy**. The policy, communicated in 2021, 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, while 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	367.1
Adj EBITDA	82.7	37.9	70.5	89.2	53.9
Adj EBIT	65.0	20.8	54.0	72.7	34.9
Reported PBT	58.2	(5.4)	56.8	72.9	26.8
Fully Adj PBT	62.5	17.4	50.7	70.6	27.9
NOPAT	52.4	17.0	42.5	58.4	26.5
Reported EPS (p)	23.6	(2.6)	19.9	27.2	9.4
Fully Adj EPS (p)	25.4	6.6	17.3	26.0	9.8
Dividend per share (p)	11.5	2.8	9.9	14.7	5.5
CASH FLOW & BALANCE SHEET	**2019**	**2020**	**2021**	**2022**	**2023E**
Operating cash flow	63.8	48.3	80.6	89.0	8.9
Free Cash flow	30.1	16.8	78.7	70.0	(14.8)
FCF per share (p)	15.2	7.8	34.5	32.4	(7.0)
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)	(76.3)
Net (Debt)/Cash, pre-IFRS 16	(43.2)	16.0	40.9	(5.9)	(82.2)
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)	(100.2)
NAV AND RETURNS	**2019**	**2020**	**2021**	**2022**	**2023E**
Net asset value	156.2	204.1	234.8	220.5	220.2
NAV/share (p)	77.9	89.3	102.7	103.6	103.5
Net Tangible Asset Value	138.0	193.1	217.1	196.9	196.6
NTAV/share (p)	68.8	84.5	94.9	92.5	92.4
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%	(19.4%)
Adj EBITDA growth	4.9%	(54.2%)	86.0%	26.5%	(39.6%)
Adj EBIT growth	(3.1%)	(68.0%)	159.6%	34.6%	(52.0%)
Adj PBT growth	(3.5%)	(72.2%)	191.4%	39.3%	(60.5%)
Adj EPS growth	(2.8%)	(74.0%)	162.2%	50.0%	(62.3%)
Dividend growth	9.5%	(75.7%)	253.6%	48.5%	(62.8%)
Adj EBIT margins	17.1%	7.1%	14.6%	16.0%	9.5%
VALUATION	**2019**	**2020**	**2021**	**2022**	**2023E**
EV/Sales (x)	0.9	1.2	1.0	0.8	1.0
EV/EBITDA (x)	4.3	9.4	5.1	4.0	6.6
EV/NOPAT (x)	6.8	21.0	8.4	6.1	13.4
PER (x)	5.7	21.8	8.3	5.5	14.7
Dividend yield	8.0%	1.9%	6.9%	10.2%	3.8%
FCF yield	10.6%	5.4%	24.0%	22.5%	(4.8%)

Source: Company information and Progressive Equity Research estimates

Progressive
EQUITY RESEARCH

11 October 2023

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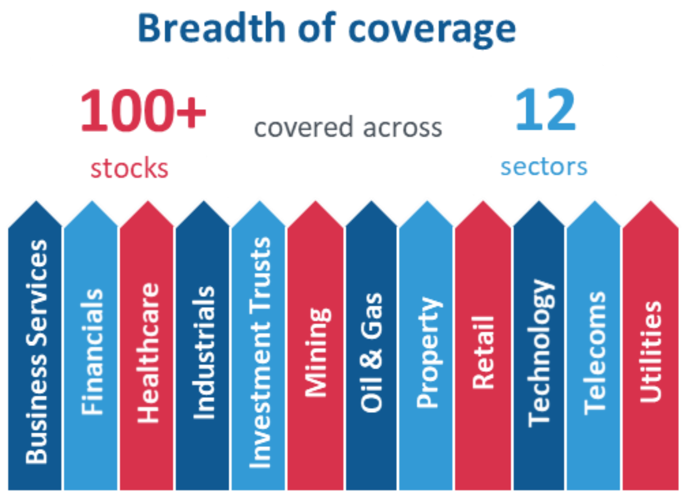

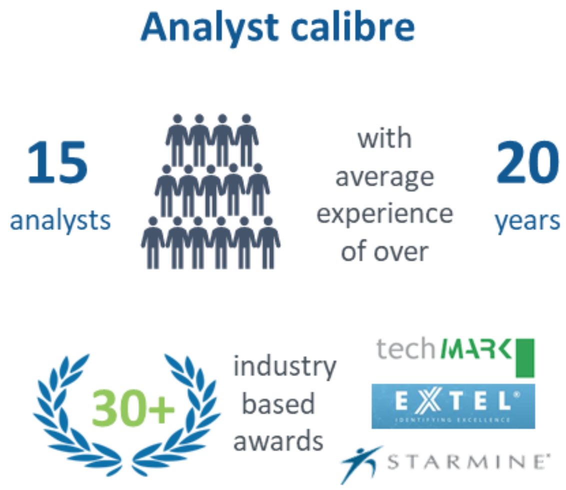

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