SEVERFIELD

ENGINEERING & CONTRACTING SERVICES

22 November 2022

SFR.L

58p

Market Cap: £179.5m

SHARE PRICE (p)

12m high/low	74p/48p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£(15.8)m *(at 24/09/22)*
Enterprise value	£195.3m
Index/market	LSE
Next news	Capital mkts day, Mar 23
Shares in Issue (m)	309.5
Chairman	Kevin Whiteman
Chief Executive	Alan Dunsmore
Finance Director	Adam Semple

COMPANY DESCRIPTION

UK's leader in design, fabrication and construction of structural steel, for commercial buildings, infrastructure etc

www.severfield.com

SEVERFIELD IS A RESEARCH CLIENT OF PROGRESSIVE

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Interims confirm sustained infrastructure drive

We have kept our FY23E-25E PBT estimates for Severfield, Britain's top steel construction specialist, as its FY23E interims maintained guidance amid 'consistently high' demand in the UK and Europe and strong growth in India. Inflationary pressures remain well-managed. We believe Chancellor Jeremy Hunt's Autumn Statement confirms the strong long-term outlook for energy and infrastructure, as explored in our extensive recent report.

- **Results.** Revenue in the first half to 24 September rose 20% Y/Y to £235m; underlying PBT +17% to £12.1m; underlying EPS +22% to 3.3p; and the interim dividend was increased by 8.3% to 1.3p. Pre-IFRS 16 net debt was £15.8m (26 March: £18.4m), reflecting a stable working capital position.
- **Headline estimates unchanged.** We have not changed our PBT estimates but have added c.£30m to each year of our forecast revenues to reflect strong pricing. We have increased our operating profit by £0.7m for each year (with forecast margins going from 6.6%, 6.9% and 6.9%, respectively, to 6.4%, 6.6% and 6.6%). The interest charge goes up by the same amount.
- **Strong order books.** The UK & Europe order book at 1 November was £464m (1 November 2021: £393m; 1 June: £486m). The Indian order book of £143m (1 June: £158m) reflects 'strong continued demand for structural steel in India'. This order book strength confirms success in a number of the long-term growth areas highlighted in our 32-page note of 26 October: nuclear, data centres and industrial, as well as the more established logistics sector.
- **Growth drivers confirmed.** There was uncertainty as to how much Hunt's fiscal statement would impact UK investment, but we believe that most of the 'growth' programmes in his predecessor Kwasi Kwarteng's 'mini-budget' remain intact. These include confirmation of HS2 and the green light for Sizewell C (page 2). As important was that the statement returned stability to the financial markets.
- **Severfield advantages: scale, skills and balance sheet.** The group is by far the biggest steel construction group in the UK, with competition from fragmented and mainly privately-owned rivals. In addition to its long-term growth markets, we believe that Severfield has a breadth of abilities, financial strength and ability to handle complex projects that are generally out of the scope of the peer group (page 3).

FYE MAR (£M)	2021	2022	2023E	2024E	2025E
Revenue	363.3	403.6	489.9	499.7	522.2
Fully Adj PBT	24.3	27.1	31.2	33.6	35.3
Fully Adj EPS (p)	6.4	7.2	8.3	8.3	8.8
Dividend per share (p)	2.9	3.1	3.3	3.5	3.7
PER (x)	9.0x	8.1x	7.0x	7.0x	6.6x
EV/EBITDA (x)	6.5x	6.1x	4.7x	4.4x	4.3x
Dividend yield	5.0%	5.3%	5.7%	6.0%	6.4%

Source: Company Information and Progressive Equity Research estimates.

Autumn Statement leaves growth opportunities intact

Chancellor Jeremy Hunt's 17 November Autumn Statement was, in our view, broadly positive for construction in general – and Severfield in particular – and countered a number of the sector concerns ahead of his speech. In our wide-ranging 32-page note of 26 October on Severfield's current and potential future markets, Opportunities abound amid new world order, we identified three broad and often overlapping trends, all of which could support demand for Severfield's services in the short to long term, increasing revenue resilience:

- **Security and 'deglobalisation' accelerated by war.** The reactions to Russia's invasion of Ukraine eclipsed, at least temporarily, some of the government's green agenda. However, many of the aims of the Energy Security Strategy (ESS) and other initiatives strongly support renewable energy. There has been an even more urgent need to reduce mainland Europe's dependence on Russian energy. However, 'security' also involves food, economic and supply-chain reliability. We envisage the pendulum of globalisation swinging backwards to a degree, with 'on-shoring' or 'near-shoring' creating more demand for factories and logistics. In the most literal sense of 'security', defence production is likely to grow. **Severfield opportunity:** nuclear facilities and process industries, within the new Nuclear & Infrastructure division, and factories and logistics space, within Commercial & Industrial.

- **Decarbonisation reprioritised.** There has been a reprioritisation of green ambitions following the Ukraine invasion, prompting calls for a temporary return to hydrocarbon exploration and production, and more of a focus on energy supply rather than efficiency, which was a major aspect of previous government green policy. However, we still believe there will be considerable opportunities, such as gigafactories and production plants for wind turbines, heat pumps and insulation products. **Severfield opportunity:** process engineering for O&G and factories for green components.

- **Politics & lifestyle changes.** A combination of Brexit, electoral pledges and lifestyle changes, mostly accelerated by the pandemic. They include: Investment Zones, among the still surviving 'growth' elements from the 'mini-budget' ahead of the 31 October Fiscal Statement under new Chancellor Jeremy Hunt and PM Rishi Sunak; datacentres (the rise in cloud computing, accelerated by home working); and a huge rise in UK film studios (content for cinema and home entertainment). **Severfield opportunity:** logistics, factories, datacentres and studios (latter two using more steel).

In our view, most of these specific opportunities remain intact following the statement. Possibly as importantly, it maintained market stability. Gilt yields fell and sterling strengthened against the dollar ahead of the announcement. The former should improve property investors' risk appetite; the latter costs of imported raw materials, including steel.

- **Energy security.** Hunt arguably emphasised energy security over decarbonisation when emphasising the government's commitment to nuclear in particular, confirming the go-ahead for Sizewell C. There was also £6bn for energy efficiency upgrades for homes and industry from 2025 to 2030, on top of the current £6.6bn programme.

- **Infrastructure.** The big positives were the preservation of HS2 (which, not for the first time, many in the media had been indicating might be curtailed) and Northern Powerhouse Rail.

- **Recommitment to levelling-up and 'growth'.** Plans for the second round of the Levelling Up Fund were also confirmed, with at least £1.7bn to be allocated to priority local infrastructure projects around the UK before the end of the year. However, the Investment Zone plan was refocused on 'left behind' university towns to create a smaller number of knowledge-intensive growth clusters.

Severfield in brief

Largest structural steel group in UK with growing European opportunities

Severfield is the UK's largest structural steel group and one of the biggest in Europe. It has a total steel capacity of c.165,000 tonnes in its five UK plants (c.18% of domestic market) and employs c.1,500. It also has a JV in India. The group and its markets are discussed in detail in our initiation note, *Election result provides clearer 2020 vision*. Acquisitions of Harry Peers & Co in 2019 and Dam Structures in February 2021 have boosted revenue, earnings, capacity and reach into sectors such as, respectively, nuclear and rail.

The three main activities it performs are:

- Design of steel structures for buildings and infrastructure.
- Fabrication of steel sections and plate in its five UK factories.
- Erection of the steel elements within larger construction projects.

The group was formed in 1978 as Severfield-Reeve and grew rapidly, both organically and through a series of acquisitions, which broadened its range of products and services. It was renamed Severfield-Rowen and then, in 2014, Severfield. Its landmark structures include the 2012 Olympic Stadium, the 'Shard', Birmingham New Street Station, Wimbledon Centre Court, the Emirates Stadium and the Paris Philharmonic Hall. It also supplies and erects industrial buildings and distribution warehouses.

Significant losses in 2013 prompted major restructuring

Significant contractual losses in 2013 prompted a major restructuring of the business, much more focused management controls and a £45m rights issue. The benefits of these actions became increasingly evident during FY15 and FY16.

Operationally, we see less risk of overcapacity, more disciplined bidding and a continued shift to higher-value, less-commoditised work. This improved quality of earnings and cashflow could, in our view, be reflected in an improved stock market rating. With a strong balance sheet and focus on high-entry-barrier markets, it is targeting opportunities for growth, while a fragmented competition largely vies for more-commoditised work.

Scale advantage against a smaller and fragmented peer group

Severfield has more than double the revenue of William Hare, its nearest competitor in a peer group that is almost entirely privately owned, except for Billington Structures.

Financial Summary: Severfield

Year end: March (£m unless shown)

PROFIT & LOSS	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Revenue	363.3	403.6	489.9	499.7	522.2
Adj EBITDA	29.9	32.0	41.8	43.9	45.3
Adj EBIT	25.5	26.9	31.2	33.2	34.5
Reported PBT	21.1	21.0	25.8	28.2	29.9
Fully Adj PBT	24.3	27.1	31.2	33.6	35.3
NOPAT	25.4	26.8	31.1	33.1	34.4
Reported EPS (p)	5.6	5.1	6.5	6.6	7.0
Fully Adj EPS (p)	6.4	7.2	8.3	8.3	8.8
Dividend per share (p)	2.9	3.1	3.3	3.5	3.7
CASH FLOW & BALANCE SHEET	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Operating cash flow	30.0	(1.9)	42.5	31.1	38.9
Free Cash flow	18.4	(11.6)	27.8	15.3	20.6
FCF per share (p)	6.0	(3.8)	9.0	4.9	6.7
Acquisitions	(20.2)	(0.7)	(11.0)	(2.0)	(2.0)
Disposals	N/A	N/A	N/A	N/A	N/A
Shares issued					
Net cash flow	(19.4)	(29.0)	7.0	2.8	7.6
Overdrafts / borrowings	31.9	26.5	14.4	14.4	14.4
Cash & equivalents	25.0	(4.0)	3.1	5.9	13.5
Net (Debt)/Cash, pre-IFRS 16	4.4	(18.4)	(11.4)	(8.5)	(0.9)
NAV AND RETURNS	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Net asset value	190.9	197.4	207.9	217.8	228.6
NAV/share (p)	61.9	63.8	67.2	70.4	73.9
Net Tangible Asset Value	95.5	104.8	109.7	123.1	137.2
NTAV/share (p)	31.0	33.9	35.4	39.8	44.3
Average equity	187.3	194.2	202.6	212.9	223.2
Post-tax ROE (%)	9.2%	8.0%	10.0%	9.6%	9.8%
METRICS	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Revenue growth	19.1%	11.1%	21.4%	2.0%	4.5%
Adj EBITDA growth	14.9%	7.2%	30.6%	5.0%	3.2%
Adj EBIT growth	16.0%	5.5%	16.1%	6.4%	3.9%
Adj PBT growth	15.8%	11.4%	15.1%	7.6%	5.0%
Adj EPS growth	17.0%	11.9%	14.9%	0.5%	5.4%
Dividend growth	3.6%	6.9%	6.5%	6.1%	5.7%
Adj EBIT margins	7.0%	6.7%	6.4%	6.6%	6.6%
VALUATION	**2021**	**2022**	**2023E**	**2024E**	**2025E**
EV/Sales (x)	0.5	0.5	0.4	0.4	0.4
EV/EBITDA (x)	6.5	6.1	4.7	4.4	4.3
EV/NOPAT (x)	7.7	7.3	6.3	5.9	5.7
PER (x)	9.0	8.1	7.0	7.0	6.6
Dividend yield	5.0%	5.3%	5.7%	6.0%	6.4%
FCF yield	10.3%	(6.5%)	15.5%	8.5%	11.5%

Source: Company information and Progressive Equity Research estimates

Progressive EQUITY RESEARCH

22 November 2022

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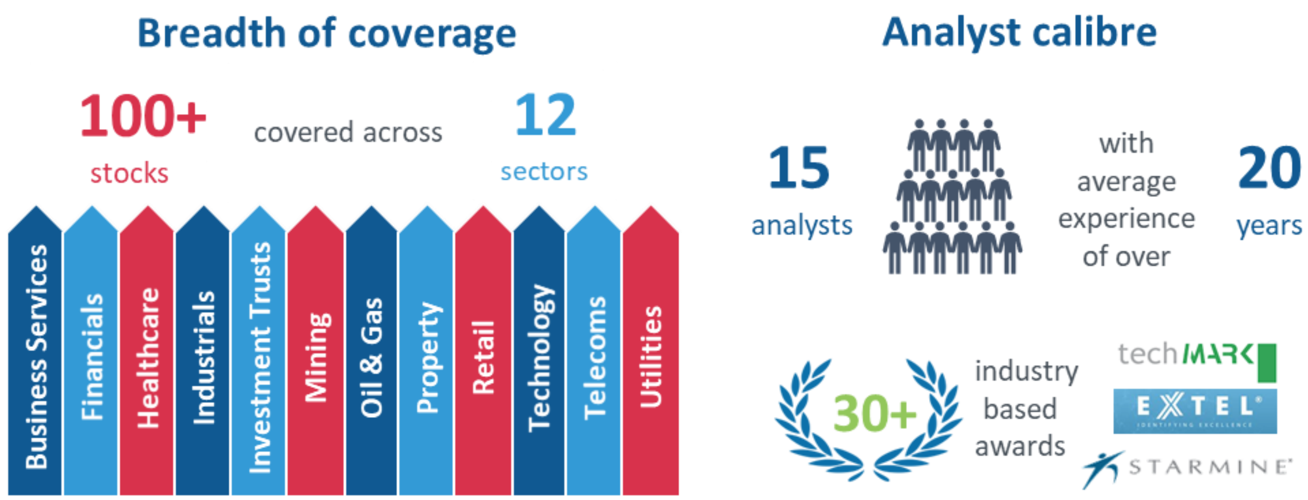

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