

SEVERFIELD

ENGINEERING & CONTRACTING SERVICES

22 April 2021

SFR.L

75.8p

Market Cap: £233.6m

SHARE PRICE (p)



12m high/low

80p/52p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	£4.0m (at 31/03/21)
Enterprise value	£229.6m
Index/market	LSE
Next news	FY results, 16 June
Shares in Issue (m)	308.2
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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Forecasts lifted after steel group raises the bar

We have raised our PBT estimates for FY2021E - 2023E after Britain's leading structural steel specialist this morning guided that results for FY2021E will be "comfortably above previous expectations". Orders have risen by 10% since November, net cash was better than we expected and the Group is "very encouraged" by the pipeline of new work opportunities in the UK and Europe, while conditions in the Indian JV have remained robust so far in the face of the pandemic. The Group has also pledged to cut carbon to zero.

- Guidance raised.** In the update, Severfield stated: "The Group is currently performing well and based on the good progress made in the second half of the 2021 financial year, we now expect to deliver a full year result which is comfortably above management's previous expectations". Year-end net cash was £4m, ahead of our estimate of £1m net debt, despite an initial £12m consideration for DAM Structures, acquired on 26 February. Orders rose by 9.8% to £315m, the second highest for at least six years.
- Margin estimates raised.** We have raised our adjusted PBT estimates for FY 2021E - 23E by 4.3%, 3.8% and 3.1% respectively, to reflect higher margins, and have also increased our net cash forecasts (Figure 1, over).
- "Good opportunities".** All group factories are now fully operational and have been trading at normal pre-pandemic levels since Q2 21. The UK and Europe order book has risen 9.8% to £315m, with £17m of the £28m increase from DAM, and 20% of the total for Europe and the Republic of Ireland. Severfield "continues to see a good number of opportunities, albeit at more competitive prices", in sectors including distribution, transport infrastructure, stadia and leisure, nuclear and data centres.
- Resilient performance in Indian JV.** After a loss making first quarter, the Indian JV has remained at break-even level. The market is "starting to show signs of recovery", reflected in an order book up 6% to £104m, mainly in higher margin commercial work, although the Group "remains mindful of the evolving Covid-19 backdrop in India".
- Carbon commitment.** Severfield also said it is signing up to SteelZero, pledging to transition to procuring, specifying, or stocking 100% net zero steel by 2050, with interim targets to be achieved by 2030 (see page 3).
- Growing markets and strong finances.** We believe Severfield should benefit from sectors such as infrastructure, logistics and datacentres; dominant market position; and strong balance sheet (page 6).

FYE MAR (£M)	2019	2020	2021E	2022E	2023E
Revenue	274.9	327.4	365.0	370.5	370.5
Fully Adj PBT	24.7	28.6	24.0	28.1	31.1
Fully Adj EPS (p)	6.6	7.7	6.3	7.4	8.2
Dividend per share (p)	2.8	2.9	2.9	3.1	3.3
PER (x)	11.5x	9.8x	12.0x	10.2x	9.3x
EV/EBITDA (x)	8.5x	7.4x	7.8x	7.0x	6.1x
Dividend yield	3.7%	3.8%	3.8%	4.1%	4.4%

Source: Company Information and Progressive Equity Research estimates.

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

Increased estimates reflect stronger margin assumptions, underpinned by strong order book

Margin outlook improves despite Covid costs

Our increased estimates (Figure 1) are almost entirely driven by higher margin assumptions, despite the cost of Covid-compliant working (which otherwise would have added approximately a further percentage point to margins, we estimate) and the more competitive pricing referred to in the update. We have not changed our revenue expectations (albeit we suspect they now look conservative, given strong orders) or the share of profits from JSSL, the Indian JV with the country's largest steel producer, JSW Steel.

We have made lower increases in EPS for FY 2022E and 2023E, of +3.0% and +2.2%, due to a higher number of shares (308.2m vs 306m) and, for FY 2023E, a tax rate of 20% rather than 19%, reflecting the start of the transition to higher rates signalled in the Budget.

Our estimates are underpinned, in our view, by the strength of the order book (Figure 2), which "which supports trading throughout the 2022 financial year and beyond", according to the statement. In addition to feeding to revenue, this strong position allows it better negotiating strength, supporting margins going forward, in our view.

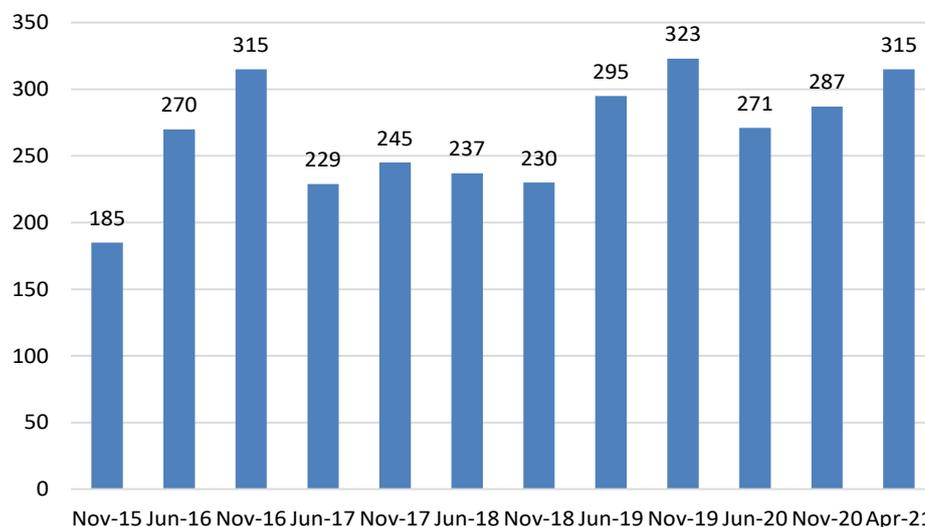
Figure 1: Main estimate changes

YE March (£m)	FY 21E new	FY 21E old	Diff (%)	FY 22E new	FY 22E old	Diff (%)	FY 23E new	FY 23E old	Diff (%)
Group revenue	365.0	365.0	0.0%	370.5	370.5	0.0%	370.5	370.5	0.0%
YoY change (%)	11.5%	11.5%		1.5%	1.5%		0.0%	0.0%	
Group op. margin (%)	6.9%	6.7%		7.8%	7.5%		8.4%	8.1%	
Group op. profit	25.3	24.3	4.1%	28.9	27.9	3.7%	30.9	30.0	3.1%
Share of income in JVs	(0.5)	(0.5)		0.4	0.4		1.4	1.4	
Op. profit inc JVs	24.8	23.8	4.1%	29.3	28.3	3.6%	32.3	31.4	2.9%
Exceptionals & gw	(3.3)	(3.3)		(2.8)	(2.8)		(2.8)	(2.8)	
Interest	(0.8)	(0.8)		(1.2)	(1.2)		(1.3)	(1.3)	
PBT, reported	20.7	19.7	5.0%	25.3	24.3	4.2%	28.3	27.3	3.4%
PBT pre-exc & goodwill	24.0	23.0	4.3%	28.1	27.1	3.8%	31.1	30.1	3.1%
EPS, dil., pre-exc (p)	6.3	6.0	4.3%	7.4	7.2	3.0%	8.2	8.0	2.2%
DPS - declared (p)	2.9	2.9	0.0%	3.1	3.1	0.0%	3.3	3.3	0.0%
EBITDA	29.3	28.3	3.5%	33.0	32.0	3.2%	37.9	37.0	2.5%
Net cash/(debt) pre-IFRS 16	4.0	(1.0)		3.8	1.8		4.1	1.4	

Source: Company Information and Progressive Equity Research estimates

H2 highlights: stronger orders, DAM deal and SteelZero pledge

Figure 2: Order book (£m)



Source: Company information

DAM acquisition strengthens rail capabilities as HS2 gathers traction

On 26 February Severfield acquired specialist fabricator DAM Structures for £12m and up to £15m in deferred and contingent considerations. Following the deal, we raised our adj EPS estimates for FY 2022E and 2023E by 6.2% and 5.6% respectively. DAM operates in complementary market sectors to Severfield, with strong growth potential including the propping, railway and steel piling markets, adding overhead line and temporary or permanent tunnelling capabilities to Severfield’s existing expertise in bridges and stations. This, in our view, should take Severfield further up the value chain in major infrastructure programmes such as HS2 and rail electrification over the next decade.

Data centres: growing demand for highly specialised skills

We see data centres as being one of Severfield’s most exciting growth markets with already strong demand accelerated by the global pandemic. According to the latest Data Centre Report from property consultancy Knight Frank and DC Byte, take up in EMEA markets increased by 11% to 701MW in 2020, while new supply grew by 19% to more than 1,589MW. Amsterdam led take-up growth, followed by London, Frankfurt, Paris and Dublin. Severfield has identified Europe as a significant growth area, including for data centres. A significant attraction is they require significantly more steel, in complex structures, to support the substantial air-conditioning equipment. We believe, the need to deliver these demanding projects on schedule rules out many groups.

SteelZero commitment strengthens ESG credentials

The Group has become the first of its major peers to sign up to SteelZero, a global client-led initiative to speed up the transition to a net zero steel industry. This commits Severfield to transition to procuring, specifying, or stocking 100% net zero steel by 2050, with certain interim targets to be achieved by 2030. We see this as aligning with investors’ priorities.

Estimates were previously upgraded after acquisition in February, which brought complementary skills, particularly in specialist rail engineering

Rise in remote working and communications from pandemic fuels already strong demand for highly demanding projects

Global initiative, led by steel buyers, in our view, chimes with growing environmental demands from institutional investors

Figure 3: P&L and per share data

YE March (£m)	2015	2016	2017	2018	2019	2020	2021E	2022E	2023E
Group revenue	201.5	239.4	262.2	274.2	274.9	327.4	365.0	370.5	370.5
<i>Change (%)</i>	-12.9%	18.8%	9.6%	4.6%	0.3%	19.1%	11.5%	1.5%	0.0%
<i>Group op. margin (%)</i>	4.5%	5.7%	7.5%	8.3%	8.5%	8.2%	6.9%	7.8%	8.4%
Group op. profit	9.0	13.7	19.6	22.9	23.3	27.0	25.3	28.9	30.9
Share of income in JVs	(0.2)	(0.2)	0.5	0.9	1.7	2.4	(0.5)	0.4	1.4
Op. profit inc JVs	8.8	13.5	20.1	23.7	24.9	29.3	24.8	29.3	32.3
Exceptionals & goodwill	(8.5)	(3.6)	(1.8)	(1.3)	-	(2.8)	(3.3)	(2.8)	(2.8)
Interest	(0.5)	(0.2)	(0.2)	(0.2)	(0.2)	(0.7)	(0.8)	(1.2)	(1.3)
PBT, reported	(0.2)	9.6	18.1	22.2	24.7	25.8	20.7	25.3	28.3
<i>Underlying tax rate (%)</i>	17.0	17.0	17.1	19.4	19.7	18.9	19.0%	19.0%	20.0%
Reported tax	0.3	(1.0)	(2.7)	(4.0)	(4.5)	(5.4)	(4.6)	(5.3)	(5.9)
Net attrib. profit	0.1	8.6	15.3	18.1	20.2	20.4	16.0	20.0	22.3
PBT pre-exc & goodwill	8.3	13.2	19.8	23.5	24.7	28.6	24.0	28.1	31.1
Wtd. ave. shares (million)	297.5	297.5	298.9	299.7	303.1	305.4	306.9	308.2	308.2
Diluted shares (million)	297.5	299.2	301.1	304.2	306.3	307.1	306.9	308.2	308.2
EPS, basic (p)	0.0	2.9	5.1	6.1	6.7	6.7	5.2	6.5	7.2
EPS, dil., pre-exc (p)	2.3	3.7	5.5	6.3	6.6	7.7	6.3	7.4	8.2
DPS - declared (p)	-	1.5	2.3	2.6	2.8	2.9	2.9	3.1	3.3
Dividend cover (x)	na	2.4	2.4	2.5	2.4	2.7	2.2	2.4	2.5
EBITDA	12.6	17.4	23.2	26.5	26.9	30.9	29.3	33.0	37.9
FCFPS (p)	2.8	6.6	6.5	4.5	2.6	5.0	4.9	2.9	5.5
TNAV (p)	26.5	29.9	32.7	38.1	39.6	34.5	37.6	42.1	44.8

Source: Company Information and Progressive Equity Research estimates

Figure 4: Adjusted cash flow and summary balance sheet

YE March (£m)	2015	2016	2017	2018	2019	2020	2021E	2022E	2023E
Adjusted cash flow statement									
Group op. profit ¹	6.2	10.9	16.7	21.4	23.2	25.6	22.4	26.1	28.1
Depreciation	3.6	3.7	3.6	3.7	3.6	3.9	4.0	4.1	4.2
Intangible amortisation	2.8	2.8	2.9	1.5	0.1	1.4	2.8	2.8	2.8
Other, non-cash	(6.0)	0.5	1.9	0.2	(1.1)	(0.7)	(0.4)	-	-
Changes in working capital	4.8	7.0	2.3	(3.7)	(7.9)	(2.2)	(1.8)	(10.7)	(3.7)
Operating cash flow	11.4	24.8	27.4	22.9	18.0	28.0	27.0	22.3	31.4
Capex (maintenance)	(1.3)	(4.1)	(5.3)	(5.4)	(6.3)	(6.2)	(6.5)	(6.8)	(7.2)
Interest, net	(0.8)	(0.2)	(0.2)	(0.2)	(0.4)	(0.6)	(0.8)	(1.2)	(1.3)
Tax	(1.0)	(0.9)	(2.4)	(3.9)	(3.4)	(6.0)	(4.6)	(5.3)	(5.9)
Free cashflow	8.4	19.6	19.5	13.4	8.0	15.2	15.1	9.0	17.0
Acquisitions, inv in JVs	(1.7)	(4.3)	(0.4)	(5.5)	(4.2)	(13.4)	(19.0)	-	(7.0)
Dividends - paid	-	(3.0)	(5.1)	(7.5)	(13.4)	(8.9)	(8.5)	(9.1)	(9.7)
Financing	(5.3)	(0.2)	(0.2)	(0.2)	1.5	26.4	-	-	-
Change in cash & equiv.	1.4	12.1	13.8	0.3	(8.1)	19.4	(12.4)	(0.2)	0.3
Summary balance sheet									
Intangible fixed assets	61.8	59.2	56.3	54.8	54.7	78.1	75.2	72.4	76.6
Tangible fixed assets etc	76.6	77.4	78.9	81.2	84.0	99.0	101.5	104.2	107.3
Investments	6.7	12.7	13.1	18.5	24.3	26.7	26.2	26.6	28.0
Working capital	10.9	0.7	(1.5)	1.7	8.4	(2.9)	(1.1)	9.6	13.3
Provisions, others	(5.3)	(5.8)	(3.8)	(2.9)	(1.6)	(14.9)	4.1	4.1	4.1
Retirement benefits	(16.5)	(14.6)	(21.4)	(17.2)	(20.0)	(18.7)	(18.7)	(18.7)	(18.7)
Net cash/(debt), pre-IFRS 16	6.4	18.7	32.6	33.0	25.2	16.4	4.0	3.8	4.1
Net assets	140.6	148.2	154.2	169.0	175.0	183.7	191.2	202.1	214.6

Source: Company Information and Progressive Equity Research estimates ¹ post intangible amortisation, pre other exceptionals

Largest structural steel group in UK with growing European opportunities

Significant losses in 2013 prompted major restructuring

Group has regularly navigated changing market trends

Severfield in brief

Severfield is the UK's largest structural steel group and one of the biggest in Europe. It has a total steel capacity of around 165,000 tonnes in its five UK plants and employs c. 1,400. 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* ([link](#)). Acquisitions of Harry Peers & Co in 2019 and Dam Structures this month have boosted revenue, earnings, capacity and reach into sectors such as, respectively, nuclear and rail.

The three main activities it performs are:

- the design of steel structures for buildings and infrastructure;
- the fabrication of steel sections and plate in its five UK factories;
- and the 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 have included 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 contractual losses in 2013, particularly on the Leadenhall Tower, the 'Cheesegrater', in the City of London, 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 FY 2015 and 2016 and we believe today's update further demonstrates the transition from restructuring to measured growth.

Operationally, we see less risk of over-capacity, more disciplined bidding, a continued shift to higher value, less commoditised work and greater managerial control. This improved quality of earnings and cashflow could, in our view, be reflected in an improved stock market rating. Now in net cash, and with a focus on high-entry barrier markets, it is targeting opportunities for growth, while a fragmented competition largely vies for more commoditised work.

Markets: ability to adapt to new growth markets as they emerge

Severfield has regularly navigated shifting patterns in demand, arguably on a more passive basis. Our opinion is there is now a more active strategy of leading rather than following demand, with the group investing in design capabilities and manufacturing capacity tailored to potentially long-term, structural growth sectors such as data centres, logistics and infrastructure, where clients are more dependent on security of delivery than, say, basic offices and retail. Europe and the potentially huge Indian market are examples of the Group's geographical strategy.

Financial Summary: Severfield

Year end: March (£m unless shown)

PROFIT & LOSS	2019	2020	2021E	2022E	2023E
Revenue	274.9	327.4	365.0	370.5	370.5
Adj EBITDA	26.9	30.9	29.3	33.0	37.9
Adj EBIT	23.3	27.0	25.3	28.9	30.9
Reported PBT	24.7	25.8	20.7	25.3	28.3
Fully Adj PBT	24.7	28.6	24.0	28.1	31.1
NOPAT	23.2	26.9	25.2	28.8	30.9
Reported EPS (p)	6.7	6.7	5.2	6.5	7.2
Fully Adj EPS (p)	6.6	7.7	6.3	7.4	8.2
Dividend per share (p)	2.8	2.9	2.9	3.1	3.3
CASH FLOW & BALANCE SHEET	2019	2020	2021E	2022E	2023E
Operating cash flow	18.0	28.0	27.0	22.3	31.4
Free Cash flow	8.0	15.2	15.1	9.0	17.0
FCF per share (p)	2.6	5.0	4.9	2.9	5.5
Acquisitions	(4.2)	(13.4)	(19.0)	0.0	(7.0)
Disposals	N/A	N/A	N/A	N/A	N/A
Shares issued					
Net cash flow	(8.1)	19.4	(12.4)	(0.2)	0.3
Overdrafts / borrowings	0.0	29.6	27.9	27.9	27.9
Cash & equivalents	25.0	44.3	31.9	31.8	32.1
Net (Debt)/Cash, pre-IFRS 16	25.2	16.4	4.0	3.8	4.1
NAV AND RETURNS	2019	2020	2021E	2022E	2023E
Net asset value	175.0	183.7	191.2	202.1	214.7
NAV/share (p)	57.6	60.0	62.0	65.6	69.7
Net Tangible Asset Value	120.3	105.6	116.0	129.7	138.2
NTAV/share (p)	39.6	34.5	37.6	42.1	44.8
Average equity	172.0	179.3	187.5	196.7	208.4
Post-tax ROE (%)	5.0%	8.5%	9.7%	10.3%	9.8%
METRICS	2019	2020	2021E	2022E	2023E
Revenue growth	N/A	19.1%	11.5%	1.5%	0.0%
Adj EBITDA growth	N/A	14.9%	(5.3%)	12.7%	15.0%
Adj EBIT growth	N/A	16.0%	(6.4%)	14.4%	7.1%
Adj PBT growth	N/A	15.8%	(16.3%)	17.3%	10.6%
Adj EPS growth	N/A	17.0%	(18.3%)	17.7%	10.1%
Dividend growth	N/A	3.6%	0.0%	6.9%	6.5%
Adj EBIT margins	8.5%	8.2%	6.9%	7.8%	8.4%
VALUATION	2019	2020	2021E	2022E	2023E
EV/Sales (x)	0.8	0.7	0.6	0.6	0.6
EV/EBITDA (x)	8.5	7.4	7.8	7.0	6.1
EV/NOPAT (x)	9.9	8.5	9.1	8.0	7.4
PER (x)	11.5	9.8	12.0	10.2	9.3
Dividend yield	3.7%	3.8%	3.8%	4.1%	4.4%
FCF yield	3.5%	6.6%	6.5%	3.8%	7.3%

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

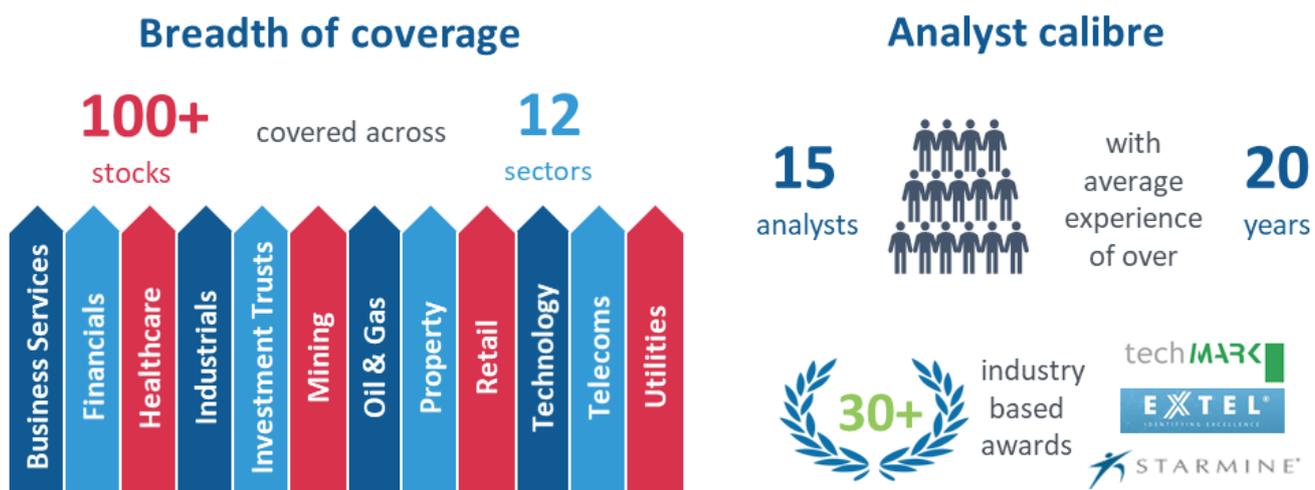
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