Low & Bonar

H116 results

Business improvement in action

General industrials

Significant investment activity, business portfolio management and more favourable financing have all been prominent features in the year to date, with group EBIT progress also delivered in H116. We expect Low & Bonar to deliver solid H2 performance and to continue its strategy of business improvement. Our estimates are modestly higher in the current year, more so in the following two and the FY17e P/E is now below 10x with a dividend yield of c 5%.

Year end	Revenue (£m)	PBT* (£m)	EPS FD* (p)	DPS (p)	P/E (x)	Yield (%)
11/14	410.6	25.2	5.4	2.7	11.5	4.3
11/15**	362.1	27.4	5.8	2.8	10.7	4.5
11/16e**	396.6	28.5	5.8	3.0	10.7	4.8
11/17e**	429.8	34.4	7.0	3.2	8.9	5.1

Note: *PBT and EPS fully diluted are normalised, excluding amortisation of acquired intangibles and exceptional items. **Ongoing businesses only.

H116 results demonstrate strategic progress

In the first six months of FY16, three of Low & Bonar's four ongoing business units demonstrated good revenue and margin progression, while the fourth was held back by internal production issues. Investment in these operations is starting to bear fruit and the intended exit from two Middle East-based businesses is a further affirmation of strategic execution under the new five-year plan. Net debt rose to £139.5m at the interim stage due to seasonal and timing effects. Cash flow back from these items, coupled with anticipated disposal proceeds of c £22m in H2, leads to our expected c £96m net debt at the year end.

Estimates moving up

We consider market conditions in the ongoing businesses to be mostly flat (in Civil Engineering and Coated Technical Textiles) to favourable (in Building & Industrial and Interiors & Transportation). Low & Bonar has entered its seasonally stronger H2 trading period, with favourable FX translation tailwinds also. After factoring in these effects and adjusting for lower interest costs, higher tax and discontinuing operations, our current year PBT estimate is marginally ahead with stronger upgrades for FY17 and FY18 also reflected in higher earnings.

Valuation: Dividend yield now, FY17 earnings step up

Low & Bonar's shares have mostly traded in the 55-65p range so far this year. Currently sitting just above the midpoint, the ytd movement is -7.4%. We would not consider the current year P/E of 10.5x (EV/EBITDA 6.6x) to be high at face value. The FY16e rating is inflated to some extent if we bear in mind that one business unit has experienced what we consider to be a temporary dip in profit contribution. One year further out, a rebound here, together with progress in the other three units, brings the P/E down sharply to 8.7x (EV/EBITDA 5.2x). In addition, Low & Bonar offers a prospective dividend yield of 4.9% (twice covered by earnings) and further growth anticipated.

2 August 2016

Price	**62.1p**
Market cap	**£204m**
	£/€1.20
Net debt (£m) at end May 2016	139.5
Shares in issue	329.0m
Free float	99%
Code	LWB
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	4.0	0.2	(10.6)
Rel (local)	1.7	(5.7)	(10.3)
52-week high/low		71.75p	55.00p

Business description

Low & Bonar produces specialist performance materials for a variety of end-markets by combining polymers with specialty additives and pigments. It now reports as four global business units: Civil Engineering (23%), Building & Industrial (18%), Interiors & Transport (27%), and Coated Technical Textiles (32%). (FY16e revenue split.)

Next events

Expected grass yarns disposal completion	End August 2016

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Low & BonarLow & Bonar is a research client of Edison Investment Research Limited

H116 results overview

Underlying group revenue and EBIT was modestly ahead in H116 and positive FX translation effects further enhanced reported numbers. Three of Low & Bonar's four ongoing business units grew underlying revenues and increased their EBIT margin, which more than carried a short-term profit reverse in Coated Technical Textiles. EPS and DPS were -1.4% and +2% respectively. Period-end net debt of £139.5m followed a c £33m cash outflow due to seasonal and some timing effects. An intention to exit certain manufacturing businesses in H216 was announced after the period end and they were reported as discontinuing activities in the H116 results. With no expected trading dislocations from the Brexit outcome expected, there are a number of other positive and negative influences on our estimates; the net result is a modest increase in expected PBT in FY16, with larger upgrades in FY17 and FY18, partly offset at the EPS level by a higher group tax charge.

Exhibit 1: Low & Bonar divisional and interim splits

£m	H115	H215	2015	H116	Reported	CER
					% ch y-o-y	% ch y-o-y
Group revenue	**169.9**	**192.2**	**362.1**	**180.6**	**+6.3%**	**+2.4%**
Building & Industrial	28.6	33.1	61.7	31.8	+11.2%	+6.4%
Civil Engineering	37.5	47.9	85.4	39.5	+5.3%	+1.3%
Coated Technical Textiles	58.2	62.2	120.4	60.1	+3.3%	---
Interiors & Transport	45.6	49.0	94.6	49.2	+7.9%	+3.8%
Group operating profit - reported (post SBP)	**12.3**	**19.5**	**31.8**	**13.3**	**+8.1%**	**+2.3%**
Building & Industrial	2.6	5.8	8.4	4.5	+73.1%	+66.7%
Civil Engineering	0.3	2.8	3.1	1.0	+233.3%	+233.3%
Coated Technical Textiles	6.7	6.1	12.8	3.5	-47.8%	-50.0%
Interiors & Transport	5.3	8.1	13.4	7.3	+37.7%	+30.4%
Unallocated central costs	-2.6	-3.3	-5.9	-3.0		

Source: Low & Bonar. Note: Ongoing operations only; prior year periods restated excluding the major part of Sport & Leisure (the smaller remaining UK operation is now reported as part of I&T). The Saudi JV was also reported as discontinuing, but was previously split out separately and not part of reported operating profit.

Building & Industrial (18% H116 revenue, 28% pre-central cost EBIT; margin 14.2%, +510bp)

Technical textiles, mats, composites, systems and screens for a range of applications

This business unit (BU) put in the strongest performance in the group in both revenue and EBIT margin progression terms. This progress was largely volume-driven with some contribution from pricing/mix also. Building products (around two-thirds of BU sales) saw good levels of demand in North America supplemented by new customer business in roofing products. The industrial subsectors also maintained recent momentum in filtration products (for automotive applications), although agricultural product sales development was constrained by a slower than expected recovery in manufacturing performance at the Lokeren facility. Progress is anticipated here over the remainder of FY16 and into FY17.

Civil Engineering (22% revenue, 6% EBIT; margin 2.5%, +170bp)

Geotextiles and construction fibres contributing to groundworks integrity in infrastructure projects

Market conditions in Europe were described as stable, but with no significant y-o-y improvement. In the period, sales strategy resulted in modestly lower volume but improved pricing/mix, leaving underlying revenue ahead y-o-y. A new divisional director was appointed during FY15, among other things to improve the BU's presence in higher-margin specification sales channels. There is understood to be progress in this regard and margin gains on flat volumes are an indication that P&L investment is beginning to bear fruit. New construction fibre capacity came on stream during H1, although its contribution will not have been material in the period. This BU is H2 seasonally weighted, so further EBIT margin progress is anticipated, although it remains well below the group average for the time being.

Coated Technical Textiles (33% revenue, 21% EBIT; margin 5.8%, -570bp)

Specialist coated woven carrier fabrics for a range of primarily outdoor applications

In underlying terms, while revenue was flat y-o-y in H116 (with volumes up slightly offset by pricing/mix effects), EBIT came in at half the level of the previous year. Margin mix partly contributed to this with trailer curtain volumes up, but architectural membrane demand remaining subdued and lower y-o-y. Operationally, this placed additional strain on the two German coating facilities (ie a larger proportion of lower-volume, shorter runs) and resulted in suboptimal performance. Under a new divisional director, changes are being implemented and management expects most of the process improvements to be bedded in by year end, resulting in enhanced manufacturing capability. In turn, this should facilitate increased volume throughput in due course.

Interiors & Transportation (27% revenue, 45% EBIT; margin 14.8%, +320bp)

Leading provider of technical non-woven carpet-backing materials, branded as Colback

The new greenfield Colback facility in Changzhou, China was successfully commissioned in H1, supporting volume growth of c +6% for this BU and further margin improvement building on good progress in FY15. Demand from carpet/carpet tile manufacturers was particularly healthy, while that from the automotive segment (less than 20% of BU revenue) was also ahead. (The retained UK woven carpet-backing operation is now reported under this BU – FY15 figures have been restated accordingly – and dilutes I&T margins slightly.) Regionally, North American demand has remained strong and Asian revenues grew to c £10m in the period, of which c £4m was from locally manufactured product in Changzhou. After a two-year development and £26m investment phase, this facility appears to have come on stream in line with plan and is to form the platform for further growth in the region. Phase II expansion has already been announced (a further US$29m/£19m investment to double capacity) and is expected to be commissioned at the end of 2017. With leading market shares in North America and Europe already, this BU now clearly has global capability with a balance of regional manufacturing facilities in its key markets.

Discontinuing operations

On 4 July, Low & Bonar announced the intended disposal of its artificial grass yarns manufacturing business in Abu Dhabi to Mattex Group. Additionally, the Bonar Natpet JV in Saudi Arabia, which produces lighter-end civil engineering materials, was also classified as discontinuing in the H116 results pending a solution to eliminate Low & Bonar's exposure to its trading losses.

Sport & Leisure: having taken full ownership of Bonar Emirates Technical Yarns in FY15, grass yarn production was consolidated in Abu Dhabi during that year. Hence the disposal of this business and related assets represents a clean exit from this activity subject only to the conclusion of staff consultation for grass yarn-related staff based in the UK. Completion is expected to be no later than 31 August and net proceeds of €29m are anticipated. As noted above, the UK non-grass yarn business (ie carpet-backing materials, based in Dundee) is retained and now part of the I&T BU; in FY15, it achieved £4.6m revenue and £0.3m reported EBIT (before allocated central costs).

Saudi JV: this company became operational at the end of 2013, but its market development has been much slower than originally envisaged. This investment (equity and loan) was written down to zero value during FY15 and we now expect an exit in some form from the JV during the current year with no additional cash implications.

Impact on estimates: before the disposal announcement and H116 results, our estimates included a reducing JV loss (from £1.5m in FY16 to break-even in FY18) and modest profit progress from S&L (from £1.8m to £2m over the same period), a small proportion of which is retained. Allowing for some orphan central costs (c £0.3m previously in S&L, now absorbed elsewhere) and lower interest costs due to the grass yarn disposal proceeds (c £22m net), the impact on our previous estimates is broadly neutral in FY16 and reduces FY17 and FY18 PBT by c £0.4m and c £1.1m respectively. This is before taking into account trading and FX impacts on the ongoing business (see below).

Net debt reduction expected in FY16

Net debt ended the period at £139.5m, having risen by £37.4m during H116. Of this increase, £32.7m (87%) was due to cash outflow and the remainder reflected adverse currency translation effects (end H116 £/€1.27 versus £/€1.35 at the end of FY15).

H116 cash outflow amplified. As a group, Low & Bonar's business has a second half weighting, driven particularly by normal Civil Engineering and Building & Industrial seasonal trading patterns. As a result, the company's cash flow profile usually includes a working capital build (and outflow) in H1, which substantially flows back in H2. The former effect was amplified in H116 by three unrelated features, being inventory build for China (ahead of and subsequent to the new facility being commissioned) and in the grass yarns business ahead of disposal, plus a smaller amount arising from the Lokeren production issues. Together, these accounted for around two-thirds of a c £15m inventory outflow in the period. With an adverse payables timing effect also, the total working capital outflow in H116 was £26m. So, although Low & Bonar generated EBITDA c £2m higher than a year earlier in the first half, operating cash outflow was £4.5m in the period compared to a (restated) £6.9m inflow in H115.

Looking at the other components of cash flow, interest, tax and dividends accounted for almost £14m of cash payments in H116 (up from £12.2m in the prior year) and total capex of £14.3m. The latter included the final build and commissioning costs of the new China facility, an additional construction fibre line in Hungary and initial spend on a new ERP system. Note that no disposal proceeds were received in the period; we have factored in the £22m net for grass yarns to come in during H216 and the JV exit to be cash neutral.

Significant inflow expected in H216. As well as the disposal receipts, we expect Low & Bonar's second half cash flow highlights to include c £21m working capital inflow, again an underlying seasonal effect exaggerated by a flow back of some of the unusual H1 items. Full year tangible capex is likely to below the £33m level seen in FY15, but will continue to be well above expected depreciation (£16m in FY16, rising thereafter) over the next three years. As well as the China Phase II investment, there is a willingness to invest in other higher value-added business activities. Our estimates include c £28m for the current year and £25m in each of the next two. We should also mention an expected pension cash recovery outflow of c £4.5m, in line with the prior year. Including these outflows and factoring in seasonally stronger H2 trading (our estimates infer a 40:60 H1:H2 EBIT split) and working capital profile indicated above, we expect a significant swing in free cash flow for Low & Bonar of c £50m between H1 and H2 and slightly negative for the year overall. Including disposal proceeds net of the H116 dividend cash payment generates a full year group cash inflow just above £10m.

Net debt ends FY16 just below 2x EBITDA. Our analysis suggests that Low & Bonar's net debt position at the end of FY16 will have reduced to c £96m versus £139.5m at the interim stage and £102m at the end of FY15. (This excludes possible further adverse period-end translation effects on c £77m/€98m euro-denominated debt at the end of H1.) Compared to our expected EBITDA of £50.6m for FY16, this represents a multiple of 1.9x.

Since the end of H116, Low & Bonar has refinanced an existing private placement loan note (€45m to September 2016 at 5.9%) with a new larger one on improved terms (€60m with 2024 average term at 2.57%). This reduces group interest costs by c £1m in a full year and takes total committed facilities on hand to £187m with a further c £23m accordion arrangement. Against our projected end-FY16 net debt, the company clearly retains some financial flexibility and a reasonably large headroom position. As well as investing in existing operations, the management team is actively looking for related M&A opportunities that diversify and extend the global product reach of these businesses. Beyond the current year, with high capex levels sustained and a rising dividend profile, we currently see FY17 as effectively cash neutral and FY18 in the order of £8m cash positive.

Positive net influences on headline estimates

H116 results were reported soon after the EU referendum result. We detected no specific management comments pointing to direct impacts in any of its markets at that initial stage. The results presentation contained a geographic matrix plotting customer location against that for the company's selling entity; the key messages here were that the majority of trade is intra-region and that the proportion of euro debt and cash generation is broadly in line. Profits are substantially generated outside the UK and consequently sterling weakness has a positive translation effect on reported earnings.

As far as estimates are concerned, there are three key influences on our revisions:

- **Underlying trading performance:** for the ongoing businesses we have made a modest upward adjustment to expected revenues in all three forecast years and a small reduction to current year EBIT with larger increases in the following two years. In all periods, this is the net result of better momentum in three divisions and a more conservative view on CTT, especially in FY16.
- **Currency movements:** in addition to the underlying performance, we have updated estimates to reflect more favourable FX translation effects on overseas earnings – especially the euro – to the tune of almost £2m in FY16 and £3m pa thereafter.
- **Discontinued:** the grass yarns and Saudi JV businesses are now stripped out from ongoing business performance, as outlined earlier.

In addition, we have trimmed interest costs for the current year and by £1m thereafter and now apply a 30% group tax charge (nudged up in all three years) in the absence of the grass yarn profit contribution, which attracted a zero charge.

The net result of all of these changes on key headline metrics is shown in Exhibit 2.

Exhibit 2: Low & Bonar estimate revisions

	EPS (p)			PBT (£m)			EBITDA (£m)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2016e	5.9	5.8	-1.7	28.0	28.5	+1.8	49.6	50.4	+1.6
2017e	6.4	7.0	+9.4	29.9	34.4	+15.1	51.7	56.6	+9.5
2018e	6.9	7.7	+11.6	32.2	37.6	+16.8	54.3	60.6	+11.6

Source: Edison Investment Research

Exhibit 3: Financial summary

£m	2013	2013	2014	2015	2015	2016e	2017e	2018e
Year end 30 November	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
		Restated IAS19R	IAS19R	IAS19R	Restated IAS19R	IAS19R	IAS19R	IAS19R
PROFIT & LOSS					**Cont.**	**Cont.**	**Cont.**	**Cont.**
Revenue	403.1	403.1	410.6	395.8	362.1	396.6	429.8	435.5
Cost of Sales								
Gross Profit								
EBITDA	45.6	44.8	45.0	45.8	40.0	50.4	56.6	60.6
Operating Profit (ex SBP)	32.8	32.0	32.3	33.4	32.4	34.4	39.6	42.6
Net Interest	(5.3)	(5.3)	(5.0)	(4.2)	(4.2)	(4.7)	(4.0)	(3.9)
SBP	(0.6)	(0.6)	(0.6)	(0.6)	(0.6)	(0.9)	(0.9)	(0.9)
Saudi JV	0	(0.6)	(1.1)	(1.8)	0.0	0.0	0.0	0.0
PNFC	(0.8)	(0.8)	(0.4)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
Profit Before Tax (company norm)	26.1	25.3	25.2	26.5	27.4	28.5	34.4	37.6
Intangible Amortisation	(5.6)	(5.6)	(5.2)	(4.1)	(4.1)	(4.1)	(4.1)	(4.1)
Exceptionals	(2.7)	(2.4)	(3.3)	(10.1)	(1.0)	(0.4)	0	0
Profit Before Tax (FRS 3)	17.8	16.7	16.7	12.4	22.3	24.1	30.4	33.5
Tax	(5.0)	(4.9)	(4.9)	(6.3)	(6.2)	(8.0)	(10.4)	(11.3)
Minorities	(0.5)	(0.5)	(0.3)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Discontinung					(9.0)	(2.6)	0.0	0.0
Profit After Tax (norm)	19.6	18.2	18.3	18.6	19.8	19.7	23.8	26.0
Profit After Tax (FRS 3)	12.8	11.8	11.8	6.1	6.6	16.1	20.0	22.2
Average Number of Shares Outstanding (m)	301.0	301.0	327.0	328.1	328.1	328.7	328.7	328.7
EPS FD- normalised (p)	6.1	5.9	5.4	5.5	5.8	5.8	7.0	7.7
EPS - FRS 3 (p)	4.1	3.7	3.5	1.7	1.7	4.7	5.9	6.6
Dividend per share (p)	2.6	2.6	2.7	2.8	2.8	3.0	3.2	3.3
Gross Margin (%)								
EBITDA Margin (%)	11.3	11.1	11.0	11.6	11.0	12.7	13.2	13.9
Operating Margin (before amort. and except) (%)	8.1	7.9	7.9	8.4	8.9	8.7	9.2	9.8
BALANCE SHEET								
Fixed Assets	232.9	232.9	230.2	232.0	223.6	240.1	244.8	248.4
Intangible Assets	115.2	115.2	105.8	89.9	89.9	94.7	91.4	88.0
Tangible Assets	114.2	114.2	119.3	132.0	123.6	140.3	148.3	155.3
Investments/other	3.5	3.5	5.1	10.1	10.1	5.1	5.1	5.1
Current Assets	186.4	186.4	192.0	187.6	196.0	189.6	198.7	207.9
Stocks	86.8	86.8	90.9	82.6	70.3	85.8	89.9	89.1
Debtors	63.8	63.8	62.8	62.9	67.2	65.0	68.5	68.4
Other	17.9	17.9	12.5	8.2	28.4	8.7	9.3	11.1
Cash	17.9	17.9	25.8	33.9	30.1	30.1	30.9	39.3
Current Liabilities	(88.4)	(88.4)	(87.7)	(114.4)	(115.6)	(94.3)	(102.3)	(107.8)
Creditors	(88.4)	(88.4)	(87.7)	(82.9)	(84.1)	(94.3)	(102.3)	(107.8)
Short term borrowings	0.0	0.0	0.0	(31.5)	(31.5)	0.0	0.0	0.0
Long Term Liabilities	(142.5)	(142.5)	(147.6)	(133.3)	(132.0)	(154.6)	(150.3)	(146.0)
Long term borrowings	(104.7)	(104.7)	(113.8)	(104.5)	(104.5)	(126.6)	(126.6)	(126.6)
Other long term liabilities	(37.8)	(37.8)	(33.8)	(28.7)	(27.5)	(28.0)	(23.7)	(19.4)
Net Assets	188.4	188.4	186.9	171.9	172.0	180.9	190.8	202.5
CASH FLOW								
Operating Cash Flow	35.9	35.9	34.1	35.3	35.3	40.7	50.9	59.8
Net Interest	(4.8)	(4.8)	(4.5)	(4.5)	(4.5)	(4.7)	(4.0)	(3.9)
Tax	(6.8)	(6.8)	(7.7)	(7.5)	(7.5)	(8.6)	(10.4)	(11.3)
Minority dividends				(1.0)	(1.0)			
Capex	(13.4)	(13.4)	(20.2)	(33.7)	(33.7)	(29.5)	(25.7)	(25.7)
Acquisitions/disposals	(25.0)	(25.0)	3.0	0.0	0.0	22	0	0
Financing	19.9	19.9	0	0.3	0.3	0	0	0
Dividends	(7.2)	(7.2)	(8.8)	(9.0)	(9.0)	(9.2)	(10.0)	(10.5)
Net Cash Flow	(1.4)	(1.4)	(4.0)	(20.1)	(20.1)	10.6	0.8	8.4
Opening net debt/(cash)	82.6	82.6	86.8	88.0	88.0	102.1	96.5	95.7
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	(2.8)	(2.8)	2.8	6.0	6.0	-4.7	0.0	0.0
Closing net debt/(cash)	86.8	86.8	88.0	102.1	102.1	96.2	95.7	87.3

Source: Company accounts, Edison Investment Research

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