CHIEF FINANCIAL OFFICER'S REPORT

"Group revenue growth again outperformed the market and cash generated remains strong."

Paul James
Chief Financial Officer

	2018 £m	2017 £m	Change
Revenue	**433.2**	411.7	+5.2%
Underlying operating profit	**74.0**	72.6	+1.9%
Underlying operating margin	**17.1%**	17.6%	-50bps

	2018 £m	2017 £m	Change %
UK	**387.1**	365.7	+5.9
Rest of Europe	**21.5**	18.9	+13.8
Rest of World	**24.6**	27.1	-9.2
Group	**433.2**	411.7	+5.2

UK revenue **5.9% higher,** *materially ahead of overall UK construction market*

Group revenue for the year ended 31 December 2018 was £433.2m (2017: £411.7m), an increase of 5.2%. With the acquisitions of Permavoid and Manthorpe on 31 August and 25 October 2018, respectively, Group revenue includes £4.1m from these businesses for the periods since acquisition and on a like-for-like basis, excluding the impact of these businesses, Group revenue increased by 4.2%. UK revenue growth was up 5.9% with approximately 2.8% driven by price increases and 3.1% from volume increases, of which 1.1% was derived from the acquisitions. This level of growth was materially ahead of the overall UK construction market where the Construction Products Association (CPA) winter forecast suggests a slight year-on-year decline of 0.2%. The Group's year-on-year growth for the first half was essentially flat as it was impacted by the severe winter weather, with strong year-on-year growth in the second half of 10.6%.

The Group underlying operating margin of 17.1% (2017: 17.6%) was impacted by the dilutive effect of increasing selling prices to recover absolute cost inflation as well as the relative growth in lower margin new housebuilding volumes and increased costs caused by operating at or near full capacity in some areas towards the end of the year.

ACQUISITIONS

On 31 August 2018, the Group acquired Permavoid, a specialist designer and supplier of surface water management solutions in commercial, residential, and sports pitch applications, for an initial cash consideration of £4.0m on a debt and cash-free normalised working capital basis, and further contingent consideration of up to £12.5m depending on the EBITDA performance of Permavoid in the two years to 30 September 2020. In accordance with IFRS 3, £1.7m contingent consideration has been accrued at the end of 2018.The acquisition of Permavoid has contributed £1.3m to Group revenue in the year and revenue for the full 12-month period ended 31 December 2018 was £5.1m. On 25 October 2018, the Group acquired Manthorpe, a leading UK producer of a range of moulded and extruded plastic and metal products, and associated land and buildings for £52.1m on a debt and cash-free normalised working capital basis. The acquisition of Manthorpe has contributed £2.8m to Group revenue in the year and revenue for the full 12-month period ended 31 December 2018 was £17.2m. These acquisitions were funded entirely from the Group's revolving credit facility. Acquisition costs of £2.0m have been charged to non-underlying items.

DISPOSALS

On 29 March 2018, the Group completed the sale of Polypipe France Holding SAS (Polypipe France), its French operations, to Ryb S.A., a France-based manufacturer and distributor of plastics in Europe, for €16.5m on a debt and cash-free normalised working capital basis. The results for Polypipe France have been treated as discontinued since 2017.

IFRS 16, LEASES

IFRS 16, Leases, was issued in January 2016 and is mandatory for annual reporting periods commencing 1 January 2019. The Group did not apply for early adoption of IFRS 16 and will first report under the new standard in the interim consolidated financial statements for the six months ending 30 June 2019, and the consolidated financial statements for the year ending 31 December 2019. The Group has reviewed all material leasing arrangements over the last year in light of the new lease accounting rules and these existing leases mainly relate to cars, some property and forklift trucks used in warehousing. The Group does not have any leases previously classified as finance leases. The Group will adopt the simplified approach to transition and will not restate comparative amounts for the year prior to first adoption. In 2019, the Group's lease commitments will be brought onto the Group's balance sheet and the timing of the recognition of lease costs within the income statement will change.

The value of lease commitments at 31 December 2018 was £14.0m. The Group expects to recognise an increase in total liabilities within the range of £12.0m – £14.0m, and the same increase in total assets. The difference between the value of lease commitments and increase in total liabilities is largely driven by the requirement to discount the lease liabilities to present value.

On a pro forma basis the Group expects that underlying EBITDA would increase by approximately £3.9m, that underlying operating profit would increase by approximately £0.2m – £0.4m and that underlying profit before tax would reduce by approximately £0.1m – £0.3m for 2019 as a result of adopting the new rules. Operating cash flows will increase, and financing cash flows will decrease because repayment of the principal portion of the lease liabilities will be classified as cash flows from financing activities. Leverage is expected to increase by approximately 0.1x as a result of including the lease liabilities within net debt partially offset by an increase in EBITDA. Interest cover is expected to reduce by approximately 0.5x as a result of a marginal increase in interest costs from the unwinding of the discount on lease liabilities. No impact is expected on banking covenants as a result of the ability to use the financial position excluding the impact of IFRS 16 under the revolving credit facility (RCF) agreement (so-called 'frozen GAAP'). Further details of the change can be found in Note 4 to the consolidated financial statements.

NON-UNDERLYING ITEMS

Non-underlying items in both 2018 and 2017 included non-cash amortisation charges in respect of intangible assets recognised with the acquisitions made during 2015. In addition, the amortisation of intangible assets charge in 2018 was impacted by the fair valuation of intangible fixed assets on the acquisition balance sheets of Manthorpe and Permavoid. Intangible assets have increased by £25.1m in the case of Manthorpe and £2.9m in respect of Permavoid, attracting additional amortisation of £0.3m (Manthorpe) and £0.1m (Permavoid).

The provision for restructuring costs of £4.3m recognised in 2017 in respect of our Middle East business has now been fully utilised. The other items included in non-underlying items are highlighted in the narrative further below.

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NON-UNDERLYING ITEMS COMPRISED:

	2018 £m	2017 £m
Amortisation of intangible assets	**5.9**	5.5
Restructuring costs	**–**	4.3
Acquisition costs	**2.0**	0.3
Contingent consideration on acquisitions	**0.3**	–
Unamortised debt issue costs written off	**0.6**	–
Loss on disposal of assets classified as held-for-sale	**0.1**	–
Non-underlying items before taxation	**8.9**	10.1
Taxation	**(1.1)**	(1.2)
Non-underlying items after taxation	**7.8**	8.9

Final dividend of
7.9 pence

Interest margin reduced
10 bps

Taxation on non-underlying items is covered in the note on taxation below.

EXCHANGE RATES

The Group trades predominantly in Sterling but has some revenues and costs in other currencies, mainly the US Dollar and the Euro, and takes appropriate forward cover on these cash flows using forward currency derivative contracts in accordance with its hedging policy.

FINANCE COSTS

Underlying finance costs of £6.9m (2017: £6.9m) are in line with last year and have a cover of 11.3x. The raised gearing from the acquisitions was in the very last stages of the year, marginally increasing borrowing costs for the period.

Interest is payable on the RCF at LIBOR plus an interest rate margin ranging from 0.90% to 2.75%. The interest rate margin at 31 December 2018 was 1.65% (2017: 1.75%).

In order to reduce exposure to future increases in interest rates the Group entered into interest rate swaps at fixed rates ranging between 1.735% and 2.21% (excluding margin) with notional amounts hedged ranging from £60.0m to £91.7m over the period of the interest rate swaps.

TAXATION

Underlying taxation:

The underlying tax charge in 2018 was £10.5m representing an effective tax rate of 15.6% (2017: 18.0%). This was below the UK standard tax rate of 19.00% (2017: 19.25%). Patent box relief contributes to a lowering of the effective tax rate by some 1.5 percentage points. In addition, the Group has released legacy tax provisions no longer required of £0.6m and recognised a deferred tax asset resulting from the acquisition of Manthorpe in respect of previously unrecognised tax losses, resulting in a benefit of £0.6m.

Taxation on non-underlying items:

The non-underlying taxation credit of £1.1m in 2018 represents an effective rate of 12.4%, due to £2.0m of acquisition costs being treated as disallowable for tax purposes.

EARNINGS PER SHARE FROM CONTINUING OPERATIONS

	2018	2017
Pence per share:		
Basic	**24.5**	22.7
Underlying basic	**28.4**	27.2
Diluted	**24.3**	22.5
Underlying diluted	**28.1**	26.9

Underlying basic EPS
4.4% higher

Dividends
4.5% higher

The Directors consider that the underlying earnings per share (EPS) measure provides a better and more consistent indication of the Group's underlying financial performance and a more meaningful comparison with prior and future periods to assess trends in our financial performance.

Underlying basic EPS improved by 4.4% in 2018 due to the improved underlying operating result after taxation.

DIVIDEND

The final dividend of 7.9 pence per share is being recommended for payment on 29 May 2019 to shareholders on the register at the close of business on 23 April 2019. The ex-dividend date will be 18 April 2019.

Our dividend policy is to pay a minimum of 40% of the Group's annual underlying profit after tax. The Directors intend that the Group will pay the total annual dividend in two tranches, an interim dividend and a final dividend, to be announced at the time of announcement of the interim and preliminary results respectively with the interim dividend being approximately one half of the prior year's final dividend.

BALANCE SHEET

The Group's balance sheet is summarised below:

	2018 £m	2017 £m
Property, plant and equipment	**118.4**	98.6
Goodwill	**343.0**	319.7
Other intangible assets	**58.9**	36.8
Net assets classified as held-for-sale	**–**	13.1
Net working capital	**(4.1)**	0.4
Taxation	**(17.3)**	(12.6)
Other current and non-current assets and liabilities	**(3.5)**	(5.6)
Net debt (loans and borrowings, net of cash and cash equivalents)	**(164.2)**	(148.4)
Net assets	**331.2**	302.0

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Property, plant and equipment increased by £19.8m and, excluding the effect of the inclusion of assets from the acquisitions of Permavoid and Manthorpe, increased by £9.0m, predominantly due to capital expenditure exceeding depreciation.

Goodwill increased by £23.3m primarily due to the acquisitions of Permavoid and Manthorpe. Other intangible assets increased by £22.1m with fair value adjustments associated with the acquisition of Permavoid and Manthorpe being offset by the routine amortisation of patents, brand names and customer relationships. Net working capital reduced by £4.5m due to continued robust management in our businesses. Net debt is discussed below.

PENSIONS

The Group does not have any defined benefit pension schemes and only has defined contribution pension arrangements in place. Pension costs for the year amounted to £2.8m (2017: £2.7m).

CASH FLOW AND NET DEBT

The Group's cash flow statement is summarised below:

	2018 £m	2017 £m
Operating cash flows before movement in net working capital	**86.2**	90.4
Add back non-underlying cash items	**4.4**	0.5
Underlying operating cash flows before movement in net working capital	**90.6**	90.9
Movement in net working capital	**3.8**	(10.0)
Underlying cash generated from operations	**94.4**	80.9
Capital expenditure net of disposals	**(23.2)**	(23.2)
Underlying cash generated from operations after net capital expenditure	**71.2**	57.7
Income tax paid	**(11.2)**	(12.6)
Interest paid	**(6.1)**	(6.6)
Non-underlying cash items	**(4.4)**	(0.5)
Acquisition of businesses	**(56.1)**	–
Disposal of businesses	**13.6**	–
Dividends paid	**(22.3)**	(21.0)
Proceeds from exercise of share options net of purchase of own shares	**0.3**	(0.7)
Other	**(0.8)**	(0.4)
Movement in net debt	**(15.8)**	15.9

The Group is highly cash-generative. Underlying cash generated from operations after net capital expenditure at £71.2m (2017: £57.7m) represents a conversion rate of 96% (2017: 79%). This improvement in conversion rate followed a programme in 2017 to replenish stock levels after a period of pre-price increase buying at the end of 2016. As a result of business growth, the Group sustained elevated net capital expenditure investment of £23.2m (2017: £23.2m), which was significantly ahead of depreciation levels, focusing on capacity expansion, efficiency improvement and innovation. The Group spent £56.1m on the acquisition of Permavoid and Manthorpe during the year and received £13.6m for the disposal of Polypipe France.

Net debt
1.7
times pro forma EBITDA

Sustained investment in strategic growth opportunities
1.5
times depreciation

Net debt of £164.2m comprised:

	2018 £m	2017 £m	Change £m
Bank loans	**(212.0)**	(185.0)	(27.0)
Cash and cash equivalents	**46.2**	35.7	10.5
Net debt (excluding unamortised debt issue costs)	**(165.8)**	(149.3)	(16.5)
Unamortised debt issue costs	**1.6**	0.9	0.7
Net debt	**(164.2)**	(148.4)	(15.8)
Net debt (excluding unamortised debt issue costs): pro forma EBITDA	**1.7**	1.6	

FINANCING

In light of the uncertainty posed by the UK's withdrawal from the EU, the Group took the decision to bring forward the renewal of its secured revolving credit facility (RCF) from mid-2019. The RCF was increased from £290m to £300m and renewed for a period of five years to November 2023 with two further uncommitted annual renewals through to November 2025 possible. A new uncommitted 'accordion' facility of up to £50m was also added. Refinancing costs of £1.7m will be amortised over the life of the RCF. Unamortised costs of £0.6m from the previous refinancing were written off within non-underlying items. The margin payable under the renewed RCF is 10 basis points lower than the previous agreement for gearing levels up to 2.0x EBITDA.

The Group is subject to two financial covenants. At 31 December 2018 there was significant headroom and facility interest cover and net debt to EBITDA covenants were comfortably achieved:

Covenant:	Covenant requirement	Position at 31 December 2018
Interest cover	>4.0:1	11.3:1
Leverage	<3.0:1	1.7:1

At 31 December 2018, liquidity headroom (cash and undrawn committed banking facilities) was £134.2m (2017: £140.7m) with the new RCF raised slightly to £300m compared to the previous RCF (2017: £290m). Focus will continue to be on deleveraging and, despite the two debt-funded acquisitions totalling £56.1m in the year, our net debt to EBITDA ratio stood at 1.7x pro forma EBITDA at 31 December 2018 (2017: 1.6x). This headroom means the Group enters 2019 well-positioned with a strong balance sheet.

FORWARD-LOOKING STATEMENTS

This report contains various forward-looking statements that reflect management's current views with respect to future events and financial and operational performance. These forward-looking statements involve known and unknown risks, uncertainties, assumptions, estimates and other factors, which may be beyond the Group's control and which may cause actual results or performance to differ materially from those expressed or implied from such forward-looking statements. All statements (including forward-looking statements) contained herein are made and reflect knowledge and information available as of the date of preparation of this report and the Group disclaims any obligation to update any forward-looking statements, whether as a result of new information, future events or results or otherwise. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements due to the inherent uncertainty therein. Nothing in this report should be construed as a profit forecast.

Paul James
Chief Financial Officer