Edison investment research

28 November 2008

British Polythene Industries

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/07	424	11.5	32.3	22.0	5.5	12.4
12/08e	490	4.0	11.1	22.0	16.0	12.4
12/09e	360	9.5	26.5	22.0	6.7	12.4

Note: *PBT and EPS are normalised, excluding goodwill amortisation.

Investment summary: Necessary restructuring

Two announcements in successive weeks present good and bad news on costs and volumes, respectively, and measures to deal with these market changes. In the current environment, the news of the extension of the group's banking facilities is perhaps as welcome as the steps to reduce costs.

Accelerating volume declines lead to plant closure

BPI reported a 5% decline in volumes in the third quarter leaving volumes flat for the first nine months of the year, despite acquisition benefits. Construction-related sales (15% of the total) are down nearly a third, however retail food and agriculture are as resilient as usual. While we are already forecasting a decline in UK operations for the full year, the increasingly uncertainty prompts a more cautious view for 2009 and we expect a small volume decline across the group. BPI is to close the loss making Stockton site and transfer production to other plants progressively in H1.

Downward price trend should help margins

The anticipated fall in polymer input prices is occurring, which is encouraging, as it removes the margin squeeze BPI has faced in the last few years. The expectation of lower product prices is resulting in some deferred volumes, however, on the positive side, the value of working capital is falling, which helps cash flow.

Short-term restructuring costs, but input costs now falling

Energy costs, which have risen by a total of £8m in 2008, are at last starting to fall and will flow through into lower costs in 2009. The announced steps to address the fixed cost base will result in restructuring costs of £5.5m in 2008 and £1m in 2009.

Financing extended

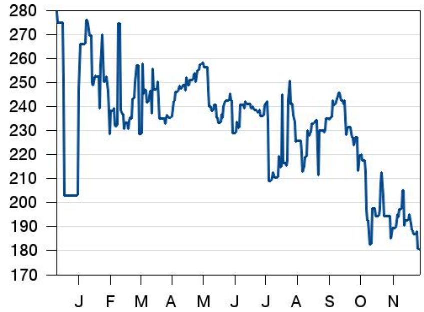
With a fully geared balance sheet, BPI has extended its total facilities of over £100m to 2011. This includes a £57.5m revolving credit element and enough flexibility for the planned restructuring.

Forecasts and valuation

We have adjusted our forecasts down to reflect restructuring costs, but assume increased margins and cost savings are cancelled by lower volumes. In these circumstances the dividend is cash-covered in 2009. The group's history is to pay a dividend through the cycle, and it now has the financial resources to do this.

Price	177.5p
Market Cap	£47m

Share price graph



Share details

Code	BPI
Listing	FULL
Sector	General Industrial
Shares in issue	26.2m

Price

52 week	High	Low
	281.5p	177.5p

Balance Sheet as at 30 June 2008

Debt/Equity (%)	109
NAV per share (p)	225
Net borrowings (£m)	64.8

Business

BPI is one of the largest manufacturers of polythene films and sheet products from polymer in Europe.

Valuation

	2007	2008e	2009e
P/E relative	58%	212%	85%
P/CF	2.1	2.9	1.9
EV/Sales	0.3	0.2	0.3
ROE	14%	5%	11%

Geography based on revenues

UK	Europe	US/Can	Other
63%	30%	5%	2%

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British Polythene Industries is a research client of Edison Investment Research Limited

Trading update

Volume declines

BPI has seen volume declines of about 20% from the building merchants and around a 40% fall in business from brick and block manufacturers. While not all the group's exposure is new build, overall the construction segment of the business (c 15% of sales) has declined by nearly a third. At the moment there is no major change in the retail food segment (as would be expected) nor in agriculture (which is in the off season anyway). The group's statement that volumes are flat in the first nine months of the year implies that UK volumes are down up to 5%, as there has been a greater contribution from Canada this year. The increasing uncertainty prompts us to take a more cautious view about 2009 and to expect a small fall in volumes for the whole group.

Polymer prices continue to fall

From a record peak of £1,255/tonne in September, input polymer prices have descended sharply. At the end of October, prices were £1,055/tonne and have fallen in November and are expected to fall again in December. The declining oil price is a major factor, but a major swing in the supply/demand cycle is also causing downward pressure, as demand fades and some new capacity in the Middle East comes on stream. We believe prices could drop to the 2005-06 levels of about £800-900/tonne. Falling prices usually help BPI's margins, but such a fast decline is not especially good news.

Of potential greater benefit is a decline in electricity prices, as these have been harder to pass on in the upswing. Forward electricity prices are at last beginning to fall and these will have an increasing impact on margins as the year progresses. Also on a positive note, there has been a reduction in scrap prices and there is now much greater availability of scrap with the Chinese export market collapsing. While this may be temporary, it is good news for BPI's four UK scrap plants.

Restructuring

BPI has announced the proposed closure of its Stockton plant with the loss of up to 165 jobs. The site is expected to lose £2.5m in 2008. The facility produced about 25,000 tonne in three main product areas, which will be transferred to other sites. The heavy duty sack business can be transferred easily elsewhere to fill up spare capacity; the films business and its machinery will be transferred to other sites; and the agriculture lines can only be transferred at the end of the season in July. So the eradication of the losses in this business will be progressive and we assume only has a real impact in 2010. The closure costs amount to a P&L hit of £4m in 2008 (bringing the total to £5.5m) and a further £1m in 2009. Of this about £3.5m will be a cash cost, which will be felt mainly in 2009.

Changes to forecasts

We have made significant changes to next year's revenues as both volume and prices are now expected to fall (£510m cut to £350m), however this has very little impact on profitability as it depends more on margins. Margins should progressively improve as the benefits of lower energy costs and restructuring feed through. In the short term, falling polymer prices should arrest the margin squeeze faced over the last few years.

In essence it is virtually impossible to predict the scale of negative volume changes and to balance the impact with the positives from lower costs. We are therefore only adjusting our forecasts by the immediate impact of restructuring charges and hence cut 2008 PBT by £5.5m and 2009 by £1m. We have not changed our forecast of a maintained dividend. BPI held its dividend through the last recession and it looks to have the bank facilities and cash flow outlook to continue to pay.

Exhibit 1: Company data sheet

Operations

BPI will have 24 plants, located in the UK (18), Belgium (2), Netherlands, Canada (2) and China. Operations are managed as four UK businesses (250k tonnes), one in Europe (60k tonnes) and one in Canada. Main European competitors: RKW (Ger), Trioplast (Swe), Aspla (Spa), Manuli (Italy). Main UK competitors: Britton, Total, Amcor. Raw material polymers are bought from multiple sources including Dow Chemicals, Exxon Mobil, Ineos and SABIC, and account for c 60% of group sales.

Film

The 100k tonne operation is run from six factories in the UK, and a sales office in Ireland and combines the film and stretch film operations. Product is either sold to other parts of the group to convert into higher added-value products or direct to customers. The main products are stretch-wrap and shrink-wrap (silage, packaging and food), and films for other converters.

Recycled

BPI operates four plants in the UK and one in China and is the largest re-processor of polyethylene in Europe, producing c 70k tonnes of product. The plants take waste from its operations and from customers and recycle into products like refuse sacks or building films. The lowest grade plastic is converted into moulded products like plastic wood for street furniture, decking etc. Having a recycling operation improves the group's efficiency. It is a fragmented market and waste had been increasingly going to the Far East, where labour costs for sorting are cheaper, however this has at least temporarily abated with a reduction in scrap prices and there is now greater scrap availability.

Converted Product — Industrial/Consumer

In this business, BPI makes c 70k tonnes polyethylene film into specific products by printing and converting it. In total there are eight plants and the business is run as two separate operations: industrial, which produces heavy duty sacks, large bags and pallet shrink wrap/hoods as well as short-run packaging products; and consumer, which does not extrude, but processes a wide range of printed bags for produce and the food industry. Converted products have higher added-value content than the film business.

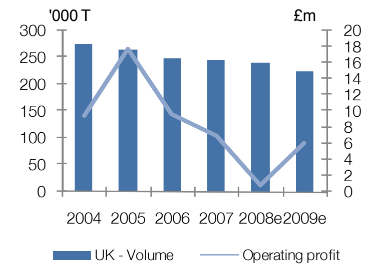
Europe

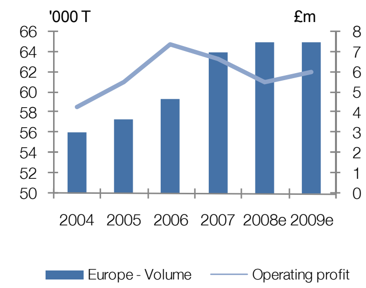
This business runs the group's one Dutch and two Belgian plants (60k tonnes). It replicates the UK Film and Converted Products operations, although it performs limited recycling. The three strongest non-UK territories for BPI are Belgium, Netherlands and France, which each account for about 5% of group sales. (NB Ireland is serviced from the UK.) The main products are silage wrap, printed film and heavy duty sacks.

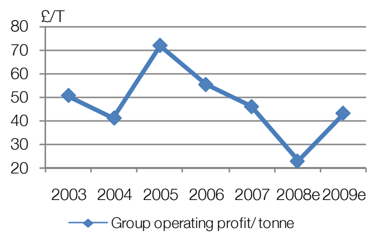
Canada

The main agricultural and horticultural markets are truly international and the recent acquisition adds c 12k tonnes capacity in Canada, and grain bags as a new product.

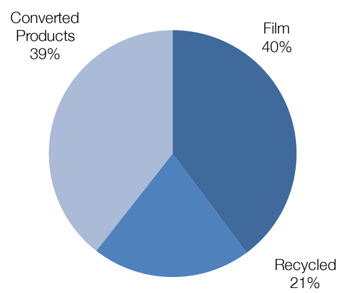
Performance





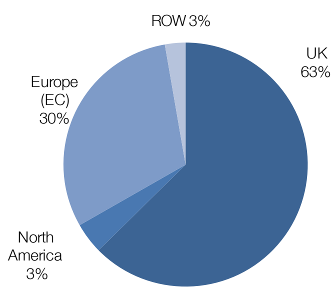


Process breakdown



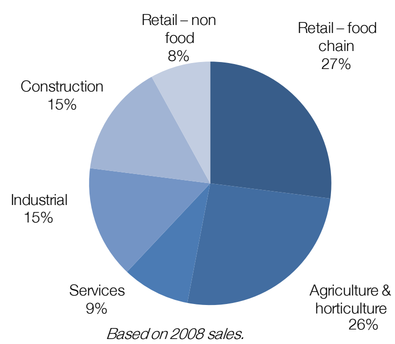
Based on 2007sales. European operations are also split into these three groups.

Geographic breakdown



Based on proforma 2007 sales by destination.

End-user market breakdown



Based on 2008 sales.

Source: Edison Investment Research

Exhibit 2: Financials

£m Year end 31 December	2005 IFRS	2006 IFRS	2007 IFRS	2008e IFRS	2009e IFRS
PROFIT & LOSS					
Revenue	410.2	414.2	424.1	490.0	360.0
Cost of Sales	(338.7)	(352.4)	(363.5)	(433.6)	(306.0)
Gross Profit	71.5	61.8	60.6	56.3	54.0
EBITDA	37.2	29.8	27.3	25.8	26.5
Operating Profit (before GW and restruct.)	23.9	17.1	14.6	12.7	14.0
Goodwill Amortisation	0.0	0.0	0.0	0.0	0.0
Net restructuring costs	(0.6)	0.0	(0.7)	(5.5)	(1.0)
Other	0.0	0.0	0.0	0.0	0.0
Operating Profit	23.3	17.1	13.9	7.2	13.0
Net Interest & pension adjustments	(3.6)	(3.0)	(2.4)	(3.2)	(3.5)
Profit Before Tax (norm)	19.7	14.0	11.5	4.0	9.5
Profit Before Tax (FRS 3)	19.7	14.0	11.5	4.0	9.5
Tax	(5.4)	(3.9)	(3.0)	(1.1)	(2.6)
Profit After Tax (norm)	14.3	10.1	8.5	2.9	6.9
Profit After Tax (FRS3)	14.3	10.1	8.5	2.9	6.9
Average Number of Shares Outstanding (m)	25.7	26.0	26.2	26.4	26.4
EPS - normalised (inc restructuring)(p)	54.3	38.5	32.3	11.1	26.5
EPS - FRS 3 (p)	55.3	38.8	32.4	11.1	26.3
Dividend per share (p)	22.0	22.0	22.0	22.0	22.0
Gross Margin (%)	17.4	14.9	14.3	11.5	15.0
EBITDA Margin (%)	9.1	7.2	6.4	5.3	7.4
Operating Margin (before GW and except.) (%)	5.8	4.1	3.4	2.6	3.9
BALANCE SHEET					
Fixed Assets	93.5	85.4	86.6	87.9	86.8
Intangible Assets	2.0	2.1	2.1	2.3	2.3
Tangible Assets	79.2	77.3	82.5	83.5	82.4
Investment/tax credits	12.3	6.0	2.0	2.1	2.1
Current Assets	119.4	120.5	127.8	146.2	108.5
Stocks	55.3	59.5	62.1	71.7	52.7
Debtors	63.2	60.5	65.1	73.5	54.8
Cash	0.9	0.5	0.6	1.0	1.0
Current Liabilities	(75.5)	(68.3)	(81.4)	(91.2)	(51.8)
Creditors	(68.7)	(60.9)	(63.5)	(73.3)	(33.9)
Short term borrowings	(6.8)	(7.4)	(17.9)	(17.9)	(17.9)
Long Term Liabilities	(100.2)	(83.2)	(70.6)	(82.9)	(81.4)
Long term borrowings	(41.2)	(45.1)	(47.5)	(58.6)	(58.6)
Other long term liabilities	(59.0)	(38.1)	(23.1)	(24.3)	(22.8)
Net Assets	37.2	54.4	62.4	60.0	62.0
CASH FLOW					
Operating Cash Flow	33.8	19.4	22.0	16.3	24.6
Net Interest	(3.2)	(2.8)	(3.6)	(4.2)	(4.5)
Tax	(4.0)	(5.6)	(2.2)	(2.2)	(2.0)
Capex	(11.6)	(11.6)	(13.2)	(12.8)	(12.4)
Acquisitions/disposals	0.0	0.0	(6.5)	0.0	0.0
Financing	0.0	1.4	(3.5)	(2.1)	0.0
Dividends	(5.4)	(5.7)	(5.8)	(5.7)	(5.7)
Net Cash Flow	9.6	(4.9)	(12.8)	(10.7)	0.0
Opening net debt/(cash)	56.7	47.1	52.0	64.8	75.5
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0
Other	(0.0)	0.0	0.0	(0.0)	(0.0)
Closing net debt/(cash)	47.1	52.0	64.8	75.5	75.5

Source: Company accounts/Edison Investment Research

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