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Update

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British Polythene Industries

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After a difficult year in 2008 British Polythene Industries PLC ('BPI') improved in H1 2009 on restructuring and a lower polymer price. **Profits in H1 2009 increased 26% to £9.1m after £2.0m of restructuring costs. Turnover fell 13% to £231.4m and tonnage volume declined 16%.** Following on last year's halving of the final dividend for 2008 the interim dividend for 2009 was cut from 7.0p to 3.5p. The improvement in margin was achieved despite lower demand for the group's film, converted and recycled polythene in virtually all of the group's key sectors, demonstrating the influence of input costs on the group's profitability, allied to the benefit of more favourable exchange rates and measures taken to restore margins.

The key issues are core profitability and debt, but we are reassured on both scores. On core profitability 70% of the group's products (refuse bags, silage film, stretch wrap, film used to package food) are resilient or reasonably resilient to recession. While just under half of group earnings are derived from efficient plants in Continental Europe and Canada, the overcapacity issues affecting UK operations are being addressed with Cowdenbeath closed in H1 and Stockton (BPI's largest UK site) scheduled for closure in mid 2010. Polymer and electricity costs have been lower in H1 2009, but polymer costs have risen in July and August and look likely to go higher still. Net debt fell from £76.0m at the December 31st 2008 year-end to £55.1m at 30th June 2009 as the lower polymer price impacted on the level of working capital but will probably climb a little in H2. We have pencilled in adjusted pre-tax profits (before exceptional items) of £12.8m in 2009.

Investors may feel disappointed by the cut dividend, which is now proportionate in size to capex and earnings. Given the share price rise since March it would seem investors are prepared to trade dividend for growth medium term, as the prospective PE and EV/EBITDA multiple are very cheap.

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RIC Code: BPI
Market Cap: £62.1m

Year to Dec	Turnover £m	Adj PBT £m	Adj EPS p	PE x	Tax %	Dividend p	Yield %	EV/EBITDA x
2006	414.0	14.0	37.2	6.4	27%	22.0	9.3	4.1
2007	424.1	12.2	39.5	6.0	27%	22.0	9.3	4.6
2008	480.7	9.3	34.9	6.8	28%	14.5	6.1	5.5
2009E	430.0	12.8	31.2	7.6	33%	11.0	4.6	4.0
2010E	440.0	15.5	37.8	6.3	33%	11.0	4.6	3.7

H1 2009 Results

In H1 2009 British Polythene Industries PLC ('BPI') reported a 44% advance in pre-tax profits before exceptional restructuring costs (of £2.0m) on the comparable period in 2008. Operating profits before restructuring costs improved by 49% to £13.7m on a turnover decline of 13% to £231.4m. Total group volumes fell 16% to 151,000 tonnes. Fully diluted adjusted EPS rose 31% from 21.4p to 28.1p. The interim dividend, following on from the halving of the final dividend for 2008, was cut from 7.0p to 3.5p.

Following a steady stream of site rationalisation BPI now operates out of 16 manufacturing sites in the UK, three in Continental Europe, two in Canada and one in China.

Trading Background

Last year, 2008, BPI's **UK & Ireland** activities made aggregate operating profits of £4.5m on turnover of £346.0m compared with £7.8m on £326m in 2007 – a poor result. H1 2009 has seen a recovery with operating profits before restructuring costs doubling to £7.8m on the back of a decline in turnover of 14.6% to £159.4m. Volumes, however, fell 17% to 109,200 tonnes in the half year, the stronger six months due to the heavy sales of silage stretch in H1 and factory downtime due to summer and end-of-year holidays in H2.

In terms of key products there was generally lower demand. The silage season failed to match the record one in 2008 due to competitive pricing in the depressed Irish market and wet weather frustrating farmers' ability to cut grass, although a better autumn may see the season extended and additional sales of silage stretch being made. Silage stretch remains the UK & Ireland's biggest source of volume and one of the group's strategic products. Collation shrink film to the soft drink sector was down for similar reasons. Sales of film and recycled film to the construction sector fell 25%, although in the second quarter volumes showed signs of stabilising. Collation stretch to the brick and block industry was down 40%. Packaging stretch film to the food and drink industry was resilient but demand from the packaging industry was weaker. In recycling, the reduction in scrap exports to China seen at the end of 2008 proved to be temporary as once again 70% of the UK's scrap is exported to China. Printed film sales to the food and drink industry held up reasonably well. The rundown of Stockton commenced although the closure will not be completed until H1 2010.

BPI's operations in **Continental Europe** have a recent history of strong growth and this continued in H1 2009, although the increase in first half sterling profits was fully down to the strength of the Euro against sterling. Operating profits advanced 17% from £4.8m to £5.6m whilst turnover declined 10% to £62.1m and volume edged 8% lower to 36,900 tonnes. Exceptional costs of £0.7m were taken, essentially a small number of redundancies at Hardenberg and the closure of the small Paris sales office.

The downturn in the northern European economies (BPI sells generally into France, the Benelux countries, Scandinavia and Germany with additional sales of silage stretch into Eastern Europe) was as marked as in the UK. Lower industrial demand and a silage season hindered by very dry weather and reduced credit extended to farmers accounted for the volume loss. There are signs that the decline in general industrial demand abated in Q2 and has remained stable into Q3.

The Continental European operation has a higher proportion of business in the higher added value sectors than the UK. In addition the plants all run close to capacity and energy costs are less and increases are more regulated

In 2007 BPI announced its first acquisition in North America – AT Films, an extruder of film for agricultural and horticultural markets. The business was acquired from AT Plastics, a subsidiary of the major US chemical group, Celanese Corporation. The consideration was US\$12m, which was mainly for its working capital.

In its first full year under BPI's control - 2008 - turnover was £22.7m on which an operating profit of £0.8m was earned. From being a loss-making position prior to acquisition, the performance was highly satisfactory. H1 2009 has seen this profit fall away, with operating profits declining to £0.3m from £0.5m on a 6% fall in turnover to £9.9m. Turnover has been supported by exchange rate movements between US\$, Canadian\$ and

sterling and a 21% reduction in volume sold to 4,900 tonnes. Volume, almost all of it destined for Canadian or US agricultural markets, declined as farmers came under pressure. Greenhouse customers delayed replacing the greenhouse coverings whenever possible. Dairy farmers postponed purchasing silage film and bags due to lower milk prices in North America. Demand from grain farmers for large grain bags was deferred due to poor spring weather. Some recovery is visible in H2 and it is unlikely this series of adverse factors will be prevalent in 2010.

The Polymer Price

Electricity and polymer costs account for a significant proportion of total group cost of sales, probably in the region of two-thirds. H1 2009 saw a downward trend in both electricity and polymer costs. Polymer is the more important - the polymer price has been rising (normally steadily but occasionally aggressively) since 2002, and this has had a highly adverse impact on margins, as can be seen below. Rarely in recent years has BPI been able to rebuild margins, if only on a temporary basis, by passing on price increases faster than they have been imposed on BPI. H1 2009 saw a welcome reversal of the trend to the extent that H1 average sterling prices were 23% below the comparable period in 2008. The rebuilding in margin should also be seen in the context of a 13% fall in turnover and a 16% fall in tonnage. Despite the loss in tonnage the group operating margin is actually the best return in any period this decade, as the following table illustrates:

Average LD Platts Polymer Price/Tonne	2001	2002	2003	2004	2005	2006	2007	2008	H1 2009
Polymer £	580	480	541	678	790	836	866	1007	773
% Change	+2	-17	+13	+25	+17	+6	+4	+16	-23*
BPI Margin %	5.7	5.0	4.8	3.8	5.7	4.2	2.7	3.3	6.0
BPI Profit per Tonne £	64.42	51.92	53.43	42.81	74.92	56.63	48.10	41.64	92.05

*Percentage change on H1 2008 Source: BPI; margin is EBIT pre pension repair costs, exceptionals and amortisation

We would caution against extrapolating H1 2009's outcome to a full year given that polymer increases are back on the agenda. Traditionally it has been easier for BPI to pass on larger increases than smaller ones, and has found a pricing environment of slow polymer price decline most conducive to rebuilding margins. The global fall-off in demand for polymer (particularly in Europe) may presage a more competitive time for polymer producers, as Middle East supplies are beginning to reach Europe and the (much-delayed) opening of SABIC's 400,000 tonne polymer plant on Teesside could be imminent. The polymer price has been pushed ahead in recent months (in excess of £900/tonne) and short term margin pressure can be expected as a result of this. Short to medium term, however, weak demand levels and increased supply must put downward pricing pressure on polymer.

Forecasts

Despite the good advance in H1 profits it would be foolhardy to assume that this rate of recovery will be continued in H2. There are the issues of the first half bias to profits, the weaker silage season and the resurgence in the price of polymer. Stockton's losses will not be fully eliminated until H2 2010, and those for 2009 will still exceed £1.5m. Net debt will not fall further by 31st December 2009 as capex steps up and H2 sees two dividend payments. Our forecast is for operating profits of £17.2m before exceptional costs of £3.0m and net finance costs of £4.4m to give adjusted PBT of £12.8m. On a higher 33% tax rate adjusted EPS should come out at 31.2p, which on our expectation of an 11.0p dividend would give a very adequate cover of 2.8x. For 2010, assuming no material change in trading conditions until maybe mid-year, the main benefits will come through operating with fewer sites in the UK and continuing depressed utility and polymer prices. This might allow an improvement to £15.5m at the adjusted pre-tax profit level and EPS of 37.8p.

Balance Sheet, Cash Flow & Dividend

As expected with the fall in the polymer price BPI managed to reduce net debt over the half year from £76.0m at 31st December 2008 to £55.1m at 30th June 2009. The reduction of £21m was due to several factors other than polymer's impact on working capital – a £3m fall in capex largely due to timing factors within the period, a £7m increase in cash generated from operations (£6m of which was down to lower working capital in part aided by the lower polymer prices), £5m assistance from the positive impact of currency translation on non-sterling borrowings (mainly the Euro but to a lesser extent the Canadian dollar), and £2m from the deferral of the reduced final dividend from H1 to H2 offset by the £3m cash cost of restructuring, mainly redundancies and relocating capacity. We would not be surprised to see net debt go back up towards £60m by 31st December 2009.

The costs of running down Stockton to closure in perhaps mid 2010 are substantial. Together with the closure of the relatively minor facility at Cowdenbeath the H1 cash cost was £3.0m to cover redundancies. On top of that there is the cost of relocating plant from Stockton (and to a small degree Canada) and there is also the capital cost of setting up equipment as well as building plant extensions, additional extruding halls and warehouses at Ardeer and Greenock. This is estimated at £8.0m, split as to £6.5m in 2009 and £1.5m in 2010. Capex in 2009 will come in at circa £15.5m. Stockton will continue to record losses until closure next year.

The pension deficit, £25.7m at 31st December 2008, deteriorated further to £52.2m at 30th June 2009 on the collapse in equity markets and on increased liabilities emanating from lower bond yields, as well a significant increase in the assumed long term rate of inflation. Clearly some consideration is being given to further actions to reduce the deficit which will have profit & loss account and cash flow implications for BPI.

The dividend was cut in 2008 from 22.0p to 14.5p (2007 – 22.0p) with the final dividend for the year halved. The uncertain economic outlook, the heavy rundown costs and losses to closure at Stockton, the irrepressible polymer price and the deteriorating pension position's impact on shareholders' funds will have affected the Board's sentiments towards the level of the 2008 final dividend in March 2009 but with little change to these influences (apart from the profits improvement) in August 2009 it is perhaps no great surprise that the Board followed through with a halving of the 2009 interim as well. This will give a dividend distribution of 11.0p for the full year at an annual cash cost of £2.9m.

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