Update

Edison investment research

7 January 2008

British Polythene Industries

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	PE (x)	Yield (%)
12/06	414	14.0	38.5	22.0	7.3	7.9
12/07e	425	11.5	32.0	22.0	8.7	7.9
12/08e	445	12.5	35.2	22.0	7.9	7.9

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

Investment summary: Challenging trading

December's profit warning was not unexpected against the backdrop of high oil prices, an industry capacity shortage for raw material ethylene and weakening UK demand. We remain confident that the dividend will be paid, as in other downturns, which means the focus remains on repairing margins by passing on price increases.

Reduction in forecasts

BPI's statement of a 15% fall from 2006 profit levels implies a PBT of c.£11.5m after £0.6m of net restructuring costs. This is a 20% reduction in our forecasts. A larger anticipated raw material price in January might ironically give BPI back some pricing power. We have cut 2008 PBT by £1.5m to £12.5m.

Volumes decline apart from silage stretchwrap

BPI reports that demand is patchy across many sectors, with only silage stretchwrap (12% of sales) showing growth in H2. After a strong year in agricultural sales and with the normal resilience in retail markets, lower industrial and construction demand might bring back volumes overall in 2008.

Polymer prices hit all time high

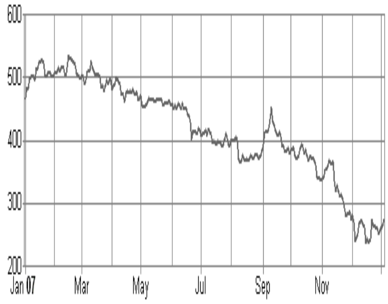
Polymer prices remained at high levels (just below £900/t) in Q4, keeping the pressure on margins, which dropped to 2.2% in H2. In fact at £875/t in 2007, the polymer price was at its highest ever average level. While high prices encourage down-gauging (lower volume) and weakening sterling will not help input costs, management is keen to take a firm approach with pricing to rebuild margins. In fact an anticipated £70–100 polymer price increase in January is large enough for BPI to be able to pass on costs directly to customers and potentially recoup some of the autumn erosion.

Valuation: Base value

While there is no visible short-term catalyst to reverse the share price decline, history suggests BPI will see a highly geared recovery once markets and sentiment improve. On an on unusually low premium to net assets (25%) for an industrial, with a c.8.0% yield, and with a dividend that has been paid through two previous downturns, we think BPI is near a base valuation. We also note that many of the board directors buying shares, so they have confidence in the long term-value.

Price	279.5p
Market Cap	£73m

Share price graph



Share details

Code	BPI
Listing	Full
Sector	General Industrial
Shares in issue	26.0m

Price

52 week	High	Low
	506p	238p

Balance Sheet as at 31 December 2007

Debt/Equity (%) *	112
NAV per share (p) *	219
Net borrowings (£m) *	64

* estimates

Business

BPI is one of the largest manufacturers of polythene film and bags from polymer in Europe.

Valuation

	2006	2007e	2008e
P/E Relative	49%	66%	65%
P/CF	3.7	3.1	2.7
EV/Sales	0.3	0.3	0.3
ROE	19%	15%	15%

Geography based on revenues

UK	Europe	US	Other
66%	31%	0%	3%

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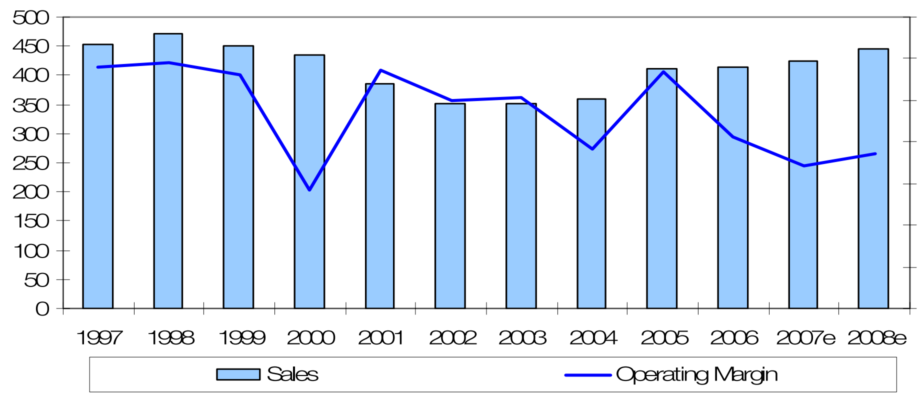
British Polythene Industries is a research client of Edison Investment Research Limited

Review of autumn visit to Heanor site

In the autumn, BPI hosted an analysts' visit to its Heanor recycling site. The visit highlighted many of the long-term strengths of the group and gives some reassurance that short-term trading difficulties can be overcome. It is worth looking at the graph below, which shows how the margin performance has dipped and recovered across several cycles.

Exhibit 1: BPI performance across the cycle



Source: BPI accounts

Recycling expansion

With a scrap polyethene price averaging £300–400/t against a raw material polyethene price of £800–900/t, there is a good business case to make products from recycled material, even if it is used in less sophisticated products. BPI produces 83k tonnes of product from both its own (58k tonnes) and others' recycled plastic. While there has been a decline in scrap supplies due to exports to the Far East, this decline is slowing and BPI has upgraded some of its facilities to take more difficult (and profitable) scrap supplies, like agricultural waste. Recycled products like damp proofing, garden furniture and decking, and a range of refuse sacks are sold across many industries including building, health, retail, local authority and catering.

Silage stretchwrap continues to grow

One area of continued strength is Silage stretchwrap, which accounts for about 12% of group sales. Multiwrap and high tack technologies have improved the properties of the product and maintained BPI's competitive edge. The business is a worldwide one and expansion into Eastern block countries has helped growth. However with all plants running at close to capacity, further growth depends on new investment decisions like the investment already announced in the UK.

Plastic printing expertise

Although a small part of the overall business, a presentation from Promopack's management emphasised the benefits of maintaining in house printing expertise. Promopack supplies plates and art work to BPI and to other UK flexographics printers, (N.B. printing on plastics uses flexographics rather than lithographics used for paper) as well providing packaging design for BPI. The business gives BPI a strong technical competitive advantage over other film producers when bidding for new work. As the only UK plate producer to use a solvent free process, it also has a competitive advantage in its own market with a quicker process and no environmental costs. While only a small part of BPI, this is a self funding centre of design for the group.

Exhibit 2: Company data sheet

Operations

BPI has 25 plants, located in the UK (19), Belgium(2), Netherlands, Canada(2) and China. Operations are managed as four UK businesses (250k tonnes) and one in Europe (60k tonnes). 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 & SABIC & account for c.60% of group sales.

Film

The 105k 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 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. Main products are stretch-wrap and shrink-wrap (silage, packaging and food), and sheet (poly tunnels, horticultural bags).

Recycled

BPI operates five plants in the UK and one in China and is the largest re-processor of polyethylene in Europe, producing c.80k tonnes of product. The plants take waste from its operations and from customers, and recycle it into products like refuse sacks or building films. The lowest grade plastic is converted into moulded products like garden furniture. Having a recycling operation improves the group's efficiency. It is a fragmented market and waste is increasingly going to the Far East, where labour costs for sorting are cheaper. Supply of waste polyethene is short due to high demand from the Far East (UK is 65% export).

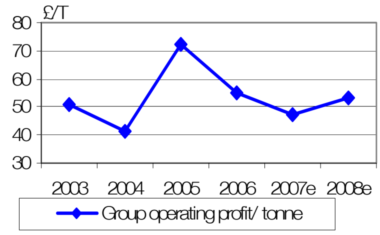
Converted Product — Industrial/Consumer

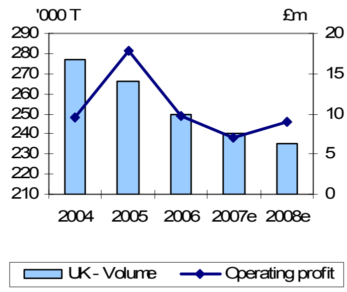
In this business, BPI makes c.70k tonnes polyethylene film into specific products by printing and converting it. In total there are eight plants and the business is run as two separate operations: Industrial, which produces heavy duty sacks, large bags and pallet shrink wrap/hoods as well as short-run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

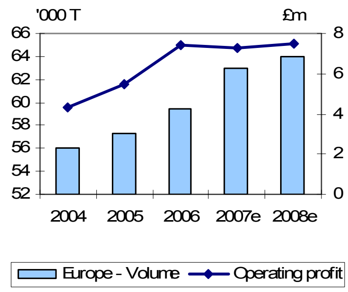
Europe

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. (N.B. Ireland is serviced from the UK.) The main products are: silage wrap, printed film and heavy duty sacks.

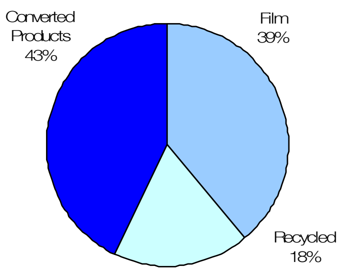
Performance





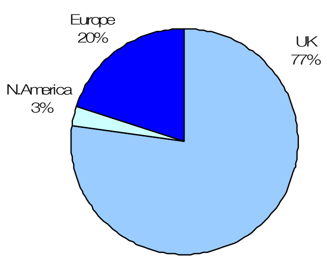


Divisional breakdown



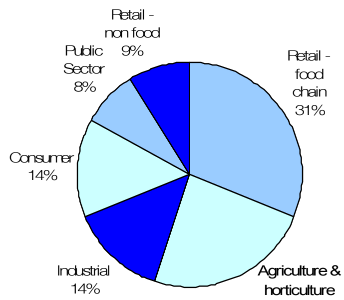
Based on 2007sales. European operations are also split into these 3 groups

Geographic breakdown



Based on proforma 2007e sales

End-user market breakdown



Based on 2007 sales

Source: Edison Investment Research

Exhibit 3: Financial information

£m	2004	2005	2006	2007e	2008e
31-December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	359.4	410.2	414.2	425.0	445.0
Cost of Sales	(300.5)	(338.7)	(352.4)	(362.6)	(379.2)
Gross Profit	58.9	71.5	61.8	62.5	65.9
EBITDA	26.8	36.6	29.8	27.3	28.8
Operating Profit (before GW and except.)	13.7	23.3	17.1	14.5	16.0
Goodwill Amortisation	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other	0.2	(0.4)	(0.3)	1.0	1.0
Operating Profit	13.9	22.9	16.7	15.5	17.0
Net Interest	(2.9)	(3.2)	(2.7)	(4.0)	(4.5)
Profit Before Tax (norm)	11.0	19.7	14.0	11.5	12.5
Profit Before Tax (FRS 3)	11.0	19.7	14.0	11.5	12.5
Tax	(2.9)	(5.4)	(3.9)	(3.1)	(3.3)
Profit After Tax (norm)	8.1	14.3	10.1	8.4	9.3
Profit After Tax (FRS3)	8.1	14.3	10.1	8.4	9.3
Average Number of Shares Outstanding (m)	25.7	25.7	26.0	26.0	26.0
EPS - normalised (p)	31.5	54.3	38.5	32.0	35.2
EPS - FRS 3 (p)	31.5	55.3	38.8	32.2	35.5
Dividend per share (p)	21.0	22.0	22.0	22.0	22.0
Gross Margin (%)	16.4	17.4	14.9	14.7	14.8
EBITDA Margin (%)	7.5	8.9	7.2	6.4	6.5
Operating Margin (before GW and except.) (%)	3.8	5.7	4.1	3.4	3.6
BALANCE SHEET					
Fixed Assets	90.7	93.5	85.4	87.4	88.6
Intangible Assets	2.6	2.0	2.1	1.5	1.3
Tangible Assets	79.4	79.2	77.3	79.8	81.3
Investment/tax credits	8.7	12.3	6.0	6.1	6.0
Current Assets	121.3	119.4	120.5	124.9	130.6
Stocks	58.4	55.3	59.5	61.1	63.9
Debtors	61.9	63.2	60.5	62.8	65.6
Cash	1.0	0.9	0.5	1.0	1.0
Current Liabilities	(104.9)	(75.5)	(68.3)	(73.8)	(83.7)
Creditors	(70.4)	(68.7)	(60.9)	(66.4)	(76.3)
Short term borrowings	(34.5)	(6.8)	(7.4)	(7.4)	(7.4)
Long Term Liabilities	(71.0)	(100.2)	(83.2)	(81.5)	(75.5)
Long term borrowings	(23.2)	(41.2)	(45.1)	(57.6)	(57.6)
Other long term liabilities	(47.8)	(59.0)	(38.1)	(23.9)	(17.9)
Net Assets	36.1	37.2	54.4	57.0	60.0
CASH FLOW					
Operating Cash Flow	16.4	33.8	19.4	23.3	26.8
Net Interest	(3.0)	(3.2)	(2.8)	(4.0)	(4.2)
Tax	(3.2)	(4.0)	(5.6)	(3.1)	(3.3)
Capex	(13.0)	(11.6)	(11.6)	(12.9)	(13.3)
Acquisitions/disposals	0.0	0.0	0.0	(5.9)	0.0
Financing	(0.2)	0.0	1.4	(3.7)	(0.3)
Dividends	(5.4)	(5.4)	(5.7)	(5.7)	(5.7)
Net Cash Flow	(8.4)	9.6	(4.9)	(12.0)	0.1
Opening net debt/(cash)	48.3	56.7	47.1	52.0	64.0
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)	56.7	47.1	52.0	64.0	64.0

Source: Company accounts/Edison Investment Research

Edison Investment Research

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