Chief Financial Officer's Report

A strong performance despite uncertainty

The Group continues to experience a strong performance despite macroeconomic and political uncertainty, ongoing high inflation and supply constraints.

Revenue and operating margin

Group revenue for the year ended 31 December 2022 was £622.2m (2021: £594.3m), an increase of 4.7% on a strong comparative year. UK revenue increased by 5.0% during a period of economic uncertainty that worsened in the second half of the year. This outperformed UK construction more broadly, which grew 1.6% (Source: CPA) versus prior year, or 1.0% when the impact of infrastructure expenditure is excluded. New housing is expected to have grown by 2.4%, after a strong first half, where starts were some 5.0% ahead of prior year (Source: UK Government DLUHC). Housing RMI declined from its 2021 historic peak by 3.1% as economic uncertainty and disposable incomes worsened during the year, as well as the macro-effect of the decline in residential property transactions of 14.8% versus prior year (Source: HMRC). The performance in the Rest of Europe was impacted by the Group's decision to exit the Russian market.

Underlying operating profit was £98.2m (2021: £95.3m), an increase of 3.0% despite considerable inflation, housing market uncertainty and supply chain disruption. The Group improved pricing processes, began the simplification of the business to unlock synergies and lower structural costs to enhance resilience for 2023. The Group underlying operating margin decreased marginally by 20 basis points to 15.8% (2021: 16.0%).

This has been expedited in 2022 through a transformation project, which has involved reviews of direct and indirect purchasing costs and also transition to the new operating structure from 2023 announced at the November 2022 Capital Markets Day.

REVENUE AND OPERATING MARGIN	2022 £m	2021 £m	Change %
Revenue	**622.2**	594.3	4.7%
Underlying operating profit	**98.2**	95.3	3.0%
Underlying operating margin	**15.8%**	16.0%	(20bps)

REVENUE BY GEOGRAPHIC DESTINATION	2022 £m	2021 £m	Change %
UK	**560.8**	534.1	5.0%
Rest of Europe	**32.4**	38.3	(15.4)%
Rest of World	**29.0**	21.9	32.4%
Group	**622.2**	594.3	4.7%

Chief Financial Officer's Report continued

Business review

REVENUE	2022 £m	2021 £m	Change %	LFL Change %
Residential Systems	**394.3**	372.9	5.7	5.0
Commercial and Infrastructure Systems	**227.9**	221.4	2.9	0.5
	622.2	594.3	4.7	3.1

UNDERLYING OPERATING PROFIT	2022 £m	ROS %	2021 £m	ROS %	Change %
Residential Systems	**79.1**	**20.1**	73.1	19.6	8.2
Commercial and Infrastructure Systems	**19.1**	**8.4**	22.2	10.0	(14.0)
	98.2	**15.8**	95.3	16.0	3.0

Profit before tax was £45.4m (2021: £62.9m), a decrease of 27.8%, driven by several factors including a write down of intangibles and increased borrowing costs.

The Group continued to invest in product development and innovation throughout the year. In 2022, underlying operating profit benefited from £1.2m of HMRC approved Research and Development expenditure credit, relating to the year ended 31 December 2022.

Residential Systems

Revenue in our Residential Systems segment was 5.7% higher than the prior year at £394.3m (2021: £372.9m), partially driven by the full year effect of the acquisitions of Adey and Nu-Heat in February 2021 with like-for-like revenue excluding acquisitions 5.0% higher than 2021.

The process of integrating Adey and Nu-Heat is now complete. Both these businesses have fitted well into the Group in a commercial, operational and a cultural sense – so much so that Adey's CEO at the time of acquisition has just been promoted to be Managing Director for one of the three new Business Units. We are driving both revenue and cost synergies aggressively. Adey has been adversely affected by the constraint in upstream boiler manufacturing caused by the shortage in the global supply of printed circuit boards (PCBs). This shortage is ongoing. Nu-Heat is performing well, benefiting from the positive mix effect of remaining market RMI spend moving into funding more efficient forms of heating homes.

During 2022 at our Broomhouse Lane and Neale Road sites in Doncaster, we took delivery of and installed 25 moulding machines for the manufacture of our mainstream products. This underpins our commitment to sustainability as the new machines will give significant energy savings over those that they replaced. The new machines will also allow us to become more flexible in our approach to using recycled content in our moulding facility than previously, which again supports our commitment to sustainability.

New product innovation remains strong. In Residential Systems, we launched several new ranges in the first half of the year, including Nuaire's DX Cooling modules designed to work in conjunction with existing Mechanical Ventilation with Heat Recovery (MVHR) ventilation units to tackle the challenges of overheating in apartments. Adey launched a number of new products to expand their range of performance enhancing heating system additives, including the new MCXS leak sealant additive.

Robust price leadership and cost saving initiatives helped Residential Systems deliver strong underlying operating profit growth of 8.2% to £79.1m (2021: £73.1m) representing a 20.1% margin (2021: 19.6%).

Commercial and Infrastructure Systems

The UK commercial and infrastructure markets proved to be a tougher operating environment and the segment's revenue was 2.9% higher at £227.9m (2021: £221.4m). On a like-for-like basis, excluding the effects of the Plura acquisition in February 2021 and the Keytec acquisition in March 2022, year-on-year revenue was broadly flat.

Divisional performance was impacted in Q2 by an isolated cyber incident that impacted Group profitability by over c.£4m at the time. It was ultimately an unsuccessful attempt but resulted in temporary disruption to manufacturing and sales in April and May.
We implemented new, stronger protection across the Group in the first half and I am pleased to report that most of this business was recovered in the second half of the year as systems came back on stream. However, our Nuaire commercial business was further impacted in the second half of the year by a shortage in supply of key components such as blowers. Thanks to the arduous work and ingenuity of our local teams, alternative sources of supply have now been secured for 2023 and beyond, although difficulties remain.

In Commercial and Infrastructure Systems, our Polypipe Civils and Green Urbanisation business launched SciClone X, a new stormwater treatment device for removing pollutants from surface water runoff.

We expanded our site at Horncastle via a land purchase that allows optimisation of site layout and flexibility for any possible future manufacturing footprint reviews. This site also commissioned a new Polysewer line in 2022 with product due to be supplied from early 2023 that will reduce carbon emissions by reducing long-distance transportation. Material handling capabilities have also been modernised using high efficiency vacuum pumps whilst reducing the risk of material spillages. At our Aylesford site in Kent, we made a major investment in multi-layer extrusion technology, allowing us to significantly increase recyclate use, propelling us on our journey towards the medium-term ESG target that 62% of our input materials must come from recycled sources.

Commercial and Infrastructure Systems delivered an underlying operating profit of £19.1m (2021: £22.2m) and represents an 8.4% margin (2021: 10.0%). The key driver of reduced margin in the year in this segment relates to operational leverage on reduced UK volumes, particularly driven by constraints in supply of key components.

Chief Financial Officer's Report continued

Acquisitions

On 31 March 2022, the Group acquired Keytec Geomembranes Holding Company Limited (Keytec), a supplier and installer of stormwater attenuation products, geomembranes, and gas protection products for an initial cash consideration of £2.5m on a cash free and debt free basis plus a deferred consideration of £0.6m due no later than 12 months from completion. The total initial cash consideration of £2.9m included a payment for net cash and working capital commitments on completion of £0.4m.

Non-underlying items

Profit before tax was £45.4m (2021: £62.9m), impacted by an increase in non-underlying items. These increased to £40.0m (2021: £34.1m) after tax. These were driven by non-cash amortisation of £15.2m (2021: £14.2m) and total impairment charges of £14.8m (2021: nil) respectively. The impaired goodwill of £12.0m originally arose from the 2021 acquisitions, and the £2.8m impairment of intangible assets arose from a customer relationship agreement ending early. Of the other items, £3.3m (2021: £6.6m) of costs related to acquisitions and other M&A costs, a product liability claim of £1.0m (2021: £2.6m), one off costs of £1.2m relating to an isolated cyber incident at Nuaire and restructuring costs of £9.3m (2021: £1.1m).

Non-underlying items comprised:

	2022 £m	2021 £m	Change %
Amortisation of intangible assets	**15.2**	14.2	7.0
Impairment of goodwill	**12.0**	–	–
Impairment of intangible assets	**2.8**	–	–
Restructuring Costs	**9.3**	1.1	745.5
Contingent consideration on acquisitions	**3.1**	1.9	63.2
Product liability claim	**1.0**	2.6	(61.5)
Acquisition costs	**0.2**	4.7	(95.7)
Isolated cyber incident	**1.2**	–	–
Fair value adjustments on acquisitions	**–**	3.7	–
Unamortised deal costs	**0.4**	–	–
Non-underlying items before taxation	**45.2**	28.2	60.3
Tax effect on non-underlying items	**(5.2)**	(3.4)	(52.9)
Impact of change in statutory tax rate	**–**	9.3	–
Non-underlying items after taxation	**40.0**	34.1	17.3

+4.7%

Revenue up despite some market softness in the latter part of the year

+3.0%

Underlying operating profit driven by strong pricing and cost controls.

Exchange rates

The Group trades predominantly in Sterling but has some revenue 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 increased to £7.6m (2021: £4.2m) due to significantly higher Standard Overnight Index Average (SONIA) interest rates partially offset by lower level of RCF borrowings. Interest cover was 16.0x for the year (2021: 31.3x).

Interest was payable on the RCF at SONIA (2021: LIBOR) plus an interest rate margin ranging from 0.90% to 2.75%. The interest rate margin at 31 December 2022 was 1.60% (2021: 1.40%). With effect from 4 January 2022, LIBOR was replaced by SONIA.

Taxation

Underlying taxation

The underlying tax charge in 2022 was £14.1m (2021: £16.0m) representing an effective tax rate of 15.6% (2021: 17.6%). This was below the UK standard tax rate of 19.0% (2021: 19.0%). Patent box relief contributes to a lowering of the underlying effective tax rate by some 1.8 percentage points.

Taxation on non-underlying items:

The non-underlying taxation credit of £5.2m (2021: £5.9m net charge) represents an effective rate of 11.5% (2021: 20.9%).

EARNINGS PER SHARE	**2022 £m**	2021 £m
Pence per share:		
Basic	**14.7**	16.7
Underlying basic	**30.8**	30.6
Diluted	**14.6**	16.5
Underlying diluted	**30.5**	30.2

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

Underlying basic EPS increased by 0.7% in 2022.

Chief Financial Officer's Report continued

Dividend

The final dividend of 8.2 pence (2021: 8.2 pence) per share is being recommended for payment on 24 May 2023 to shareholders on the register at the close of business on 21 April 2023. The ex-dividend date will be 20 April 2023.

Our dividend policy is normally 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, announced at the time of publication 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:

	2022 £m	2021 £m
Property, plant and equipment	**169.9**	151.7
Right-of-use assets	**22.3**	20.6
Goodwill	**455.4**	467.7
Other intangible assets	**159.7**	175.1
Net working capital	**33.9**	22.0
Taxation	**(47.9)**	(47.4)
Other current and non-current assets and liabilities	**0.1**	(6.3)
Net debt (loans and borrowings, and lease liabilities, net of cash and cash equivalents)	**(166.2)**	(165.7)
Net assets	**627.1**	617.7

The net value of property, plant and equipment has increased by £18.2m following the acquisition of additional land at one of our sites and the Group's continued strategic investment in its businesses. The value of right-of-use assets has increased by £1.7m.

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 £6.5m (2021: £5.4m) reflecting the inclusion of the acquisitions made in the previous year and an overall increase in the number of scheme participants.

Cash flow and net debt

The Group's cash flow statement is summarised below:

	2022 £m	2021 £m
Operating cash flows before movement in net working capital	**113.6**	111.4
Add back non-underlying cash items	**9.6**	6.9
Underlying operating cash flows before movement in net working capital	**123.2**	118.3
Movement in net working capital	**(19.7)**	(27.0)
Capital expenditure net of proceeds from sale	**(40.9)**	(34.1)
Underlying cash generated from operations after net capital expenditure	**62.6**	57.2
Income tax paid	**(7.0)**	(9.5)
Interest paid	**(3.7)**	(2.9)
Non-underlying cash items	**(9.6)**	(6.9)
Settlement of deferred and contingent consideration	**(0.5)**	–
Acquisition of businesses	**(2.6)**	(236.4)
Issue of Euro-Commercial Paper	**–**	–
Buyback of Euro-Commercial Paper	**–**	–
Net proceeds from issue of share capital	**–**	93.5
Debt issue costs	**(3.1)**	–
Dividends paid	**(30.5)**	(21.7)
Proceeds from exercise of share options net of purchase of own shares	**0.4**	2.1
Other	**(4.0)**	(5.7)
Movement in net debt – excluding IFRS 16	**2.0**	(130.3)
Movement in IFRS 16	**(2.5)**	(7.7)
Movement in net debt – including IFRS 16	**(0.5)**	(138.0)

Chief Financial Officer's Report continued

Delivery of good cash generation remains core to the Group's strategy. Underlying cash generated from operations after net capital expenditure at £62.6m (2021: £57.2m) represents a conversion rate of 63.7% (2021: 60.0%). The Group remains committed to achieving a conversion rate of 90.0% over the medium term.

Working capital movement in the year was driven by a rebuilding of inventory to improve customer service performance following the recovery in demand after the pandemic, as well as the effects of cost inflation.

Net capital expenditure investment increased to £40.9m (2021: £34.1m) as the Group continued to focus on investing in key, strategic and innovative projects. In 2023, we anticipate that capital expenditure will be approximately £40.0m.

Net debt of £166.2m comprised:

	2022 £m	2021 £m	Change %
Bank loans	**(195.9)**	(198.0)	2.1
Cash and cash equivalents	**50.0**	52.3	(2.3)
Net debt (excluding unamortised debt issue costs)	**(145.9)**	(145.7)	(0.2)
Unamortised debt issue costs	**2.8**	0.6	2.2
IFRS 16	**(23.1)**	(20.6)	(2.5)
Net debt	**(166.2)**	(165.7)	(0.5)
Net debt (excluding unamortised debt issue costs): pro forma EBITDA	**1.2**	1.2	–

Financing

The Group has a Sustainability-Linked Loan (SLL) committed through to August 2027 with two further uncommitted annual renewals through to August 2029 following a refinancing with the existing bank syndicate during the year. The facility limit is £350.0m with an uncommitted 'accordion' facility of up to £50.0m on top. At 31 December 2022, £170.9m of the RCF was drawn down. Additionally, the Group entered a fixed rate £25.0m seven-year private placement loan note until August 2029 with an uncommitted shelf facility of an additional £125.0m.

The Group is subject to two financial covenants. At 31 December 2022, there was significant headroom and facility interest cover and net debt to EBITDA covenants were comfortably achieved:

Covenant

	Covenant requirement	Position at 31 December 2022
Interest cover	>4.0:1	16.0:1
Leverage	<3.0:1	1.2:1

Going concern

The Group continues to meet its day-to-day working capital and other funding requirements through a combination of long-term funding and cash deposits. The Group's bank financing facilities consist of a £350.0m Sustainability-Linked Loan with an uncommitted 'accordion' facility of £50.0m and a seven-year private placement loan note of £25.0m with an uncommitted £125.0m shelf facility. At 31 December 2022, liquidity headroom (cash and undrawn committed banking facilities) was £229.1m (2021: £154.3m). Our focus will continue to be on deleveraging, and our net debt to EBITDA ratio stood at 1.2x pro forma EBITDA at 31 December 2022 (2021: 1.2x), increasing to 1.4x (2021: 1.4x) pro forma EBITDA including the effects of IFRS 16. This headroom means the Group is well-positioned with a strong balance sheet.

As a result, the Directors have satisfied themselves that the Group has adequate financial resources to continue in operational existence for a period of at least the next 21 months. Accordingly, they continue to adopt the going concern basis in preparing the consolidated financial statements.

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
14 March 2023