CHIEF EXECUTIVE OFFICER'S REVIEW

"Polypipe's balanced business model, underpinned by the long-term growth drivers of legacy material substitution and continuing legislative tailwinds, has helped produce another record performance in 2017."

In my first review since appointment as Chief Executive Officer, I am pleased to report that Polypipe has delivered another record performance in 2017, with revenue from continuing operations 6.3% higher than the prior year at £411.7m (2016 restated: £387.2m) and underlying operating profit 6.0% higher at £72.6m (2016 restated: £68.5m). Against a background of mixed conditions in the UK construction market, this performance shows the robust nature of the Polypipe business model and the strength of its long-term strategic drivers of legacy material substitution and continuing legislative tailwinds in water management and carbon efficiency. Polypipe continues to be cash generative and has reduced leverage to 1.6 times EBITDA (2016: 1.9 times) leaving the Group well invested and able to pursue bolt-on acquisitions that complement the Group's current activities. The Group will continue to focus on its key strategic and operational priorities, and I am confident that we will maintain revenue growth ahead of the overall UK construction market.

In January 2018, the Group announced that it was in advanced negotiations to dispose of its French subsidiary (Polypipe France) to Ryb S.A., a private French business that operates in similar French markets to Polypipe France, for €16.5m on a cash-free, debt-free, normalised working capital basis. In 2017, Polypipe France generated revenue of £58.4m and underlying operating profit of £1.4m. There is very little strategic overlap between our UK and French businesses as they operate in different product areas, the latter operating in the significantly lower margin electrical conduit, potable water, gas and irrigation pipe product groups. Following a full review of the business, the Board decided Polypipe France was not core to the Group and to dispose of it. Completion of the transaction is expected in the first half of 2018. I believe this deal represents excellent shareholder value and once completed will allow the Group to concentrate on its higher margin product areas. For the purposes of this report, the results of Polypipe France have been treated as discontinued.

I am pleased to say that the Group has risen to several commercial and operational challenges during the year. Following the EU Referendum in June 2016 and the subsequent devaluation of Sterling, materials costs rose substantially in the second half of 2016 and into 2017. While we do all we can to ameliorate price increases through cost reduction, selling price increases were inevitable. These were successfully implemented across the Group in the first half of 2017 to mitigate materials and other inflationary increases, taking effect progressively throughout the period. Although exchange rates were relatively stable throughout 2017, increasing oil prices as well as tight polymer markets in the second half of the year pushed materials prices higher still, and impacted on second half performance. Further selling price increases are being actioned in early 2018 to address this and other inflationary effects. The Group has a good history of cost inflation recovery, even in difficult market conditions, and I have confidence the Group will be successful with this latest challenge.

In June 2017, a trade embargo was introduced between Qatar and many of the Gulf states following ongoing political disagreements. With approximately 60% of our pipeline projects emanating from Qatar, and the more general project financing issues in the wider Gulf in the first half of the year, the decision was taken to temporarily cease manufacturing in our Dubai facility, and a non-underlying charge of £0.9m was recorded in our interim results covering redundancy costs and stock provisions. During the second half of the year there has been no change to the situation between Qatar and the other Gulf states; the trade embargo remains in force, and general project financing still appears to be slow as the region adjusts to a lower oil price. While the Middle East still represents a significant opportunity for the Group, we have decided to pursue an alternative manufacturing strategy in the region through use of sub-contractors and to close permanently our Dubai manufacturing facility. All equipment will be relocated back to our Horncastle plant where Polystorm is manufactured for the UK market, enabling us to remove the need for more expensive sub-contract manufacturing in the UK. A further non-underlying charge of £3.1m has been recorded covering machinery relocation costs, further redundancy, onerous lease costs and asset impairments, leaving the total non-underlying charge for the year at £4.0m, of which £1.7m is non-cash.

As well as expanding capacity where necessary, we continue to invest in both new product technology and automation in our businesses. Our new £2.2m multi-layer extrusion lines in our main Doncaster plant became operational in the early part of 2017 which has allowed us to significantly increase the amount of recycled material used in manufacturing our drainage and latterly our soil and waste pipes. Towards the end of the year, our new £5.0m large diameter continuous corrugator came into operation at our Horncastle plant. This increases our capacity to manufacture 750mm and 900mm drainage pipes and allows the Group to make further inroads in this area of the market. These new pipes, as well as much of our existing civils drainage pipe offer, are manufactured from recycled milk bottles and other polyethylene consumer liquid bottles using our wash plant recycling facility at Horncastle. We consume approximately 44,000 tonnes of recycled material representing one-third of the overall material requirement across the Group, and both of these projects further enhance our already strong sustainability and recycling credentials, something that is important to Polypipe, our customers and our wider stakeholders.

As well as new product technology, there has been further investment in automation in the year to expand capacity, but also to test out new automation techniques. We took delivery of our first collaborative robot in December, which when fully integrated into our manufacturing process will further improve productivity and quality. This advanced, lower cost automation technology has the potential to unlock productivity opportunities that have not been achievable previously because of technical or financial constraints.

The treatment of Polypipe France in this report has caused the Group to review its segmental analysis. The remaining part of the previously reported Commercial and Infrastructure – Mainland Europe segment, being our Italian business Effast, will be consolidated with the existing Commercial and Infrastructure – UK segment to create one segment called Commercial and Infrastructure Systems.

Polypipe

CHIEF EXECUTIVE OFFICER'S REVIEW

The following tables set out Group revenue and underlying operating profit by operating segment:

REVENUE

	2017 £m	2016 restated £m	Change %
Residential Systems	**223.5**	202.7	10.3
Commercial and Infrastructure Systems	**188.2**	184.5	2.0
Revenue	**411.7**	387.2	6.3

UNDERLYING OPERATING PROFIT

	2017 £m	2016 restated £m	Change %
Residential Systems	**44.3**	39.1	13.3
Commercial and Infrastructure Systems	**28.3**	29.4	(3.7)
Underlying operating profit	**72.6**	68.5	6.0

The Group gains significant resilience by having a balanced exposure to the different elements of the UK construction market, all of which have different drivers and move at different paces, and this year's performance perhaps more than most demonstrates this.

RESIDENTIAL SYSTEMS

Revenue in our Residential Systems segment, which is almost exclusively derived from the UK market, was 10.3% higher than the prior year at £223.5m (2016: £202.7m), of which 6.6% is volume growth, considerably ahead of the market.

Strong demand in the new housebuild sector continued to drive growth in the year as the Government's Help-to-Buy scheme continues to support first time buyers' demand. The Repair, Maintenance and Improvement (RMI) market however continues to be slow, with weak consumer confidence and falling real wages constraining private RMI, and austerity in Government spending on social housing stock constraining public RMI.

Continued growth in this segment, exacerbated by merchant pull forward of orders ahead of the February 2017 selling price increase, led to some challenges in the earlier part of the year, notably in capacity planning and logistics. The year started with below normal levels of stock following some pull forward of orders into December 2016, but as a number of areas moved into seven day working these stock levels normalised. Capital expenditure on new capacity allowed us to revert back to more normal shift patterns in those areas during the year, and leaves the business well placed to continue to benefit from the buoyant UK residential market.

Residential Systems delivered an underlying operating profit 13.3% higher than the prior year of £44.3m (2016: £39.1m) representing a 19.8% margin (2016: 19.3%).

COMMERCIAL AND INFRASTRUCTURE SYSTEMS

Revenue in our Commercial and Infrastructure Systems segment was 2.0% higher than the prior year at £188.2m (2016 restated: £184.5m).

UK revenue, which accounts for 79% of the overall segment revenue, was 4.1% higher than the prior year, against strong comparatives in 2016. In the infrastructure sector, our Civils business has seen strong demand for stormwater collection, storage and attenuation products from the new housebuild sector. However, strong demand in 2016 from the Aberdeen Bypass road project, which finished in early 2017, and delays in the A14 road upgrade and other projects has meant the roads sector has been more challenging. The dip in commercial project awards seen around the time of the EU Referendum in the middle of 2016, together with a 12 to 18 month lag before delivery to site for our products, led to subdued demand in the commercial sector. Although the project pipeline improved towards the back end of the year, it is clear that projects are being delayed as the continuing political and economic situation in the UK causes uncertainty.

Export revenue, which accounts for approximately 21% of overall segment revenue, was 5.4% lower than the prior year, with the performance in the Middle East driving this. The large Jebel Ali Hills project in 2016 that was supplied initially from our Horncastle plant, and later in the year from our Dubai manufacturing facility, completed in early 2017. A combination of project customer funding issues, and latterly the Qatar trade embargo, meant new projects did not come through at a pace to compensate. More encouragingly, exports to Europe performed well, and in particular our Italian business, Effast, made good progress.

GROUP REVENUE

£411.7m

↑ 6.3%

UNDERLYING OPERATING PROFIT

£72.6m

↑ 6.0%

Commercial and Infrastructure Systems delivered an underlying operating profit of £28.3m (2016 restated: £29.4m) and represents a 15.0% margin (2016 restated: 15.9%). The financial performance of our Dubai manufacturing facility, including the temporary cessation of manufacturing in the second half of the year, is the main driver behind this reduction in operating profit and, as described earlier, decisive actions have been taken to improve future performance in the Middle East.

OUTLOOK

Following the Group's record performance in 2017, the current year has started ahead of the same period last year. Forecasts for 2018 show a broadly flat construction market although the Group has a strong track record of outperforming the market. While the UK RMI market is likely to remain tough throughout the coming year, the strength of the UK new housebuild sector will continue to drive demand for our Residential Systems segment, for which the year has started well. Conditions in the UK commercial and infrastructure sectors remain positive in terms of project pipeline, and demand from key road projects such as the A14 road upgrade should gather pace this year, but there is evidence that project starts continue to be delayed, impacting performance in our Commercial and Infrastructure Systems segment in the early part of the year. The news of Carillion's demise in January may potentially lead to further project delays as main contracts are renegotiated and the impact on sub-contractors works through the market.

Having successfully delivered the necessary actions in 2017 to mitigate polymer and other cost inflation arising from the post EU Referendum weakening of Sterling, we again need to pass through polymer and other cost inflation seen during 2017 and into early 2018. While doing everything we can to alleviate the need for selling price increases, we are confident that our customers expect us to pass on essential increases, and we expect to see the benefit of these price increases coming through as we move into the second quarter of 2018.

Our continued focus on delivering innovative new products and excellent customer service, together with the strength of our growth drivers of legacy material substitution, continuing legislative tailwinds and our balanced exposure to the different sectors of the construction industry, gives the Board confidence that despite a mixed market outlook, 2018 will be another year of progress for the Group and our expectations for the year remain unchanged.

Martin Payne
Chief Executive Officer