Chief Executive Officer's Report

Well positioned FOR 2021

> We took decisive action in response to COVID-19 to protect the business and our stakeholders. After a strong second half operating and financial performance, we are well-placed to capitalise on opportunities as markets develop."

Mark Kelly
Chief Executive Officer

Moving forward together

Introduction

We started 2020 in a good position. With manufacturing constraints resolved through investment in 2019, our intended focus for the year was the delivery of operating efficiencies and the successful transition to our new warehouse. However, 2020 was shaped by the challenges posed by COVID-19.

The initial measures implemented by the UK Government to control the pandemic had a major impact on our operations and financial performance in the first half. However, we took decisive action to protect our employees, the business and our other stakeholders, leaving the Group well-placed to capitalise on opportunities as we emerged from the first lockdown towards the end of Q2. Since then, our operating performance has been strong.

The repair, maintenance and improvement (RMI) market was stronger than we anticipated throughout the second half. House building activity has also been increasing, supported by high levels of mortgage approvals. Our products have resonated well with customers seeking, possibly as a result of the pandemic, to improve their homes and create more usable space, both inside and outside of their properties. Products such as conservatories, warm roofs and garden rooms have been particularly strong.

With H2 sales exceeding expectations and good operating efficiencies delivered throughout this period, we were very pleased to report good financial performance and strong profit growth for the second half.

Actions in response to COVID-19

Operational actions

In line with UK Government guidance issued towards the end of March 2020, we closed our manufacturing plants, branch network, distribution and recycling operations. The shut-down was carefully controlled, in order to leave the business ready to recommence operations and trading when appropriate to do so.

Following updated guidance from the Government in mid-May, which permits tradesmen to work in domestic dwellings so long as appropriate precautions are taken, we commenced a phased reopening. This process was successful, with COVID protection measures working effectively. All sites have been open since July and operating efficiencies since then have been good.

Health and safety actions

Prior to reopening, we conducted a thorough review of work practices and implemented a range of COVID protection measures. Extensive work was undertaken to examine how COVID risks would impact operational activities; to define more extensive standards for protection (referencing UK Government and HSE guidance); and to develop programmes for effective implementation. Our employees were very actively engaged in supporting this process. The approach addressed various aspects, including: social distancing, physical barriers, screen and other protections, workplace hygiene and cleaning, personal hygiene and handwashing, personal protective equipment and swift case/symptom reporting, response and post-case sanitisation.

The restart was carefully phased and controlled to ensure that our COVID protection measures were effective with rising employee numbers. Employees returning to work were provided with relevant training, and personal protective equipment where necessary, before re-entering their workplace.

Thereafter, we have continued to review and develop our protection measures in accordance with official guidance and emerging best practice. We continually monitor the effectiveness of and compliance with these measures.

Financial actions

We increased our bank facility from £60 million to £75 million in March 2020.

At the outset of the pandemic, we took several actions to conserve cash, including the deferral of non-essential capex and other discretionary expenditure and cancellation of the proposed final dividend for 2019. In April we raised £17.1 million (net) by way of a share placing, with the proceeds to be used to ensure we retain headroom on our bank facility, even under an extended shut-down, and to provide sufficient liquidity to continue investment in the new warehouse. We also utilised Government support measures, including the Job Retention Scheme, through which we received payments of £6.5 million.

Cash flow management has continued to be a key priority for the business and the measures taken in 2020 to improve our cash position have been effective, with net debt at 31 December 2020 on a pre-IFRS 16 basis reduced to £9.9 million (31 December 2019: £34.6 million), demonstrating significant headroom on our bank facility.

Cost savings and operating efficiency improvements

During the year, we performed a full review of our operating, support and management structures to ensure that the business is as efficient as possible. We identified several opportunities to streamline the organisation, which resulted in a small reduction in headcount. Approximately 50 positions (representing c.3% of our workforce) were impacted, although a significant proportion relate to vacancies that were not filled. As a result, non-underlying restructuring costs of £0.6 million were incurred in H2 (primarily redundancy). These changes result in a more efficient structure and deliver fixed cost savings, but have no impact on production capacity or our ability to satisfy customer demand.

We were concerned that COVID-safe working methods might impact on our operating efficiencies, but through careful management and with the full cooperation of our employees, we have seen no negative impact.

Our COO, Mark Hemming, is leading the work to continually improve operational efficiencies, which will be further enhanced as anticipated when the new warehouse is fully operational, expected to be in Q2 2021.

Financial results

Sales for the year were £258 million, or 8% below 2019. We reported an adjusted profit before tax of £8.5 million (2019: £22.7 million).

As described above, the first lockdown had a major impact on our H1 performance. Sales for the first six months of 2020, which includes the period from late-March to mid-May when the business was closed, were 31% below H1 2019, and we reported an adjusted loss before tax, driven by significantly lower sales volumes and the impact of operational gearing.

However, throughout the second half our markets were stronger than we had anticipated, we continued to gain share and our operational performance was good. Sales for the six months ended 31 December 2020 grew by 15% on H2 2019, and we reported an adjusted profit before tax for the period well up on H2 2019.

The statutory loss before tax for the year was £1.5 million, which includes a non-cash goodwill impairment charge of £5.8 million and dual running costs of the new warehouse of £2.7 million. Further information on our financial performance is included in the Chief Financial Officer's Report and Divisional Reviews.

Operational performance

Health and safety

The safety and well-being of our employees and contractors is always our first operational priority and we continue to maintain good health and safety performance. Our Lost Time Injury Frequency Rate ('LTIR') was 0.7 in 2020, compared to 0.9 in 2019. There were no major injuries and 19 minor accidents (2019: no major injuries, 17 minor injuries) recorded under the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 2013 ('RIDDOR').

Production

In 2020 we manufactured 45.5k tonnes of rigid and foam PVC profiles at our primary extrusion facilities, down from 54.6k tonnes in 2019, a decrease of 17%. This reflects lower sales in H1 2020 as a result of the first COVID lockdown. In addition, 2019 production included a stock build programme to increase availability at our branches and mitigate the risk of raw material supply interruption due to Brexit.

Also in 2019, we completed a substantial capex programme, at a cost of c.£5 million, to improve manufacturing efficiency and increase co-extrusion and foam capacity by 30% and 15% respectively. In extrusion, Overall Equipment Effectiveness ('OEE'), a measure which takes into account machine availability, performance and yield, improved to 75% in 2020 (2019: 73%).

Recycling

We used 12.4k tonnes of recycled PVC compound alongside virgin resin in the manufacture of co-extruded rigid profiles, representing 25% of overall material consumption, up from 23% (13.4k tonnes) in 2019, driving a substantial saving compared to the cost of using virgin material.

Brexit and supply chain

We took several steps to protect the business from the potential negative effects of Brexit. In this context, it is worth noting that over 95% of our sales are to UK-based customers and that the vast majority of our workforce has the right to work in the UK.

Some of our key raw materials do originate from Europe, so any disruption in supplies could impact our manufacturing operations. With that in mind, whilst we have only limited capacity to hold additional raw materials at our own sites, we completed a significant investment in additional stocks in 2019, adding c.£5 million to finished goods for key product lines, most of which remained in place throughout 2020.

Now that the nature of the future trading relationship between the UK and the EU has been substantially defined, the risks relating to the imposition of import tariffs are largely behind us.

More generally, whilst the impact of increased demand, supplier production outages and new administrative requirements for EU imports have together put sector supply chains under pressure, we have continued to secure the raw materials we require. So far, we have not experienced any significant adverse effects from the delays at UK ports.

However, PVC resin prices began to increase towards the end of 2020 and this trend has continued into the new year. We are therefore implementing selling price increases, starting in February 2021, to recover this and other cost inflation.

Moving forward together

Warehousing capacity expansion

Towards the end of 2019 we concluded that our existing main warehouse was a major constraint to future growth and operating efficiency. Early in 2020 we secured a new facility, located within three miles of our primary manufacturing site, existing main warehouse and head office. The new site has 260,000 square feet of high bay, state-of-the-art warehouse accommodation, dedicated office space and car parking.

In designing the new facility, we have taken the opportunity to modernise our storage solutions, using cantilever racking to store up to 12 stillages high (our existing warehouse is restricted to seven); and mobile racking to allow high density storage, which has increased capacity by more than 60%. Similarly, we have modernised picking processes, with the use of mobile platforms to replace manual techniques, thereby providing a safer and more productive solution.

The project to fit-out the new warehouse has progressed well and remains on track. We achieved a major milestone in January 2021, with commercial operations beginning successfully from the new site. In line with our plans, transition will continue over the coming weeks, with the final stages expected to complete in Q2 2021.

We will convert our existing warehouse to a specialist manufacturing site, relocating, beginning later in 2021, secondary operations including foiling and conservatory roofs. This will free up space to future-proof extrusion capacity.

We are excited about the opportunities for growth opened up by this investment. As well as being central to increasing capacity, the new warehouse is key to delivering anticipated improvements in operating efficiencies.

Strategy

Strategic priorities overview

Our overall strategic objective is to deliver sustainable growth in shareholder value by increasing sales and profits at or above market growth rates. Over the last five years we have targeted five strategic priorities to help us achieve this objective and have delivered significant progress in each of them as follows:

- Grow market share in Profiles – now the largest supplier of rigid PVC profile to the UK market (c.17% share)
- Expand the branch network – 208 sites in 2020 compared to 141 in 2015
- Increase the use of recycled materials – 25% of material consumption in 2020 compared to 9% in 2015
- Develop innovative new products – sales from products introduced since 2017 were c.£24 million of 2020 revenue
- Explore potential bolt-on acquisition opportunities – six acquisitions completed since 2015

Further information in relation to these priorities is set out in the following paragraphs. More recently, we have assessed whether they remain relevant for the next five years and our conclusions are also described below.

Grow market share in Profiles

In 2018 we became the leading supplier of rigid PVC profile to the UK market, with a share of c.15%[1]. We continue to consolidate our position and believe we now have a share of around 17%[1]. Our objective is to increase this to at least 20%.

In the Profiles division, trade fabrication currently represents c.60% of sales. There is a compelling case for larger trade fabricators to switch to Eurocell. This includes: a strong product range, continued product development, the benefits of pull-through profile and hardware specifications and the opportunity to supply our branches, all delivered via best-in-class service.

New build represents c.30% of Profiles sales. Expanding our share of the new build market has been a key driver of recent growth and we believe favourable market dynamics and low interest rates are set to continue. We have strong relationships with large and medium-sized housebuilders, maintained by our specification and technical teams. In addition, with a focus on sustainability, we believe our use of recycled material is becoming increasingly attractive to housebuilders.

In the commercial sector (c.10% of profiles sales), energy efficiency and lower cost underpin a strong case for the benefits of using PVC profile over aluminium, particularly in sub-sectors such as private rentals, build-to-rent, purpose-built student accommodation, education and local authority refurbishment – all habitual users of aluminium.

Expand the branch network

Our strategic objective for Building Plastics is to achieve sector-leading operations from 270 - 300 sites. The growth will come mostly at the expense of independent operators, who currently have more than 60% market share.

In the existing estate (208 branches at 31 December 2020), we are implementing plans to improve up-selling and cross-selling opportunities, to target lapsed customers, and to tighten margin controls. We also intend to enhance promotional activities with support from key suppliers. In terms of products, we are focusing on improving conversion rates for high value made-to-order items and extending our range, including the introduction of a new suite of outdoor living products.

With additional warehousing capacity now coming on line, we plan to open up to 12 new sites in 2021, with the final number to be determined based on the economic environment and business performance. Up to six of these will be in a new, larger format store, with expanded trade counter and showroom-style displays designed to engage customers and drive big-ticket purchases such as windows and doors. This follows successful trials of this format in 2019/20.

We continue to robustly test an opportunity to develop and implement a sector-leading consumer online windows and doors proposition, using our branch network to provide infrastructure where needed (e.g. delivery point for installers). We began a trial in the North West in Q3 2020 and will provide an update on our progress later in 2021. This proposition directly aligns with our commercial strategy of continuing to create pull-through demand for our products.

Increase the use of recycled material

Expanding the use of recycled material increases our profits, because the cost of recycled compound is typically lower through the cycle than the price of virgin material, and it reduces our exposure to volatile commodity prices. It also improves product and business sustainability, with less plastic going to landfill. Closed-loop recycling (where windows being replaced are recycled into the new product) is attractive to decision makers such as local authorities and architects, which helps us develop tight specifications for our products.

We have been investing to increase our recycling capability through the expansion of Eurocell Recycle Midlands, the acquisition of Eurocell Recycle North and by investment in new co-extrusion tooling, which allows a greater proportion of recycled material to be used in our products.

We have become the leading UK-based recycler of PVC windows. Our use of recycled material increased from 4.1k tonnes (or 9% of materials consumed) in 2015 to 13.4k tonnes (or 23% of consumption) in 2019 and 12.4k tonnes (or 25% of consumption) in 2020, with volumes in the latter reduced by the impact of COVID. In doing so, in both 2019 and 2020 we saved the equivalent of c.3 million window frames from landfill.

We expect internal demand for recycled material to increase. This can be satisfied largely through the expansion of Eurocell Recycle North.

1 Eurocell estimates.

Develop innovative new products
We are committed to maintaining market leadership by offering the very latest in product improvement, both through development of existing products and the introduction of new ones. We work closely with our customers and technical advisors on development and to help maintain our product pipeline. Recent highlights for Profiles include the introduction of a flush window sash for the popular Logik range, a new sliding patio door system (Syncro) and development of a through-colour grey substrate profile. In Building Plastics, the Equinox conservatory roof system has been developed to include a skylight (Vega) and our new suite of outdoor living products, including the Kyube garden room, has been very well received.

Explore potential bolt-on acquisitions
We have completed six acquisitions since our IPO in 2015. We will continue to assess and consider bolt-on acquisition opportunities in the markets in which we operate over the medium term. However, our focus for 2021 will be delivering operating efficiencies from recent investments in manufacturing and warehousing capacity.

2021 strategy update
Early in 2021 we conducted a review of the Group's strategy, our markets and activities. We reaffirmed our overall strategic objective of sustainable growth in shareholder value. We also decided that, whilst the five priorities described above remain relevant, we would refine one of them and introduce two new priorities, making seven in all.

It is therefore our intention in 2021 to develop the existing recycling priority into a 'sustainability strategy' for the whole business. We are working now to define long-term sustainability objectives, linked to the relevant UN Sustainable Development Goals and the UK Government's transition towards a net zero carbon economy, along with an implementation plan and appropriate KPIs against which to measure progress. We will communicate further on sustainability later in 2021.

We will also introduce a new strategic priority to 'deliver sustained operational excellence'. Through 2016-19, the success of our commercial strategies resulted in a strong compound annual growth rate in sales of 12%. However, profits for that period were impacted by sales running substantially ahead of our expectations, thereby exceeding the available operating capacity thus leading to inefficiencies and extra costs. Manufacturing and warehousing constraints have now been resolved through major investments in new capacity. Looking ahead, we expect sustained operational excellence to result in the benefit of our sales growth flowing through to improved profits and margins.

Finally, we will introduce a new strategic priority to 'develop a sector-leading digital proposition'. Stakeholders in most organisations increasingly require full end-to-end digital solutions; a trend exacerbated by the COVID pandemic. We now intend to make the continued development of our digital proposition a strategic priority. We expect a sector-leading digital proposition to act as an enabler to our other priorities and improve the supplier, customer and employee experience, making Eurocell an even better business partner all round.

Overall, we are confident that, through the successful progression of our strategic priorities, we will outperform our markets and deliver sustainable growth in shareholder value.

Outlook
COVID-19 has created unprecedented challenges. Our first priority continues to be the health, safety and well-being of our employees. Through their hard work and dedication, we have implemented safe working practices in line with recommended guidelines, and I would like to thank them all again for their continued commitment and support.

In response to the pandemic, we took a number of decisive actions to safeguard our future and ensure the business was well-placed to capitalise on opportunities as markets developed.

The RMI market was stronger than we anticipated throughout the second half. Sales exceeded our expectations, particularly in the branch network, operating efficiencies were good and gross margins improved as volumes increased. As a result, we were very pleased to report strong profit growth for H2.

Our focus now includes completing the warehouse transition successfully, thereby facilitating future growth and the delivery of anticipated operating efficiencies. Whilst the current levels of uncertainty mean it is difficult to predict the outcome for the year, 2021 has started well with sales to the end of February up 8% on 2020 and it remains our intention to return to paying dividends this year. We continue to see good potential to outperform our markets, take share and deliver further progress.

Mark Kelly
Chief Executive Officer


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