New Purchase – Heidelberg Cement

Having sought an opportunity to buy a high quality heavy-side building materials company for the TB Saracen Global Income and Growth Fund ('SGIG') for some time, we alighted on Heidelberg Cement (HEI-ETR) following a meeting with their Management team at a conference in Munich.

As the name suggests, Heidelberg is primarily involved in the production and distribution of cement (49% of revenue and 60% of EBITDA), however it is the number 1 globally in aggregates (22% of sales and 28% of profits)*. Its product range is substantially complemented by downstream ready-mixed concrete and asphalt activities.

Heidelberg ticks all of the boxes we look for in SGIG:

- It is a global leading producer of building materials, operating in 60 countries world-wide.
- It ranks number 1,2 and 3 globally in its core aggregates, cement, and ready-mixed concrete business lines.
- It has long-term revenue growth prospects from an uplift in infrastructure spending in the US, recovery in Europe and structural growth in Emerging Markets (the business is equally split between the US, Europe, and the Rest of the World).
- The business has strong and sustainable margin profile – the EBITDA margin is currently 20%.

The Balance Sheet leverage is slightly higher than normal at 2.8x net debt/EBITDA which is reflective of the recent acquisition of Italcementi, the world's 5th largest cement producer. However, we forecast that the Balance sheet quickly de-levers over our 5-year forecast period. Most importantly, the shares currently trade on a very attractive valuation (12X PER Dec 2018 and 8.5X Year 5 PER).

We model a continued recovery in Europe where volumes in the main markets of Germany, France, Italy and the UK remain significantly (20%+) below peak levels. We only assume a continuation of the current strength in the US market which excludes any benefit from President Trump's Infrastructure plans. We also forecast long-term structural growth in Emerging Markets. These factors will drive the top-line and EBITDA growth.

The recent acquisition of Italcementi should provide more than €500m synergies which will hit the P&L by 2019 – more than offsetting any input cost inflation from rising energy prices.

In addition, annual Interest payments are expected to reduce by around €200 million in the next three years which equates to more than 10% of group operating profit. As the chart below highlights, very expensive debt will mature between 2017 and 2020 and we expect this will be replaced by significantly lower coupon debt. We observe that Heidelberg has been refinancing its debt at between 1.5% to 2.5%.

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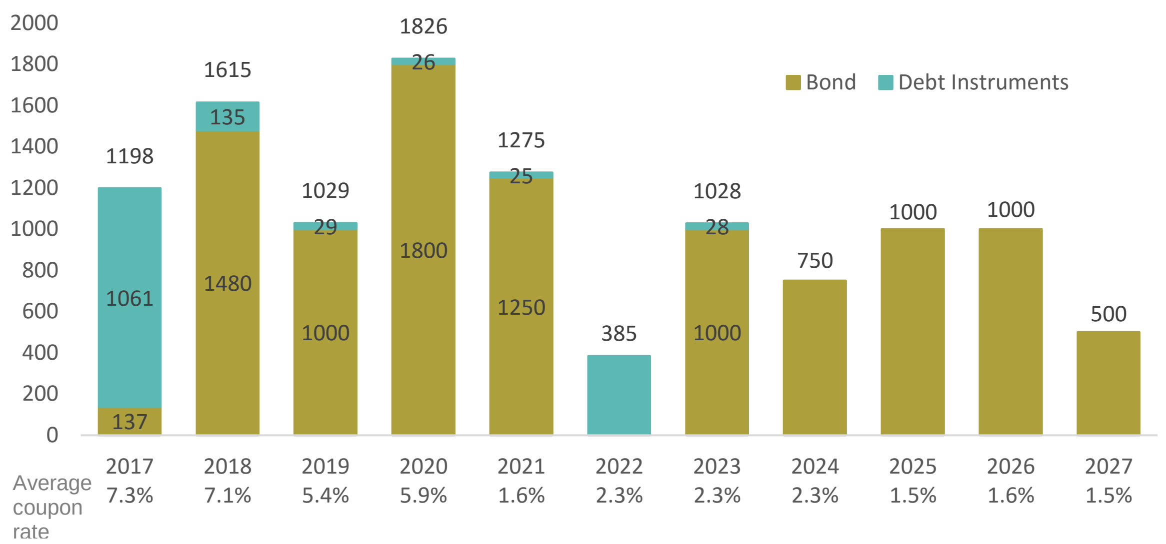
Heidelberg Cement Debt Maturity Profile as per 30 June 2017 (mEUR)



Further increase in financial result expected from well balanced maturity profile and payback of high coupon bonds

Source: Heidelberg Cement

We therefore forecast compound annual earnings growth of 11% over the 5-year forecast period.

The key attraction for us is the dividend. Whilst the shares are only yielding 2.4% today – Heidelberg intends to pursue a progressive dividend policy over the next few years. The pay-out ratio is targeted to increase to 40%–45% by 2019 from a 30% pay-out ratio in 2016. This should lead to 18.5% dividend growth over the 5-year forecast period.

We have taken advantage of the recent share price weakness caused by country specific issues in Indonesia to buy a position for SGIG.

David Keir – Executive Director and Co-manager of the TB Saracen Global Income and Growth Fund

*(NB Cement and aggregates are the two essential raw materials for the manufacture of concrete)