Annual Results 2022 earnings call

Company participants

- James Brotherton, Chief Financial Officer
- Rob Wood, Chief Executive Officer

Other participants

- Analyst
- Andy Murphy
- Christen Hjorth
- Clyde Lewis
- David OBrien
- Glynis Johnson
- John Fraser-Andrews
- Marcus Cole
- Robert Chantry
- Ross Harvey
- Tobias Woerner

Presentation

Rob Wood, CEO

Good morning, everybody, and welcome to our 2022 Results Presentation. James and I will take you through our presentation, and then open things up for questions.

We've delivered another record year at Breedon successfully navigating numerous challenges to deliver results ahead of expectations. This performance is a testament to the quality and integrity of our people, and their resilience and dedication regardless of the challenges they faced. I'm extremely proud of their achievements, and I thank them wholeheartedly.

So what contributed to our performance? Our key construction markets noticeably infrastructure, housing, and industrial continued to benefit from long-term structural growth drivers. Our dynamic pricing strategy complemented by our forward hedging program and careful cost management insured full cost recovery. And we continue to invest for growth completing three strategically significant acquisitions and increasing organic investment. Our numbers matter, but so do the value generators that you can't see directly in the numbers, and that's what I want to show you in this next slide.

In parallel to delivering the financials, I'm delighted by the progress, we've made in our three strategic priorities. In respect of our sustained priority, we have progressed a range of initiatives. We have established a new Board level sustainability committee. Our commitment to develop climate-related carbon targets has been accepted by the science-based targets initiative. And we have complied with TCFD and assessed and quantified the potential physical and transitional risks and opportunities posed by climate change.

We have achieved our highest ever rate of cement alternative fuel use. We have launched our sustainable Breedon balanced range of products. And last but not least, we kept our focus on health, safety, and well-being, and this is showing in our KPIs.

In respect of our optimized priority, we have continued to drive efficiency and utilization. Progress during the year has included the implementation of electronic proof of delivery across the group improving customer service, accelerating cash receipts, and using less paper, the delivery of the Cemex synergies, and the introduction of an operating model to optimize quarry efficiency.

And lastly, in respect of our expand priority. We have expanded our surfacing business in GB with the award of a place on the National Highways Pavement Delivery Framework, and through the acquisition of Thomas Bow. We are executing our GB surfacing strategy, which is all about pulling additional volume through the business without being margin dilutive or changing our risk profile.

We have added marine dredging to our portfolio of activities through the acquisition of Severn Sands. And we have continued to invest in the lifeblood of our business, namely our minerals. In summary, we've delivered another great year at Breedon.

I now pass you on to James, to deliver his financial review.

James Brotherton, CFO

Good morning, everyone, and thank you Rob. So 2022 was a further year of significant progress for us as a group.

Revenue increased by 13% despite the challenging macro backdrop. And in a year with significant cost headwinds, we successfully expanded our operating margin by some 30 basis points to 11.1% and EBIT for the year has come in around 5% ahead of consensus. We increased our returns on invested capital building on the progress, we made in the first half of the year and delivering a full year return some 130 basis points higher than in 2021.

As a consequence of the investment we made in the business free cash flow generation was lower than our medium term target with cash conversion of 29%. We reduced our leverage both year-on-year, and since the half-year. Finally, we've increased the dividend by 31% reflecting both our progressive dividend policy and in line with our plans to grow that payout ratio towards 40% over time.

Our top-line growth of 13% in the year was principally generated through the success of our dynamic pricing actions with overall pricing of around 20% offsetting volume declines of around 10%. Excluding acquisitions, which contributed around GBP33 million, our revenue grew by 11%. And that pricing meant that we recovered the impact of the significantly increased input costs during the year, and help to offset the drop through on those lower volumes.

You'll recall from this time last year that we'd originally planned for around GBP100 million of incremental cost to come into our business in 2022, and we ended up with nearly doubled that due to the impact of inflation. And there's a detailed breakdown of our cost mix in the packet Slide 31.

The business did an excellent job of managing through what was a really changeable cost environment and our hedging strategy delivered exactly what it is designed to do. Giving our operations, a degree of cost certainty, and ensuring that we were not caught out by the significant energy price shocks that came through. And the changes that we made to our pricing model back in 2021 enabled us to react appropriately as those increased costs came through.

We have hedges in place for substantially all of our power needs across 2023, and while those hedges are at higher levels than we were able to secure for this year, they're well below the compete cost that were seen in 2022. I estimate that the year-on-year cost impact of increased power in '23 for our business will be around GBP25 million. Bitumen supplies stabilized over the course of the year and is felt to be much less of a risk in 2023.

As a reminder, we typically look to fix the bitumen elements of large contracts at the start of those contracts to give us a price certainty. And as you know the key question with bitumen isn't the absolute price that we pay for it as a raw material, it's the jet delta that we generate. The cost of carbon has resumed its upward trend since the turn of the year with EU allowances now around EUR95 a tons and GB allowances around GBP80.

Our surcharge mechanism allows us to recover the cost of that carbon, and has been well-received by customers. And that gives them certainty around carbon cost for the quarter ahead allowing them to plan with confidence. Our most effective hedge of course, remains the 1 billion tons of reserves and resources that we control and that sit on our balance sheet at historic cost.

In 2022, we've replenished our production, and importantly, we have around 100 million tons of resources at various stages of the planning pipeline. In what is likely to be a headline deflationary environment, I expect that securing real price increases will be more challenging this year than in the past two years. However, as you would expect, we will continue to scrutinize the cost-based closely and will use look to use dynamic pricing as required to protect and enhance margins and returns.

Each of our divisions has contributed to that improved EBIT performance and to the overall improvement in our margins. GB materials expanded its EBIT margin to 8.9% and delivered GBP2 million of synergies from this Cemex transaction across the year,

principally through the increased utilization of the acquired assets and the work that we've done to internalize supply.

The underlying Cemex margin continues to improve and grew faster than the overall divisional margin in the year. In Ireland, the team delivered a resilient performance, recovering input costs, and maintaining margin, and as a business is well positioned for 2023.

Cement had another strong year, recording a good drop through on its top line to increase its margins by 40 basis points across the year. So overall, a 13% increase on the top line and a 16% increase on the bottom line leading to a 30 basis point improvement to our underlying EBIT margin. And that's a pretty cleanly bit number, given that below the line we only booked GBP2.2 million of exceptionals along with GBP4.8 million amortization of intangibles.

We generated GBP69 million of free cash flow during the year and secured a strong working capital unwind in the second half of just under GBP44 million leading to an outflow for the full-year of GBP33 million. A proportion of this is down to the impact of inflation working through the balance sheet, as well as the GBP20 million of carbon allowances that we acquired for cash in the first half of the year.

Net CapEx for the year came in at GBP102 million in line with guidance. And bear in mind that about GBP20 of that spending was committed in 2021, however, capitals supply chain challenges meant that the investment couldn't be made until this year. As a reminder, our banking facilities were extended during the year out to 2025, and we retained the option of a further extension to June '26. And there's a detailed breakdown of our debt maturity dates in the appendix to your pack.

Terms of our technical guidance for the balance of the year. The NPA forecasting volumes to be mid-single-digits lower this year and that seems to us sensible as a core market assumption. We will get some benefit from pricing drag through from 2022, however, pricing as a whole for this year is likely to be lower than last probably mid to high single-digits. General cost inflation expected to run at similar sorts of levels and as I mentioned earlier, we will see an increase in our energy costs year-on-year.

Net interest expense for this year around GBP15 million with substantially all of our drawn facilities at fixed rates and net cash interest paid probably closer to GBP9 million. We're expecting an underlying effective tax rate of around 20% and our cash tax payments will be slightly higher than the effective rate due to the expiry of the super deduction at around GBP35 million.

I'm expecting the normal working capital profile of a bill to the half year reducing over the year as a whole for a net outflow of around GBP20 million. CapEx for this year is expected to be lower than last at around GBP90 million. Bringing all this together, we combine it with cash dividend payments for '23 of around GBP35 million and that should lead you to a year end net debt number of around GBP165 million.

I wanted to finish up this morning by taking you back to two slides that we covered off at our Capital Markets event back in November of 2021. We talked then about the balance financial framework that underpins our business model and aims to ensure that we allocate our capital in the most thoughtful manner possible.

In 2023, we've invested in our business at all levels not only replenishing our reserves and resources, but also creating a clear pathway to securing future planning applications. Not only with high profile capital projects, such as the Mansfield asphalt plant, but also spending GBP3 million to upgrade welfare facilities for our colleagues across the estate. Each of our three completed transactions helps develop a fresh angle to our business and the M&A pipeline in both the UK and Ireland looks promising.

We've met our strategic objectives, we pay cash dividends to shareholders of over GBP30 million in our first full year of dividend payments and that reduced leverage means that we retain balance sheet optionality. And we've achieved all of this in combination with a further improvement in our return on invested capital to 10.8% exceeding our target significantly faster than we'd expected. So our financial framework is delivering for shareholders.

And our record '22 performance means that we continued to make progress towards the targets and commitments that we outlined at the Capital Markets event. We've grown the top line and increased our profitability. The investments, we've made into the business have had a knock-on effect on our short-term cash conversion. However, these investments will strengthen and benefit the business going forward.

Our balance sheet is strong, our returns are improving, and those cash returns to shareholders have increased materially. So the report card for '22 is pretty good. 2023 will throw up a different set of challenges, which we will need to respond to, and for now, our expectations for this year remain unchanged.

Thank you. I'll now pass back to Rob.

Rob Wood, CEO

Thanks, James. I'll start the operational review by highlighting that the central theme of the market review is the normalization of demand following the exceptional post-COVID demand in 2021, and moderating growth in the second half of 2022 as inflationary pressures have grown.

Let's look first at our UK market, where the picture in 2022 has yes been one of normalizing demand and moderating growth. UK GDP is estimated to have grown by 4.1% in 2022. However, there was a meaningful loss of momentum in the second half of the year as high inflation and rising interest rates impacted on growth. Construction output is estimated to have grown by 1.6% in 2022 with growth driven by infrastructure, housing, and industrial demand, however, momentum has again been lost in the second half.

The latest data available for NPA volumes has confirmed that demand for mineral products declined as the year progressed with their estimate for the year being a decline in aggregates of 8%, in asphalt of 7%, and in concrete of 4%. Confidence as measured by the construction PMI also declined as the year progressed and stood at 48.8% sorry, 48.8 at December 2022.

Considered against this backdrop, our UK performance in 2022 has been outstanding, and I will talk more about how it was achieved in our business review shortly. But before I do that, I want to turn next to our market in the Republic of Ireland, where the operating environment was more positive, modified domestic demand is estimated to have grown by 7.7% in 2022 that made it one of the strongest performing advanced economies in the world.

And construction output is estimated to have grown by 9%. Our businesses in the Republic of Ireland benefited from this growth backdrop. Having said this, the benefits of this were masked at the Ireland level by the absence of the governing assembly more specifically spending in Northern Ireland and as with the UK momentum was lost in the second half. Again, like the UK confidence declined with the construction PMI standing at 43.2 at December 2022.

Moving on to our businesses and to GB. Our GB business has had a successful year delivering significant organic growth and fully recovering rising input costs. Volume softened in line with the broader industry as the UK economic growth moderated. However, we built on the servicing platform we established last year expanding our presence in the East Midlands by acquiring the Thomas Bow business. And we were awarded a place on the National Highways Pavement delivery framework in England.

Our associate BEAR Scotland also successfully retained the Transport Scotland Northwest management managed contract. We expanded our strategic capability and reserves through the acquisition of Severn Sands and marine dredging business. And we increased our concrete offering through the acquisition of RT Mycock.

We complemented M&A activities with significant organic investment directing a meaningful proportion of our increased spend toward projects aimed at driving growth. For example, our new Mansfield asphalt plant has expanded production capacity, optimized efficiency, and enhanced sustainability by enabling the use of up to 50% recycled asphalt.

In terms of sustainability, we invested in mineral reserves and resources and accelerated the sales of more sustainable asphalt and concrete products. We also launched Breedon Balance, our new product range that meet stringent sustainability criteria. Lastly, in anticipation of a change to building regulations in 2023, we also invested in a network of silos, so that we can increase the use of CEM II in our concrete, a product with a reduced carbon intensity.

Turning to our Irish business. It delivered a resilient performance, fully recovering input costs, and winning high quality new work. Softness in volumes at the half year reflected

the absence of the governing assembly in the Northern Ireland, and the tendering delays that we reported at the half year in the Republic of Ireland. In the Republic of Ireland, tendering activity accelerated noticeably in the second half.

In Northern Ireland, the DfI revise the procurement process for infrastructure tenders in the second half leading to several contract awards coming through. We were successful in the first two rounds of awards securing the Down and Armagh District Term Surfacing contracts. Tenders have also been submitted for the remaining rounds with outcomes expected to be phased through 2023.

We also have a successful street lighting maintenance business in Northern Ireland, which benefits from the switch to more efficient LED technology. In the second half, we were pleased to win to street lighting maintenance contracts with the DFL -- DfI -- sorry each for a five year term. We are positioning the business in Ireland for growth and rebranded Whitemountain and Lagan as Breedon during 2022, and made further investments in the team there.

A review of strategic opportunities in Ireland also crystallized our decision to exit our civil engineering business during the year, where the contract risk profile had deteriorated. Our mineral reserves and resources pipeline made substantial progress during the year opening a previously dormant quarrying carry and progressing numerous other extension opportunities.

Cement, our cement business delivered a strong 2022 volume software GB in line with the broader industry as economic growth moderated. Pricing remained resilient increasing steadily during the year in response to rising input costs. We introduced the dynamic and transparent pricing strategy implementing a carbon surcharge mechanism, which gives our customers direct visibility of the carbon cost of the cement they purchase.

Our forward hedging programme afforded us a clear view of our input costs empowering our commercial teams to focus on full cost recovery. Our Kinnegad plant improved kiln reliability, a creditable performance considering the high performance, high proportion of alternative fuels that utilizes, which adds complexity to the production process.

In 2021, our Hope plant achieved plant mastery status for delivering three consecutive years of kiln reliability in excess of 96%. This is an industry recognized measure, which denotes market-leading plants with strong cost and quality control, high workforce engagement, and excellent health, safety and environmental records. This remarkable performance was sustained in 2022 with kiln reliability of 96.1%. Both plants delivered their planned kilns maintenance shutdowns on schedule and within budget.

We are pursuing numerous strategies to reduce our carbon footprint, switching away from fossil fuel inputs, reducing the clinker content of our cementitious products and turning to innovation for carbon abatement solutions. In 2022, both plants increased fossil fuel replacement achieving a blended rate of nearly 50%, alternative fuel utilization, Hope increased its replacement by 2 percentage points, and Kinnegad improved its world-leading alternative fuel usage to 77%.

Kinnegad was also granted planning permission for a 17 megawatt solar farm. The energy output has the potential to supply nearly 20% of the plants total energy needs. Reducing the clinker content of our products supports our clients sustainability objectives and lower clinker contents CEM II now comprises 50% of Kinnegad sales up from 40% and we expect this contribution to increase. With respect to carbon abatement, our Hope plant is actively involved in the HyNet decarbonization project as a member of the Peak Cluster.

Moving away from 2022 and looking forward, we enter 2023 in a strong position. Our strategy provides multiple options for growth, while our strong balance sheets provides the financial flexibility to take measured action at the right time. Our M&A platform -- pipeline sorry, remains robust. And we continue to engage with asset owners in GB and Ireland as we seek to infill our existing capability and footprint in the near-term.

Longer term, we will continue to explore the possibility of establishing a platform in the U.S. a large and fragmented market with that offers attractive growth prospects. We recognized the macro economic backdrop remains uncertain, but we have confidence. The UK is now only expected to suffer a shallow recession in 2023. The March construction PMI published on Monday of 54.6 supports this view.

Whilst total construction output is forecast to fall by 4.7% in 2023 our end use is well exposed the markets, where there a still expected to be long-term structural growth, namely infrastructure and industrial. And the government remains committed to infrastructure spending GBP600 billion over the next five years.

In the Republic of Ireland, modified domestic demand is forecast to grow by 1.2% in 2023. Total construction output is expected to grow by 2.5%. And lastly, the government is also committed to infrastructure spending a EUR165 billion by 2030.

So to briefly summarize before opening for questions. We've delivered a strong 2022 at Breedon. We've advanced margins earnings and delivered higher returns. In parallel, we've made good progress on our strategic priorities. And whilst the macro economic backdrop remains uncertain, our end use exposure is supportive and we have started 2023 positively.

Lastly, as well as our results announcement this morning, you will also seen our announcement about seeking admission to the main market. We believe, the time is now right and that the main market now offers us the appropriate listing given our scale, maturity, and growth ambitions.

Going back to the outlook, whatever materializes the Breedon model and the people, who operate it have repeatedly demonstrated their resilience delivering strong operational performances irrespective of the macro economic backdrop, and I remain confident in our ability to continue to deliver.

Thank you. We now welcome your questions.

Q&A

(Question And Answer)

Q - Rob Chantry

Hi. Rob Chantry at Berenberg. Thanks for presentation. Just three questions. Firstly, on pricing; could you just give a bit more color around some of the geographical differences in the UK and how that's evolving and are there any spaces, where there's particular to get high prices getting through and good demand versus the address of that?

Secondly, on the end market dynamics, could you just talk a bit more about the kind of non-infrastructure and non-commercial areas specifically areas like new builds in terms of timing how those interactions are going? And how that's changed over the past few months?

And thirdly, could you just give some more strategic thoughts on different routes to market in the UK and how it's evolved? I know there's been a focus in the past year on servicing work and as a route to market are there anymore avenues you can kind of explore to open opportunities up? Thanks.

A – James Brotherton

If I take the pricing one and then Rob if you take the other two. So, I wouldn't say that there were notable pricing variations regionally within GB. Clearly, there's a range of pricing outcomes depending upon the mix of the product set and who the customer is. But I wouldn't say there were notable differences depending upon regions or geographies.

A – Rob Wood

I think in terms of market dynamics, our markets are slightly different. So, if I pick off GB and Ireland separately if I could; if I start with Ireland, I think the key bit of news flow in the recent weeks has been the Windsor agreements. And I think if that is accepted by all sides, I think it's upside for Northern Ireland versus where we are at the moment. Given what I've said about the spending challenges that have been there to date.

I think in the Republic of Ireland, I think the growth prospects are positive. And as I close there, I mean the government are committed to infrastructure spending there. There's due to be inward migration of up to a million people in the Republic of Ireland in the sort of years to come. So, it's looking positive there longer term.

I think in GB, I'd say the short-term challenge is probably around house building and I think you'll have -- you will all know more about what the house builders have said that we know, but I think the one key thing I would point out is just our end use exposure to that sector, which is relatively modest at circa 20% and really what's driving us going forward

will be the infrastructure, where there is forecast still to be positive momentum and growth and industrial. And there is a view that investment in warehousing and things might have peaked, but I think there's still a still a pipeline over the next 12 or 18 months for that to be delivered.

On the third thing about surfacing, I think the one thing and I mentioned before was just this is all about the route to market. We post-acquiring the Cemex assets, we then had a national footprint to be able to compete nationally and the national highways award of the contract for the next four years. It's really just the logical next step for Breedon. We will continue to try and expand surfacing business wind filling regional businesses. As I said, when I started this morning and as I said back at the capital markets event, it's not about margin dilution, it's not about changing risks. It's just about pulling through additional volumes from our businesses.

A – James Brotherton

If you look at the contracts up in Scotland that underpins about GBP50 million of revenue for our materials business.

Q – Manfred Bizzarri

Hi. Manfred Bizzarri from Morgan Stanley. Just coming back on the pricing comments, sorry, I missed the guidance; did you say mid-single digit up in 2023 for pricing?

A – James Brotherton

Yeah, I think so. I mean, at a macro level, I think it's quite difficult to see how the market could absorb another year of pricing similar to what was seen in '22 and '21. So, I think there will be price that come through this year, but I think it will revert to something more like sort of mid to high single digits.

Q – Manfred Bizzarri

And assuming your pricing holds, so you cannot secure price increases, what's your rollover pricing from '22 for the year?

A – James Brotherton

Yes. I think, there'll be again, a sort of a mid-single digit rollover in terms of price from '22 coming through in '23.

Q – Manfred Bizzarri

Okay. And lastly, in terms of pricing by product, could you guide there cement aggregate?

A – James Brotherton

I mean, there's a range clearly and we don't operate in terms of one price for each across the entire product set. I think I'd leave it to you to extrapolate what the pricing might be.

Q – Clyde Lewis

Clyde Lewis at Peel Hunt. I think three if I may. You've very clearly given us the pricing impact for the business for last year. Can you maybe just give us an idea as to where you think you were relative to the industry moves? Because the second question, which follows on from that is obviously so the volume numbers that you've given, look as if you've slightly undershot the NPA numbers, I think that Rob readout. And historically, you've never really chased volume hard. But just sort of -- it'd be useful to get a bit of color as to I suppose where the volume differences were and again how we deliberately chosen to price a bit better and accept that you might do a little bit worse than the industry in terms of volumes.

And the follow on from that is in terms of CapEx thoughts, are you thinking more about given the volume profile that we probably got in '23? You're thinking more about CapEx, should be more aimed at cutting costs, rather than adding more capacity?

A – James Brotherton

So, in terms of the first one, I don't think that our pricing left us at a relative disadvantage across the market last year. I think that if you look particularly at ready-mix, we've changed our operating model quite substantially there over the last few years. So, if you remember coming out of COVID, we didn't bring back all of our ready-mix plants at that point. The Cemex acquisition allowed us to look at the overall ready-mix footprint and we've not been afraid to walk away from work, where necessary.

So, I don't think that overall, the pricing left us at a relative disadvantage in the market. And I think that where there has been volume contraction, it is either down to the market contraction that we saw relative to the high numbers that came through in 2021, which was a consequence of the post-COVID snapback or alternatively it's down to us being disciplined about the type of work that we're willing to undertake.

I think, in terms of capital investment, we talked about Mansfield a lot and it's a bit of a poster child for us within the business. Because what it does for us is, one, it improves us operationally, but it brings a lot of other benefits as well. It's a significantly greener asphalt plant, if there is such a thing. It allows us to internalize supply of aggregate still further and it's very much the model of what we want to do going forward. And we think that targeted investment along those sorts of lines can continue to make a difference for us.

A – Rob Wood

-- our volumes are materially different from the industry and there's so many regional variations. I mean, I wouldn't get hung up on the MPA volumes and we're not there just to chase volume.

Q – Christen Hjorth

Christen Hjorth from Numis. Three for me if that's okay this morning. So, first of all, you've touched on the surfacing a couple of times and the margin dynamic. Could you just sort of provide maybe, I don't know -- so if you win a new surfacing contract, why does that margin, why is that not margin dilutive just of running through the different pieces, because I understand the surfacing piece in itself would be like slightly lower margin?

The second one you sort of pointed to the NPA expectations for volumes, I know it last year the volume drop through looked like it was just below 30%. Is that a number to a reference point looking forward in terms of how we should think about volume drop through in '23?

And the third one is, obviously the ROIC performance has now got above target already despite the fact that margins are below target. So, just sort of trying to understand the moving parts there is that maybe, because there's been a little bit less M&A, which in the first instance can be a bit dilutive to returns. Some color there would be great. Thank you.

A – Rob Wood

Shall I do the surfacing one, James, and then pass those other two to you?

The worked example of the surfacing is securing a surfacing sort of maintenance contract, and then delivering the surfacing margin, which is relatively small. But given the capital employed, it's a high ROIC and a high return. But what we're also doing is pulling through that asphalt margin. And we're also pulling through the aggregate margin. And so when you get to see it reported up in our numbers, you end up with the surfacing revenue. But you end up with the surfacing margin, the asphalt margin, and the aggregate margin. And that's why it's not margin dilutive for the group.

A – James Brotherton

I mean, clearly with volume drop through, it does depend upon the mix and what volume has varied. But I think a good start point is a 30% drop through plus or minus on the volumes. In terms of the ROIC, it was a really good performance at the half year. I think our aim would have been to hold on to the change that we delivered in the first half to the full year. We did that and then a bit more. Clearly, we benefited from the drop through that's come through on the price cost dynamic in on the EBIT margin has flown through into the ROIC as well. We're not revising the target as yet. But we're very pleased that we're ahead of the target and we would certainly aim to remain ahead of the target going forward.

Q – John Fraser-Andrews

John Fraser-Andrews, HSBC. Three for me as well please. James, the cost buckets, you've said power is all hedged is all of your energy -- fuels for the various businesses all secured now and perhaps you can elaborate on other cost buckets like staff wages, salaries? Are there any other specific items that are significant?

Second one would be on the bolt-ons that you made last year. I'm assuming there's still some more juice to come from them in terms of margins, so, Cemex might be done, but the there might be some more coming there. And then finally, on bolt-ons. The ones you're looking at the M&A market in UK and Ireland. Are you seeing pricing for deals getting any better given the volume circumstances? Thank you.

A – James Brotherton

So, I'll take one and two, and then you take the third.

So, in terms of the cost base, there's a breakdown on Slide 31 of your pack. Our energy is fully hedged for this year. As I touched on earlier, the hedges for '23 are more in line with where the market is at. So, we will see a step up in the costs attached to energy of around GBP25 million coming through the business in 2023. But the hedging strategy delivered exactly what it was meant to do last year. It gave us cost certainty in a year of unprecedented energy price volatility. So, the idea of our -- behind our hedging policy and our hedging strategy is not to chase rainbows, it's about giving the business certainty. And it absolutely did that last year.

In terms of other fuels and in particular bitumen, which is around GBP100 million of spend for us in any year, the strategy, there is very much that gets passed through to the customers in terms of the pricing. With bitumen, we typically look to hedge about a third coming into the year and that's been secured. We have a third that we will lock in at the start of a longer-term project. So, for example -- project that we've been doing out in East Anglia and then the remaining third is passed on a job-to-job basis.

In terms of the bolt-ons, I mean they're all pretty small in terms of what they may or may not deliver financially in the context of the group. Strategically, they all bring slightly different things. We've talked about the dredging, we've talked about the volumetric concrete, we talked about the surfacing optionality that Thomas Bow brings us. Yes, we would expect each of them to deliver and enhance and improve performance on a like-for-like basis in the course of 2023 as a consequence of being part of a bigger group, but the real reason that those three acquisitions were made was because of what they gave us strategically rather than necessarily what they would deliver financially to the group.

A – Rob Wood

I think, in terms of pricing on deals, I think there was a slight disconnect probably between public sort of multiples and valuations and private expectations during 2022, but I think given the macroeconomic uncertainty out there, hopefully they will start to correlate again and we do have a positive pipeline for 2023.

Q – John Fraser-Andrews

James, just on staff costs and any other big item -- or any other things significant, there's inflation that's coming through that we should be aware of.

A – James Brotherton

Yeah. So, I mean, I think that we will see employment costs running in mid-single digits. This year that's I think in line with broader industry and broader market. Other cost, I think the challenge this year, in terms of costs and in terms of cost management is going to be that the headlines are all going to be about deflation, but in the real world, there is still inflation coming into cost basis.

Q – Tobias Woerner

Tobias Woerner here from Stifel Europe. Three questions if I may as well. Firstly, Firstly, probably for James with regard to the cash flow. Last year, you've had an impact from

carbon credits. Maybe you can give us the number what your short at or maybe even in pounds if possible. In context of CapEx, you gave us guidance GBP19 million for '23. On a normalized basis or percentage of sales, what would you say that compares to?

The second question is about your quite sizable reserves and resources 1 billion tonnes; this is a real asset. They don't make them anymore, especially given our planning system in the UK. Do you have any royalty deals to give us a sense of comparative values per tonne or any other deals recently struck in the aggregate space, probably one for Rob.

And then, just lastly the other day on LinkedIn, I saw your JV partner, Colas and yourself working together, Colas obviously being a global international. What sort of cooperation do you have with them? Just remind us of the JVs what sort of work you do?

A – James Brotherton

Okay. That was four questions, Tobias, not three. Carbon, we are covered for '23 and '24, so we have the allowances that we need for '23 and '24, and we've got layers going out into the into 2025. CapEx this year was by some margin the highest that we've ever invested in the business; some of that as I touched on earlier was down to pull through from investment we'd originally planned to make in 2021, but we couldn't make because of capitals supply chain challenges. The EUR90 million will again be a significantly higher than our long-run average of capital investment back into the business.

A – Rob Wood

I think, in terms of reserves and resources, you know, it is a huge asset. And it is the lifeblood that will feed the business. And as we sit here today, we have over 30 years worth of reserves and resources. And we currently have GBP100 million in the pipeline in the minerals pipeline as well at the moment, so it is positive.

We do have some royalty agreements. I think we do split minerals out in the accounts. I'm looking at Anthony at the back between freehold and leasehold. No, we don't, okay. Well, we don't do that. I thought we did. But we do have some, but it's commercially sensitive as to what the implied or what the royalties are on those or what the implied royalties are. But I think a lot of research has been done by the analyst community over the last decade or two on implied royalties. So, I think I'll leave it to the community to come up with their own conclusions on that. But it is an important asset underpinning our business.

Colas, I mean the joint venture is in the process of being formed. We -- it will start trading, I think, in April. And what did we bring to the party and what did Colas bring to the party? Well, Colas bring bitumen and innovation and we bring the materials; and between us, we will deliver on the contract for national highways. So, it's a sort of marriage made, where both partners are bringing something to the table and 1 plus 1 equals 3, which delivered for us on the national framework agreements.

Q – Tobias Woerner

Thank you.

Q – Glynis Johnson

Morning. Glynis Johnson, Jeffries. Three if I may, actually all focused on sustainability. Can you maybe give us some color? I don't expect numbers from you, but maybe a little bit of color in terms of the price premium you get on your sustainable products. I'm thinking the CEM II and also the recycled asphalt.

And then talk about maybe the constraints in terms of the uptake of that product. Is it about just how much you can actually deliver to the customer or all the customers being very price sensitive about their use of sustainable products?

And then just a quick update in terms of carbon capture. When will carbon capture do you think become meaningful for your business?

A – James Brotherton

So, I think on the first one on the pricing, I'm really sorry, but I'm going to have to hide behind the cement market data order and say, we're just not in a position to comment on any form of cementitious pricing. On number two, and on CEM II, I mean if you look at Ireland and where we are in Ireland, 50% of our sales volumes been of CEM II; and in the UK, it's in single digits. We need to have the standards in the UK. We need British standards to be updated. We're expecting them to be updated and we do expect. We already are investing in silos to be able to have offer it to our customers. But we need the standards and when we've got the standards, we expect the demand for that to accelerate significantly in the UK.

On carbon capture, look, the industry would like it and would like it now. But there's an awful lot that needs to be done and I think the key to having commercially available carbon capture and storage is to all the feed studies that will need to be done in the next few years. But I think it's going to be in the early 2030s before it's commercially available generally to the UK industry.

Q – Marcus Cole

Marcus Cole, UBS. Just one question on M&A; I was wondering if you consider any product adjacencies such as clay bricks or anything else?

A – James Brotherton

We would always consider things. And I think the most logical place for you to consider for us would be we have our core outputs, which are cement and aggregates and then everything else is a value-enhancing product and a route to market. So, I think it's much more likely to be either through the surfacing or growing or concrete products business, which will be pulling through cement and aggregates as opposed to clay directly.

Are there any calls on the line?

Operator

Yes, indeed. (Operator Instructions) And we take one from David OBrien of Goodbody. Please go ahead.

Q – David O'Brien

Morning, guys. Thanks for taking my question. A couple for me, please. Look, you've been quite successful in a number of fronts in terms of winning the framework agreements or winning tendering. Simple questions is, what is the edge you think you have in winning these? What is the feedback that's coming back? I'm sure it's nice. You're just a cheapest in the market. So, can you give us a little bit of color and maybe building on Glynis's question to a different angle; is your sustainability capabilities playing into winning those framework agreements?

And then finally, something that clearly gets focus from you guys is safety not so much when we we're talking from an equity markets point of view, but clearly you're succeeding when we look at the data that you provided today. What investments are you making there and I guess how important is -- attracting, retaining talent, and does it become a talking point or a consideration with the business owners that you're trying to acquire assets, but also people from over the last number of years?

A – James Brotherton

Tendering, I don't know how much color I really can provide or want to provide, because it's a competitive advantage really. But I think what I can say is that gone are the days when tendering is just based on a pricing decision, quality including sustainability is quite often now the majority of the awards in terms of scoring. I can -- without saying what they were, but I can talk about projects last year, where vehicle movements and proximity of our plants was the key determination for us securing those jobs. So, I think -- I mean the world is changing and it's not all about price any longer.

In terms of safety, David, it's a really good question. And I think over the last year or 18 months, we have implemented a home safe and well action plan, and not only colleague safety, but also colleague wellbeing has been a critical sort of part of that plan. We aim to bring everyone into work and send them home at the end of every day safe and well. We've got more to do, but James touched on the amount we've invested during the year on the wellbeing facilities of all our colleagues. We've done a lot of stuff on the softer things, in terms of mental health and well-being this year. We've also done a lot with people to try and help and alleviate the pressures from the credit crunch and the cost of living crisis. So, it is front and center. And actually, safety and the wellbeing of our colleagues is our number one priority.

Q – David O'Brien

That's great. Thanks, guys.

Operator

Thank you. And our next question comes from Andy Murphy of Edison Research. Please go ahead.

Q – Andy Murphy

Good morning. Thank you for taking my questions, and that was a great presentation, so thank you for that. Three questions, around the cement plants and the investment that you're putting in, do you foresee a point, where your cement plants reach zero carbon? That's my first question.

Secondly, you touched on this earlier on around UK house builders and it's around 20% of your business. But I was just wondering whether thinking about the outlook for '23, maybe '24. Now compared to perhaps Christmas time whether you're more optimistic or just less pessimistic.

And then finally, on the M&A, you talked about moving away from the UK towards the U.S., just wondering why the U.S. as opposed to continental Europe, which is a bit closer and arguably a little easier to keep your eye on.

A – Rob Wood

I think they're probably for me, those. Cement plants and the investment needed to deliver net zero. Hopefully, Andy, you would have seen our roadmap. There is going to have to be significant investment, not only Breedon, but across the industry to deliver that net zero by 2050. The lead technological solution at the moment is carbon capture and storage and it will need material investment over the next two to three decades.

I think what is key and the government's recognized not only here, but globally that it's not going to be done just by industry. It's going to need the framework and the support of governments around the world to deliver that. I think in terms of house building in your comment about now versus where we were before Christmas, if you're an optimist, I would say, you're probably slightly more optimistic than where you were on Christmas eve; and if you're pessimistic person, it's slightly less pessimistic than it was there. But I would say, the sentiment is more positive today than where it was a couple of months ago.

I think then the U.S. and I think your question was really the U.S. versus continental Europe. And I think you have to go back to what we said at the original capital markets event in November 2021 and it's all about the growth prospects of those relative two markets and about the degree of fragmentation and i.e. the opportunity for Breedon to replicate the Breedon story in a third platform and to us and please look at those growth statistics and the fragmented nature of the market, but hopefully you'll agree with us.

Q – Andy Murphy

Thank you very much.

Operator

Thank you. And up next, we have Ross Harvey from Davy with our next question. Please go ahead.

Q – Ross Harvey

Hey. Morning, all. Thanks for taking my questions. I've got two. The first is just in regards to the return of as the capital. Obviously, you're above target now and putting in some good figures there. Can you just give us a directional feel on the returns by business lines or the way that they are tracking and/or by geography -- more for out there?

In terms then of the CapEx side, just wondering in terms of investments you're making this year and that you've made last year, what sort of returns hurdles you may have -- and whether they are -- specifically obviously, but anything you can give us there in terms of whether they're more short-end weighted or long-term weighted just so we can anticipate, when we might see implications of that financially. Thanks.

A – James Brotherton

So, I think in terms of returns on invested capital, clearly, we have one part of our business is very high capital intensity and that would obviously be the cement business in terms of the capital requirements of manufacturing cement. If you go and look at the other end of the spectrum, you look at the servicing business, that's a relatively low capital intensity business. The reason that we look at it on a blended basis is that, all of our business is important to us and the build-up of margin and the build-up of returns that we generate from that integrated model is important to us and important to stakeholders.

In terms of the capital investment you've got a mix there. You've got the replacement of things like plant and equipment, plant and machinery. The quarry environment, it's an open air environment. It's an abrasive environment. So, there is wear and tear. We do a lot of planned maintenance. We spend a lot of time and effort and energy in keeping our machines going and on the road. But there is necessary replacement and replacement cycles, that sit there.

There is growth CapEx, investments for growth and that would be -- a good example of that would be Mansfield and what we've done there. And then there's investment for sustainability. And in particular one of the reasons that our CapEx for 2023 and beyond is going to be higher than it has been historically is that we are making some quite significant capital investments off the balance sheet in order to improve sustainability, characteristics of the business and particularly of the cement business. And the Armagh project that we've secured planning permission for this year up at Hope is a good example and an important example of that.

We now have the consent to bring in alternative raw materials to use within the cement manufacturing process. In order to bring those materials in, we need to make an investment in the infrastructure of the plant and that's what we've approved and that's what we're -- that's what we'll be making that investment on. You won't see the return necessarily on that investment for some period of time, but it's a very necessary investment in order to improve our sustainability credentials.

Q – Ross Harvey

Yeah. And just one quick follow-up. Yeah, just in terms of the ROIC level, I presume as you look at this between GB and Ireland, you have more scale clearly in GB, but is it fair to say

that probably the return is better in Ireland and just given the surface and it's been invested in across the business really?

A – James Brotherton

Yes, proportionally. You would expect the Irish business to deliver a higher ROIC than the GB materials business.

A – Rob Wood

Good. So, I think we're going to draw it to a close. We've just taken over an hour. I know you're all busy people and there's a lot of -- there's a lot of results and reporting going on at the moment. But I would just like to just remind you, we are really pleased with what we've delivered in 2022 and James and I are confident that we as Breedon will continue to deliver. Thank you very much.

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