

Augean

FY19 results

Strong underlying performance in FY19

FY19 results were ahead of our expectations on an underlying basis and extended the recovery in profitability evident since 2017. With the financial liability to HMRC now discharged and strong growth expected in Augean's key markets, we believe that the company is well positioned to continue to deliver returns for shareholders.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/18	79.7	11.5	9.1	0.0	23.6	N/A
12/19	107.1	19.3	21.0	0.0	10.2	N/A
12/20e	120.8	22.8	17.9	0.0	12.0	N/A
12/21e	131.5	26.4	20.7	0.0	10.4	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Underlying FY19 results exceed forecasts

Despite four management upgrades to FY19 market expectations during the year, Augean succeeded in surpassing our forecasts. Underlying PBT of £19.2m was £0.8m ahead of our estimates, powered by volume growth across all business segments and margin improvement (contributing £3.1m of extra profitability). Exceptional cash payments of £44.5m made in December, including £40.4m to HMRC and £4.0m for the Long Term Incentive Plan (LTIP), meant that net debt of £13.2m was worse than forecast, although on an underlying basis it was slightly ahead of our expectation of net cash of £30m ($-\text{£}13.2\text{m} + \text{£}44.5\text{m} = \text{£}31.3\text{m}$). Despite the payments in FY19, the balance sheet remains robust, with an FY19 net debt/equity ratio of 27.9%.

Extending the growth profile

FY19 results marked a continuation of the improvement in the profitability of the business seen in recent years, with a compound annual growth rate (CAGR) in revenue of 19% and 31% in EBITDA (2016–19). Since FY17, the return on capital employed (ROCE) has improved from 9% to 37.3% in 2019. It is also worth highlighting that net debt of £13.2m compares to net debt of £10.8m in FY17, during which period Augean settled the outstanding landfill tax liability with HM Revenue & Customs (HMRC). Having achieved a turnaround in the business, Augean is well placed, with strong market positions in its constituent businesses to achieve further growth for its shareholders. We estimate that Augean will continue to generate cash at the rate of c £1.5–2.0m per month, eliminating net debt during FY20.

Valuation: Upside despite recent share price strength

Following the FY19 results we have updated our forecasts (only small incremental changes) and valuation analysis. Based on peer group multiples we believe that Augean could be worth c 276p/share. For the purposes of our analysis we have not assumed any rebate of the landfill tax payment to HMRC (total payment worth 39p/share). Despite the recent strong share price performance, we still see potential for additional upside.

Industrial support services

28 February 2020

Price 215p
Market cap £224m

Net debt (£m) at 31 December 2019	13.2
Shares in issue	104.1m
Free float	35.1%
Code	AUG
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	3.4	21.1	160.6
Rel (local)	12.4	31.4	168.5
52-week high/low	225.0p		85.5p

Business description

Augean is a UK-based specialist waste management business. The business operates via two divisions: Treatment & disposal and North Sea Services

Next events

AGM	April 2020
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Focus on growth

FY19: Strong underlying results beat our forecasts

Augean's headline figures for FY19 were distorted by two significant events that occurred during the course of the year and which were accounted for as non-underlying items, in total amounting to £34.5m (of which the settlement of landfill tax assessments with HMRC accounted for £26.2m and share-based payments a further £7.7m). The cash payments associated with these two events were £40.4m for landfill tax assessments and £4.0m for the cash cost of the LTIP (December 2019).

Exhibit 1: Augean FY19 vs FY18 – key figures

£000s	FY18	FY19	Comments
Revenue (excluding Landfill tax)	75,820	91,526	Excludes landfill tax
Adjusted operating profit	12,186	19,909	Strong growth (£7.7m) in adjusted operating profit
Share-based payments and exceptional items	(845)	(34,536)	Charges against HMRC assessments and share-based payments
Operating profit	11,341	(14,627)	
Profit before tax (reported)	10,593	(15,324)	Adjusted FY19 PBT of £19.2m shown in Exhibit 2 below.
EPS (reported basic)	9.61	(12.26)	
Net cash/(debt)	8,240	(13,202)	FY19 struck after payments to HMRC and cash LTIP (see above)

Source: Augean, Edison Investment Research

However, Augean's underlying results for FY19 demonstrated impressive year-on-year growth. On an adjusted basis, revenue increased by 33% to £91.5m (excluding the landfill tax), while adjusted EBITDA rose by 52% to £28.8m and adjusted PBT 68% to £19.2m. The performance exceeded our forecasts for EBITDA of £27.1m and PBT of £18.4m. Exhibit 2 shows the adjustments to PBT.

Exhibit 2: Reconciliation of headline PBT to underlying PBT

£000s	Statutory PBT	Share-based payments	Non-underlying items	Adjusted PBT
FY19	(15,324)	7,693	26,843	19,212

Source: Augean

The better than expected results were achieved thanks to strong sales growth across all divisions: Treatment and disposal (+24%) and North Sea Services (+61%). The T&D business was boosted by a 12% increase in residues from energy from waste (EfW) plants despite the absence of any new plants commencing operation in FY19. The business also benefited from a 46% increase in soil volumes helped by a full year from the impact of the soils sales team, which returned in FY18.

As Exhibit 3 highlights, underlying cash flow also remained strong, with FY19 net cash generation of £24.5m (FY18: £20m). Once again the headline figures were distorted by an exceptional payment of £44.5m (LTIP + HMRC payment), which led to a net cash outflow of £20m. However, financing totalling £30.5m increased the cash balance by c £10.5m (Exhibit 7). Despite the scale of the exceptional payments, the balance sheet remains strong, with net debt of £13.2m, representing a net debt/equity ratio of 27.9% and net debt/EBITDA of c 0.5x (banking covenants 2.5x).

Exhibit 3: Simplified cash flow before financing

£m	2018	2019
EBITDA	18.9	28.8
Net working capital	(0.3)	(0.5)
Interest tax and other	(1.4)	(1.3)
Net operating cash flows	17.2	27.0
Capex	(3.4)	(5.8)
Sale of businesses and assets	6.2	3.3
Net cash generation	20.00	24.5
Exceptional items	(0.3)	(44.5)
Net cash flow	19.70	(20.00)

Source: Augean

FY19 in context: Further evidence of turnaround

The FY19 results represent only the latest instalment of an impressive turnaround in the fortunes of the business under the aegis of Jim Meredith (appointed executive chairman in October 2017), Mark Fryer (FD) and John Rauch (COO). The focus on disposal of underperforming businesses, cost control and cash management has transformed Augean's financial profits, as shown in Exhibit 4. Notably, EBITDA in FY19 was almost double the figure for FY17.

Exhibit 4: Evidence of significant improvement in financial performance

	Period end net (debt)/cash (£m)	EBITDA (£m)	Annualised ROCE
FY17	(10.8)	14.5	9%
FY18	8.2	18.9	21.6%
FY19	(13.2)*	28.8	37.3%

Source: Augean. Note: *The FY19 cash balance is struck after the payment of the landfill tax liability to HMRC of £40.4m and the cash LTIP of £4.0m.

Strategy

The strategy for the business is to eliminate net debt (£13.2m), optimise returns on capital and support the drive for growth in its key markets. As we have seen Augean made a payment of £40.4m to HMRC in 2019 for outstanding landfill tax (LFT) liabilities enabling it to prevent further accrual of interest and receive a corporation tax deduction. However, Augean continues to challenge the LFT assessments and awaits the First Tier Tax Tribunal hearing, expected no earlier than late 2020.

Outlook

We continue to take a positive view on the prospects for Augean. FY19 demonstrated good growth across all divisions and we expect that Augean will continue to grow given the strong market positions of its underlying businesses (Augean has c 40% of UK hazardous waste landfill capacity), which have demonstrated high ROCE and high EBITDA margins. In particular, we expect a strong performance from the ash business as volumes rise, boosted by EfW plants scheduled to come online during the course of the year.

Financials and valuation

Following the FY19 results we have made only small incremental refinements to our forecasts (see Exhibit 5). The only significant change relates to the cash position following the impact of the HMRC and LTIP payments. As stated above, the growth that we expect is driven largely by ash volumes from EfW plants. If all six EfW plants contracted by Augean were to commence operation in FY20 (at the start of the year), they would contribute a theoretical maximum of 60,000 tonnes to ash volumes (2019: c 210,000 tonnes of total ash volumes). In reality, the FY20 contribution is likely to be much less than that due to delays and part year operation – we assume an additional c 25,000 tonnes. We do not include any dividend payments in our forecasts and Augean has stated that it will not pay dividends while it is carrying net debt on its balance sheet. Once net debt has been eliminated, Augean may choose to revisit this decision, although it is important to stress that it has made no commitment to do so.

Exhibit 5: Changes to forecasts, FY20–23e

	Revenue (£m)			PBT* (£m)			Net cash (£m)		
	Old	New	% change	Old	New	% change	Old	New	% change
FY20e	120.1	120.8	0.6	22.8	22.8	0.0	52.7	4.8	-90.9
FY21e	132.0	131.5	-0.4	26.5	26.4	-0.4	79.4	27.0	-66.0
FY22e	141.4	141.4	0.0	31.3	31.3	0.0	109.7	57.2	-47.9
FY23e	151.4	151.6	0.1	35.1	35.2	0.3	143.9	89.7	-37.7

Source: Edison Investment Research. Note: *PBT shown is normalised.

Since we last published on the company ([October 2019](#)), Augean's share price has risen from 150p to 215p and, driven by greater certainty surrounding the HMRC liability, the rating of the shares has also increased, from a forward P/E ratio of 10.1x in October, to 12.0x now. The shares are currently trading towards the top end of our previously identified range of 175–225p.

Following the FY19 results, we have also updated our valuation analysis to reflect market movements in peer group valuations and changes to our forecasts. We consider EV/EBITDA and P/E valuations for a small group of selected peers for FY1 and FY2, establishing peer group averages for each category and then applying the multiples to our forecasts for FY1 and FY2 for Augean. The average of our analysis indicates a value of 276p/share (an FY20e P/E of c 15.4x). The analysis takes no account of any potential rebate that might be received as a result of arbitration on the landfill tax dispute with HMRC. Although we do not expect a resolution to the dispute in 2020, it is worth remembering that the £40.4m paid by Augean amounts to c 39p/share. Even a partial rebate of the total payment could deliver an additional meaningful reward to shareholders.

Exhibit 6: Augean peer group valuation analysis

	Country	Code	Currency	FY1	Market cap (local)	Price	P/E (x)		EV/EBITDA (x)		Dividend yield (%)	
							FY1	FY2	FY1	FY2	FY1	FY2
Renewi	UK	RWI	p	Mar-21	319	40	9.1	8.3	6.1	6.0	4.7	4.8
Veolia Environnement	France	VIE	€	Dec-20	15,814	28	20.3	18.5	7.3	7.1	3.8	4.1
Suez	France	SEV	€	Dec-20	9,763	16	23.7	20.2	7.6	7.4	4.2	4.2
Clean Harbors (CLH)	US	CLH	\$	Dec-20	4,725	85	37.6	32.3	10.6	10.1	n/a	n/a
Average							22.7	19.8	7.9	7.7	4.2	4.4
Average (excluding CLH)							17.7	15.7	7.0	6.8	4.2	4.4
Edison forecasts for Augean												
EPS (p/share)							17.9	20.7				
EBITDA (£000)									33,189	37,228		
DPS (p/share)											N/A	N/A
Implied equity value excluding CLH (p/share)							316	324	232	230	N/A	N/A
Average of implied values (p/share)	276											

Source: Refinitiv, Edison Investment Research (Augean). Note: Prices as 25 February 2020.

Exhibit 7: Financial summary

	£'000	2018	2019	2020e	2021e	2022e	2023e
31-December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		79,749	107,137	120,772	131,530	141,411	151,590
Cost of Sales		(67,269)	(73,669)	(85,688)	(92,637)	(97,558)	(103,831)
Gross Profit		12,480	33,468	35,084	38,893	43,852	47,759
EBITDA		18,944	28,848	33,189	37,228	42,150	46,008
Operating Profit (before amort. and except & SBP.)		12,244	19,948	24,154	27,621	32,524	36,382
Intangible Amortisation		(58)	(39)	0	0	0	0
Exceptionals		(322)	(26,843)	0	0	0	0
Share Based Payments		(523)	(7,693)	0	0	0	0
Operating Profit		11,341	(14,627)	24,154	27,621	32,524	36,382
Associated company		0	0	0	0	0	0
Exceptionals		0	0	0	0	0	0
Net Interest		(748)	(697)	(1,309)	(1,209)	(1,183)	(1,151)
Profit Before Tax (norm)		11,496	19,251	22,845	26,412	31,342	35,230
Profit Before Tax (IFRS)		10,593	(15,324)	22,845	26,412	31,342	35,230
Tax		(2,043)	2,568	(4,112)	(4,754)	(5,641)	(6,341)
Profit After Tax (norm)		9,453	21,819	18,733	21,658	25,700	28,889
Profit After Tax (IFRS)		8,550	(12,756)	18,733	21,658	25,700	28,889
Average Number of Shares Outstanding (m)		103.4	104.0	104.8	104.8	104.8	104.8
EPS - normalised (p)		9.14	20.98	17.88	20.67	24.53	27.57
EPS - normalised and fully diluted (p)		9.14	20.98	17.88	20.67	24.53	27.57
EPS - (IFRS) (p)		9.61	(12.26)	17.88	20.67	24.53	27.57
Dividend per share (p)		0.00	0.00	0.00	0.00	0.00	0.00
Gross Margin (%)		15.6	31.2	29.0	29.6	31.0	31.5
EBITDA Margin (%)		23.8	26.9	27.5	28.3	29.8	30.4
Operating Margin (before GW and except.) (%)		15.4	18.6	20.0	21.0	23.0	24.0
BALANCE SHEET							
Fixed Assets		61,977	66,977	63,892	59,136	54,510	49,883
Intangible Assets		19,823	24,318	24,318	24,318	24,318	24,318
Tangible Assets		40,373	38,309	35,074	30,468	25,842	21,215
Investments & Other		1,781	4,350	4,500	4,350	4,350	4,350
Current Assets		33,371	62,090	79,263	106,493	136,712	172,247
Stocks		277	302	338	362	378	400
Debtors		18,628	40,200	46,000	51,000	51,000	54,000
Cash		11,162	21,588	32,925	55,131	85,335	117,847
Other		3,304	0	0	0	0	0
Current Liabilities		(23,585)	(40,017)	(37,652)	(40,248)	(41,921)	(44,270)
Creditors		(23,585)	(33,350)	(37,652)	(40,248)	(41,921)	(44,270)
Short term borrowings		0	(6,667)	0	0	0	0
Long Term Liabilities		(11,463)	(39,469)	(36,085)	(35,805)	(35,525)	(35,245)
Long term borrowings		(2,922)	(28,123)	(28,123)	(28,123)	(28,123)	(28,123)
Other long term liabilities		(8,541)	(11,346)	(7,962)	(7,682)	(7,402)	(7,122)
Net Assets		60,300	49,581	69,418	89,576	113,776	142,616
CASH FLOW							
Operating Cash Flow		17,413	(16,215)	30,725	34,670	43,528	45,055
Net Interest		(360)	(597)	(1,309)	(1,209)	(1,183)	(1,151)
Tax		(1,063)	(820)	(4,112)	(4,754)	(5,641)	(6,341)
Capex		(3,413)	(5,841)	(5,800)	(5,000)	(5,000)	(5,000)
Acquisitions/disposals		6,212	3,350	0	0	0	0
Financing		250	(1,319)	(1,500)	(1,500)	(1,500)	(49)
Dividends		0	0	0	0	0	0
Net Cash Flow		19,039	(21,442)	18,004	22,206	30,203	32,513
Opening net debt/(cash)		10,799	(8,240)	13,202	(4,802)	(27,008)	(57,212)
HP finance leases initiated		0	0	0	0	0	0
Other		0	0	0	0	0	0
Closing net debt/(cash)		(8,240)	13,202	(4,802)	(27,008)	(57,212)	(89,724)

Source: Augean accounts, Edison Investment Research

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